

# Business Insurance

November 17, 2008

www.businessinsurance.com



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**DEALMAKER BERNARD MIZEL LOOKS TO BUILD NEW BROKER / PAGE 3**

**COMMUTER RAILROAD SETTLES CASE INVOLVING FATAL DERAILMENT / PAGE 3**

## In Brief

### Hartford to buy bank, seek Treasury funds

The Hartford Financial Services Group Inc. said it plans to acquire a Florida savings bank for \$10 million so that it will be eligible to receive up to \$3.4 billion in federal funds under the U.S. Treasury Department's Capital Purchase Program. Hartford said its purchase of Federal Trust Bank is contingent on the Treasury Department's approval of its application to participate in the CPP and the Office of Thrift Supervision's approval of its bid to become a savings and loan holding company, among other factors.

### Pusey to become AIA president/CEO

Marc Racicot will step down as president and chief executive officer of the American Insurance Assn. in February and

See **IN BRIEF** page 35

# BAILOUT RESTRUCTURED



**\$152.5 BILLION AIG BAILOUT**  
*What the government's revised plan offers*

- \$60 BILLION** revolving credit facility, extended to five years from current two.
- \$40 BILLION** from purchase of AIG preferred stock by the U.S. Treasury.
- \$30 BILLION** in funding for a new entity to buy AIG-insured collateralized debt obligations. AIG will provide \$5 billion in additional funding.
- \$22.5 BILLION** in funding for a second entity to buy residential mortgage-backed securities held by AIG as part of its securities lending program. AIG will provide \$1 billion in additional funding.

Treasury Secretary Henry Paulson

REUTERS/LANDOV

## AIG, Fed extend loan to five years; observers ask, will it be enough?

By **DOUGLAS McLEOD**

**NEW YORK**—American International Group Inc.'s revised federal bailout package improves its chances of survival, but the insurer still faces big challenges that include selling noncore units at acceptable prices and unwinding its disastrous financial products business, analysts say.

The revised plan gives AIG more time to spin off operations—avoiding a “fire sale” of assets—and reduces its exposure to credit default swaps that created a huge cash drain at the insurer.

“It was obviously good for the company. I think it gives them a little bit more breathing room,” said Cliff Gallant, an analyst with Keefe, Bruyette & Woods Inc. in

New York. “If they had not received this plan, I think the risk of bankruptcy, in the near term, would still have been pretty high.”

Even with extending the term of a \$60 billion federal loan facility to five years from two, it is still not clear what price AIG will realize for the U.S. life insurance and other assets it will sell, given tight credit markets and a declining economy, analysts say.

While the revised program removes the worst of its CDS exposure, AIG's financial products division will continue to hold credit derivative contracts with a net notional exposure of more than \$305 billion, based on Sept. 30 figures. The costs of unwinding

See **BAILOUT** page 34

## SPOTLIGHT

### CLIMATE CHANGE & ENVIRONMENTAL RISKS



Cap-and-trade systems expected to get closer look in U.S.; insurers not yet excluding climate change-related risks; American standards exported.

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# Competitors question AIG moves

## AIG denies accusation it's slashing rates to retain business

By **DOUGLAS McLEOD**

**NEW YORK**—American International Group Inc. is increasingly the target of complaints from competitors that it is slashing rates to hold on to commercial property/casualty business, complaints the insurer maintains are unfounded.

Edmund F. Kelly, chairman, president and chief executive officer of Boston-based Liberty Mutual Group Inc., last week chided AIG during a conference call with analysts.

“AIG has intensified its efforts to increase its market share, or at least preserve it,” Mr. Kelly said. “In fact, it's fair to say they are doing some

very stupid things in the market.”

Charging that AIG management is “paying little attention to actuality what is going on in the trenches,” Mr. Kelly added, “if this is not reined in, it could be very destabilizing for the market.”

See **MARKET** page 35



**HANK SAYS:** Ex-Chief Maurice Greenberg says bailout “should be enough” to save AIG. **Page 34**



**HOW CRISIS HAPPENED:** Columnist John J. Hampton explains how AIG got into its financial troubles. **Page 30**



Sen. Max Baucus, D-Mont., outlined a health care reform proposal similar to one offered by the president-elect.

# Health care reform on fast track

## Senate finance chief, employer groups begin push for action

By **JOANNE WOJCIK**

**WASHINGTON**—Despite the nation's deepening economic crisis, the pressure is on to put health care reform on a fast track in Congress.

Senate Finance Committee Chairman Max Baucus, D-Mont., last week launched the opening salvo, unveiling a white paper, “A Call to Action, Health Reform 2009,” that outlines a proposal much like that

put forth by President-elect Barack Obama on the campaign trail.

“The link between health care costs and the economy is undeniable. Reforming the health care system is essential to restoring America's overall economy and the financial security of our working families,” Sen. Baucus asserted in a Nov. 12 statement announcing the white paper.

But even before the introduction

of Sen. Baucus' proposal, employer groups, labor organizations and consumers already were urging the next president to consider health care reform as essential to restoring the nation's fiscal fitness.

Divided We Fail, a group comprising the Business Roundtable, the National Federation of Independent Business, the Service Employ-

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## On the Web

### EMERGING RISK STRATEGIES

#### How AIG got into its financial troubles

Columnist John J. Hampton, in his latest column on Emerging Risk Strategies, discusses how the crisis at American International Group Inc.



developed when it expanded into non-insurance areas.

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Business Insurance (ISSN 0007-6864) Vol. 42, No. 43, is published weekly by Crain Communications Inc., 360 N. Michigan Ave., Chicago, Ill. 60601-3806. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Send address changes to Business Insurance Circulation Department, 1155 Gratiot Ave. Detroit, Mich. 48207-2912. \$5 a copy and \$97 a year in the U.S. \$130 in Canada and Mexico (includes GST). All other countries, \$230 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 40012850, GST No. 136760444, Canadian return address: 4960-2 Walker Road, Windsor, ON N9A6J3. Printed in U.S.A. Copyright © 2008 by Crain Communications Inc.

# Wyeth faces suit for injury from generic drug

*Drugmaker can be held liable even though it didn't produce drug claimant took, court says*

By JUDY GREENWALD

**SAN FRANCISCO**—A name-brand prescription drug manufacturer can be held liable for injuries caused by the generic version of the drug made by another manufacturer, a California appellate court has ruled.

The ruling, which allows a lawsuit against Madison, N.J.-based Wyeth Inc. to go to trial, is the opposite of numerous other decisions on the issue and could create liability concerns for brand drug manufacturers if upheld, attorneys say.

The 1st District Court of Appeal in San Francisco said its Nov. 7 decision in *Elizabeth Ann Conte v. Wyeth Inc.* was based on Ms. Conte's physician's alleged reliance on Wyeth's representations about Reglan, the brand name of metoclo-



pramide, which is used to treat gastroesophageal reflux disease.

Ms. Conte developed tardive dyskinesia, a debilitating and incurable neurological disorder that causes involuntary muscle movements, after

taking a generic version of the drug for nearly four years, although it is approved for only 12 weeks of use. Ms. Conte, who never took Reglan, claimed Reglan's product warnings substantially understated the risks of serious side effects from extended use.

She sued Wyeth for fraud, fraud by concealment and negligent misrepresentation. She also sued three generic manufacturers of the drug, on the grounds of, among other things, negligence and strict product liability.

A lower court dismissed the charges against all the drug manufacturers. On Wyeth, the court concluded that neither Ms. Conte nor her doctor relied on drug information provided by Wyeth, and that Wyeth owed no "duty of care" to users of generic versions of its drug.

It also dismissed the case against the generic drug manufacturers, deciding that Ms. Conte's state tort claims were pre-empted by federal law.

The appellate court, however, unanimously

See **WYETH** page 32

## Mizel builds financial firm to serve middle market

*USI founder's new venture to be one-stop shop*

By SALLY ROBERTS

**SAN RAMON, Calif.**—Longtime insurance brokerage executive Bernard H. Mizel is back to doing what he's known best for in the industry: building a middle-market brokerage.

Since investing his own money in San Ramon, Calif.-based California Coastal Insurance Inc. in 2003, Mr. Mizel has been quietly transforming the 40-year-old family-owned property/casualty brokerage into an integrated financial services distribution firm.

That transformation, which included changing the name to CCI Financial & Insurance Services, is nearly complete following the May buyout of CCI's founder Michael Henry Vawter and the hiring of Valli Bowman, a former executive of San Diego-based employee benefits broker Inter-care Insurance Solutions, to become CCI's chief operating officer, Mr. Mizel said.

Mr. Vawter's sons, James P. Vawter and Michael Vawter, were named CCI's president and chief executive officer, and executive vp, respectively, earlier this year. Mr. Mizel is chairman.

Today, CCI is in the process of completing its first merger with an unspecified financial services administration firm, which it expects to complete in January. The company has set its sights on adding human resources, safety

consulting and 401(k) administration capabilities soon.

Within the next three months, executives say CCI will be able to offer clients—those with between 25 and 250 employees—a full suite of integrated property/casualty insurance and employee benefits products, automated payroll services, human resources consulting and outsourcing, and retirement planning and executive benefits through a platform it calls SingleSource.

Such an integrated approach has been a longtime goal of Mr. Mizel's and one he attempted to execute when he formed USI Holdings Corp. in 1994, he said. Mr. Mizel retired as USI's chairman and CEO in 2002 (see chart, page 33).

"USI morphed into something more like a conventional brokerage firm," Mr. Mizel said. "We were acquiring so quickly we just couldn't train the salespeople to do what we were talking about. CCI is going

to be very disciplined and very focused on the integrated concept, and it will include all the elements of administration that we really didn't have with USI."

Moreover, unlike other agents and brokers that partner with outside vendors to provide payroll, human resources and other services, CCI is differentiating itself by bringing all of its capabilities under one in-house platform, Mr. Mizel said. Such an approach not only saves



**"CCI will include all the elements of administration that we really didn't have with USI."**

Bernard H. Mizel, CCI Financial & Insurance Services



AP PHOTO  
The 2005 derailment of a Metra commuter train has led to an \$11 million settlement with the families of two women killed in the incident.

## Commuter railroad covered for payouts over fatal derailment

*Lexington, AWAC help fund \$11M pact*

By JEFF CASALE

**CHICAGO**—The Northeast Illinois Regional Commuter Railroad Corp., known as Metra, agreed earlier this week to pay \$11 million to the families of two women killed in a 2005 derailment.

Metra, a rail network that serves the suburbs of Chicago under the Regional Transit Authority, made the settlement for the deaths Wednesday. A Metra spokesman confirmed that primary and excess layers of liability coverage contributed to the settlement.

The first \$5 million of the loss was self-insured, he said.

Boston-based Lexington Insurance Co., a subsidiary of American International Group Inc., and Pembroke, Bermuda-based Allied World Assurance Co. Holdings Ltd. participated in a \$10 million layer excess of the self-insured retention. New York-based AIG writes a \$35 million layer above the first \$15 million, the spokesman said.

The two passengers, Jane Cuthbert, 22, of Oak Forest, Ill., and Allison Walsh, 38, of New Lenox, Ill., were aboard a train heading toward Chicago on Sept. 17, 2005, when it derailed and struck a steel bridge. An additional 117 passengers were injured in the crash.

See **CCI** page 33



According to Hewitt Associates Inc., about 88% of the companies it works with are offering influenza and pneumonia vaccines this year.

## Employers take a shot to head off worker flu

*Competition, aging workforce reasons for rise*

By ZACK PHILLIPS

More employers are offering flu vaccines or encouraging their workers to get inoculated this year, consultants and industry executives say.

Some experts attribute the rise to the tumultuous economic climate, which increases the importance of having a productive—and healthy—workforce. Workers who contract the flu either miss work or hurt productivity by spreading the virus to their colleagues. Consultants also cite the aging workforce as a possible reason for the increase, because older workers are more susceptible to the harmful effects of influenza.

According to Lincolnshire, Ill.-based Hewitt Associates Inc., about 88% of the more than 1,200 companies it works with are offering immunizations this year, including flu and pneumonia vaccines. That's up from 76% last year, a spokeswoman said.

Randall Abbott, a senior consultant with Watson Wyatt Worldwide in Wellesley Hills, Mass., said about two-thirds of the businesses he works with have employer-sponsored vaccination programs and about three-quarters encourage workers to get vaccinations.

"Employers have been promoting it (this year) to a much greater degree, doing e-mails, engaging supervisors to motivate employees to get their flu shots, setting up kiosks in the lobby," Mr. Abbott said. "We have seen a surge in flu clinics, flu fairs and a range of initiatives all around getting your flu shot."

Helen Darling, president of the Washington-based National Business Group on Health, said an August survey showed 96.3% of NBGH members sponsor flu vaccination programs for employees,

while 28% sponsor flu shots at all their worksites. Those figures have risen steadily for the past five years, she said. The 304 businesses in the group include 63 Fortune 500 firms.

Many observers cite competitive advantage as one reason for the apparent increase in employer-sponsored programs.

"It's considered really, really smart business practice," Mrs. Darling said. "It's good business because the more people who don't get sick, the less spread of that sickness. And in both cases, if they're sick or spreading it, it's a big-time productivity loss."

Watson Wyatt's Mr. Abbott also said the increase in part could be due to the rising age of the workforce—older workers are more susceptible to the harmful effects of influenza—and to an abundant vaccine supply.

Six manufacturers project that 143 million to 146 million doses of influenza vaccine will be available in the United States during the 2008-2009 flu season, according to the U.S. Centers for Disease Control and Prevention.

That would be a record number of flu vaccines released in the country in a single season, the CDC said. By comparison, about 132 million doses were made available last year and 120 million the year before. Of the 132 million doses in 2007, 18 million were unsold.

Mr. Abbott said he has seen participation rates of 65% to 70% by employees at companies offering free flu shots this year. Historically, he said, that rate tends to be between 30% and 40%.

Susan Adams, global health and well-being manager at Intel Corp. in Chandler, Ariz., said the company

See **FLU** page 33

### Errors & Omissions

The company Hoffmann-La Roche Inc. was incorrectly identified in a Nov. 10 item promoting the online Perspective article, "Pandemic Plans Still Important," written by Mike McGuire, vp of anti-infectives at the pharmaceutical company.

# Data risks often underprotected

*Companies unsure how to respond, PLUS panel says*

By DAVE LENCKUS

**SAN FRANCISCO**—Many companies do not understand their data theft risks or how to respond effectively to a computer security breach, according to a panel of experts.

While there is no foolproof data security, companies can do much more to effectively safeguard themselves and their customers, stressed the panelists at 21st Annual Professional Liability Underwriting Society's International Conference.

"There's no such thing as a secure network," said Thomas C. Katona, president and managing member of Wayne, Pa.-based brokerage Apogee Insurance Group L.L.C.

"It's a Main Street issue now,"

not only a problem for big companies, Mr. Katona said.

Despite millions of data breaches daily, companies "don't see this as a major exposure for them," Mr. Katona said during a session at the Nov. 5-7 conference in San Francisco.

Computer hackers are not the sole data breach risk, said Leslie Lamb, manager-global risk management at Cisco Systems Inc. in San Jose, Calif. Many breaches are inside jobs, she said.

Other breaches are opportunistic rather than planned strikes, said Adam L. Sills, an underwriter at Darwin National Assurance Co. in Farmington, Conn. Those breaches result from thieves stealing laptop computers or backup computer tapes containing sensitive data from cars and airports, he said.

Regardless how breaches occur, they are costly problems, the panel noted.

A breach on average costs the targeted company \$6.3 million,

with lost business accounting for \$4.1 million of the total, said Nicholas Economidis, an underwriter with Beazley USA in Philadelphia.

Customer notification and credit monitoring account for the remaining costs, he said. On average, notification costs amount to \$1 to \$2 per person notified. Credit monitoring typically costs \$10 to \$20 per person, and about 10% to 20% of customers offered the service after a data breach sign up for it, Mr. Economidis said.

The panel suggested that both large and small companies take several measures to immediately improve their data security.

A data security risk assessment is paramount, but the analysis should expand beyond the information technology department, Ms. Lamb and Mr. Sills stressed.

Risk management and a company's legal department also

See **DATA** page 32

## Financial crisis spawning lawsuits

By DAVE LENCKUS

**SAN FRANCISCO**—Financial institutions face wide-ranging litigation triggered by the subprime mortgage debacle and the ensuing economic crisis, according to insurance and legal experts.

Plaintiffs include homeowners, shareholders, cities and regulators alleging various deceptive practices, fraud and improper employer practices, the experts noted during panel sessions at the 21st Annual Professional Liability Underwriting Society's International Conference.

But plaintiffs will face challenges proving their cases, an attorney said during one session at the Nov. 5-7 conference in San Francisco.

Mortgage lenders face numerous claims alleging misrepresentation and concealment of lend-



ing practices, a lack of internal controls and portfolio valuation overstatements, said claims executive Anthony Tatulli, the New York-based president of financial lines at lines at AIG Domestic Claims Inc., a subsidiary of American International Group Inc.

In addition, shareholders have filed two dozen derivative lawsuits, in which investors seek recoveries for the organization, rather than themselves, from directors and officers.

"They are significant cases now," Mr. Tatulli said.

Companies cannot indemnify

executive management in such cases, so the defendant executives would be insured only by Side A coverage of traditional D&O policies and any separate Side A coverage they might have.

At the same time, unsecured creditors, which "are looking for every penny," are "more aggressive than (shareholder) plaintiffs attorneys," Mr. Tatulli said.

Lenders also face errors and omissions claims, including charges of predatory and unfair lending and discrimination, he said.

And some whistle-blowing employees have filed employment practices liability claims, he said.

Meanwhile, securities dealers and investment banks face lawsuits from clients drawn into auc-

See **SUBPRIME** page 32

## Deadline for RMOY nominations Dec. 1

*Business Insurance* invites its readers to nominate candidates for the magazine's annual Risk Manager of the Year award and Risk Management Honor Roll by the deadline of Dec. 1.

*BI* and the Risk & Insurance Management Society Inc. are collaborating on the annual honors.

Anyone involved in risk management for a corporation, financial institution, nonprofit organization or government entity can be nominated. Candidates need not practice risk management full time but must be a full-time employee of the orga-

nization for which he or she manages risk.

A simplified, two-part process for nominating candidates has been implemented for the awards.

Part I requires a summary not more than 600 words in length of a candidate's most recent accomplishments and factors that make him or her worthy of the award. An independent panel of former award winners and risk management professionals will screen the Part I nominations.

If selected as a finalist, the more detailed Part II Risk Manager of the

Year nomination form will be required and reviewed by a panel of independent judges, including executives from leading industry companies, the president of RIMS as well as the immediate past winners of the awards.

Winners will be profiled in the April 20, 2009, issue of *Business Insurance*, and the 2009 Risk Manager of the Year will be the 32nd person so honored.

To download nomination forms and instructions for completing the forms, please visit [www.BusinessInsurance.com/RMOY](http://www.BusinessInsurance.com/RMOY).

# 200,000 REASONS A SPRINKLER HEAD DOES NOT DOUBLE AS A COAT RACK.

**WAUSAU PACKAGE AT WORK.** Recently, we received some interesting property claims. Hotel guests, trying to expand their closet space, enlisted the help of sidewall sprinkler heads, using them as makeshift coat racks. The weight of the clothing damaged the fusible element of the sprinklers, setting them off and causing more than \$200,000 in water damage. When our loss



prevention experts located the source of the problem, they quickly advised clients to place a warning sign next to sidewall

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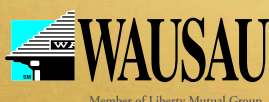
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## Commentary

# A simple 'I'm sorry' would be nice gesture

Call me old-fashioned, but there's something disturbing about an ever-growing line of corporate supplicants seeking federal assistance.

I know we've been through this before, most notably with Chrysler Corp. about 30 years ago. And Chrysler may have set a bad example in more ways than one; it not only asked for and got the bailout, but the feds ultimately made money on the deal. The possibility of extra cash for the federal budget made future deals that much more attractive.

I worry that the "possibility" part has blinded some observers to the very real risk that as the number of bailout recipients increases, we—we being the taxpayers—are simply going to be throwing good money after bad. I realize, despite my deeply held free-market beliefs, that occasionally the government is justified in stepping in to deal with a market crisis, and the current situation certainly falls into that category. But stepping in doesn't necessarily mean diving in with total abandon.

What has made this particularly troubling to me is the attitude of some of the people who made the mess. Not that long ago, a corporate chieftain who went cap in hand to the feds seeking a bailout would have felt a deep sense of shame—asking for help would have been to admit failure. But times have changed, and not for the better.

For example, the House Committee on Oversight and Government Reform has held a series of hearings into what went wrong across the economy. This is admittedly not the best forum. For one, the committee cannot originate much legislation other than that dealing with the federal workforce. And as is the case with any congressional committee, there's always a temptation among some members to grandstand, particularly in an election year.

Still, the hearings there and elsewhere on Capitol Hill were remarkable for the lack of remorse shown by most of the key participants. It's almost as though they were the victims of some sort of external force—sort of a financial Hurricane Katrina—rather than the architects of the financial meltdown.

I don't expect anyone to follow the examples of some of the ancient Romans and not-so-ancient Japanese. No one expects a former titan of Wall Street to fall on his sword in an effort to atone for his errors.



**MARK A. HOFMANN**

Senior Editor Mark A. Hofmann can be reached at: [mhofmann@businessinsurance.com](mailto:mhofmann@businessinsurance.com)

But it would be edifying to see someone stand up and say: "Hey, I'm really sorry that I made some really bad decisions involving matters of which I had little or no real knowledge, decisions so bad that the people of the United States have to cover my losses. I promise to do the best I can, little as that may be in practical terms, to rectify the situation. I also promise not to profit by as much as penny from the help I'm receiving from the

**No one expects a former titan of Wall Street to fall on his sword in an effort to atone for his errors.**

people and government of the United States."

That would be a nice gesture. After all, football coaches face the press and fans after a game whether they win or lose. They have to accept responsibility for what happens on the field. Some may do it with more grace than others, but the important thing is they do accept responsibility.

I haven't seen that in this crisis.

Too often, the attitude has been: "I can't explain what happened, but I feel no shame about it, either. And, anyway, I wasn't the only one playing with financial instruments so exotic that the feds would have required me to have special permit to bring them into the country if they had been wildlife."

That's not enough. Nothing short of full contrition will suffice. We, our children and probably our grandchildren will be stuck with the bill.

Saying everybody else was doing it never cut it with mom, and it shouldn't cut it with the American people, either.



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# Business Insurance OPINIONS

## Government walks fine line in AIG deal

WILL THE LATEST FEDERAL BAILOUT package ensure the survival of American International Group Inc.?

With so many unknowns—not the least of which are how much AIG will gain from selling noncore lines of business and its ultimate losses from its disastrous foray in the credit default swap business—no one can answer that question at this early stage.

We do know that the government had no choice but revamp and ease the terms extended to AIG, such as lowering interest rates on borrowed funds. Certainly, it has become widely understood in recent weeks that the original terms imposed on AIG were so onerous that it likely would have failed, with disastrous consequences to AIG, its policyholders and the U.S. taxpayers funding the deal.

We realize that those crafting the bailout walk a very fine and difficult line. The terms can't be too easy, as no company is entitled to a no-strings-attached federal bailout. At the same time, the terms can't be so onerous as to make it impossible for AIG to survive.

We think that the latest bailout achieves an elusive middle ground. No doubt, there will be further tinkering, and that is to be expected given the government's lack of experience in the realm of bailouts. On this one, the government must get it right.

As to charges by some competitors and brokers that AIG is slashing rates—without the experience to justify such reductions—to hold on to business, the evidence of that is inconclusive as best as we can see.

We do know that insurance underwriting discipline always was one of AIG's strengths. If it is to survive, it cannot abandon that discipline. Buyers, after all, may interpret such a move as desperation and likely would not consider placing business with an insurer that threw its underwriting pen out the window. AIG's top executives surely must be aware of that.

*We think that the latest bailout achieves an elusive middle ground.*

## Everyone must work to better environment

CLIMATE CHANGE remains a controversial issue. Some scientists and policymakers disagree on whether climate change is happening and if it's due to human activity or merely a naturally occurring cycle.

We believe those questions are beside the point. Our planet today shows signs of environmental effects that will make life more challenging for future generations. As we report beginning on page 11, the insurance industry is concerned that climate change will lead to increased frequency and severity of natural catastrophes, and an emerging area of law imputes liability to organizations and individuals contributing to such change. While underwriters are not yet excluding risks related to climate change, that, too, may change.

Trading systems are developing around the world to offset carbon emissions, which some believe are a culprit in climate change. Market innovation is encouraged, but amid the current global financial crisis, it's clear that sensible regulation of cap-and-trade systems is necessary.

Nations, corporations and individuals, meanwhile, must work together to be better stewards of the environment. Reducing waste and pollutants, balancing production and consumption, and preserving natural resources will go a long way to making the future brighter.



### WRITE

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#### THIS WEEK'S RESULTS

How long will it take the Obama administration to reform health care?



#### NEXT WEEK'S QUESTION

Should insurance buyers expect favorable conditions at Jan. 1 renewals?

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## Nanotech: Little objects that may pose big risks

Nanotechnology, used in more than 300 products currently, is a booming field that is expected to be a \$2 trillion business by 2014, but the still largely unknown risks posed by nanoparticles makes for a scary prospect in terms on insurance recovery, says Matthew J. Schlesinger, partner, and Jacqueline Bennett, counsel, in law firm Reed Smith L.L.P.'s Washington office. They recommend a series of steps that businesses should take and offer questions that corporate executives should try to answer to begin to mitigate their potential risks.

ONLINE

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ADVERTISING: Boston: 617-292-4856; Chicago: 312-649-5276; Los Angeles 323-370-2405; New York: 212-210-0133

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Business Insurance is published by

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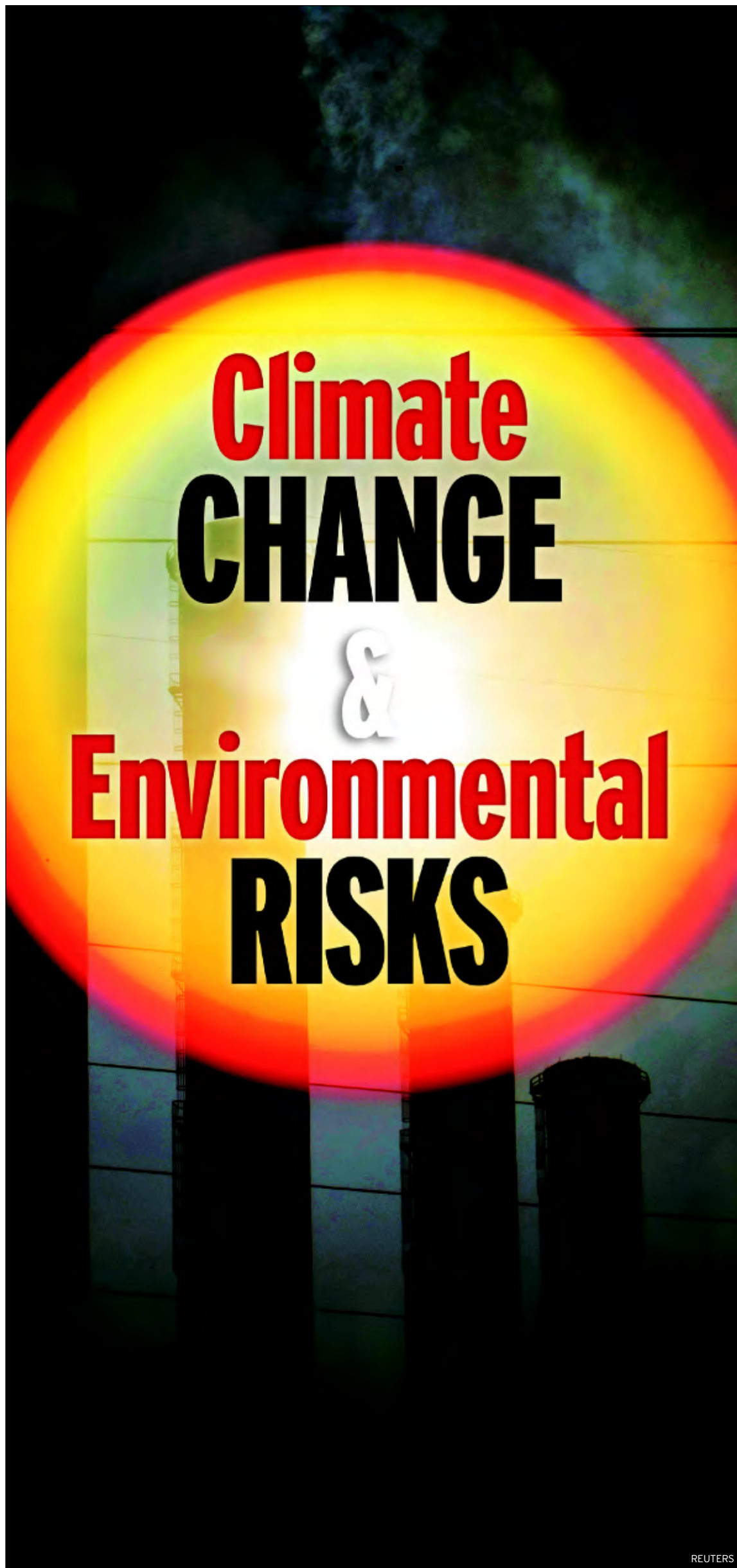


## Just ask City of Hope.

The City of Hope and Aon salute this year's Spirit of Life Award recipient, CNA chairman and CEO Stephen W. Lilienthal, for his dedication to fund-raising efforts benefiting the City of Hope.

The City of Hope is a leading biomedical research and treatment institution for cancer and other life-threatening diseases. The 2008 Spirit of Life fundraising campaign marks the 30th time the insurance industry has come together in support of this worthy cause. To date, more than \$20 million has been raised as a result of these efforts.





REUTERS

## Changes coming on emissions?

*Obama seen exploring pollution caps linked to credit trading system*

By **SALLY ROBERTS**

Although the United States is among the largest emitters of carbon dioxide, it lags other nations when it comes to mandatory programs to reduce greenhouse emissions.

The United States remains one of the only industrialized nations not to have ratified the Kyoto Protocol, a 1997 international agreement signed by more than 180 countries to work toward reducing greenhouse gas emissions in the atmosphere, which have been linked to climate change.

Observers expect the incoming administration of President-elect Barack Obama will look to address greenhouse gas emissions.

Under the Kyoto Protocol, which went into effect in February 2005, industrialized countries agreed to reduce their collective greenhouse gas emissions by 5.2% to 1990 levels over the period 2008 to 2012.

While most of the targets must be met through national measures, Kyoto did introduce three flexible mechanisms to give countries additional means of meeting their reduction targets, including a carbon emission trading system, whereby countries that have emission credits to spare can sell the credits to countries that are behind their reduction targets.

The other two mechanisms—the Clean Development Mechanism and Joint Implementation—allow countries to invest in emission-reduction projects in developing or transitional countries in exchange for carbon credits.

The largest cap-and-trade system outside the Kyoto Protocol is the European Union Emission Trading Scheme, which began in 2005.

The Emission Trading Scheme sets mandatory emission caps on energy and industrial companies, which are collectively responsible for nearly half of Europe's emissions of carbon dioxide, according to the European Commission. Under the program, E.U. industrial operators have allowances or credits, which they can trade privately or via a climate exchange.

The trading program also lets entities import project-based carbon credits generated under Kyoto's flexible mechanisms as a way to meet compliance requirements.

See **EMISSIONS** page 14

# SPOTLIGHT

**LARGEST INDEPENDENT U.S. RISK MANAGEMENT CONSULTANTS: RANKING**  
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**COVERAGE OF CARBON CREDIT INVESTMENTS OFFERED BY JUST A FEW**  
PAGE 14

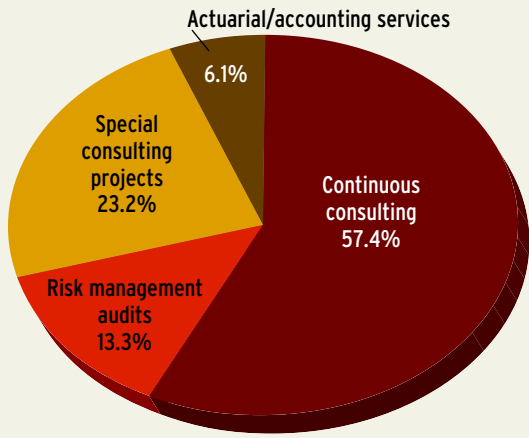
**MOST D&O INSURERS HAVE YET TO FOCUS ON CLIMATE-RELATED RISKS**  
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**GREENHOUSE GAS PRODUCERS NEED TO CHECK POLICY LANGUAGE**  
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**INDUSTRY HELPS FUND RESEARCH INTO EFFECTS OF CLIMATE CHANGE**  
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**BREAKDOWN OF REVENUES**

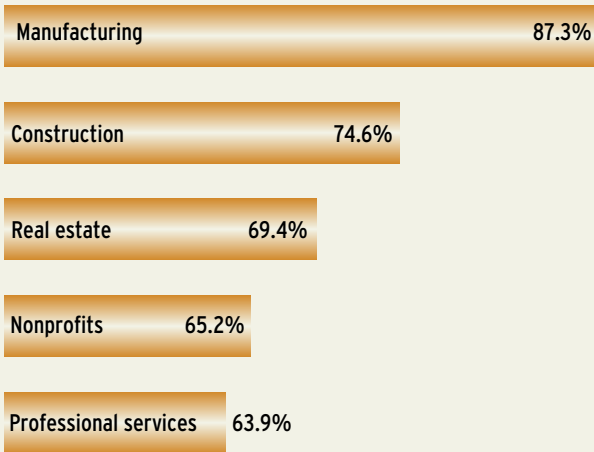
Revenue sources for all companies listed in the directory.



Source: BI survey

**MOST COMMON INDUSTRIES SERVED**

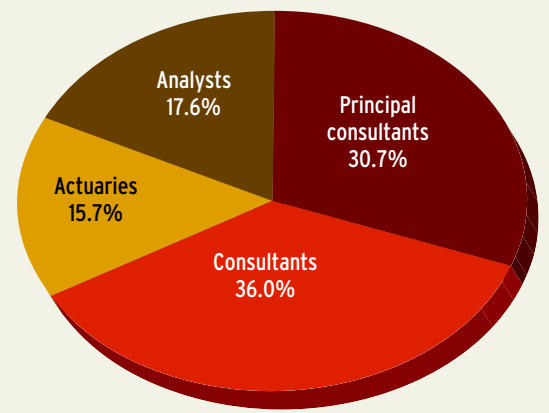
Percentage of companies serving these major industries.



Source: BI survey

**BREAKDOWN OF PROFESSIONAL STAFF**

Risk management professionals for all companies listed in the directory.



Source: BI survey

# Largest independent U.S. risk management consultants

Companies deriving a majority of their gross revenues from unbundled risk management consulting<sup>1</sup>

Rank	Company/Address	Phone/Web site	2008 unbundled revenue from risk management consulting <sup>2</sup>	Unbundled clients <sup>3</sup>	Professional staff <sup>3</sup>	Principal officer
<b>1</b>	RMI Consulting Inc. 20 Soundview Marketplace, Port Washington, N.Y. 11050	516-767-7373 <a href="http://www.rmiconsulting.com">www.rmiconsulting.com</a>	\$12,200,000	550	31	MaryAnn Sackman, president
<b>2</b>	J.H. Albert International Insurance Advisors Inc. dba Albert Risk Management Consultants 72 River Park, Needham Heights, Mass. 02494-2631	781-449-2866 <a href="http://www.albertrisk.com">www.albertrisk.com</a>	\$8,300,000	600	33	Alfred H. Nagelberg, Stuart T. Cowart, presidents
<b>3</b>	Sigma Consulting Corp. 201 St. Charles Ave., Suite 2401, New Orleans, La. 70170	504-598-0100 <a href="http://www.sigmacorp.net">www.sigmacorp.net</a>	\$4,511,900	45	11	Bret A. Clesi, president
<b>4</b>	Alpha Risk Management Inc. 60 Cutter Mill Road, Great Neck, N.Y. 11021	516-829-3500 <a href="http://www.alphariskmanagement.com">www.alphariskmanagement.com</a>	\$4,350,000	79	19	Herbert H. Feldman, president/CEO
<b>5</b>	Risk International Services Inc. 4055 Embassy Parkway, Suite 100, Fairlawn, Ohio 44333	216-255-3400 <a href="http://www.riskinternational.com">www.riskinternational.com</a>	\$4,298,000	50	20	Douglas L. Talley, chairman/CEO
<b>6</b>	RCS Services Inc. 5506 Mitchelldale, Houston, Texas 77092	800-807-7475 <a href="http://www.rcsservicesinc.com">www.rcsservicesinc.com</a>	\$3,910,000	900	14	Trish McCall, CEO
<b>7</b>	Robert Hughes Associates Inc. 508 Twilight Trail, Suite 200, Richardson, Texas 75080	972-980-0088 <a href="http://www.roberthughes.com">www.roberthughes.com</a>	\$2,600,000	245	13	John R. Oakley, president
<b>8</b>	Kevin F. Donoghue & Associates 190 High St., Boston, Mass. 02110	617-482-7015 <a href="http://www.kfda.com">www.kfda.com</a>	\$2,400,000	180	N/A	Kevin F. Donoghue, president
<b>8</b>	Risk Navigation Group L.L.C. 37 Dumont Road, Suite 100, Far Hills, N.J. 07931	908-470-1010 <a href="http://www.risknavigation.com">www.risknavigation.com</a>	\$2,400,000	75	8	Richard M. Sabetta, managing principal
<b>10</b>	Insurance Buyers' Council Inc. & First Risk Management/IBC Inc. 9720 Greenside Drive, Suite 1E, Cockeysville, Md. 21030	410-666-0500 <a href="http://www.consultibc.com">www.consultibc.com</a>	\$2,350,000	130	9	Adam P. Sielicki Jr., president/treasurer

<sup>1</sup> Business Insurance defines independent consulting operations as those that are not owned by insurers or brokers. In addition, companies deriving 50% or more of their revenues from actuarial, captive, environmental, property loss or safety consulting are not ranked. <sup>2</sup> Estimated. <sup>3</sup> As of 6/30/2008.

Source: BI survey

Researched by: Kevin Edison and Karen Tucker

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## CLEARING THE AIR

So-called Clean Development Mechanism projects reduce or remove emissions from the atmosphere.

REGISTERED CDM PROJECTS: 1,197

CDM PROJECTS IN THE PIPELINE: 4,200

CDM PROJECTS REQUESTING REGISTRATION: 109

Source: United Nations Framework Convention on Climate Change

# Climate-friendly investments inherently risky

*A small but growing number of insurers cover risks that prevent delivery of carbon credits*

By SALLY ROBERTS

Companies seeking to invest in sustainable development projects in emerging countries as a means to generate tradable carbon credits will find a handful of underwriters ready to insure their risks.

Under the 1997 Kyoto Protocol's Clean Development Mechanism, participating industrialized countries can invest in renewable energy, clean technology and other related projects in emerging countries such as India, Brazil and China in return

for certified emission reduction credits, known as CERs. A company can then sell those credits privately or on various carbon exchanges, or use them to offset their own emission reduction shortfalls.

Countries also can earn credits—known as emission reduction units—by investing in climate-friendly projects in other developed countries under the Kyoto Protocol's Joint Implementation mechanism. Such projects, however, have only recently started to come to fruition.

The European Union Emission Trading Scheme, the world's largest cap-and-trade system that sets mandatory emission caps on energy and industrial companies in the European Union, allows importation of CER credits as a way of meeting those companies' compliance requirements.

But because CDM projects must qualify through a rigorous public registration and issuance process, there is inherent risk in such projects getting off the ground, experts say. At the same time, there also is

no guarantee that such projects will meet companies' emission reduction and CER targets if they do get off the ground, they note. Political uprisings, equipment malfunctions and construction delays are just a few of the risks that could hamper a CDM project's success in delivering expected carbon credits.

See **CARBON CREDITS** page 16

## Emissions: U.S. carbon market only voluntary

CONTINUED FROM PAGE 11

In the United States, there is no federal cap-and-trade program. There is, however, a growing voluntary carbon market. In addition to the Chicago Climate Exchange, a voluntary cap-and-trade scheme for U.S. companies, there also are several regional programs in operation.

Among them is the Regional Greenhouse Gas Initiative, an agreement by 10 Northeastern and Mid-Atlantic states to reduce power plant greenhouse gas emissions by 10% by 2018. The states sell emission allowances through auctions and invest the proceeds in energy efficiency, renewable energy and other clean-energy technologies.

"We're still at the point where we don't have a single federal regulation here in the U.S.," said Rick Hawkinberry, a senior vp in Willis HRH's environmental practice in Pittsburgh. "Since it's voluntary, we're not really seeing the volume we expect to see when the huge market is created when we finally have a national law that will set up a carbon trading scheme here in the U.S."

"It's pretty much accepted that the next administration will do something," he said. "From that perspective, we've certainly had clients ask questions about it. They're trying to educate themselves about it."

President-elect Obama supports an "economywide" cap-and-trade program to reduce greenhouse gas emissions 80% by 2050, according to his official Web site.

Rather than allocating pollution credits, however, Sen. Obama has supported auctioning the credits, with proceeds to go to investments in clean energy, habitat protections, and rebates and other transition relief for families.

While details of such a program remain to be seen, a cap-and-trade system poses a number of risks for greenhouse gas-emitting companies.

*Business Insurance* looked at two such risks: those associated with shareholder lawsuits and those associated with the carbon trading market (see related stories, this page and pages 20).

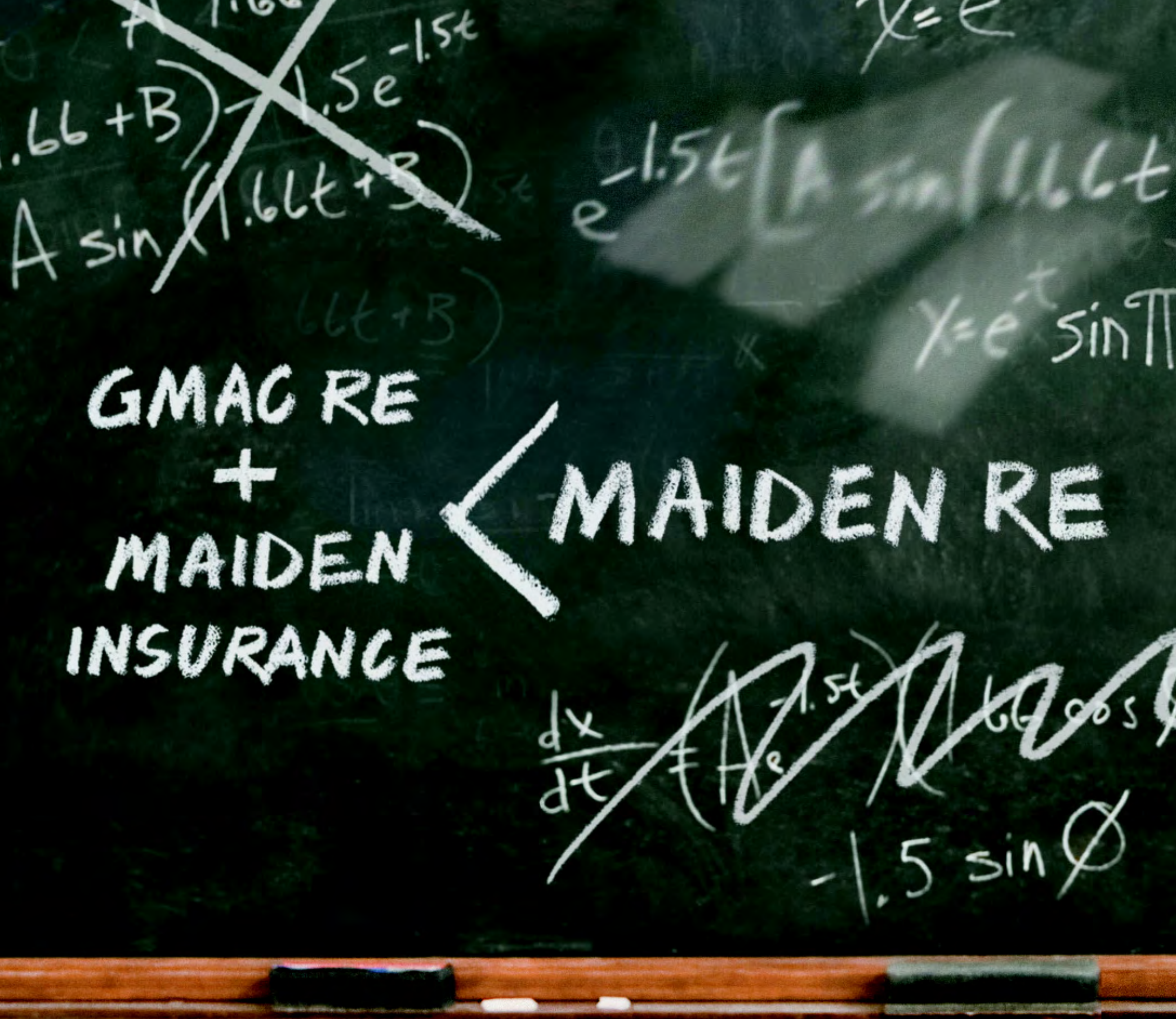
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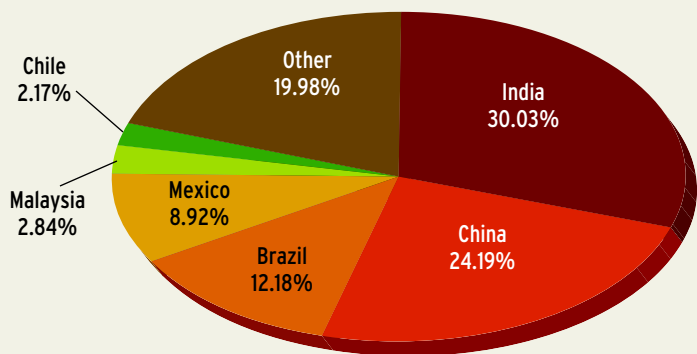
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REGISTERED CLEAN DEVELOPMENT MECHANISM ACTIVITIES

Registered projects around the world to lower or remove emissions from the atmosphere



Source: United Nations Framework Convention on Climate Change

# Carbon credits: Coverage options grow

CONTINUED FROM PAGE 14

As such, a handful of insurers have recently begun offering customized solutions for project investors.

The burgeoning carbon trading market in Europe together with more demand for coverage by carbon traders is prompting insurers to get “a lot more serious and specific about how to participate, where the risks are and what types of products and services are needed,” said Evan Mills, staff scientist at the U.S. Department of Energy’s Lawrence Berkeley National Laboratory, one of the world’s leading research cen-

ters on energy and the environment.

The risk profile of a CDM investment is similar to other projects designed to generate renewable energy or innovative technologies that insurers are accustomed to underwriting, insurers and brokers say. The fundamental difference is that investors are trying to get the carbon credit out of a CDM project, they note.

“There is a growing number of quite sophisticated operations in this industry—like large utilities, banks and industrial companies already regulated under the (E.U. Emission Trading Scheme)—that

are actively either looking to prepare for meeting caps as additional schemes come into place or looking to develop and bank credits in anticipation of trading on the market,” said Karl Russek, senior vp-environmental risks for ACE Overseas General in Philadelphia.

“The companies doing a lot of the (CDM) funding are actively involved in projects in the developing world and buy political risk and trade coverage for other types of projects, so it stands to reason that they would buy coverage for this,” Mr. Russek said.

ACE launched its political risk and trade credit coverage for CDM investors, project sponsors and carbon buyers in September.

“It’s adapted to take into account certain nuances of the market, but it is a similar product to a classic political risk product,” Mr. Russek said.

Zurich Financial Services Group

**‘This is a cross-border transaction that looks like a lot of risks we write in the political risk arena.’**

Lindene Patton,  
Zurich Financial Services

also saw the opportunity and began providing political risk insurance for CDM projects in February.

If a cement factory in Germany chooses to invest in a CDM project in China, the project design must be submitted and approved by a governing body and its emissions must be monitored, tested and verified that less greenhouse gases were produced, said Lindene Patton, climate product officer for Zurich Financial Services in Washington. If that happens, a carbon credit is created that has a value of a certain number of tons of carbon.

However, “in that mechanism, there are a lot of things that could happen,” Ms. Patton said. The facility in China could stop operating due to a war or a riot and “all of the sudden, the buyer has no carbon credit and now has to buy it somewhere else.”

“This is a cross-boarder transaction that looks like a lot of risks we write in the political risk arena,” Ms. Patton said.

But it’s not just political risks that can stymie the delivery of carbon credits, experts say.

“These projects earn carbon credits by virtue of the amount of carbon that they don’t put up in the atmosphere” and there are many risks that can interfere with the operations of those projects, such as physical damage...and insolvency of a supplier, which could ultimately result in less-than-expected reductions, said Jonathan Young, a carbon credit underwriter for Munich Re Group in London.

At the end of 2007, Munich Re developed a tailor-made reinsurance product known as the Kyoto Multi Risk Policy, which provides reinsurance coverage against the

See **CARBON CREDITS** page 18

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## Carbon credits: Investment coverage often customized

CONTINUED FROM PAGE 16

risk that a facility set up as part of a CDM or JI project might not produce its expected emission reductions.

The coverage, which incorporates elements of property insurance, credit and bond insurance, and political risk insurance, is being marketed in collaboration with Munich Re's ceding insurer clients.

Swiss Reinsurance Co. also provides coverage for a variety of CDM and JI project-related risks, including the risks associated with project registration.

Swiss Re structured the first such

insurance policy in 2006 for RNK Capital L.L.C., a New York-based private investment firm specializing in the U.S. and international environmental markets. The policy covers RNK for the risks associated with its CDM projects, including the failure or delay in the approval, certification and/or issuance of CERs.

Ben Lashkari, head of emissions at Swiss Re's environmental and commodity markets division in London, noted that there has since been a lot of interest in the product and that Swiss Re is "currently working on a number of potential transactions, with some in very advanced stages."

In addition to Kyoto process risks, Swiss Re also will provide coverage for property, natural catastrophes, construction, technology and upstream fuel risks, such as whether the wind blows on a wind energy generation farm. Claims are settled with either a financial payment or in-kind CERs.

Swiss Re also provides guarantee coverage for CDM and JI investors seeking to hedge their risks associated with the price of carbon credits.

"Any time a project produces 80 credits rather than (the expected) 100, you have to buy the extra 20 and you're exposed to market risk," Mr. Lashkari said. With the use of

financial instruments, investors can hedge those risks, he said.

Earlier this year, Swiss Re created a structured product for the government of Luxembourg guaranteeing CERs generated from renewable energy projects in China.

While more insurance products are coming to the market, much of the underwriting remains highly customized, insurers and brokers say.

"We get several calls a month from people who think they have an angle, like developing 20 hydro plants or 15 ethanol plants, and they want to know if it can be insured," said Rod Taylor, managing director of Aon Environmental Services Group in Orlando, Fla. "It's very difficult (to answer that) with no more information than they have contacts in Ecuador and they're going to be growing saw grass, and it's going to be harvested and sent to Europe to make ethanol."

"The line gets so long and complicated. All we can say is that we're going to work through this with you when you have a concrete plan about what the entire project will look like, but we will be able to insure a significant number of those risks," he said.



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# D&O insurers not yet closely examining climate change risks

*No director, officer has been sued for failure to adequately disclose a company's risks*

By **DAVE LENCKUS**

Investors and prosecutors are asking a lot of questions about corporate America's greenhouse gas emissions and climate change risks, but risk managers are not facing nearly as much scrutiny from directors and officers liability insurers, according to experts.

While some D&O insurers ask a few questions about climate change risks during renewals, insurers generally have not decided how to underwrite such risks, bro-

kers and insurers say.

But attorneys say a lack of attention so far from D&O insurers does not suggest that company executives have nothing to worry about. To date, only companies—rather than executives—have faced lawsuits alleging they failed to adequately disclose climate change risks, but that could change as investors and prosecutors more aggressively pursue that information, experts warn.

The challenge is deciding what to disclose, given uncertainties over

what constitutes a climate risk. But companies have some fairly clear guidelines, especially from two settlements of lawsuits brought by New York's attorney general, experts say.

That even goes for companies that contend climate changes either are not occurring or are not driven by human activity, attorneys say.

Experts anticipate that greenhouse gas emissions and climate change risks will get a lot more attention in President-elect Barack Obama's administration. While

some regional and state carbon emission cap-and-trade systems already are in place, Sen. Obama has said he supports a national system.

In addition, the U.S. Supreme Court in 2007 ruled that greenhouse gas emissions are pollutants that the Environmental Protection Agency is authorized to regulate under the Clean Air Act (*BI*, April 23, 2007).

Climate change risks, though, already have grown in importance to investors, who increasingly have

been taking action on this risk.

For six years, the Carbon Disclosure Project, a London-based non-profit intermediary between investors and corporations on climate change issues, has surveyed S&P 500 corporations on their greenhouse gas emissions and climate change-related competitive, regulatory and litigation risks. This year, 64% of the companies responded, compared with 56% last year and 47% in 2006. In addition, the quality of information provided has improved, according to the CDP.

At the same time, investors increasingly are pushing companies to adopt climate change-related resolutions that seek, for example, to reduce a company's greenhouse gas emissions or make its products more ecologically friendly, according to Ceres, a Boston-based coalition of investors and environmental groups that works with companies to address sustainability challenges. Ceres also directs the Investor Network on Climate Risk, an alliance of 72 institutional investors with \$7.3 trillion in assets.

Ceres reports that a record 57 shareholder climate-change resolutions were filed this year, 25 of which were withdrawn after the companies agreed to various climate-related commitments. Resolutions that were voted on received 23.5% support on average, which also was a record, according to Ceres, which has tracked those figures since 1995 (see chart, page 22).

Thirteen years ago, shareholders filed few climate change resolutions; as recently as 2004, 25 resolutions—less than half of the 2008 total—were filed. Among those, seven were withdrawn and the 18 remaining resolutions garnered much weaker 14.4% support on average, according to Ceres.

"It's certainly safe to say more companies every year are responding to these things," said Rob Berridge, program manager-investor programs at Ceres in Boston. "But still more needs to be done."

To that end, 14 large institutional investors on Oct. 23 petitioned the Securities and Exchange Commission to require more disclosure of climate risks, including a broader range of environmental, social and governance risks. The letter responded to the SEC's request for public comment on its 21st Century Disclosure Initiative, which is intended to improve the current disclosure system.

The investor letter also asked the SEC to require companies to include the so-called ESG risks in their SEC filings. Many companies already include that information in sustainability reports and on Web sites, but investors contend that is inadequate because of the potential financial implications that ESG risks pose.

Some companies, though, face much more pressing demands for

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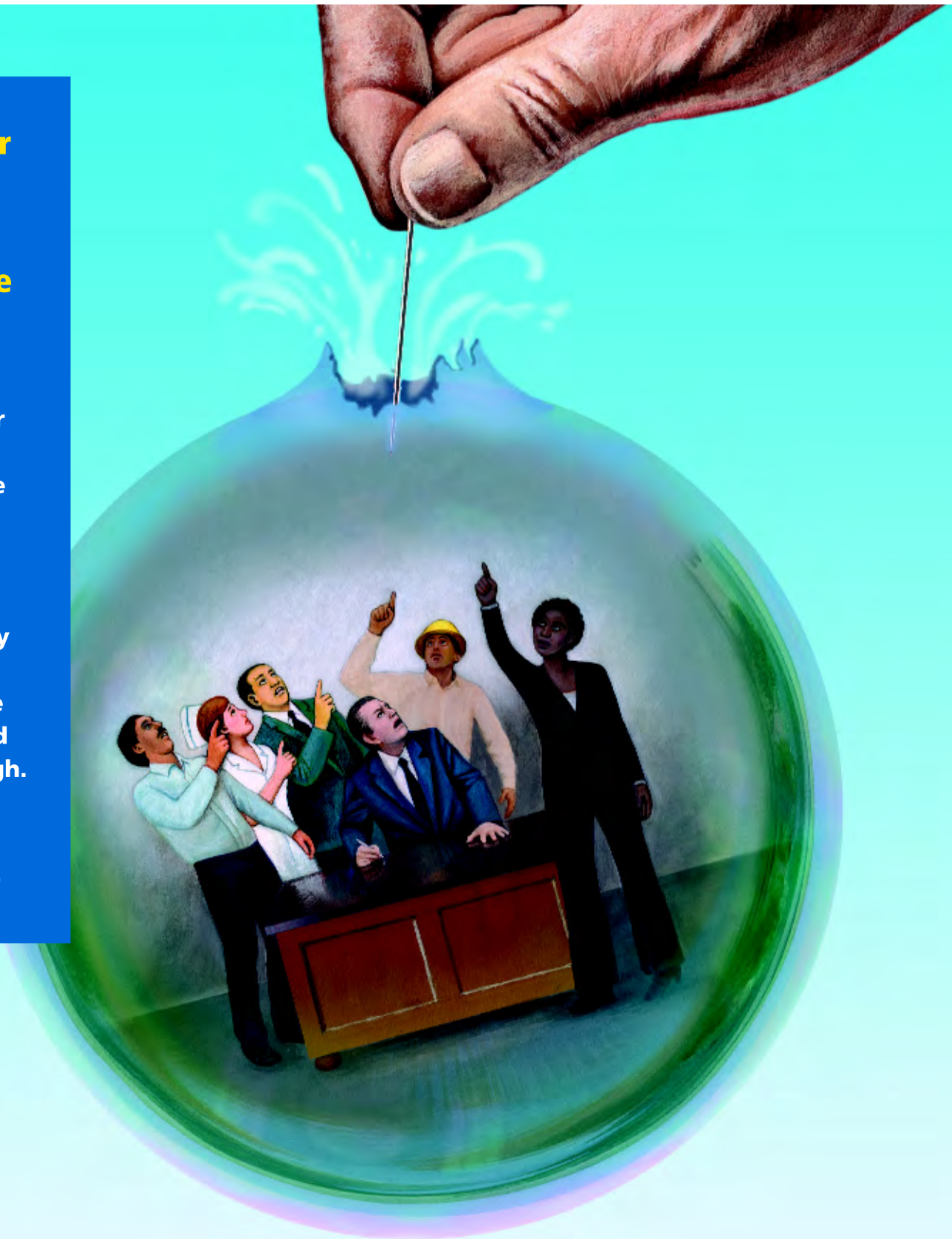
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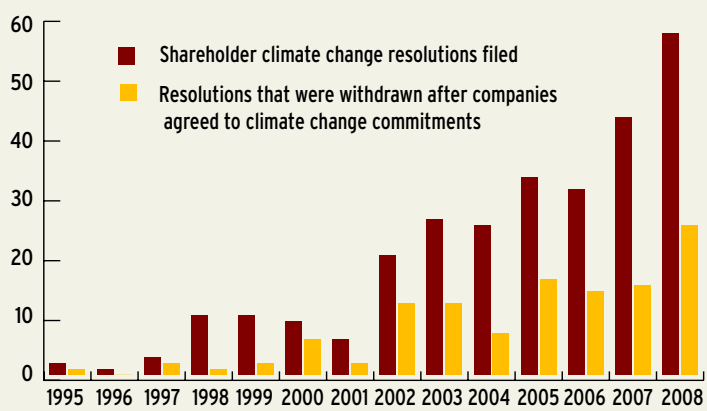
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Source: Ceres

## Liability: D&amp;O climate change scrutiny

CONTINUED FROM PAGE 20

information on climate change risks.

For example, Houston-based utility Dynegy Inc. in October and Minneapolis-based utility Xcel Energy Inc. in August settled lawsuits filed by New York Attorney General Andrew M. Cuomo by agreeing to include in their 10-K SEC filings detailed information on climate change risks.

Three similar suits Mr. Cuomo has filed against other utilities are pending.

Still, D&O insurers have not developed solid approaches to the

risk, brokers and insurers say.

"Distracted" by their own financial concerns and the potential of burgeoning policyholder losses as the economy deteriorates, D&O underwriters are not paying a lot of attention to climate change risk, said Ann M. Longmore, a New York-based executive vp and the D&O practice leader at Willis HRH, a unit of Willis Group Holdings Inc.

The exception for D&O insurers is the oil and gas industry, but many of those companies already provide substantial climate change risk information, Ms. Longmore said.

Many D&O insurers would not comment for this report. Others were uncertain how D&O insurance eventually would treat climate change risks.

A spokeswoman for St. Paul, Minn.-based Travelers Cos. Inc. said the insurer's "coverage to date hasn't changed due to this issue. Travelers is continuing to monitor the situation with respect to climate change and any impacts that may result from pending legislation."

Unlike subprime mortgage-related risks, the New York-based professional risk unit of ACE USA has not added a climate change addendum to its D&O application form, said Carol Zacharias, senior vp and chief counsel.

"We have educated our underwriters on climate change risk and have shared with them questions they should be asking (the) appropriate accounts," she said.

Reinsurance underwriting executive Bill Redington said predicting how D&O coverage for climate change risks will evolve depends on underwriters' ability to measure and price the risks, which he said is "nearly impossible" now. Factors he said play into the situation include the Supreme Court's 2007 decision on greenhouse gases; SEC financial disclosure regulations and the amount of disclosure that policyholders provide insurers; lawsuits over greenhouse gas emissions; and the interpretation of inconsistently worded D&O policy exclusions pertaining to pollution liability, bodily injury and property damage.

As a result, any climate change-related D&O claim "will be based upon its own facts," said Mr. Redington, a senior vp and the head of professional liability at Munich Reinsurance America Inc. in Princeton, N.J. "It's an evolving area" for insurers and reinsurers.

Regardless of what insurers and reinsurers decide, attorneys and brokers echo Ms. Longmore's advice that policyholders get in front of the issue by systematically analyzing and disclosing their current and potential climate change risks.

That can be a challenging task, said attorney Bill Stewart, a partner with Cozen O'Connor P.C. in West Conshohocken, Pa. "Clearly, disclosure requirements are trending up, and clearly, there will have to be more disclosure" than there is now.

In particular, evaluating potential liability for physical risk would be difficult, because science in the area has not advanced enough to measure such risk, said attorney Greg Rogers, chairman of the American Bar Assn.'s Environmental Disclosure Committee.

But assessing climate change regulatory risks involves much more "straightforward analysis" for companies, said Mr. Rogers, of counsel with Guida, Slavich & Flores P.C. in Dallas.

Companies also should disclose the climate risk of building a major facility in one location vs. another, Mr. Stewart said. Such an analysis would involve, for example, the availability and cost of resources such as water, wind and solar energy to power the operation, he said.



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# Insurers have yet to restrict climate change-related losses

## Risk managers look to tap pollution liability coverage

By **DAVE LENCKUS**

Pollution liability insurers generally have not modified their coverage to restrict climate change-related losses, and one executive says the risk creates an opportunity for insurers.

But at least one pollution liability insurer is concerned about covering the risk, and others likely will be in certain cases, one broker reports.

Gerry Finley, a senior vp and casualty treaty underwriter at Munich Re America in Princeton, N.J., said pollution liability insurers are not taking "any overt action" to restrict or provide pollution liability coverage, but "I don't know that the industry has enough surplus to broadly cover climate change" damages.

The good news for buyers is that insurers are not saying that climate change losses are not covered, said broker Rick Hawkinberry, a Pittsburgh-based senior vp in the environmental practice of Willis HRH, a unit of Willis Group Holdings Ltd.

With the uncertainty of whether directors and officers liability insurers eventually will exclude climate change losses, some risk managers hope to tap their pollution liability policies, said Ann M. Longmore, a New York-based executive vp and the D&O practice leader at Willis HRH.

Ms. Longmore noted that high-profile climate change-related litigation filed to date includes suits by the New York and California attorneys general against carmakers and utilities. But such state actions do not trigger D&O policies, she said.

"We're telling clients, 'If you think you'll need coverage, get it now before (new) regulations impact what's available'" from pollution liability insurers, Mr. Hawkinberry said. Multiyear pollution liability policies covering three to five years "are readily available."

Broker Rod Taylor also said he has not seen "any request for additional information" from insurers about policyholders' climate change risks.

"I have not seen insurance companies do much of anything with policies," with one exception, said Mr. Taylor, the Orlando, Fla.-based managing director for the environmental services group at Aon Risk Services Inc.

Mr. Taylor related that an insurer recently added a climate change exclusion to an automaker's pollution liability policy.

He predicted that pollution liability insurers will more closely scrutinize and limit coverage for the climate change risks faced by auto, steel, utility and paper industries because of their operations' or products' greenhouse gas emissions.

Mr. Taylor noted that energy and utility companies were sued for contributing to global warming and feeding Hurricane Katrina in 2005. In addition, California's attorney general sued six automakers for contributing to global warming. While federal judges dismissed both suits last year, the cost of defending similar claims could be steep, even

if they are dismissed.

Insurer executive Joe Boren said, depending on a pollution liability insurance policy's language, he could foresee a policyholder successfully arguing it should be covered for defense costs if sued for emitting greenhouse gases or devaluing property because of its emissions.

That argument would carry weight because the U.S. Supreme Court in

2007 ruled that greenhouse gases are pollutants that can be regulated under the Clean Air Act, said Mr. Boren, chairman and chief executive officer of New York-based Commerce & Industry Insurance Co., the environmental insurance unit of American International Group Inc.

For pollution liability policyholders facing climate change-related bodily injury or diminution of val-

ue claims, "I would easily see how those would be covered," depending on the policy's wording, Mr. Boren said. In addition, he said, "producers of greenhouse gases will need to think of how they're protecting themselves. So that will present itself as an opportunity for pollution liability insurers."

For example, some utilities are experimenting with carbon seques-

tration—storing carbon emissions in the earth—"and are asking whether you can use a pollution legal liability policy in case this isn't a good idea," Mr. Boren said.

"We will be able to meet the needs of those who request that kind of coverage" with limits up to \$50 million, the amount that AIG typically can provide for pollution liability coverage, he said.



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Pollutants cloud the Pearl River in Guangzhou, China. China has said authorities will target polluters and require environmental liability insurance.

AP PHOTOS

# Standards used in U.S. often adapted for environmental liabilities abroad

*Insurers expanding products to meet foreign demand, globalization*

By **ROBERTO CENICEROS**

Environmental liability risks are increasing globally, but risk managers say it's easier to find local coverage solutions and practices that mirror those in the United States.

More countries are implementing laws or enforcing regulations that they previously ignored, observers

say. Fortunately for companies expanding globally, the environmental laws and practices being adopted around the world generally follow U.S. standards, they add.

Due diligence and risk management practices that protect companies and comply with foreign laws also are similar to practices already applied in the United States, brokers say.

Insurers, meanwhile, are adapting and expanding their environmental liability products to meet foreign demand that is driven by client globalization, say brokers, underwriters and risk managers.

In addition, insurers are opening foreign offices or cooperating with local underwriters to provide commercial policyholders with global coverage that fits seamlessly with their U.S. policies.

"The products available outside the U.S. are more closely mirroring what is available in the U.S., which is a very positive strength," said Jeff Bray. Mr. Bray is vp of risk management for AMB Property Corp., a San Francisco-based industrial real estate developer and property owner in North America, Europe and Asia.

Several examples exist of countries or regions placing greater focus on controlling pollution, holding parties financially accountable for

environmental cleanup or mandating that companies purchase insurance for industrial operations, brokers say, including:

- The European Union's Environmental Liability Directive, which became effective in 2007. It is based on the polluter-pays principle of forcing industrial operators to fund prevention and pollution remediation costs.

- Argentina this fall joined countries such as Germany that require environmental insurance for industrial operations.

- China, like other Asian nations, has said its environmental protection authorities will target polluters and require environmental liability insurance.

In addition to new laws and the enforcement of existing ones, companies also are feeling pressure to improve their global environmental stewardship, said Michael Balmer, environmental practice leader in Boston for Willis HRH, a unit of London-based Willis Group Holdings Ltd.

Those other pressures include regulatory demands for accurate reporting of all corporate environmental liabilities and societal demands that companies reduce their carbon footprints and pursue

Continued on next page



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CONTINUED FROM PREVIOUS PAGE

“sustainability” practices, Mr. Balmer said.

Nongovernmental organizations operating outside the United States also are pressuring companies to fully report their environmental impact, said Kenneth Ayers, managing director for Aon Environmental Services Group in Nashville, Tenn.

### Exporting risk practices

Companies expanding overseas are therefore taking with them the environmental mitigation practices they have honed in the United States, Mr. Ayers said.

“We are seeing a lot of folks, through their corporate governance, looking at treating the entire world the same way, which is just really good business practice,” Mr. Ayers said.

“The format...where a company already has a U.S. (environmental) program and expands it to cover all of its overseas operations is probably the most common thing we are seeing,” Mr. Balmer said.

In the past, companies expand-

**‘We are seeing a lot of folks, looking at treating the entire world the same way, which is just really good business practice.’**

Kenneth Ayers,  
Aon Environmental Services Group

ing internationally focused more on business factors such as the cost of labor and raw materials, several brokers said. But environmental concerns are becoming a greater part of their decisionmaking.

“As we see greater complexity and higher risk on a global basis, couple that with the ever-growing pressure of companies to improve their environmental stewardship, companies are taking a more strategic approach to (global) environmental risk management,” Mr. Balmer said.

With growing pollution law enforcement and with new laws generally following U.S. standards, it is increasingly common for companies considering global acquisitions to hire U.S.-based environmental consultants to conduct due diligence on potential acquisition targets, said Matthew Pateidl, vp for environmental risk at Lockton Cos. L.L.C. in Kansas City, Mo.

“They are applying the best practices that are established here in U.S. to do due diligence abroad,” Mr. Pateidl said.

In one example, an Illinois-based company considering an acquisition in India obtained soil samples as part of its due diligence, Mr. Pateidl said. The samples would help the company determine whether the contamination levels at the acquisition site could cause bodily injury or require cleanup.

But the company’s consultants found that India had not established threshold limits for acceptable amounts of contamination. So

they compared their soil samples to standards set by the state of Illinois, he said.

“What they are doing is adopting a lot of U.S.-based threshold limits because we have done the science,” Mr. Pateidl said.

Other due diligence and risk management practices common in the United States and now increasingly applied to global acquisitions, brokers say, include:

- Reviewing production history.
- Evaluating the waste stream.
- Determining natural resource consumption.
- And measuring the polluting agents produced.

Evaluating local laws to determine their impact on issues such as whether cleanups would stop at the

property boundary or expand beyond is also crucial, the brokers say.

Best practices for purchasing insurance also mirror those in the United States. Numerous product types and triggers are available, brokers say, making it important for companies to understand an operation’s objectives to find the appropriate options.

Whether a company is most concerned about past pollution or the potential for future pollution, for instance, could determine the coverage trigger sought, brokers advise.

Increasingly, companies operating globally are finding that purchasing coverage locally, tailored for the specific country or region, is better than the traditional method

of buying coverage in the United States, several brokers agree.

It’s a better way to manage risks for a specific country, Mr. Ayers said. Local policies are more likely to address specific laws, and local defense attorneys will understand the policies and how to provide a defense under them.

Insurers, meanwhile, have been tailoring their U.S. products to meet mandatory terms and conditions unique to specific countries, several sources say.

New York-based American International Group Inc., for example, has localized its U.S. environmental liability products to meet laws and languages in other countries, said Rod H. King, worldwide manager environmental liability at AIG divi-

sion American International Underwriters in New York.

“The idea behind the coverage we offer overseas is to take the same intent behind the coverage offered here on the domestic side,” Mr. King said. “The intent is not to have a gap in the coverages that are available here in the U.S. vs. what we are offering internationally.”

Insurers’ efforts to provide similar coverage globally is meeting with risk manager approval.

“I’d say there has been significant change in the last 12 months, and I would not have any hesitation purchasing coverage locally, knowing I would most likely have very similar coverage to what is available in the U.S.,” said Mr. Bray, the risk manager for AMB Property.



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# Insurers, reinsurers often back research into climate change

*Studies provide 'critical' data for the industry to gauge its underwriting risks as well as point out future opportunities*

By **TONY DOWDING**

As an industry that could be shouldered with much of the costs relat-

ed to the consequences of changes in weather patterns, the insurance industry has for years funded and participated in research into

changes brought on by the climate.

The two largest reinsurers in the world, Swiss Reinsurance Co. and Munich Reinsurance Co., began studying climate change about 30 years ago.

As well as having their own research teams, insurers, reinsurers and brokers fund research from scientists at institutes and universities around the world.

In addition, said Andreas Spiegel, senior climate change advisor at Zurich-based Swiss Re, the reinsurer supports research and initiatives conducted by leading nongovernmental organizations and United Nations organizations, such as the Climate Group and the U.N. Environment Program Finance Initiative Climate Change Working Group.

Munich Re has collaborated with the London School of Economics and Political Science's and University of Leeds' newly established Centre for Climate Change Economics and Policy to research into the economic consequences of climate

change.

Meanwhile, among brokers, Willis Group Holdings Ltd. is working with the National Center for Atmospheric Research in Boulder, Colo., on a study to examine how global warming will influence hurricanes in the Gulf of Mexico and Caribbean Sea in the next few decades. And London-based Benfield Group Ltd., soon to be acquired by Aon Corp., sponsors the University College London's Hazard Research Center.

David Simmons, head of remetrics financial modeling at Benfield Group, said the purpose of the research is to understand the risks the industry faces. "Are the climate extremes we see natural variability, partially understood natural cycles or the result of a longer-term trend, e.g. global warming? In truth, in many cases it is a combination of all three," he said.

"Unless we understand trends and cycles, we cannot fully understand the past, and so cannot properly assess risk in the present let alone the future. The main climate change issue the insurance industry faces is not the risks we may face in 20-plus years but understanding the risks we face now," Mr. Simmons added.

Industry-sponsored research is often related to a specific project, such as Hamilton, Bermuda-based Catlin Group Ltd.'s sponsorship of a scientific expedition to the Arctic ice cap. The Catlin Arctic Survey will be led by British explorer Pen Hadow and will measure the thickness and density of the North Pole ice cap next year.

"None of us know the true impact that global warming will have on the Earth and its inhabitants," said Stephen Catlin, chief executive of Catlin in London.

The survey "will provide critical data on how quickly the Arctic ice cap is disappearing due to climate change." Such projects "are crucial to produce the information necessary to secure our future," he said in an e-mail response to questions.

In some cases, the link between the insurance industry and academ-

ic research is simply through funding, but often it involves co-operation between scientists and the industry.

Ernst Rauch, head of department, climate risks, research and development in the georisks research division of Munich Re, said: "Our general policy is to develop and maintain a network into the research organizations (such as the London School of Economics), to have

**'None of us know the true impact that global warming will have on the Earth and its inhabitants.'**

Stephen Catlin, Catlin Group Ltd.



Veteran explorer Pen Hadow is to lead the Catlin Arctic Survey team early next year to examine the state of the ice cap from Canada to the North Pole.

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Reinsurers say that the research data is integrated into their risk models and their risk management activities. "Our end goal is to quantify interconnected risks and to integrate the results into our risk models, pricing, capacity and hedging strategy," said Swiss Re's Mr. Spiegel.

Rowan Douglas, chairman of London-based Willis Research Network, said that the aim is to help refine and shape the academic research that has already been undertaken, give it an additional focus for the insurance industry and improve models that help insurers understand the risk.

In the context of climate change, the Willis research is focused on existing research teams that use supercomputers to examine climate issues. "The insurance industry cannot build their own supercomputers, so it is effectively aligning itself with those existing, very large public academic research programs," said Mr. Douglas.

Mr. Douglas said Willis' focus is on open, free, transparent academic research, because the effectiveness of the scientific research will be driven by its adoption by the big cat modeling companies.

The industry funds research, not only to combat changing exposures but also to capitalize on business opportunities, experts say.

"Historically with respect to climate change, we have addressed and focused on the downside risk, such as natural catastrophes and their impact on adverse loss development," said Mr. Rauch.

"What really has changed in recent years is that climate change has become a very concrete business case, meaning that there is significant resource allocated towards the development of new insurance and reinsurance products, for instance, in the context of renewable energies, new technologies and emissions trading," he said.

## Products & Services

### AIG eDelivery system adds environmental policies

**NEW YORK**—AIG Environmental has joined other units of American International Group Inc. in issuing policies electronically through the online AIG eDelivery system.

The Web-based system allows brokers to access and download newly issued policies and endorsements in a PDF format one day after they are issued, which AIG Environmental said is expected to save approximately 11 tons of paper a year.

According to the New York-based insurer, communication between the broker and the underwriter will improve using AIG eDelivery because contact information will be provided along with the details of a submission or policy.

The program is designed to expedite policy delivery and eliminate the need for traditional paper policy issuance, the company said.

AIG Environmental joins several other AIG Commercial Insurance units offering eDelivery, including AIG Excess Casualty, AIG Executive Liability, AIG Specialty Workers'

Compensation and AIG Small Business.

For more information, contact Joseph Boren, chairman and chief executive officer of AIG Environmental, at 800-348-4314 or e-mail [aigenvironmental@aig.com](mailto:aigenvironmental@aig.com).



### RIMS offers professional development courses

**NEW YORK**—The Risk & Insurance Management Society Inc. is offering a series of professional development workshops for risk managers.

Workshops cover standard industry practices and recent developments and techniques to help organizations develop a competitive risk management program, according to the New York-based society.

Upcoming workshops include "Techniques of Risk Management,"

which will be held Nov. 19-20 in Miami.

The course focuses on risk identification, including risk mapping and quantifying losses; whether to retain or transfer such risks; risk financing and use of captives.

On Nov. 20-21, RIMS is holding "Move Your Program to the Next Level: RIMS Risk Maturity Model for ERM" in Phoenix.

The course helps risk managers determine their company's current level of enterprise risk management and establish a plan for ERM implementation.

RIMS also is offering a two-day workshop in New York called "Entrepreneurial Risk Management (ERMe): Risk Management as a Profit Center."

The Dec. 4-5 event will cover ERM essentials and teach participants how to begin the process in their own organizations.

For more information, including fees to attend the workshops, or to register, visit [www.rims.org/education](http://www.rims.org/education).

### Mutual Boiler Re adds green equipment cover

**MALVERN, Pa.**—Mutual Boiler Re, a unit of Malvern, Pa.-based Factory Mutual Insurance Co., is offering green equipment breakdown coverage to help organizations replace damaged or destroyed equipment with environmentally-friendly alternatives.

The company said the coverage allows property/casualty insurers to offer the green equipment coverage at no additional cost to policyholders.

Aside from green equipment replacement, the reinsurance also covers hiring an accredited green consultant to help with design; green removal, disposal and recycling of damaged property; costs associated with procuring environmentally friendly certification; and business interruption costs.

For more information, contact Sam Broomer, vp-Mutual Boiler Re, at 800-814-4458 ext. 804 or e-mail [Samuel.Broomer@MutualBoilerRe.com](mailto:Samuel.Broomer@MutualBoilerRe.com).

### ICW develops online Risk Management Rx

**SAN DIEGO**—ICW Group Insurance Cos. has rolled out an online risk management program to help employers develop and implement workplace safety programs.

Risk Management Rx is a Web-based program available free to workers compensation policyholders of the San Diego-based insurance group.

The program allows users to track workplace incidents and injuries, develop and maintain logs for the Occupational Safety and Health Administration, monitor safety training programs and other resources. Policyholders also can set up customized safety training poli-

cies and procedures, track certificates of insurance and manage materials safety data sheets. The password-protected system allows users to generate customized reports for various needs, such as audits, ICW said.

Policyholders can also access an online safety library, which contains documents in English and Spanish, to access downloadable safety articles, procedures and training programs.

For more information, contact David Hoppen, chief operations officer of ICW Group, at 858-350-2992 or send an e-mail to [dhoppen@icwgroup.com](mailto:dhoppen@icwgroup.com).

### TO SUBMIT ITEMS

BI's Products & Services reports on new product offerings.

Personnel changes appear in Comings & Goings, while Market Moves column reports on activities by insurance industry companies and related entities.

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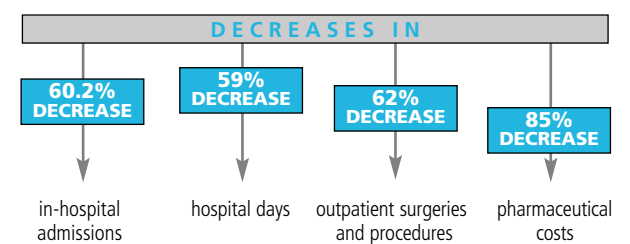


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SOURCE: JOURNAL OF MANIPULATIVE AND PHYSIOLOGICAL THERAPEUTICS, MAY 2007

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Alternative Medicine Integration study results available at: [www.jmptonline.org/article/S0161-4754\(07\)00076-0/abstract](http://www.jmptonline.org/article/S0161-4754(07)00076-0/abstract)

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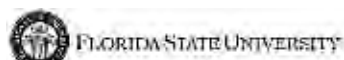
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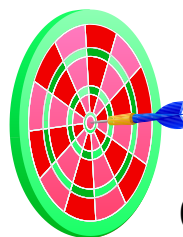
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# International NEWS

## Europe seeks to impose rules on rating agencies

By RICHARD MILLER

**BRUSSELS, Belgium**—The European Commission adopted draft legislation last week to regulate credit rating agencies, which have been criticized for failures in light of the current financial crisis.

In a statement, the Commission said the proposals are designed to “ensure high-quality credit ratings, which are not tainted by the conflicts of interest which are inherent to the ratings business.”

“I want Europe to adopt a leading role in this area,” said Charlie McCreevy, E.U. Internal Market and Services commissioner. “Our proposal goes further than the rules which apply in other jurisdictions. These very exacting rules are necessary to restore the confidence of the market in the ratings business in the European Union.”

Under the proposed rules, credit rating agencies would not be allowed to provide advisory services and they would not be allowed rate financial instruments if they do not have sufficient quality information on which to base their ratings. They would be required to publish an annual transparency report and establish an internal function to review the quality of their ratings.

The Commission is also calling on rating agencies to have at least three independent directors on their boards whose pay does not depend on the firm’s performance. At least one would have to be an expert in securitization and structured finance.

Rating agencies have been criticized for giving investment-grade ratings to complex securities that eventually led to the global financial crisis. They have also come under fire for maintaining the high ratings of American International Group Inc. only days before the insurer needed to be rescued with a loan from the Federal Reserve Bank of New York.

Responding with a statement, Stephen Joynt, chief executive officer of Fitch Ratings, said his firm supports a “globally consistent approach to the regulation of credit rating agencies,” and ideally based on standards of the International Organization of Securities Commissions.

“Fitch welcomes the Commission’s commitment to setting up a regulatory framework in the European Union, comparable to that applied in the United States and based on the same principles. We are also pleased to see a provision in the proposal explicitly prohibiting interference by the regulatory authorities in the content of our credit opinions,” Mr. Joynt said.

“While Fitch will continue to search for common ground on a few key provisions in the proposals, we will engage in a balanced and constructive way with the Commission, the European Council and the European Parliament as the approval process moves forward,” he said.

If approved by individual governments and the European Parliament, the Commission said the rules could go into effect as soon as 2010.

## European Parliament awaits vote by ECOFIN on Solvency II

*Several potentially sticky issues still need to be resolved*

By RICHARD MILLER

**BRUSSELS, Belgium**—A long-awaited vote by the European Parliament on Solvency II has been delayed as the body waits for the Economic and Financial Affairs Council to reach its own consensus on the directive at its Dec. 2 meeting.

Peter Skinner, a U.K. member of the European Parliament and rapporteur on Solvency II, said the delay was unexpected, but that in many ways politics is about negotiations.

Solvency II, slated for enactment in 2012, will introduce a risk-based capital regime in Europe for insurers and captive companies above a certain size.

After a parliamentary committee approved compromises to Solvency II on Oct. 7, Mr. Skinner had hoped that the directive could be approved quickly at the first-reading stage. At that time, he had forecast a vote by the European Parliament at its plenary session in mid-November.

But Parliament is waiting for ECOFIN, currently under the French presidency, to conclude its deliberations. ECOFIN is made up of the economic and finance ministers as well as budget ministers of the member states.

“Parliament has done its job and now we are just waiting for Council to come back,” said Mr. Skinner. “We are waiting for them to finalize their viewpoint, but the first reading (in the European Parliament) depends upon whether or not council and Parliament have a position which is close to each other, and if they can negotiate,” he said.

If the two sides cannot agree, then a typical legislative process—



The European Parliament, which meets in the Belgium facility above, put off its vote on Solvency II to await the decision of the Economic and Financial Affairs Council on proposed language for the risk-based capital regime.

which could take more than a year—would follow, Mr. Skinner said. “At the moment, we are just waiting and holding our breath to see what the Council is going to do next: Are they going to follow the Parliament’s lead and adopt the Parliament’s paper?”

Under the first-reading stage option, if an informal agreement can be reached between Parliament and ECOFIN, then the text as proposed could become law at the first reading stage, a spokesman said.

Assuming ECOFIN can reach agreement at its Dec. 2 meeting, Mr. Skinner said Parliament could take its vote in December. If not, the process will have to continue under the next E.U. presidency—to be held by the Czech Republic—with a vote in early 2009.

“My sense is that it will probably be pushed back to next year,” Mr. Skinner said.

There are at least three outstanding issues that ECOFIN needs to resolve, a spokesman said: group support, division of responsibilities with regard to supervisions and equity risk.

Mr. Skinner said he hoped ECOFIN would examine the solutions Parliament devised. “Group support is still a sticky area for some, but there may be some solutions. Certainly Parliament has a good solution.”

Group support, in which insurers with their headquarters in one member state implicitly support subsidiaries in other member states, has been a matter of intense debate among politicians.

## Despite losses by some, most insurers well-capitalized: Moody’s

By STUART COLLINS

**LONDON**—Many insurers have reported sharp declines in profits and shareholders’ equity in recent weeks, but the sector is generally well-positioned to weather the financial storm, and potential rate increases in 2009 are likely to be limited, analysts at Moody’s Investors Service Inc. say.

While buyers are right to be concerned about insurers’ financial strength—particularly when they buy liability insurance—they should not consider the current situation a catastrophe, said Simon Harris, team managing director of European insurance at Moody’s.

Moody’s has seen heightened demand for information on insurers’ financial strength in the current

**‘Insurers are still profitable and fundamentally the insurance business has performed well.’**

Simon Harris, Moody’s Investors Service Inc.

environment, he said. While there have been selective rating actions taken on a few insurers, the sector is well-capitalized, and has generally not invested directly in the structured products that have plagued the banking sector, Mr. Harris added.

Recent results show that while insurers are not immune from the turmoil in financial markets, asset quality and insurers’ liquidity are good, Mr. Harris said. “Insurers are still profitable and fundamentally

the insurance business has performed well,” he said. “Some companies—such as American International Group Inc. and Swiss Reinsurance Co. have had problems—but most insurers do not have the same risk profile, so (buyers) should be careful to not read these issues for the rest of the market.”

European insurers are relatively unexposed to U.S. asset-backed securities, said Paul Oates, Moody’s vp and senior analyst of European insurance. And while European

insurers still have significant exposures to equities, current investment impairments are more a reflection of accounting policy rather than economic losses, he said.

Investment losses accelerated in the third quarter, but actual losses would likely be low as losses so far have been mostly unrealized, and insurers have the ability to hold securities until maturity, said Ted Collins, group managing director of global insurance at Moody’s.

Moody’s analysts at its Global Insurance Conference in London last week, noted that the majority of insurers and reinsurers were A-rated. And while there is rating pressure from investment write-downs and the fall in equity markets, Moody’s maintains a stable rating outlook on the U.S. and

European insurance sectors.

Despite a recent deterioration in capital markets and a pickup in the pace of downgrades, strong underwriting results and healthy balance sheets support that stable outlook in the short-term, said David Masters, analyst for European Insurance at Moody’s.

But capital market turbulence has put the financial flexibility of reinsurers under pressure, said Dominic Simpson, vp and senior credit officer of European insurance at Moody’s.

The capital market view of insurers has deteriorated and this reduces refinancing options for reinsurers, he said, and some smaller reinsurers could have difficulty raising capital after a large catastrophic event.

# How trouble arrived at AIG's door

*Move into noninsurance securities proved to be a dramatic change*

By John J. Hampton

American International Group Inc. is facing significant challenges amid the global financial crisis. In this article, let's explore how AIG got in trouble.

AIG has been known for three major business components:

- Sell insurance. As an insurer, AIG reimburses organizations and individuals that suffer financial losses and defends them when they are sued.

- Park assets. AIG borrows money and buys assets for clients. It shows assets and debt on its balance sheet. It also leases assets to companies that do not want to show liabilities on their own balance sheets.

- Smooth earnings. AIG has used its financial strength to reduce the volatility of net income for clients through alternative risk transfer mechanisms, such as credit derivatives.

For many years, the model worked splendidly. AIG would aggressively evaluate and accept risks that others considered to be too risky. The company used its financial muscle to develop risk transfer products that were beyond the capabilities of smaller or weaker insurers. AIG executives prided themselves on finding creative and profitable solutions to policyholder problems. Under former Chairman and Chief Executive Maurice Greenberg, AIG built a culture that rewarded success and punished failure.

For a long time, AIG expanded beyond regulated insurance. Statutory accounting limits profits and growth rates by allowing insurers to show only admitted assets and forbidding the deferral of certain costs, among other requirements. Capital markets are not so constrained. AIG and others created securities to bring the capital markets to accept catastrophic and other risks.

## How the problems started

To understand AIG and its bailout, which has now reached \$150 billion, let's start with conservative insurance accounting. Underwriters recommend products to offer in the market and standards to evaluate risks. Insurers forecast the likely level of losses. Regulators allow only the most safe and liquid assets to be shown on balance sheets. New business, profits and growth are restricted by understated capital.

The next problem arises because insurers and reinsurers lack sufficient capital to handle large insured losses, such as: Hurricane Katrina, \$43.6 billion; Hurricane Andrew, \$22.9 billion; the Sept. 11, 2001, terrorist attacks, \$22 billion; and the Northridge, Calif., earthquake, \$17.5 billion. These figures, compiled by the Insurance Information Institute, reflect 2007 dollars.

Global insurance capacity is a small fraction of the values exposed. The solution to catastrophic risk is to bring in the global capital markets, which recently had

## Emerging Risk STRATEGIES



John J. Hampton is the KPMG Professor of Business and Dean of the School of Professional and Continuing Studies and Graduate Business Programs at St. Peter's College in New Jersey. To read Mr. Hampton's columns and interviews, visit [www.BusinessInsurance.com/ERM](http://www.BusinessInsurance.com/ERM).

more than \$50 trillion in capital. That's a large number even compared with the \$30 trillion of U.S. home values.

Thus, AIG added to its business model the sale and guarantee of derivatives—securities whose value derives from another security or asset. Also called risk securitization and alternative risk transfer, an insurance company transfers underwriting risks to the capital markets, through:

- Tradable securities, which can be sold in pieces, or tranches, to many investors;

- Contingencies, in which investors agree to waive principal repayment if a contingent loss occurs;

- Interest rates that offer relatively high returns to holders of the portions of the security;

- Principal repayment, either periodically or at maturity, to investors.

An example of ART is the catastrophe bond. Say an insurer faces a \$300 million loss if a hurricane damages insured property in Florida. The insurer creates a two-year cat bond offering 15% annual interest and sells it to an investment banker that invests the cash received in secure assets. Investors purchase tranches of the bond, collect interest for two years and hope a hurricane doesn't hit Florida. With no loss, they get back \$300 million at maturity. If a hurricane causes a \$175 million loss, they receive only \$125 million.

Two things are true with catastrophe bonds and other insurance securities. First, profits are based on payments to protect insurers against a natural or other disaster. Second, it actually is insurance. The invested money is available to pay losses if they occur. AIG and others are not likely to get into trouble with cat bonds and similar deriva-

tives.

The situation changes dramatically when insurers move into noninsurance securitization. These securities are attractive to investors because they offer above-market returns and have a low correlation to other investments that move in tandem with interest rates, inflation and economic optimism. The combination of high return and low correlation diversify a financial portfolio—at least in theory.

Three specific noninsurance securities handled by AIG and others can help us understand what happened:

- Guaranteed investment contracts. A municipality approves a construction project and issues a bond sold to investors. The issuer deposits the proceeds in a low-rate interest account secured by a GIC from an investment bank that assures the return of principal when needed. The investment bank profits by investing the cash elsewhere at a higher rate of interest.

- Collateralized debt obligations. An investor wants to diversify a financial portfolio by purchasing home mortgages and buys from an investment bank a security with 1,000 mortgages as collateral. An investment bank can create CDOs from nonmortgage assets, but subprime mortgages were the genesis of the financial crisis. The investor collects monthly mortgage payments and receives the remaining principal when homeowners repay the loans.

- Credit default swaps. The investor who buys a CDO is concerned about the risk of default of the underlying loans, in this case homeowners defaulting on their mortgages. So the investment bank guarantees the monthly mortgage payments and eventual repayment of principal. The investor pays a fee for the guarantee.

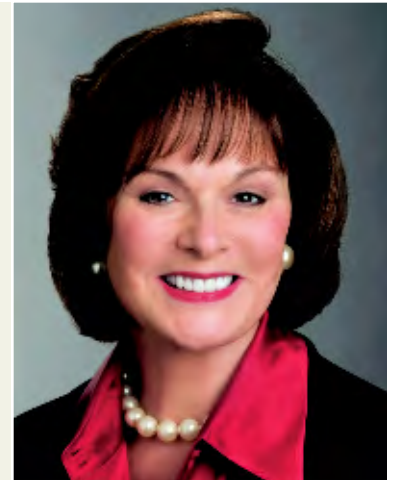
## Caught in the implosion

AIG got into the investment banking business when it entered the realm of noninsurance securitization. The derivatives offered high returns, growth and no government regulation. The company did not have to maintain reserves or otherwise comply with statutory restrictions.

As the credit markets imploded, AIG was caught in a liquidity squeeze. Municipalities, concerned about home mortgages, demanded funds early. Homeowners defaulted on monthly mortgage payments, banks foreclosed and holders of AIG credit default swaps demanded their money. It was only after these events that AIG began to understand the full impact of its exposure, and that's what prompted the massive federal bailout.

So what happens now? We will see. It appears that governments around the world are moving to stop foreclosures, provide liquidity and offer guarantees to avoid collapse of the financial system. If governments fail in this task, AIG will not be out of the woods.

## UP Comings & Goings CLOSE



### PATRICIA HEMINGWAY HALL

**NEW JOB TITLE:** President and chief executive officer of Chicago-based Health Care Service Corp., the parent company of Blue Cross and Blue Shield plans in Illinois, New Mexico, Oklahoma and Texas.

**PREVIOUS POSITION:** President and chief operating officer.

**VITAL STATISTICS:** Member of the boards of directors of the Blue Cross and Blue Shield Assn., America's Health Insurance Plans, Blue Health Intelligence, MEDecision and TriServ L.L.C.

**GOALS FOR NEW POSITION:** The biggest priority we have is to continue the excellent performance that we have delivered over the last decade with our growth and financial performance. We want to keep doing what we've been doing and continue to deliver exceptional performance.

**ROLE MODELS:** I have high regard for many of the people I've worked with throughout the years. (Retired HCSC) CEO Raymond McCaskey has helped me to grow to the point where I can succeed in my current position. It's been a learning experience watching him and

learning from him. Also, the person who hired me at Blue Cross and Blue Shield of Texas, Dr. Rogers Coleman, helped me to understand all of the issues we're facing in the health care industry. Particularly, he demonstrated a commitment to looking for solutions for the uninsured. His perspective and commitment were very inspirational.

**DID YOU ENVISION YOURSELF WHERE YOU ARE NOW:** My career has been one where I have tried to do the best I can in whatever position I have. I've stepped up when given opportunities. This wasn't on my list of things to do, but I've been fortunate. A lot of it has been being in the right place at the right time, and here I am, and I'm thrilled to be here.

**PASSIONS:** I feel passionate about having balance in my life. You can only perform at your peak professionally if you have good balance in your life. When you leave work, having other interests or areas that can refresh you are important so you can come back to the always intense work environment. I love to travel. My husband and I own a recreational tug boat and we traveled from the Bahamas to Canada in that recently.

## Comings & Goings ONLINE

**VISIT** [www.BusinessInsurance.com/ComingsandGoings](http://www.BusinessInsurance.com/ComingsandGoings)

for a full list of this week's personnel moves and promotions. Check our Web site daily for additional postings. Sign up online for the weekly Comings & Goings e-mail alert.

### TO SUBMIT ITEMS

*Business Insurance* would like to report on senior-level changes at commercial insurance companies and service providers. Please send news and photos of recently promoted, hired or appointed senior-level executives to:

Allison Martinat  
*Business Insurance*  
360 N. Michigan Ave.  
Chicago, Ill. 60601-3806

[amartinat@businessinsurance.com](mailto:amartinat@businessinsurance.com)

### POSTING THIS WEEK

#### ASSOCIATIONS:

- The American Society for Healthcare Risk Management

#### OTHER PROVIDERS:

- Mesirow Financial Services Inc.
- Maiden Holdings Ltd
- Mercer L.L.C.
- Aon Consulting Worldwide



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## Data: Security concerns

CONTINUED FROM PAGE 4

should examine the risk from their professional perspectives and develop plans to protect the company "before something happens," Ms. Lamb said.

FBI Special Agent Shena Crowe advised companies to pay close attention to two big security problems.

Ms. Crowe, who works in the agency's San Francisco office, said companies create problems for themselves when they view their data security differently than their facility security.

"Shop owners lock their doors" at night, but because "the digital space is not that available," companies think they get "security from obscurity," she said.

But the system breach of a "mom and pop" organization's small server illustrates how dangerous that attitude can be, Ms. Crowe said. An examination of the server, which was never taken down at night, found that a terrorist organization had "parked" a video "on the back of it," she said.

Ms. Crowe also noted that there is a strong correlation between the presence of WiFi, or wireless Internet capability, and large-scale data thefts involving personal information.

In addition, company insiders often point data thieves to the information, she said.

Despite the prevalence of inside help in data thefts, many companies do not conduct background checks on IT personnel, who "have the keys to the system," Apogee's Mr. Katona said.

While tight data security can make breaching a system difficult, no system is impenetrable, so companies should prepare for that, the panel said.

Ms. Lamb suggested that companies practice how they would respond to a breach so that person-

## Duo receives honors at PLUS annual conference

**SAN FRANCISCO**—The Professional Liability Underwriting Society honored broker Kevin M. LaCroix with its annual PLUS Founders Award and insurance executive John J. Degnan with its PLUS1 Award during the organization's 21<sup>st</sup> Annual International Conference, held Nov. 5-7 in San Francisco.

Mr. LaCroix is a partner with OakBridge Insurance Services L.L.C. in Beachwood, Ohio. Mr. LaCroix, who also is an attorney, previously was president of directors and officers liability insurer Genesis Professional Liability Managers, a unit of Berkshire Hathaway Inc. The Founders Award recognizes a PLUS member who has made lasting and outstanding contributions to the organization.

Mr. Degnan is vice chairman and chief operating officer of Warren, N.J.-based Chubb Corp. He received the PLUS1 Award for his contributions to the advancement and image of the professional liability industry.

More than 1,750 registrants attended the PLUS conference this year, a decrease of about 300 from 2007's attendance because of economic conditions, according to a PLUS spokeswoman.

The organization's next international conference is scheduled for Nov. 11-13, 2009, in Chicago at the Sheraton Chicago Hotel & Towers.

Additional information about PLUS and its conferences is available at the organization's Web site, [www.plusweb.org](http://www.plusweb.org).

—Dave Lenckus

nel know immediately how to respond. A prompt, well-coordinated response could limit damage to a company's reputation, she said.

Ms. Crowe said contacting law enforcement immediately after a breach "is critical" because, realistically, there is only a 30-day window to catch data thieves. That's because Internet service providers routinely clean their records of users' computer usage at least every 30 days. That's important because data thieves routinely sell the information they obtain to others online, Ms. Crowe said.

But in dealing with customers after a security breach, Beazley's Mr. Economidis warned companies not to overreact or act hastily.

For example, he said some companies have notified customers after a breach in circumstances that did not warrant such notification.

Other companies have signed up for the first customer credit monitoring service they came across

without evaluating whether less costly services were available.

The damages companies face after a security breach can be covered by special insurance policies, but many companies are not aware of the coverage, Mr. Katona said.

Professional liability insurers offer the coverage but charge an additional premium unless data security is a core element of a policyholder's business, Messrs. Katona and Economidis said.

The coverage falls into "three bushels," Mr. Economidis said: third-party liability; customer notification and credit monitoring costs; and first-party damage, including data repair costs, business interruption and extortion demands.

"Pricing is all over the place," Mr. Sills said.

Plenty of capacity for the risk is available, though high excess insurers are leaving the market because "they don't understand the risk," he said.

## Subprime: Litigation ahead

CONTINUED FROM PAGE 4

tion rate securities, Mr. Tatulli said. The market for those securities froze up earlier this year.

The plaintiffs argue that the defendants told them the auction rate securities market was as safe as money markets, which are not federally insured but historically have been safe investment vehicles, Mr. Tatulli explained.

Rating agencies are another lawsuit target for not catching the subprime problem, said insurer attorney George M. Gowen III, a member of Cozen O'Connor P.C. in Philadelphia.

Claims executive Paul Lavelle said cities eventually could form another big block of plaintiffs against financial institutions.

Mr. Lavelle, the New York-based president of LVL Claims Services L.L.C., cited a lawsuit filed by Cleveland against 21 financial institutions. The city claims that the defendants violated a city nuisance ordinance when they engaged in lending practices that caused numerous foreclosures and abandoned homes.

If the city's case succeeds, it could trigger a wave of similar lawsuits against financial institutions by other cities, Mr. Lavelle said. He likened the situation to tobacco company liability litigation, which failed for years before plaintiffs won a case in 1988. The tobacco industry eventually agreed to pay hundreds of billions of dollars to settle liability lawsuits and finance anti-smoking campaigns.

Baltimore filed a similar lawsuit against Wells Fargo Bank N.A. The suit charged that the bank's subprime lending activities violated federal fair housing regulations by focusing on African-American homebuyers.

Financial institutions also face litigation by state attorneys general and the Securities and Exchange Commission, Mr. Tatulli said.

The good news for defendants, he said, is that courts have dismissed a "significant number" of these claims. The bad news is that judges

dismissed the cases without prejudice, which means plaintiffs may refile them.

But one dismissal in particular shows a big problem for plaintiffs, said defense attorney Mark Meyer, a partner with Edwards Angell Palmer & Dodge U.K. L.L.P. in London.

In June, a federal judge dismissed the securities fraud lawsuit against subprime lender NovaStar Financial Inc. with prejudice. The judge ruled that the plaintiffs could not point to a single false statement in the company's financial results nor identify "the 'truth' that should have been disclosed" (*BI*, June 23).

Mr. Meyer noted that the NovaStar complaint exceeded 100 pages and still the court concluded it did not contain specific evidence that executive management intended to defraud investors.

"It's quite a hurdle for the plaintiffs bar" to clear in all cases, he said.

But the ability of defendants to obtain case dismissals with that argument likely will vary by judge, said Mr. Meyer and Dion N. Cominos, managing partner at Gordon & Rees L.L.P. in San Francisco.

However, there is an argument that the crisis was foreseeable, said Frederick C. Dunbar, senior vp for New York-based NERA Economic Consulting, a unit of Marsh & McLennan Cos. Inc.

When Mr. Cominos asked why no one saw the potential economic crisis in extending mortgage loans to subprime borrowers, Mr. Dunbar responded, "The academics did."

A major mistake that financial institutions made was calculating that there was "safety through diversification," Mr. Dunbar said, referring to the concept that housing prices in various regions of the country are not correlated.

"They're all correlated," he said.

Exacerbating the crisis was the tightening of bank credit "for no good reason" even before Lehman Bros. failed, he said. That occurred because of an "information cascade," which leads people to act with a "herd mentality" rather than process information independently, he said.

## Wyeth: Court holds firm can be liable for effects of generic drug

CONTINUED FROM PAGE 3

reversed the judgment in favor of Wyeth while upholding the dismissal of claims against the generic drug manufacturers.

Referring to Wyeth, the three-judge panel's decision said "a name-brand manufacturer that disseminates information about its product owes a duty of care to ensure the information's accuracy to any doctor who prescribes the drug in reasonable reliance on that information, even if the patient ends up taking the name-brand product's generic equivalent."

The court said it affirmed the dismissal against the generic drug manufacturers because, while there is a dispute as to whether the woman's doctor relied on Wyeth's product information, Ms. Conte was unable

to show her doctor relied on any information provided by the generic drugmakers.

The appellate court did not deal with the federal pre-emption issue in its opinion, stating it was unnecessary in light of its disposition of the appeal. It also acknowledged its ruling conflicts with previous court rulings outside California on the subject.

A case now before the U.S. Supreme Court, *Wyeth Inc. vs. Diana Levine*, focuses on whether the Food and Drug Administration's approval of a warning label on an anti-nausea drug pre-empts a state product liability lawsuit (*BI*, June 30).

A Wyeth spokesman said the California appellate court decision will be appealed.

"The company disagrees with the reasoning of the court, which

rejects a long line of cases in which courts have uniformly found that a drug manufacturer of a brand drug cannot be liable for injuries caused by a generic version of the brand drug sold by another manufacturer," the Wyeth spokesman said in a statement.

The spokesman said while he is unsure as to whether this is the first case to rule this way, 14 other jurisdictions have held that a brand name-drug manufacturer cannot be held liable in cases involving generic drugmakers.

The decision stands product liability law "on its head," said James M. Beck, a product liability defense attorney with Dechert L.L.P. in Philadelphia.

"It's an extreme extension of the law. It eliminates altogether the connection between making a

product and being liable for that product," he said.

It creates a situation where the actual drugmaker is not liable but the firm that made the pioneer drug "is liable for somebody else's product, and that's just absurd," Mr. Beck said.

Jonathan Allan Klein, a defense attorney with Kelly, Hockel & Klein, P.C. in San Francisco, said the unprecedented decision "has tremendous significance."

It "opens up a Pandora's box of litigation," said Mr. Klein.

Brand name-drug manufacturers, it would seem, "now need to be worried about being sued because someone who took a different drug, one it did not manufacture," might allege their warnings were inadequate. This will make drug companies reluctant to invest more into

research, Mr. Klein said.

To hold the manufacturer of a pioneer drug liable "for a drug it didn't expressly manufacture is problematic," said Heather L. Hodges, a defense attorney with Crowell & Moring L.L.P. in Washington.

She said it is difficult to tell how significant the decision is because it is a ruling by an intermediate state court. "It's definitely something that caught a lot of observers off-guard," and a case that pharmaceutical companies will watch closely, Ms. Hodges said.

Ms. Conte's attorney could not be reached.

*Elizabeth Ann Conte vs. Wyeth Inc., et al.; Court of Appeal of the State of California, First Appellate District, Division Three; A116707, A117353; Nov. 7, 2008.*

# Health care: Proposal puts reform on congressional fast track

CONTINUED FROM PAGE 1

ees International Union and the AARP, took out a page ad in last Tuesday's USA Today offering to host a health care reform summit if President-elect Obama commits to taking action early in his administration, perhaps even during the first 100 days.

John Castellani, president of the Business Roundtable, reiterated the invitation during a keynote speech last week at the National Business Coalition on Health meeting in Washington.

"At a time when American competitiveness is most in peril, we simply cannot default to the position we have taken as a nation over the past 10 to 14 years and simply do nothing and run away from the issue," Mr. Castellani said. "Few business pressures today come as close to the pressure of rising health care costs," he said. "It is hampering our ability to compete with other countries, particularly in today's international economy."

But some lawmakers and policy experts are urging President-elect Obama to take it slow. They say speedy action, at least in part, was what helped undo health care reform efforts led in 1993 and 1994 by former First Lady Hillary Clinton. Too many people became frightened because they didn't have

time to review the massive proposal. The plan also crashed because of the Clinton administration's failure to line up support from key federal legislators.

Like the Obama plan, the Baucus proposal includes an employer mandate to either offer coverage or pay some kind of assessment; guaranteed-issue policies; a national insurance pool; premium subsidies for low-income individuals, families and small businesses; expansion of the State Children's Health Insurance Program; emphasis on primary care and prevention; and investments in health information technology.

Among the differences are an individual mandate; a Medicare buy-in for individuals aged 55 to 64; and a total revamp of the Medicare payment system, lowering payments to specialists and increasing them for primary care doctors. Perhaps the most controversial element of the Baucus proposal is the suggestion to limit the current tax exemption for employer-paid insurance, either through a cap or by income level.

While some of the components of the Baucus proposal would take several years to implement, it includes elements that could be launched almost immediately, such as issuing a RightChoices card that would guarantee access to recom-

mended preventive care and cancer screenings to individuals without private coverage who are not enrolled in a public health insurance program.

The Baucus plan came as a sur-



REUTERS

Sen. Edward Kennedy, D-Mass., praised a health care package proposed by Sen. Max Baucus, D-Mont., as "thoughtful recommendations for reform."

prise for some Washington insiders who had expected the first health reform proposal of the new administration to come from Sen. Edward Kennedy, D-Mass., who had been working on a plan during the summer and fall from his sick bed in Massachusetts following brain can-

cer surgery.

However, the Kennedy camp welcomed Sen. Baucus' contribution to the debate as well as his timing.

"It provides an important analysis of the urgent need for significant improvements in our health care system, and thoughtful recommendations for reform," Sen. Kennedy said in a statement. "I look forward to working with Sen. Baucus, our colleagues in Congress on both sides of the aisle, and the Obama administration to see that we at last achieve the goal of quality, affordable health care for all Americans. Senator Baucus' white paper brings us closer to that goal."

"The proposals in the white paper really do track a lot of what President-elect Obama released on the campaign trail," said Kelly Traw, a principal with Mercer L.L.C. in Washington. "And there are a lot of elements that look like what Massachusetts enacted. Those are the things that Sen. Kennedy is purportedly looking to. So it seems to be that at least these key players — Sen. Baucus, Sen. Kennedy and President-elect Obama—have a lot of common ground."

Frank McArdle, a consultant with Hewitt Associates Inc. in Washington, said the intent is to create a single bill to work from during the lame duck session of Congress that could be ready for Mr. Obama to

sign once he takes office Jan. 20.

"We knew that Sen. Baucus was going to be coming out with his white paper, and simultaneously Sen. Kennedy has been working on a proposal, reaching out and having discussions about that," Mr. McArdle said. "My understanding is that Sen. Kennedy was not going to follow suit and release his plan publicly, but now that Sen. Baucus has come out with his recommendations, Sen. Kennedy was going to start working with the Finance Committee to see if they could come up with a common legislative proposal that they could have ready around inauguration day."

But John Sheils, the Falls Church, Va.-based senior vp heading the Lewin Group's health reform work, is concerned that lawmakers may be moving too fast, which could frighten some constituents the same way as when the former first lady tried to revamp the nation's health care system shortly after President Bill Clinton took office.

"Everybody says you've got to do it in the first 100 days," but when legislation moves too quickly, it leads to speculation by third parties not associated with it, Mr. Sheils said, pointing to the "Harry and Louise" ads sponsored by a major health insurance trade association, which was concerned about the changes.

## Flu: Employers take a shot at keeping employees well

CONTINUED FROM PAGE 4

has sponsored flu vaccinations for employees for six or seven years. This year, she said Intel offers vacci-

nations during two-hour periods every day during lunch and shift changes rather than a single-day, one-time event.

"We've done (a single-day vaccination program) in the past and you sort of get a limited response because of people's availability," Ms. Adams said.

Linda Kuklinski, employee benefits and risk manager of Generac Power Systems Inc. in Waukesha, Wis., said Generac has offered free flu shots onsite to employees and their families for at least five years. She said more than 30% of the 1,200 employees participate.

"We just believe healthier employees create a healthier environment and make them more productive on and off the job," Ms. Kuklinski said.

While she said she hasn't noticed an increase in popularity this year in Generac's longstanding program, she has noticed an increase in vaccination programs in southeastern Wisconsin.

"Local churches are bringing nurses onsite, community centers, even some of the local pharmacies are offering (flu inoculations), so it does seem to be increasing in popularity," she said.

Mr. Abbott said he is aware of some employers that are offering free flu shots to their vendors and even their contract workers.

"This is really the most activity we've seen, I would say in my career," Mr. Abbott said.

### NEARLY 50 YEARS IN INDUSTRY

Major events in the career of insurance brokerage veteran Bernard H. Mizel

- 1959:** Began his career as an account executive with Levin, Knox & Co., a San Francisco-based brokerage.
- 1963:** Purchased brokerage Albert M. Bender & Co.
- 1978:** Sold Albert M. Bender & Co. to Bache Halsey Stuart, staying on as chairman and CEO of the combined brokerage.
- 1982:** Sold Bache Insurance Services to Prudential Insurance Co. of America, which spun the brokerage off to Jardine Insurance Brokers Inc., where he remained as president.
- 1984:** Left Jardine to form American Business Insurance Inc.
- 1992:** Left American Business Insurance, which Acordia Inc.—now Wells Fargo Insurance Services—acquired in 1993.
- 1994:** Formed USI Insurance Services Corp.
- 2002:** Stepped down as chairman and CEO of USI
- 2003:** Became chairman of California Coastal Insurance Inc., now CCI Financial & Insurance Services.

## CCI: Industry vet aims to build regional powerhouse

CONTINUED FROM PAGE 3

customers time and money, it also allows CCI to better weather the insurance cycles, he said.

But to be truly successful, "you have to have a deliverable you control and it has to be integrated with the salespeople," he said.

Mr. Mizel said he wants to grow CCI—which reported about \$5.5 million in 2007 revenues—to about \$25 million in annual revenues in the next three to four years through a series of mergers, which he says he prefers to acquisitions because the two parties' interests are better aligned.

At that point, he said CCI's leaders may decide to expand its regional footprint.

"We set this up as a platform for the development of a large regional brokerage firm," with initial plans to keep it in California, Mr. Mizel said.

At 72, he said he doesn't want to travel anymore.

### Trend toward diversification

Observers say CCI's strategy indicates a growing diversification trend today among middle-market agents and brokers.

"Leading brokers are moving towards this model as a mechanism to provide clients with a series of value-added services, while at the same time diversifying the broker's risk profile relative to P/C rates," said Patrick T. Linnert, executive vp

of consulting firm Marsh, Berry & Co. Inc. in Willoughby, Ohio.

"Does it mean that all agents and brokers are out there with that kind of diversified offering? Absolutely not," said Demmie Hicks, president and CEO of DBH Consulting Inc. in Atlanta. "But are there agents and brokers who have had that as a strategic initiative for a number of years now? Absolutely," Ms. Hicks said.

Whether those diversified services are outsourced or offered under one roof doesn't make that much of a difference, said Bobby Reagan, president of Atlanta-based Reagan Consulting Inc.

"I am not aware of any situations where a fully integrated and fully in-house insurance operation outperformed others that offered those services but did so by outsourcing some portion of them," Mr. Reagan said.

"The success is more of a function of the quality of their people and the job they can do and not whether...they are fully integrated and fully in-house," Mr. Reagan said.

Timothy J. Cunningham, for one, said he's uncertain about the success of a single-source option for commercial buyers.

"I don't perceive a need from employers for a one-stop-only approach with all these products and services," said Mr. Cunningham, a principal of OPTIS Partners L.L.C. in Chicago.

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# Bailout: Government extends loan, eases terms for AIG aid package

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this portfolio "could be substantial," Moody's Investors Service cautioned.

While AIG is benefiting from fed-

eral support in a number of ways, "it would be difficult to say definitively that the restructuring plan will be sufficient to see AIG through its challenges, given the highly volatile market," said Bruce Ballentine, vp

and senior credit officer at Moody's.

In reporting a \$24.5 billion net loss for the third quarter, AIG last week unveiled the revised federal aid package to replace an \$85 billion loan facility put in place in September and a \$37.8 billion facility supporting AIG's securities-lending operations established in October.

The original two-year loan facility carried an interest rate of 8.5% above the London Interbank Offered Rate on borrowed funds and 8.5% on unused funds. Analysts increasingly saw AIG burdened by the high interest costs, the difficulty of selling enough assets to repay the loan within two years and the continuing drain of collateral demands by counterparties to AIG's CDS contracts.

"Obviously, they didn't get it right the first time, so they had to go back," said Myron Picoult, a New York-based independent insurance consultant.

The revamped federal aid program includes four major components: a revised credit facility, purchase of AIG preferred shares and warrants, and establishment of two special-purpose entities.

- The revised credit facility, cut to \$60 billion from \$85 billion, has an interest rate of 3% over LIBOR on borrowed funds and 0.75% over LIBOR on unused funds, and a term extended to five years.

- The U.S. Treasury will purchase \$40 billion in AIG preferred shares and warrants through its Troubled Asset Relief Program. The preferred stock will pay a 10% annual dividend, and AIG will use the proceeds to pay down its debt under the federal credit facility.

AIG has borrowed about \$61 billion, an amount that will be reduced to \$21 billion with the preferred stock sale.

The government will continue to have a 79.9% stake in the insurer.

- A special-purpose entity will be established to buy up to \$70 billion of multisector collateralized debt obligations from banks and others covered by AIG credit default swaps. The Federal Reserve Bank of New York will provide \$30 billion in senior funding for the facility and AIG will provide \$5 billion in subordinated funding, which it will borrow from the credit facility.

Holders of AIG-insured multisector CDOs will be able to keep roughly \$35 billion in collateral that AIG already posted under its swap contracts, and the funding entity will negotiate a buyout of CDOs at prices expected to amount to about 50 cents on the dollar, resulting in a recovery of the CDOs' par value by investors.

AIG will then be able to terminate the related CDS contracts, ending the drain of further collateral calls.

While the multisector CDOs accounted for only 25% of AIG's CDS business, they produced 95% of the insurer's CDS write-downs, and collateral demands on the contracts accounted for as much as \$55 billion of the \$61 billion that AIG has borrowed under the loan facility, said Edward M. Liddy, the insurer's chairman and chief executive officer.

- A second special-purpose entity

will be established to buy the residential mortgage-backed securities that AIG acquired as part of its securities lending program. The Fed will provide \$22.5 billion in senior funding while AIG will provide \$1 billion in subordinated funding borrowed from the loan facility.

Terminating the securities lending activity, which was concentrated in AIG's life insurance units, puts the units in a better position to be sold, AIG officials said.

The residential mortgage-backed securities entity replaces the Fed's previous \$37.8 billion facility, under which AIG has borrowed \$19.9 billion.

"We still have a lot of work to do to execute this plan and ultimately transition to a restructured and recapitalized AIG," Mr. Liddy said of the plan during a conference call last week. "Today's agreements put us in a position to succeed and emerge as a focused, profitable global insurance company."

U.S. Treasury Secretary Henry M. Paulson Jr. emphasized AIG's importance to the overall financial market in a statement last Wednesday: "Because the system remains fragile, we must continue to stand ready to prevent systemic failures. That is the basis for Monday's action to purchase preferred shares in AIG," he said.

Analysts and other observers agree the plan is good for AIG in several ways.

"With these new solutions in place, we believe that AIG is now positioned to survive and it now has the ability to sell its noncore assets when market conditions improve," Bijan Moazami, an analyst with Arlington, Va.-based FBR Capital Markets, said in a report.

"The new plan is better targeted to the root cause of the problem," which is the credit default swaps, said John L. Ward, CEO of Cincinnati Partners L.L.P. in Cincinnati. "There may need to be more going into that channel of assistance," but the new entity to buy CDOs may provide "real relief," he said.

"They are still writing policies and still paying claims and with the full backing of the federal government this time. Based on that, so far it sounds pretty safe to me as far as continuing to do business," said Lance Ewing, vp-risk management at Harrah's Entertainment Inc. in Cordova, Tenn., and a member of AIG's client advisory board.

Observers still see big challenges, though, including uncertainty about AIG's ability to sell noncore units.

"The financial turmoil has pushed down the prices AIG might get for selling its financial services businesses," including its life insurance operations, said Stewart Johnson, a portfolio manager with Stamford, Conn.-based investment bank Philo Smith & Co. "It has also reduced the borrowing capacity for potential buyers."

Columbus, Ga.-based life insurer Aflac Inc. has bowed out of talks to acquire AIG life operations in Japan over concerns about the cost of

financing, an Aflac spokeswoman confirmed last week.

A.M. Best Co. also said it is "quite guarded" about valuations of the assets for sale, noting the cost and availability of financing and the potential for "franchise deterioration" if the operations remain on the market for an extended period.



"While it is obvious that the insurance subsidiaries are solid, the ability of AIG to stay intact is my concern," Wayne Salen, director of risk management at

Labor Finders International Inc. in Palm Beach, Fla., said in an e-mail. "If they can't pay down this debt load, then the relevant domicile insurance regulators will have their hands full as they engage in preserving and spinning off the insurance operations. Getting caught in that type of activity is last thing an insured would want to do."

The cost of winding down hundreds of billions of dollars in derivative contracts remaining at AIG Financial Products is also unknown, and "could generate material cash or capital needs under various scenarios," Fitch Ratings noted last week.

Overall, the new bailout package has not erased doubts about whether AIG can carry out its restructuring without more federal assistance down the road.

The new plan "leaves one to worry that the uncertainties and the problems at AIG are deeper than people imagined, and it raises suspicion that we're not done yet," said E. Keith Wirtz, president and chief investment officer of Cincinnati-based Fifth Third Asset Management Inc.

"It's the bar of soap that nobody can grab ahold of," Mr. Picoult said of the steadily rising cost of AIG's rescue.

Best and Fitch both affirmed their financial strength ratings of AIG's insurance units after the announcement last week, and both said the decisions were heavily influenced by the government's continued support.

Standard & Poor's Corp. kept its ratings of AIG units under review with negative implications, while Moody's kept its AIG ratings under review for possible downgrade.

AIG officials, meanwhile, expressed confidence that the new deal will allow them to carry out their restructuring plans.

Referring to the \$60 billion credit facility, Robert S. Schimek, chief financial officer for AIG Property Casualty Group, said "there should be every reason to believe that a) it's big enough, b) we can afford the interest rate, and c) the nature of the structure is such that we can avoid a fire sale" of AIG assets.

Meanwhile, AIG last week said it plans to terminate 14 voluntary deferred compensation programs, opting to pay out the \$500 million in funds in an effort to retain about 5,600 employees, independent agents and representatives.

Senior editors Judy Greenwald and Mark A. Hofmann contributed to this story.

## Greenberg says new deal should keep AIG running

**WASHINGTON**—Federal assistance of \$150 billion "should be enough" to keep American International Group Inc. afloat, the troubled insurer's former chairman and chief executive officer said last week.

Maurice R. Greenberg, now chairman and CEO of C.V. Starr & Co. Inc., also said "there's a lot of money in the Middle East and Asia" that would be willing to invest in AIG. But he said such foreign investors will not put money into a "nationalized" company. The federal government owns



REUTERS

**Maurice R. Greenberg says the new deal will take 'toxic' credit products off AIG's balance sheet.**

nearly 80% of AIG as a part of the original \$85 billion rescue plan it reached with the insurance holding company in September.

Mr. Greenberg's comments came only hours after AIG and the federal government announced a revised plan that brought the federal government's aid to AIG to as much as \$150 billion. Under the plan, the government agreed to buy \$40 billion in AIG preferred stock and fund a new facility that will allow AIG to terminate billions of dollars of credit default swaps. The deal will also ease the terms of AIG's existing credit facility, in part to allow the insurer more time to conduct an orderly sale of assets to repay the government.

Mr. Greenberg said the new deal will take "toxic" credit products off AIG's balance sheet. The enhanced government assistance "should be enough," he said.

Mr. Greenberg spoke live from New York via an interactive video feed to the annual conference of the Captive Insurance Council of the District of Columbia. He had been scheduled to appear at the con-

ference, but said the developments surrounding the new plan kept him in New York.

Mr. Greenberg said the new plan is an improvement on the government's original approach. He said terms attached to the original \$85 billion bailout were "strangling the company." He said he hopes that liberalized terms in the latest plan would give AIG three years to sell off assets at a "decent value."

"The only way the taxpayer will get paid back" will not be out of earnings but rather through selling assets, Mr. Greenberg said. "But you can't sell subsidiaries in this market," he said, saying that cash is scarce and most insurers are struggling. He said there was no point in having what he called a "garage sale" of AIG assets in the current depressed market.

He said AIG is likely to sell off much of its life insurance business and personal lines business as well as some other units, but that the decision of what to sell rests with federal authorities, not AIG management.

"AIG management is controlled by the Fed," Mr. Greenberg said.

He said that the company's problems arose from actions taken after he stepped down in 2005. The credit default swap problems stemmed from the actions of the AIG Financial Services unit.

"When I was running the company, it was a money-making and controlled entity with very strong risk management," Mr. Greenberg said.

He criticized the actions of management and boards of directors that followed him.

"What was management doing? To me it's a tragedy. I'm angry. Obviously, I'm angry. How did all this begin and how did it end?"

"It began by an aggressive attorney general who was seeking to become governor, and looking to take down some of the biggest names he could find," Mr. Greenberg said in referring to former New York Gov. Eliot Spitzer, who resigned earlier this year after he admitted patronizing prostitutes. "I think a lot needs to be looked at in our own justice system, or injustice system," Mr. Greenberg said.

—Mark A. Hofmann

# News In Brief

CONTINUED FROM PAGE 1

be succeeded by Leigh Ann Pusey, currently the organization's chief operating officer and senior vp. In a statement, AIA Chairman Evan Greenberg said: "In keeping with his strong leadership commitment, Governor Racicot has made a number of important management and reorganization proposals to the AIA board of directors, which the board has endorsed. One of those proposals calls for a realignment of AIA management and a change of leadership."

## Guernsey allows Lloyd's syndicates

Lloyd's of London is expanding into Guernsey under new regulations that

allow syndicates to set up operations there. The new rules, approved recently by the States of Guernsey and signed by the Guernsey Financial Services Commission's chairman, will allow syndicates to establish a physical presence in Guernsey and operate under its regulatory framework for insurance managers.

## Calif.'s SCIF seeks 8.9% rate increase

California's State Compensation Insurance Fund has filed workers compensation rate increases averaging 8.9% for policies incepting on Jan. 1, 2009. SCIF cited medical inflation as the main reason for the increase. Medical costs have been rising about 12% per year over the past two years, the insurer said. California Insurance Commissioner Steve Poizner last month rejected a Workers' Compensation Insurance Rating Bureau request for a 16% rate increase and instead accepted a 5% increase. California's insurance commissioner can only recommend rates and cannot mandate that insurers follow his recommendations.

## Moody's drops outlook for health insurers

Moody's Investors Service Inc. has revised to negative its credit outlook for U.S. health insurance companies over the next 12 to 18 months, citing operational, economic and political challenges that will likely lower margins and hamper growth as reasons for the downgrade. Stephen Zaharuk, vp at New York-based Moody's and the report's author, said in a statement that the combination of the economic downturn and mounting health care costs that test the willingness of employers to continue providing health insurance may cause the health care insurance sector to become more vulnerable.

## Mass. comp law bars suit even if no benefits paid

Massachusetts' workers compensation law bars the family of a teenage clerk killed on the job from suing his former employer, even though the family never received workers comp benefits for the death,

the state's highest court has ruled. In *Taciana Ribeiro Saab et al. vs. CVS Pharmacy L.L.C.*, the Supreme Judicial Court of Massachusetts upheld a lower court's ruling and dismissed a wrongful death suit brought by the family of a slain CVS worker because of the exclusivity provision in the state's workers comp laws.

## Noted

Final Labor Department regulations issued last week resolve numerous questions employers have raised about legislation enacted earlier this year that expands the **Family and Medical Leave Act** for employees whose family members are in the military....A.M. Best Co. Inc. has downgraded **Health Net Inc.**'s financial strength rating to B+ from B++. Best also lowered Woodland Hills, Calif.-based Health Net's issuer credit rating to bbb- from bbb+. Best cited various concerns about Health Net, including that increasing medical costs and litigation charges have reduced the company's financial flexibility.

# Market: AIG denies reports of widespread price-cutting

CONTINUED FROM PAGE 1

The remarks followed similar, but less pointed, comments by other insurer executives in their recent analyst conference calls.

Whether AIG is systematically cutting rates, or the extent to which this is happening, is unclear.

Some brokers say they have recently renewed casualty programs with AIG at rate reductions of 10% or more, but a representative of another large broker said its executives have seen little evidence of rate-cutting in casualty lines.

AIG denies the accusations.

"We are not sacrificing rate to retain market share," an AIG spokesman said in a statement. "In fact, since mid-September our U.S. commercial insurance operations have had several points of rate improvement compared to year-to-date results."

"It is possible that allegations of price-cutting are coming from markets frustrated by their inability to win significant market share from AIG," the spokesman said. "Fortunately, our market strengths and customer relationships were built over many years and are not easily replicated."

U.S. and Canadian commercial property/casualty pricing eroded by about 8.8% in the third quarter for AIG but started to improve modestly in mid-September, and AIG's client retention rate is normal, said John Q. Doyle, president and CEO of AIG Commercial Insurance.

## Rate concerns

Any effort by AIG to keep clients by reducing rates could ultimately create more problems for the beleaguered insurer, some observers say.

Despite AIG's denials, "I have heard stories to the contrary that

AIG was, in fact, cutting prices in an attempt to retain customers," said Stewart Johnson, a portfolio manager with Stamford, Conn.-based investment bank Philo Smith & Co.

If that is the case, "it's very likely the underwriting results will deteriorate, and that puts downward pressure on the value of those businesses," Mr. Johnson said.

Comments about the turmoil at AIG and its pricing practices have recently accumulated in investor meetings and conference calls of rival insurers.

Several insurers reported sometimes dramatic increases in submissions from potential clients, and they suggested—without saying so directly—that the increases are related to financial stress at AIG and some other insurers.

Evan Greenberg, chairman and CEO of Switzerland-based ACE Ltd., told analysts that underwriting submissions were up more than 50% in October compared with the prior year, with large-account submissions up 80%.

He attributed that to "the weakness that is occurring with other insurers in terms of either rating downgrades...or those owned by the government today."

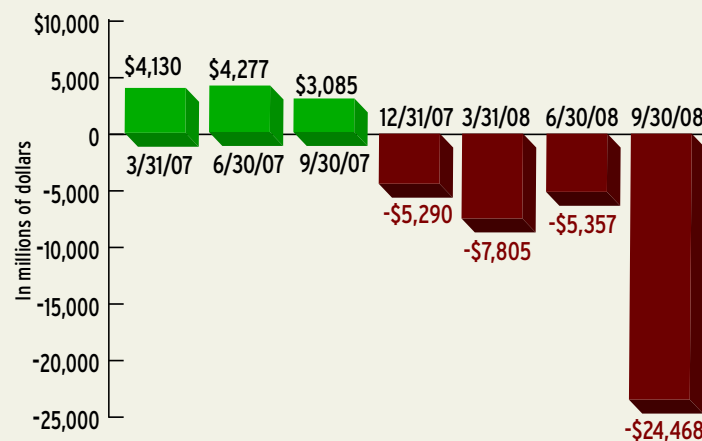
Chubb Corp. executives said they have seen a significant rise in submissions for professional liability and other commercial lines.

At the same time, several insurer executives have accused AIG of undercutting competitors' price, some without naming the insurer directly.

"When it comes to the one large player who is under stress, they are an outlier right now in the pricing environment today," ACE's Mr. Greenberg told analysts. "They are aggressively cutting pricing in an irresponsible way to maintain busi-

## QUARTERLY PERFORMANCE DROPS

American International Group Inc. has posted more than \$37 billion in losses this year.



Source: Securities and Exchange Commission filings

ness. And it's worrisome."

Though Mr. Greenberg did not mention AIG specifically, he is widely understood to have been referring to the insurer.

"We are seeing much more aggressive pricing come from the carrier in order to hold onto their base of business," James S. Tisch, president and CEO of CNA Financial Corp. parent Loews Corp., said when asked about AIG during an investor meeting earlier this month.

Similarly, John J. Degnan, Chubb's vice chairman and chief operating officer, was asked about AIG's pricing behavior in an analyst conference call last month.

"Clearly, we have seen some erratic and inconsistent behavior on the part of a couple of our competitors," Mr. Degnan said. "Where pricing has gotten aggressive, it generally relates to the carrier's own renewal book, so it's clearly an attempt on their part to protect their own book rather than to grow the business."

Brokers report varying experiences.

One large broker representative, who requested anonymity, said the broker's casualty executives have seen no evidence of unusually large rate reductions from AIG.

However, a smaller consultant, who also requested anonymity, said he recently has seen clients renew AIG policies at double-digit rate reductions.

Neil C. Krauter, chairman and CEO of New York broker Krauter & Co., said he has seen AIG offer reductions averaging 10% on casualty business, similar to the cuts being offered by many insurers nine months ago.

"We haven't seen AIG slashing prices or looking to do ridiculously stupid deals," Mr. Krauter said.

"Clients are appreciating the fact that at least there is an alternative out there that is not looking to raise prices," he said.

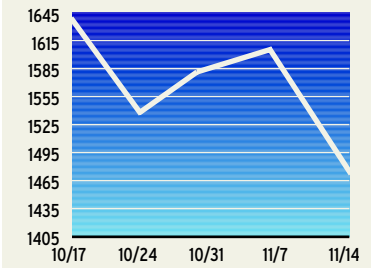
Senior Editor Judy Greenwald contributed to this report.

## Stock Index

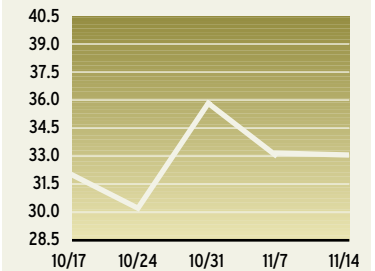
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Up-to-the-minute data for all 82 companies that comprise the BI Stock Index can be found at [www.IndustryFocus.com](http://www.IndustryFocus.com).

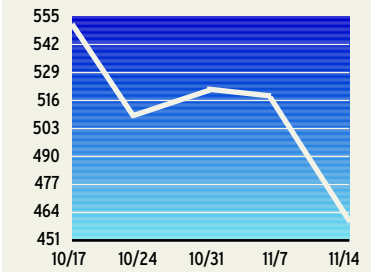
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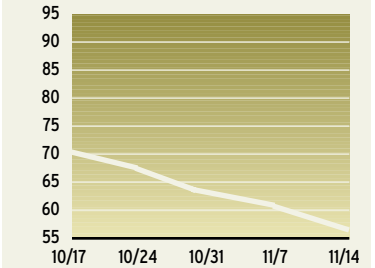
### BI BROKERS INDEX



### BI INSURER/REINSURERS INDEX



### BI MANAGED CARE ORGANIZATIONS INDEX



Percentage change of BI Stock Index vs. key indicators

<b>BI STOCK INDEX</b>	1455.97	↓ -8.58%
<b>DOW JONES</b>	8497.31	↓ -4.99%
<b>S&amp;P 500</b>	873.29	↓ -6.20%

### LARGEST GAINS

SCOR S.A.	15.13%
Old Republic International	8.06%
UNICO American Corp.	6.57%
Aon Corp.	4.75%
Navigators Group Inc.	4.59%

### LARGEST LOSSES

Lincoln National Corp.	-27.42%
XL Capital Ltd.	-27.08%
Mbia Inc.	-26.07%
Gainsco Inc.	-20.69%
Allmerica Financial Co.	-20.00%

Source: Financial Content Inc. <http://financialcontent.com>



VICTORIASSECRET.COM

## 'Angels' bra gave plaintiff devil of a time

Victoria's Secret is...formaldehyde?

That's the allegation of one woman, who charges that Victoria's Secret bras left her with itchy welts.

"I had welts...very red, hot to the touch, extremely inflamed, blistering. It itched profusely," Roberta Ritter told ABC News about symptoms she experienced after wearing Victoria's Secret Angels Secret Embrace bra and Very Sexy Extreme Me Push-Up bra (above). "I couldn't sleep, waking up itching. I was just utterly sick."

Ms. Ritter filed a lawsuit against the Columbus, Ohio-based company earlier this year. In doing so, she found that several women experienced similar symptoms from the same bras, according to news reports. Lab tests conducted on the bras by the firm representing Ms. Ritter found that they tested positive for the chemical formaldehyde, ABC News reported.

Victoria's Secret told ABC News it had received complaints from customers, but said the bras remain on store shelves and denied the presence of formaldehyde in the bras.

## Firm stuck with big legal bill in blood test fight

A West Virginia employer may have spent more than \$50,000 on legal fees to fight a \$40 medical bill.

Sam Juniper, who had retired from M&G Polymers, filed suit in Mason County Court in 2002 after the administrator of the company's self-insured health benefit plan denied his claim for \$40 in blood work. He said the medical services had been guaranteed under his union-negotiated benefits contract.

The blood work, which Mr. Juniper receives regularly, was covered when UnitedHealth Group was the administrator of the health plan, but Aetna Inc. denied the claim when it took over administration, he said.

After a county magistrate ordered M&G to refund the \$40, the employer's defense counsel sought to have the case moved to federal court, asserting it was governed by the Employee Retirement Income Security Act.

Then last month, the 4th U.S. Circuit Court of Appeals in Richmond, Va., upheld the magistrate's order that M&G reimburse Mr. Juniper for the blood work.

Although Mr. Juniper's lawyer, Mark Underwood of Huntington, W.Va., provided his services pro bono, he estimated that the employer's defense costs would have been between \$50,000 and \$100,000.

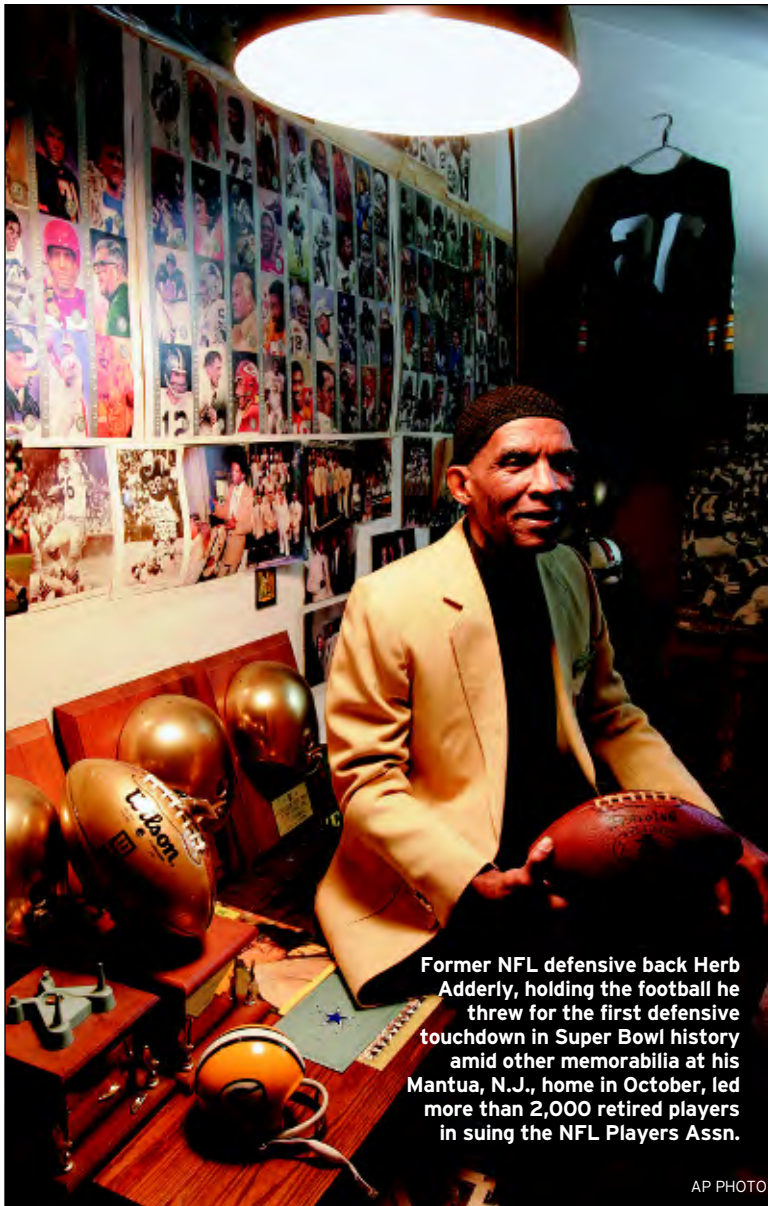
"M&G Polymers USA acted in accordance with its interpretation of the relevant benefits plan and plan documents," M&G said in a statement, which noted the appeals court ruling. "M&G intends to comply with the Court of Appeals' decision."

"When you talk about lawsuit abuse, it happens on both sides," Mr. Juniper said of the costly and lengthy litigation.



# Business Insurance END PAGE

Contributing: Jeff Casale, Mark A. Hofmann, Joanne Wojcik



Former NFL defensive back Herb Adderly, holding the football he threw for the first defensive touchdown in Super Bowl history amid other memorabilia at his Mantua, N.J., home in October, led more than 2,000 retired players in suing the NFL Players Assn.

AP PHOTO

## Court throws flag at NFL union in ex-players' case

Just because you're retired from professional football doesn't mean you can't still score; it just means you might score on a different field.

For a group of retired NFL players seeking compensation for using their scrambled images in a variety of merchandise, including video games, a score settled in the courtroom last week carries with it a reward of \$28.1 million.

That's the amount a federal jury in San Francisco ordered the NFL Players Assn.—the union that represents pro football players—to pay a class of more than 2,000 retired players.

The case arose when the ex-players alleged that union leaders ignored contracts that the retired players had signed that they be compensated for the use of their images in video games, trading cards and other goods.

Lawyers representing the retired players argued that the union intentionally cut them out of licensing deals to give more money to active NFL players and the players union's for-profit subsidiary, Players Inc.

Documents presented to the court bolstered their case and the jury last week awarded the players \$7.1 million in compensatory damages and \$21 million in punitive damages.

According to published reports, the union plans to seek a reversal of the verdict and, if that fails, appeal the jury's decision.

Unfortunately for the players, there's no instant replay on the field of justice, and they may have to wait quite a while to see if their legal touchdown stands.

## Buffett portrait seeks high ROI for charity

It may not be a Picasso, but a painting by performance artist Michael Israel seems destined for at least 15 minutes of fame—and a price tag of at least six figures.

The painting in question, which measures 7 feet by 7 feet framed, is of none other than the Oracle of Omaha, Warren Buffett.

Mr. Israel painted the portrait in less than 10 minutes earlier this year during the annual meeting of Omaha, Neb.-based Berkshire Hathaway Inc., of which Mr. Buffett is chairman and chief executive officer.

The painting went up for sale on eBay Inc. last week, with a minimum opening bid of \$100,000 and a requirement that bidders be prequalified. Bidding remains open until Nov. 20.

The entire proceeds of the sale will go to local charity Girls Inc. of

Omaha.

Would-be buyers who don't know much about art may be momentarily concerned about Mr. Buffett's admonition never to invest in a business you don't understand.

But even a buyer who knows nothing of art is sure to receive the Oracle's blessing for his or her purchase of the portrait that is autographed by Mr. Buffett and the artist and includes free shipping. After all, the portrait was painted with Benjamin Moore paints, which also happen to be owned by Berkshire Hathaway.

Billionaire investor Warren Buffett signs a portrait of himself in May, which had been painted earlier in the day by performance artist Michael Israel in less than 10 minutes.



AP PHOTO



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**SPOTLIGHT REPORT BEGINS ON PAGE 11**

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### Maximizing net potential

The turmoil in the financial markets is driving some agent/brokers and consumers to insurers' Web sites as they look to cope with economic pressures. Insurers' ability to capitalize on the increased traffic will depend on their degree of commitment to Web-based operations and whether they can provide the online services the marketplace seeks. **Page 10**

### Pressing fast forward

Technological changes are creating a workplace reality to which the insurance industry must respond

or face losing both customers and future employees, a Microsoft Corp. executive says. To survive, insurance-related companies must embrace a multichannel approach to business, using the Web as an integral component. **Page 13**

## FEATURES

### Modeling, agencies

Risk models and rating agencies were the subject of a lively debate at the annual meeting of the Property Casualty Insurers Assn. of America. **Page 16**

### Change for the better

Oracle's Chuck Johnston discusses how flexible IT infrastructure can help position insurance industry companies to benefit from change. **Page 18**

### Outsource: Resource

Whether it's information processing, storage or help with business processes, a number of companies can provide IT help to the insurance industry **Page 19**

### Exceeding expectations

In the insurance business, customer service includes introducing customers to products they might not even know they need. **Page 20**



### THREE QUESTIONS

Andrew M. Appel of Aon Corp.'s Aon Re Global unit, on the likely challenges looming in this reinsurance renewal season. **Page 5**

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## The whole insurance world's watching

I write this not too long after what by anyone's calculation has to be considered a pretty remarkable election, particularly remarkable, I think, if you happened to be here in Chicago.

As a Chicagoan, much of what has occurred on the periphery of the campaign has been pretty interesting. For example, most everyone, it seemed, knew someone who lives near Barack Obama's Hyde Park home and could offer firsthand accounts of what it's like living around the block from a major party presidential candidate.

On Election Day, seeing people pouring into downtown Chicago for that night's gathering in Grant Park brought an immediacy to the events of the election that I hadn't previously experienced, even as someone who has been lucky enough in the past to interview candidates and cover conventions.

Throughout election night, my wife, Kathy, and I responded to text messages and calls to our cell phones from relatives and friends around the country wondering if we were in Grant Park. We weren't. Despite our proximity to history, like most Americans, we followed developments from our living room, relying on television and our laptops.

As it turned out, the trip home that evening was its own piece of the local election experience.

Crowd control concerns had led many downtown Chicago employers to encourage employees to work from home on election day or allow workers to head home early.

By the time I headed home at what would typically be the end of the evening rush, I boarded an unusually empty bus that proceeded to make spectacular time for the hour, heading away from downtown on the similarly empty northbound lanes of Lake Shore Drive. Weird.

Politics has always been something of a spectator sport in Chicago, so for most of us here, it's really kind of fun to experience our moment at the center of the political universe. Of course the novelty may wear off soon, as perhaps it already has for President-elect Obama, particularly with the scary briefings he's receiving, the economic issues and ongoing military conflicts he inherits, and various other challenges ahead.

Some of the same factors that will challenge President Obama will likely cause some sleepless nights for many leaders of the insurance industry in the months ahead. I spoke with David A. Sampson, president and chief executive officer of the Property Casualty Insurers Assn. of America, a couple of weeks back, and he certainly didn't sugarcoat the issues he sees facing the industry.

Among other things, Mr. Sampson envisions the PCI representing its members' interests in the coming debate over financial services regulatory reform in what he said "is likely to be the most anti-business political climate in the past 60 years."

What impact will President Obama ultimately have on U.S. business? Naturally, even before he's taken office, there are no

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**POLITICS HAS ALWAYS BEEN something of a spectator sport in Chicago. It's really kind of fun to experience our moment at the center of the political universe.**

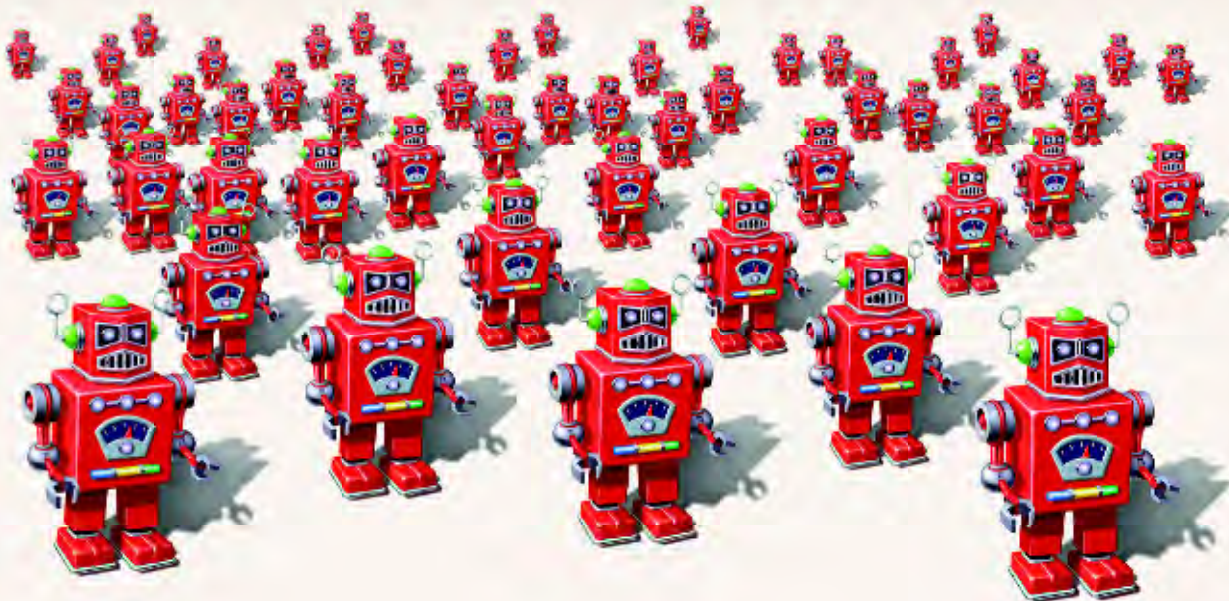
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doubt partisans on either side of the political fence who'd tell you with certainty that they know the answer. But, of course, only time will tell.

Still it seems pretty clear that Mr. Obama's election has already had some business impact.

In the days after the election, there were reports of newspapers flying off the racks as people sought keepsakes of this moment in American history. The afternoon after election day, the Chicago Tribune reported it would print an extra 200,000 copies of that day's paper. That evening, as I walked to my bus stop around 7 p.m., a line of people looking for copies was still pouring through the door at Tribune Tower.

Hey, I may not know what impact Barack Obama's election will have on the insurance industry, but from my perspective as a journalism partisan, it's truly an historic event.



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## Data, Analytics, Decision Support

# Most insurers' capital levels adequate: S&P

By Rodd Zolkos

Recent catastrophes and investment losses have combined with soft pricing conditions to create a challenging environment for commercial lines insurers, but rating agency Standard & Poor's Corp. considers most insurers' capital positions to be adequate for now.

"We believe the industry is well-capitalized and has sufficient liquidity to meet its obligations," Grace Osborne, managing director and North American insurance practice leader at S&P in New York, said last month.

S&P will examine insurers' ability to hold onto their investment assets until the market regains more normal footing, Ms. Osborne said. "The big question will be

how long the market disruption continues and the insurance companies' ability to weather the storm without allowing their portfolio to become impaired because they'd have to sell into the market," she said.

The rating agency maintains a negative outlook on the commercial lines sector, and, as third-quarter earnings information becomes available, S&P will accelerate its review of companies it feels are likely to be most affected by recent events.

"It remains to be seen whether insurance companies can take steps now to either slow down the softening prices and the broadening terms and conditions that we have seen, and whether the concerns they have with their capital will cause them to reinvigorate



**'WE BELIEVE the industry is well-capitalized and has sufficient liquidity to meet its obligations.'**

**GRACE OSBORNE**  
STANDARD & POOR'S CORP.

their underwriting discipline" and examine the capacity they're willing to offer, Ms. Osborne said.

S&P expects many to look to cede more risk. "We're anticipating that they'll be seeking more capacity from their reinsurers," she said. ■

# NAMIC to partner in study of P/C policy systems

**INDIANAPOLIS**—The National Assn. of Mutual Insurance Cos. will partner with management consulting, advisory and research firm Insurance Technology Group Inc. on a comprehensive survey of the business drivers influencing property/casualty insurers' policy administration practices and processing.

The survey will shape the business context for a policy administration study Toronto-based ITG is conducting with the sponsorship of *Industry Focus* and the support of O'Brien Communications Group L.L.C.

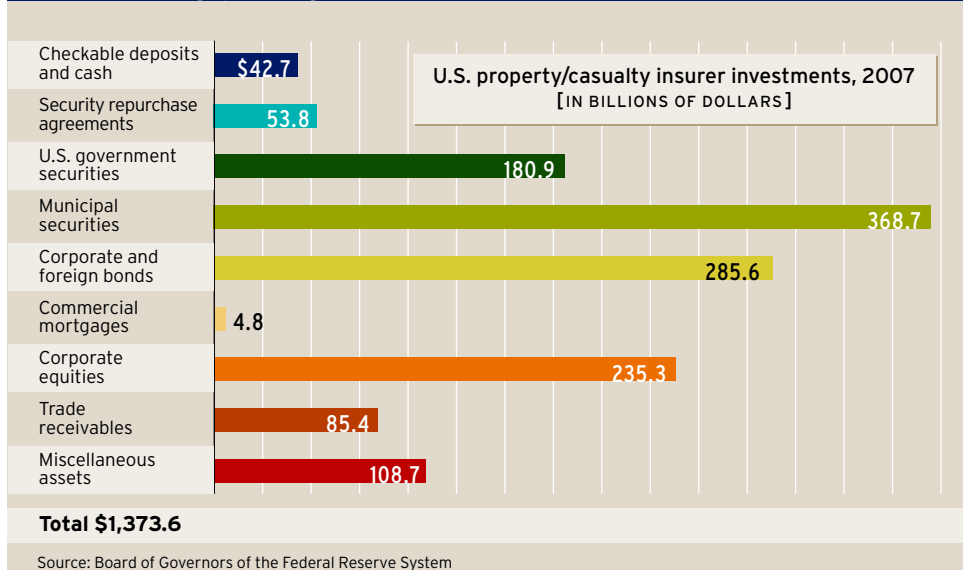
The partnership with Indianapolis-based NAMIC will include a telephone survey beginning this month of NAMIC members investigating insurers' business strategies and their experiences with policy administration practices and solutions.

The partnership will also include a webcast reporting initial results, and a survey of summary results.

The ultimate policy administration study will be an in-depth collection of information on vendors and their solutions. The study will begin in January, with results to be published and available in the second quarter of 2009.

In a statement, Bart Anderson, NAMIC's senior vp of member services and communications, said the survey "will help NAMIC better serve its members by providing valuable information for aligning business and IT strategies." ■

## BY THE NUMBERS





*Andrew M. Appel, chief executive officer of Chicago-based Aon Corp.'s Aon Re Global unit, expects this reinsurance renewal season to be a challenging one, as ceding companies look to protect themselves not just from traditional exposures but also from heightened share price volatility. Recently, Mr. Appel shared his thoughts on factors affecting this renewal season.*

**How are current events shaping the reinsurance market as ceding companies approach Jan. 1 renewals?**

**I** think there are several things going on in the industry at this point that people are trying to get their arms

around. The first is that losses from Ike and Gustav continue to go up, which is, in certain lines—particularly offshore energy—causing people to blow through a lot of their covers, so there are questions of capacity going into the next renewal season.

Then, on the asset side, I think as best as anyone can tell this is an unprecedented occasion where there is a material loss corresponding with a significant markdown in assets. So it's causing an unusual level of anxiety in the reinsurance markets between cedents and reinsurers.

So you've got an unusual situation where asset quality is degraded significantly, expected investment returns are down for the reinsurers themselves, retro costs are expected to harden, at least flatten—they could be going up. And the ability to raise additional capital is difficult.

So those five or six factors combine to create an interesting and challenging renewal season.

**How are Aon Re's clients dealing with this "unusual situation" that's confronting them?**

**I** think there's a big question for clients as to what you do in this environment. There's a lot going on, and it changes every day. So clients are asking about market security, and

I think there are three things that clients should be thinking about: diversification of their reinsurers is probably a good thing; flight to quality, even if it's more expensive—now is not the year to be nonconservative in the choice of reinsurers; I think the third is to evaluate the asset quality of the reinsurers more carefully than in prior years.

**What's the impact of the current market volatility on how insurers should look at risk management?**

**W**e live in unprecedented times where negative earnings and return surprises are causing two, three times greater impact on share price. So now is not the year you want to surprise your investors with volatility because, as you can see, it's not a 5% decline in share price, it's a 20%, 30%, 40% decline in share price. So if I were the CEO of an insurance company, I would probably figure out ways to minimize the probability of losses next year. Because I'd much rather have slightly lower earnings with a lot more certainty than unusual surprises.

Insurance CEOs and ceding (reinsurance) managers are thinking about ways to minimize volatility given the current crisis in the equity markets and the likely particularly negative reaction to surprises. ■

## CEO pay and bonuses flat or declining: Study

By Rodd Zolkos

**T**he current economic decline, uncertain financial markets and the crisis in the financial services industry will likely keep pressure on insurance industry executive compensation, according to Mercer L.L.C.

The New York-based benefit and human capital consultant said its survey of chief executive officer pay practices at insurers showed that 2007 CEO pay levels were flat or slightly lower compared with 2006.

Among the 17 property/casualty and 13 life/health companies surveyed, medi-

an total compensation decreased 15% among property/ casualty companies compared with the prior year and was flat among life and health companies.

The survey found that insurance companies are paying for performance and that where there was fluctuation in compensation year-to-year changes in CEO pay were aligned with a company's performance trends.

The Mercer survey found CEO bonuses in 2007 were down 20% or more at more than 40% of the companies studied, with the median bonus paid to the 17 P/C company CEOs being 40% less than in 2006, while bonuses fell 9% for

CEOs at the life/health companies.

While shareholders seem to favor the industry's use of long-term incentives in top executive compensation, the current environment makes setting long-term goals particularly challenging, Mercer said.

The consultant noted that shareholders and the Securities and Exchange Commission are looking for a clear link between executive rewards and company performance. But, Mercer said, financial services companies are struggling with balancing shareholder pressure to pay for performance and the need to retain key talent. ■

## Big I endorses Swiss Re Agency Shield Program

**ALEXANDRIA, Va.**—The Independent Insurance Agents & Brokers of America has endorsed the Agency Shield Program from Swiss Reinsurance Co. Ltd.'s Commercial Insurance Group for its agency errors and omissions policyholders.

The Agency Shield Program is available to Big I member agencies through state associations and is a loss control service and self-assessment program designed for insurance agencies.

According to the Alexandria, Va.-based Big I, the Agency Shield Program helps agencies reduce errors and omissions exposures, improve client service and build sustainable businesses.

The Agency Shield Program focuses on reducing agencies' E&O claims by allowing agencies to conduct comprehensive reviews of their processes, procedures and guidelines. **IF**

## CPCU Society opens meeting to nonmembers

**MALVERN, Pa.**—Starting with its 2009 gathering in Denver, the CPCU Society will open registration to its annual meeting and seminars to nonmembers.

Previously, the event was open only to members of the Malvern, Pa.-based CPCU Society and their guests.

In announcing that the 2009 gathering, scheduled for Aug. 29 to Sept. 1, would be open to those who haven't attained the Chartered Property Casualty Underwriter designation, society leaders noted the need for the insurance industry to replenish its skilled workers as baby boomers retire.

Marvin Kelly, 2008-2009 CPCU Society president and executive director of the Texas Property and Casualty Insurance Guaranty Assn. in Austin, Texas, said in a statement that the new policy will allow previously excluded attendees to see the quality of the seminars and services that the society provides. **IF**



FM Global says a \$38 million expansion of its Rhode Island research facility includes what will be the world's largest fire-testing laboratory.

COURTESY OF FACTORY MUTUAL INSURANCE CO.

## FM Global to expand research campus, increase workforce

**WEST GLOCESTER, R.I.**—Factory Mutual Insurance Co., which does business as FM Global, has announced a \$38 million expansion of its 1,600-acre research campus in West Glocester, R.I.

FM Global says the enhancements of the facility will ensure that it can keep pace with its clients' loss prevention needs, particularly with the growing impact of globalization and increased supply chain risks.

FM Global said the expansion will see the company increasing its workforce at the research campus by 7% over the current 108.

Research at the current research campus replicates warehouse-size fires, dust explosions and virtually every type of natural disaster, accord-

ing to FM Global. Research at the site helps FM Global customers better protect their facilities from property risks and related business disruptions.

Construction on the existing research campus began in 2001 and cost \$85 million. The expansion will add capabilities for studying the effects of such natural hazards as wind, flood and earthquakes, as well as what FM Global says will be the world's largest fire-testing laboratory. The expanded facility will also include a new 4,500 square foot multimedia center.

The insurer says the improvements will provide higher quality research and testing, enabling it to better serve businesses looking to deal with evolving exposures. **IF**



### THE QUOTE

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# Groups offer global regulatory principles

By Rodd Zolkos

The Property Casualty Insurers Assn. of America joined other international trade associations last month in discussions focusing on the international financial crisis and related insurance supervision issues at the annual conference of the International Assn. of Insurance Supervisors in Budapest, Hungary.

The PCI was among the organizations submitting a statement to the IAIS' Executive Committee outlining key principles for insurance regulation.

Among the principles were that the insurance industry should share regula-

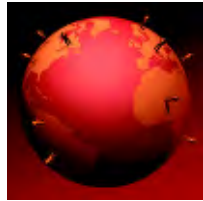
tors' objective of protecting policyholders; that international insurance companies should be regulated on a group-wide basis, with enhanced cooperation among supervisors; and that supervisory authorities should strengthen their ability to cooperate in identifying emerging problems and in using their existing powers efficiently and appropriately to safeguard policyholders and beneficiaries.

Other principles were that the industry needs to encourage the trend toward risk-sensitive regulation, that prudential requirements should reflect the level of risk and diversification, and that regulation should encourage competition.

Organizations joining the Des

Plaines, Ill.-based PCI in promoting the principles included the Assn. of British Insurers, the Assn. of Bermuda Insurers & Reinsurers, the American Council of Life Insurers, the Assn. of Mutual Insurers & Insurance Cooperatives in Europe, the Assn. for Savings & Investment South Africa, and the European Insurance & Reinsurance Federation.

Others were the Canadian Life & Health Insurance Assn., the Dublin International Insurance & Management Assn., the General Insurance Assn. of Japan, the General Insurance Assn. of Korea, the Insurance Council of Australia, the Korea Life Insurance Assn., the Reinsurance Assn. of America and the South African Insurance Assn. ■



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**Ms. Reynolds**

New York-based American International Group Inc. has named **Paula Rospot Reynolds** vice chairman and chief restructuring officer. Ms. Reynolds previously was chairman, president and chief executive officer of Safeco Corp. AIG also named **David L. Herzog** executive vp and chief financial officer. Mr. Herzog, who previously was AIG's senior vp and comptroller, replaces Steven J. Bensinger, who left. Mr. Bensinger had been vice chairman-financial services and acting CFO since May. Separately, AIG named **Rick Gibbons**, an AIG executive vp, president of AIU Marine & Energy, to replace David Hawksby, who resigned.

ACE USA, the Philadelphia-based division of ACE Ltd., has made several executive appointments. **David Brosnan**, who most recently was president of the ACE casualty risk division, was named CEO of ACE Canada. **Karen Barkley**, who has held several roles with ACE Canada since joining the company in 1992, was named chief operations officer of ACE Canada and president of ACE Canada's property/casualty business. **Chris Maleno**, previously president of ACE USA regional operations, was named pres-

ident of ACE casualty risk. **Joseph Clabby**, previously president of ACE USA West, succeeds Mr. Maleno as president of ACE USA regional operations.

**Ruud Bosman** was named vice chairman of Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global. Mr. Bosman previously was executive vp.

**Frank Costa** has been appointed president of Berkley Offshore Underwriting Managers L.L.C., a new unit created by Greenwich, Conn.-based W.R. Berkley Corp. Mr. Costa, who will be based in New York, previously was president of AIG Oil Rig. Also, **John R. Benedetto** was named president of new W.R. Berkley unit Berkley Professional Liability L.L.C. Mr. Benedetto previously was president of the national accounts division at AIG Executive Liability. Meanwhile, at AIG, **Dorian Grey** was named president of AIG Oil Rig, replacing Mr. Costa.

New York Life International L.L.C., the international unit of New York Life Insurance Co., has named **Gary Bennett** executive vp and Greater China CEO. Mr. Bennett previously had been CEO and managing director for Max New York Life Insurance Ltd., New York Life's joint venture with Max India Ltd. in India. **Rajesh Sud** has been named to replace Mr. Bennett in the Max New York Life posts. In addition, **Rajit Mehta** was named chief operating officer of Max New York Life. Mr. Sud

previously was Max New York Life's deputy managing director and Mr. Mehta was deputy COO.

Munich Re America HealthCare has promoted **Richard Phillips** to chief underwriting officer. Mr. Phillips previously was underwriting manager for first-dollar medical business. Princeton, N.J.-based Munich Re America HealthCare is a division of Munich America Reinsurance Inc., which is part of the Munich Re Group.

**Clare Collins-Newton** has been named chief information officer of Mercer L.L.C. in Norwood, Mass. Ms. Collins-Newton most recently was vp of information technical management at Affiliated Computer Services Inc.



**Mr. Assadi**

**Mehran Assadi** has been named the next president and CEO of National Life Group. Mr. Assadi, currently president of Montpelier, Vt.-based NLGroup's life and annuity division, will succeed Thomas MacLeay, who is retiring Dec. 31 as president and CEO but will remain as chairman.

**John C.R. Hele**, CFO of ING Group, will become CFO of Hamilton, Bermuda-based Arch Capital Group Ltd. effective April 1,

2009. Mr. Hele will replace John Vallaro, who will move from his role as CFO to a position as senior adviser to the company.

Hartford Financial Services Group Inc. has named **Robert Paiano** senior vp and enterprise chief risk officer. Mr. Paiano previously was CRO of the Hartford, Conn.-based insurer's property/casualty operations.

Palmdale, Calif.-based National E&S Insurance Brokers Inc. has named **John McGovern** president. Mr. McGovern, who will be based in Middletown, N.J., previously was managing director of American Risk Management Resources Network L.L.C.

**Michael Dinkins** has been hired as executive vp and CFO by Briarcliff Manor, N.Y.-based USI Holdings Corp. Mr. Dinkins previously was CFO of Glen Allen, Va.-based Hilb Rogal & Hobbs Co., which recently was acquired by Willis Group Holdings Ltd. Mr. Dinkins succeeds Edward J. Bowler, who had been interim CFO and will resume his duties as senior vp of corporate development.

Capitol Insurance Cos. of Middleton, Wis. has named **Richard W. Allen III** president of its surety and fidelity operations. Mr. Allen had been senior vp of surety and fidelity underwriting.

London-based Aon Ltd. has appointed **Pauline Colvin** to the newly created post of CRO. Ms. Colvin previously was CRO at Skandia Group. **F**

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opportunities

By Meg Fletcher

The turmoil in the financial markets is driving some agent/brokers and consumers to insurers' Web sites in search of ways to cope with the economic pressures.

Those agent/brokers and consumers are seeking information about coverage options—especially for vehicles—and want to find better pricing or broader coverage to help stretch their insurance dollars, experts say.

Whether insurers will be able to take advantage of the increased traffic depends on their degree of commitment to Web-based operations and whether they will grow their Web-based capabilities, services and operations.

Economic pressures may make some less committed insurers risk-averse to funding Web-related enhancements. Those insurers are more concerned about holding the line on costs

# ONLINE STRATEGIES greatest HITS

rather than seizing a business opportunity, experts say.

Other insurers may expand their Web-based advertising and services to woo consumers as well as help agent/brokers. Those insurers are more concerned about being perceived as innovative and approachable. They also want to position themselves to reduce the costs of underwriting and servicing online customers' policies, experts say.

"The financial services industry will be under a microscope because of the credit stimulus package and people looking for culpability," said William Rice, president of the Simsbury, Conn.-based Web Marketing Assn.

Coping with fear of recession is a particularly sensitive area for insurers, which are one part of the financial services industry that caused the problems—although technically most insurance-specific operations are in better financial shape than other financial services operations that were more directly connected to mortgage-backed securities.

From an insurer's perspective, the financial turmoil has no effect unless the company's solvency is threatened, which is not the situation at this time, said Richard Look, vp of marketing communications for West Chester, Pa.-based Inventure Inc., which does business as Venture Insurance Programs. He also is president of the Insurance Marketing Communications Assn. in Gig Harbor, Wash.

The outcome of reinsurance treaty renewals in January 2009 may be a major factor in determining insurers' decisions about allocating money for marketing, Mr. Look said. "With stock prices down and shareholders looking for returns, chances are that reinsurers will raise their rates," he said. If ceding insurers pay higher prices for reinsurance, they will have to address their own pricing.

If they raise prices and capacity is reduced, he predicted that a lot of insurers will increase their spending on interactive-related media. "A lot of companies held off last four years because their marketing dollars have been squeezed," Mr. Look said.

The U.S. financial services industry—including banks, credit card companies, brokerages and insurers—is second only to retail in Internet advertising spending," said Lisa Phillips, senior analyst at eMarketer.

U.S. insurance companies' online ad spending accounted for about 28% of the financial services total in 2006, or \$720 million, eMarketer said.

She projected that insurers' online ad spending would grow to \$1.38 billion this year.

## **AUTO INSURERS NO. 1 IN INTERNET ADS**

According to research by TNS Media Intelligence, the four insurers spending the most last year for advertising in all types of media were GEICO, \$541 million; Allstate Corp., \$351.8 million; Progressive Casualty Insurance Co., \$310.7 million; and State Farm Mutual Automobile Insurance Co, \$295.6 million.

TNS reported those four companies spent \$1.28 billion for auto insurance advertising in 2007, with network television taking 31.4% of the total; cable TV, 28.7%; local TV, 13.6%; radio, 11.7%; Internet, 6.9%; and other, 7.7%.

Spending the most on Internet advertising were auto insurers Progressive, which spent 13% of its advertising budget on Internet ads; and State Farm which spent 11% of its ad budget on Internet ads.

That advertising seems to be paying off in terms of generating customer demand, according to several studies of Internet usage by insurers.

## **2 MILLION AUTO POLICIES SOLD ONLINE**

Before purchasing insurance, 55% of U.S. Internet users in the United States and select Western European countries explored an insurer's Web site and used price comparison tools, according to the 2008 World Insurance Report from Paris-based consultant Capgemini and the European Financial Management & Marketing Assn. The data is based on surveys and interviews with more than 11,000 insurance customers, 350 distributors and more than 50 insurance executives in the United States and six European nations.

"The Internet is a critical channel for the auto insurance industry," eMarketer reported in March. Between 2004 and 2007, U.S. consumers requested more than 100 million auto insurance rate quotes, according to comScore Inc., a marketing research company. Nearly one-third—32 million—occurred in 2007 alone, which was up 15% over 2006.

More importantly, the number of auto insurance policies purchased over the Internet reached 2 million in 2007, 37% more than 2006, according to eMarketer.

"Consumers are demanding the freedom to choose their method for interacting with their auto insurer—whether online, by phone or in person, said Kevin Levitt, vp at comScore. "The rapid growth of the Internet demonstrates the importance of a multichannel approach that includes the ability to request quotes, purchase policies and service accounts online."

The Internet also helps meet the needs of managing general agents and program administrators in the hospitality and entertainment industries, the IMCA's Mr. Look said.

Among his dozen clients in those fields, those planning to market a product using interactive services are still moving forward. "We've yet to see anyone contact us and say let's hold back," Mr. Look said.

His services include search optimization, which increases the frequency with which a client's Web site will turn up in results of consumer searches. He also offers customized agency sales tools that an MGA can provide an agent on specific insurance product lines as well as online kits a client can give his agent. He also has been involved with automating an insurance rating service for beauty salons, so getting a price quote requires very little agent participation.

Separate from sales, insurers can do more to increase their use of online services, several sources said.

"Technology is a strength and weakness for the insurance industry," said Paul Springman, executive vp at Richmond, Va.-based specialty insurer Markel Corp. during a recent panel discussion hosted in Chicago by the Katie School of Insurance and Financial Services at Illinois State University. "Companies have invested millions of dollars in it for serv-

ices that can deliver a better priced product. The trick is differentiating yourself from your competitors," Mr. Springman said.

Some insurers are expanding their use of technology to better serve customers, including recent innovations such as issuing policies electronically.

"The industry has a bad rap about technology," said panelist John Lupica, president and CEO of Philadelphia-based ACE USA. Contract certainty is an issue for many of our customers because not having the policy in hand represents "a control deficiency," he said. Mr. Lupica said he wants to be able to issue a customer's policy electronically so that the policyholder will have a copy of the policy on the day of the policy's inception.

Earlier this year, the U.S. commercial property/casualty operations of American International Group Inc. began offering electronic issuance of executive liability policies. It recently expanded its AIG eDelivery system to also include issuance of excess casualty policies and endorsements, according to a statement from New York-based AIG.

### EFFICIENT, FRIENDLY TO THE ENVIRONMENT

The system makes policy documents available to brokers online the next business day after issuance. The system brings efficiency to brokers and allows them to easily share policy documents electronically with clients, according to AIG.

"It is also indicative of our companywide commitment to environmental responsibility," said Tim McAuliffe, president of AIG Excess Casualty. "The new system has the potential to save approximately five tons of paper annually and to reduce yearly (carbon dioxide) emissions by approximately 15,500 pounds," according to the statement.

In addition, insurers can gain a marketing advantage by being technologically proficient, said panelist Daniel H. Kugler, assistant treasurer-corporate risk management for toolmaker Snap-on Inc. in Kenosha, Wis. Snap-on operates in a paperless environment, scanning documents and filing them electronically. Yet when insurance companies come in to do an audit or look at the company's claims experience, they want to see paper documentation, he said.

If an insurer is unwilling to respond flexibly to policyholder's paperless environment, some risk managers may change insurers, Mr. Kugler said.

"In this economic climate, agent/brokers will be under a lot of pressure to bring value" to a transaction, the WMA's Mr. Rice said.

In the current economy, "a lot of leisure industries are hit really hard," Mr. Look said.

For example, marinas and public golf courses are struggling and some golf courses tied to residential developments are especially hit hard due to foreclosures, he said. Mr. Look said inquiries are coming in from agents and brokers and "I'm sure their clients are screaming at them" to get them a better deal on insurance.

In terms of auto insurance, the growth of Internet sales is taking market share from traditional agents, according to a May analysis of a related comScore study that was published

by the Indianapolis-based National Assn. of Mutual Insurance Cos. The traditional agent channel saw a 3 percentage point decrease in market share in 2007, to 53% of total policies purchased.

"Purchasing with a local agent has historically been the dominant method by which people purchased auto insurance," Mr. Levitt said. "While it still remains the primary method, these latest findings show us that the landscape is beginning to change, with more and more consumers turning from traditional offline channels to the Internet."

"The study also found that even consumers who bought a policy through an agent still relied on the Internet to obtain information about auto insurance," the comScore report said.

In contrast, both agents and consumers win with a Web site developed by John Hancock Life Insurance Co. that was developed to enhance its sale of annuities, Mr. Rice said. The site, [www.jhannuities.com](http://www.jhannuities.com), won the Web Marketing Assn.'s 2008 award for best investment Web site.

The site used a simple design enhanced by interactive tutorials and embedded videos, Mr. Rice said. The site contained specific information of interest to prospective clients, current clients and agent/brokers who sell the annuities. It contains customer service features that keep the agent involved, such as one that notifies both the insurer and agent when a customer updated his address, he said.

### TOOLS PROMOTE DECISIONMAKING

When financial conditions become tight, consumers try to save what they can when life, health and car policies come up for renewal, sources said.

Consumers also should care about using their discretionary funds and making wise financial choices about a variety of benefits, including their employers' health care offerings and Social Security, said Ric Ritter, vp marketing for institutional business at MetLife Inc. "Unfortunately, people typically spend more time planning a vacation than they do choosing benefits," Mr. Ritter said.

The insurer developed several free, online tools to help employees simplify their benefit choices at work, select life insurance and make decisions about choosing when to take Social Security benefits. The insurer provides the information online at [www.metlife.com](http://www.metlife.com) as a community service and does not target visitors to the site for follow-up sales calls, Mr. Ritter said.

One of the biggest challenges of online insurance sales for both consumers and insurers is underwriting.

Swedish insurer Trygg-Hansa Forsakrings AB Publikt won the 2008 Webby award in the insurance category for creating a series of "friendly and nonthreatening" underwriting questions, said David-Michel Davies, executive director of the award program sponsored by the New York-based International Academy of Digital Arts and Sciences. Using "a very simple and comfortable interaction" that simulated a summer jaunt, the consumer describes his possessions sufficiently so the insurer can quote appropriate coverages. ■

*Jeff Casale contributed to this article.*



# ONLINE STRATEGIES changing CHANNELS

## Meet expectations with tech tools

By Meg Fletcher

**T**echnological changes are creating a workplace reality to which the insurance industry must respond or face losing both customers and future employees, a Microsoft Corp. executive says.

Overall, the development of connected experiences is "changing the game in insurance," said Bill Hartnett, U.S. insur-

ance solutions director for Microsoft.

Contributing to that is the decline in the cost of the components of information technology, which have become "essentially free"—or at least significantly less expensive—since the first computers were built 40 or 50 years ago, he said.

For example, processing is relatively inexpensive because the cost per transistor declined to \$.0000001 in 2004 from \$1 in 1968, he said.

Storage is nearly free because the cost per gigabyte declined to 40 cents in 2006 from \$78 in 1997, Mr. Hartnett said.

"The Y2K problem should have been a wake-up call" that it is time for innovation. It occurred because the developers thought by the year 2000 the technology would have been replaced, he said in a presentation at the 2008 eInsurance Symposium at Cityplace Conference Center in Dallas.

"By 2050, for \$1,000 you'll be able to buy the equivalent of all the human brains on the planet in processing power," Mr. Hartnett said. "That's a staggering thing to think about."

### MEETING NICHE NEEDS

Previously, expensive technology meant innovation was limited because it was costly to implement, he said, so companies directed their goods to the greatest number of people.

Development of the Internet has rev-

adopted innovations and use "experience as a brand differentiator," Mr. Hartnett said. Those include Amazon.com Inc., Starbucks Corp. and Harley-Davidson Inc.

For example, Amazon "is probably the prime example of this long-tail marketplace," Mr. Hartnett said. That company would not exist if it weren't for the Web and related IT expenses being relatively inexpensive.

Amazon has "set the expectations of the consumer. They've also set the expectation for the people that work for you," he said.

"It's really a dramatic difference in the way they've used technology to kind of change that experience and use experience as a differentiator," Mr. Hartnett said.

Amazon began as an online bookstore that grew to become the world's largest online retailer of consumer goods by putting market share ahead of profits, according to Hoover's Inc.

afraid of him.' You can substitute...insurance agent for accountant," Mr. Hartnett said.

"That's a very powerful statement of how powerful experience can be. It's a differentiator," Mr. Hartnett said. He again quoted the Harley-Davidson CFO: "Our philosophy is we don't really advertise much because when the significant portion of your customers have your logo tattooed some place on their body...you don't really need to advertise very much. They're a loyal, loyal audience."

### CUSTOMIZING COVERAGE

"Where is the business model eruption like Amazon in insurance? There kind of isn't one," Mr. Hartnett said.

For example, the standard homeowner's policy, which was designed in the 1950s, shows its age by automatically including some coverage for silverware and coin or stamp collections. Relatively few people today have those items, so they "would probably be pretty annoyed that they're paying money for that"—if they took the time to look at the policy.

"So why can't we just pull that coverage out and customize it" to create some really flexible forms that let people include what they want, even if there is no break in price. Using technology, you ought to be able to do this pretty easily in the insurance business," Mr. Hartnett said.

Other technological innovations that are available allow high-quality video conferencing and provide automatic written transcripts of discussions as well as gesture-based controls of video screens, like those that newscasters use in manipulating U.S. maps to demonstrate election results.

Some insurers are considering software that allows the gesture-based controls for handling claims settlement and underwriting documents, Mr. Hartnett said. It allows them to move photographs and other documents around and then put them all back into a file. It makes it "a lot more streamlined, a lot more efficient," he said.

In addition to technological and marketing innovations, globalization, constant communication and trans-



**'BY 2050, for \$1,000 you'll be able to buy the equivalent of all the human brains on the planet in processing power. That's a staggering thing to think about.'**

**BILL HARTNETT**  
MICROSOFT CORP.

olutionized that situation, Mr. Hartnett said. With IT relatively inexpensive, it is possible to meet the needs of any niche, which creates "a long-tail marketplace," as described by Chris Anderson in his book, "The Long Tail: Why the Future of Business is Selling Less of More."

"If we start to think of it in a different way, we can come up with some very different answers for how we innovate in this market," Mr. Hartnett said.

The idea is to transform how an insurer's employees—who sell policies and settle claims—think about their company and how those who do business with the insurer think about it, he said.

Insurance-related companies should position themselves to follow in the footsteps of companies that have

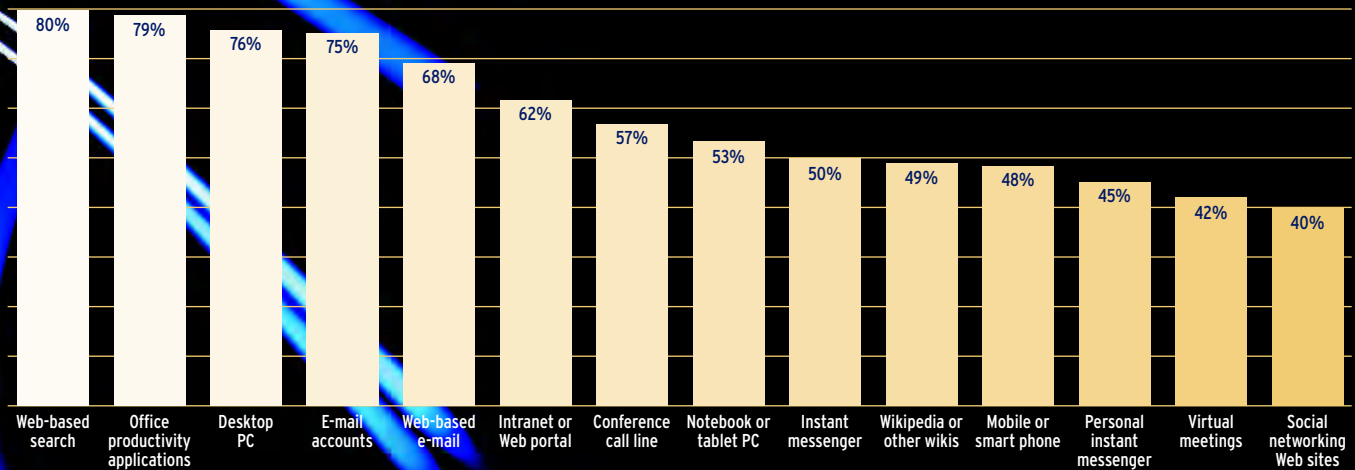
One of his favorite Amazon services is free shipping of most items for a \$75 annual fee.

Although most people think of coffee when you say "Starbucks," its real innovation is establishing a pleasant "sanctuary" apart from the home or office. People go to Starbucks and hang out all day "because of that experience," Mr. Hartnett said.

"My favorite, though, is Harley-Davidson if you want to see the power of experience," he said.

According to Mr. Hartnett, Harley-Davidson's chief financial officer described the key to the company's success this way: "What we sell...to a 40-year-old accountant (is the experience) of riding through town in leathers on his (motorcycle) and having people be

## GREATER EXPECTATIONS Millennials' technology expectations of workplaces



Source: Microsoft Corp.

parency are other issues affecting insurance-related organizations, he said.

An immediate concern for the insurance industry is the change in the workforce that will come with the retirement of the baby boomers and the recruitment of new workers to fill their jobs, he said.

He cited figures from the Washington-based Employment Policy Foundation that found that "the number of available jobs could outnumber workers by 4.3 million when the baby boomers start retiring." The gap would then widen "to a staggering 35 million workers by 2031," according to the foundation.

### TALENT COMPETITION

In the "incredible competition" for new talent, the insurance industry is handicapped by some negative perceptions about the industry's lack of technological innovations and poor public image, he said.

The insurance industry also must consider job applicants' desire for a high-tech workplace, according to the results of a Microsoft-commissioned May study of so-called "millennials" in North America, those individuals

between the ages of 18 and 27.

According to those results, "there are some really high expectations of things that a lot of us don't provide right now," he said.

Millennials expect everyone to be able to search within a company and be able to find information that's relevant to settling a claim or underwriting a policy, the report said. They expect to have a desktop computer, company e-mail and also want access to personal e-mail at work. They also want a company intranet or Web portal, but they also expect access to social networking sites (see chart).

"I don't know of any insurance company that offers all that stuff," Mr. Hartnett said.

The study also found that 91% of the respondents said that having more access to innovative technologies would make them "more likely" to consider a potential job.

One way for an employer to attract employees is to allow them to put up their own Web sites, Mr. Hartnett said. The tools exist to let them do that yet keep it secure and protect sensitive information.

That exemplifies taking a long-tail

approach to abundant technology. "It's no longer, 'I have to go to the IT department, get them to commission a site for me (and) make sure it meets all these policies.'"

According to the report, millennials' perception of the insurance industry is not a good one, he said.

"They think it's an old industry populated by old people," Mr. Hartnett said, and more than half said they thought it was "not innovative."

"That's sad, and you all ought to be ambassadors to try and change it," Mr. Hartnett said. "I think we have a real crisis in the business trying to attract these people." So insurers face not only a technological challenge but also a human resources problem.

To attract these new workers, the insurance industry also needs to change its "apprenticeship model" of having new hires train to be an underwriter or claims representative by spending three or four years shadowing an experienced employee before allowing them to work on their own.

"These people probably won't be around in three or four years. They see life...and work as a series of jobs," he said. **IF**

# For-profit rating agencies, models examined at PCI

By Meg Fletcher

**SCOTTSDALE, Ariz.**—Illinois Insurance Director Michael McRaith discussed the role rating agencies have played in the current economic crisis with restraint, but his disapproval of rating agencies' "stealth regulation" was apparent.

He predicted that the current system of for-profit rating agencies would be replaced by nonprofit entities that are more independent of the insurers they rate and freer of other marketplace pressures.

"I want to see an independent, non-profit rating agency only for the insurance industry," Mr. McRaith said at the Property Casualty Insurers Assn. of America's annual meeting in Scottsdale, Ariz.

He also said the call to establish such an entity would be made in the coming months.

Mr. McRaith made the call as he and four other panelists—representing two rating agencies, an insurer and an actuarial firm—discussed The Impact of Risk Models and Rating Agencies as part of a PCI panel during last month's meeting.

The insurance industry has relied on modeling analytics to "to help it function efficiently," said panel moderator Regis Coccia, editor of *Business Insurance*.

Financial models attempt to take reality and represent it through a series of mathematical or statistical equations so analysts can study the effects of risks, said Roosevelt Mosley Jr., principal and consulting actuary with Pinnacle Actuarial Resources Inc. in Bloomington, Ill. Predictive models also can be used, for example, to estimate future claims or pricing.

Rating agencies analyze an insurer's capital models to determine data quality and reserve adequacy, among other things. Their staffs want to see how well an insurer uses the data to move into new products or change prices, said Damien Magarelli, New York-based director of financial services ratings for

North American insurance at Standard & Poor's Corp.

For insurers that underwrite property catastrophe risks, their rating agencies and regulators review the outcomes of catastrophe models to assess insurers' financial condition, said Messrs. Magarelli and McRaith.

A rating agency wants to know if the information is credible, said Anthony Diodato, group vp with A.M. Best Co. Inc. in Oldwick, N.J.

Use of models "provides a guide to us," said Steven D. Monahan, president and chief operating officer of Auto Club Insurance Assn. in Dearborn, Mich.

Models "don't give us the end-all, be-all answer," because they cannot totally reflect any reality, Mr. Mosley said. It is important to overlay the findings with "some real-life business judgment," he said.

"One of the things to always keep in mind is that (the data resulting from) models doesn't translate into ratings," Mr. Magarelli said. Insurers need to have robust models and executives who understand the results, he said.

An insurer's business team may seek a rating agency's approval for using a model and basing business decisions on its results, but the team doesn't have to follow the modeled results blindly, Mr. Diodato said. If the business team believes it needs to take a different direction and can validate its actions based on prior experience, "that's good," he said.

"There is no quick or easy way...to validate a model," Mr. Diodato said.

It is important to remember that "a model is only as good as the assumptions on which it is based," Mr. McRaith said. "Some regulators are not interested in the models" and care

more about insurers' essential financial data, like capital adequacy.

Regulators also need to revisit rules that limit insurer investments as well as lending arrangements involving securities, if they are going to be allowed to occur at all, Mr. McRaith said.

Much of securities-related lending is done at the holding company level and an insurance unit might not expect to be part of it, the rating agency representatives said.

In light of the current economic crisis, "clearly, some did not understand the nature of the risk," Mr. Monahan said. There also was a lack of communication and transparency about the nature of the risk—mortgages given to consumers with little or no assessment of their ability to pay for them, which contributed to the problems, he said.

Such lack of communication was apparent when a major property/casualty insurer, which he declined to name, had its stock value drop precipitously in a single day and its executives could not explain to employees why it happened, Mr. Monahan said.

Financial market woes are "on everybody's mind," Mr. Monahan said. Many insurers have responded by sending out bulletins trying to allay policyholders' concerns.

"What role should rating agencies play?" is the key question being asked, Mr. Coccia said.

A.M. Best's mission is to be "an independent voice" to help prevent and detect insolvencies by evaluating insurers' financial decisions that could affect their claims-paying ability, Mr. Diodato said.

While rating agencies may have seen that as their traditional mission, major changes are needed in the structure of the rating-agency system, Mr. McRaith said, adding that he was speaking "respectfully" in light of the fact that two fellow panelists represented rating agencies.

"As a regulator, we don't need any form of secondary or stealth regulation,



**'ONE OF THE THINGS** to always keep in mind is that (the data resulting from) models don't translate into ratings.'

**DAMIEN MAGARELLI**, STANDARD & POOR'S CORP.



From left, Damien Magarelli, Regis Coccia, Anthony Diodato, Steven D. Monahan.

which is effectively what rating agencies are now," Mr. McRaith said.

Currently, rating agencies operations are dictating to the marketplace, he said. It should not be possible for a rating agency's downgrade of an insurer to force the insurer into receivership, Mr. McRaith said. He said that reportedly happened in Illinois before he was appointed director, although he declined to identify the insurer.

"There is no place for a for-profit rating agency," he said.

Mr. McRaith said he wanted to see an independent, nonprofit rating agency only for the insurance industry that is "free and clear" of influence from the industry or regulators. He said such an independent rating agency should not rely on fees or dues paid by the insurers being rated, as rating agencies currently do.

"Expect a proposal for an independent nonprofit rating agency within the next few months," Mr. McRaith said.

Responding to the issue of rating agency independence, Best's Mr. Diodato emphasized the importance of "the strong segregation" between Best's rating and fee-charging operations. He said he didn't know how much the rating agency charges an insurer, because such knowledge could jeopardize his independence.

"There is a need for what we do," Mr.

Diodato said.

Given that Best's North American rating operation has 50 or so analysts, Mr. Diodato also questioned whether regulators would have sufficient knowledgeable staff to create an alternative system.

S&P's Mr. Magarelli also said there was a division between the fee and the analytic side of S&P's operations.

For an insurer executive such as Mr. Monahan, a rating agency review "is a mirror, an inspection of your expectations. (It is) a big deal" to be downgraded, he said.

Yet, a rating agency has a responsibility to report any trends that may affect the ability of an insurer to pay claims, Mr. Diodato said.

The speed with which markets responded to recent negative news about some insurers caught many unaware, and Mr. Coccia questioned whether regulators and rating agencies are responding quickly enough to changing market conditions.

Mr. McRaith said regulators have been "very involved and engaged" and are looking for ways to enhance regulation. "We have to view this as an opportunity," he said.

Rating agencies try to operate in a practical manner but face particular challenges. Critics will complain that they respond too quickly or slowly, rating agency spokesmen said.

"We don't rate stock prices," Mr. Magarelli said. A rating agency looks at stock prices but only to the extent that it "complements our core analytics," he said. But a rating agency must pay attention to stock prices if they have a fundamental effect on an insurer's ability to pay claims.

In addition, "we don't rate to market rumor," but will investigate reported developments, he said. "Our ratings are there for the long-term."

Mr. Monahan urged rating agencies to speak with insurer executives to get a better understanding of any situation.

In response to an audience question, panelists advised a spokesman for a small insurer that plans to start financial risk modeling this year. The spokesman, who did not identify his company, said the firm is being driven to undertake financial modeling by "rating agencies looking at it."

Implementing a financial risk modeling process is "a huge expense" for a smaller company, especially to obtain competent personnel, the insurer spokesman said.

"It can be expensive," Mr. Mosley said. He recommended that the insurer start with limited, focused analyses to produce targets that can be achieved. "It is a very real concern," especially for smaller companies, he said.

"There is no one-size-fits-all model," Mr. Diodato said. In fact, if an insurer does not think it needs to use such a financial risk model, that decision will not disproportionately affect the company's rating, he said.

The issue is how an insurer manages its capital. If a company is adequately capitalized and run prudently, "we don't ask you to put money into (the) process," Mr. Diodato said. But if a company has a predictive model but doesn't use it for capital allocation, then it won't help its rating, he said.

"There is no requirement to have a model," Mr. Magarelli said. "The industry is in different stages of development" and this is a learning and testing period.

Operating without a model "is not an automatic negative," he said. "We want see how a company reflects its own risk profile." ■

# Take advantage of change with agile IT infrastructure

By **Chuck Johnston**

In many ways, insurance is the business of predicting change and helping customers minimize the negative impact of that change. The insurers I talk to every day have found that extremely difficult recently.

In today's tumultuous marketplace, insurers are looking for safe harbor and reassurance themselves. While some insurance executives are pulling back and preparing to ride out a down market, many recognize there is opportunity in change. They are positioning for a near-term market shift toward more conservative investments and the inevitable market rebound, as well as for the next big opportunity.

This repositioning requires insurance executives to examine everything from channel disposition to business process economics to technology enablement. Insurers are looking to drive down costs and maintain margin as investment returns decline. They tell me they see even greater need to focus on speed to market for new products that better suit the current economy. They also are looking for ways to broaden distribution channels as the more conservative insurance industry captures a greater share of the wealth and retirement business.

## MERGERS AND ACQUISITIONS

As a few troubled large insurers make drastic maneuvers to survive, midsize and international players see opportunity through mergers and acquisitions for scale and new markets that were not on the radar screen a few quarters past.

These radical shifts are forcing insurers to take a hard look at their business processes and associated enabling technologies. Many legacy systems will not meet the needs of this rapidly changing market.

Change is an inevitable part of doing business.

IT infrastructures are becoming the key issue as insurers consider system consolidation, improved integration between business applications and legacy system modernization as critical elements of business transformation—and, ultimately, of profitable growth.

Legacy business systems are too old and too heavily modified at the source code level to enable rapid introduction of new product initiatives and support the level of business agility now required. At the same time, they represent significant investments and provide some ongoing value, so are not easily abandoned.

To move their business forward, insurers require a long-term IT modernization and consolida-

tion strategy. This strategy must include a focus on simplification and integration of the infrastructure, information access and distribution/transaction processing layers. The resulting infrastructure is agile, cost-efficient and open, providing application flexibility to support shifting business priorities.

By adopting a flexible and open architecture, insurance companies will be better positioned to meet ever-changing market and customer needs, despite the disruptions that may occur. As opportunity for consolidation arises, the open infrastructure approach is indispensable in facilitat-

ing rapid and seamless onboarding of acquisitions—critical to sustaining value and customer loyalty.

Where should you start the transformation to get the greatest impact? The answer depends on your company and its circumstances.

However, when seeking faster speed to market, greater agility and operational efficiency, many insurers are taking aim at core systems—policy administration, rating and underwriting and claims—seeking open solutions that integrate easily with existing legacy systems while delivering new value.

These solutions must provide best-of-breed functionality, facilitate streamlined deployment in existing architectures and reduce time to market by leveraging preloaded industry content.

## SINGLE-SYSTEM CAPABILITIES

Rule-based capabilities available today deliver new levels of agility and simplicity, enabling insurers to define new-product and business transactions with no programming. Insurers also can support multiple product lines on a single system and manage business and regulatory requirements at the product, product line and company level.

Companies also can improve the entire policy life cycle for customers and streamline transactions by implementing straight-through processing. By enabling process automation based on configurable business rules, insurers eliminate the need for manual data entry, gaining significant process efficiencies. Agents and customers also win through faster service fulfillment.

In the end, as the industry continues to evolve in difficult times, customers can still be the big winners. With an open IT infrastructure at the core, companies can be agile in meeting customers' needs by bringing new products to market quickly and providing great service. Companies that strategically leverage open IT solutions will be poised to capitalize on new opportunities and overcome challenges in today's market. ■



*Charles "Chuck" Johnston is vp of strategy and alliances for Oracle Insurance, a unit of Redwood Shores, Calif.-based software company Oracle Corp.*

As they look for the information technology power they need to do business effectively, many insurance industry companies often find it most efficient to look to outside partners rather than setting up systems in-house. Whether it's information processing, document storage or help with various business processes, a number of companies have positioned themselves to provide IT outsourcing to the insurance industry. Here's a look at a few key players.

## Accenture

**HEADQUARTERS:** New York

**WEB SITE:** [www.accenture.com](http://www.accenture.com)

**RELEVANT DATA:** Accenture has a global network of more than 50 delivery centers that provide various outsourcing services.

**WHAT THEY OFFER:** Through its insurance industry group, Accenture provides a range of insurance-specific and cross-business outsourcing services, including IT infrastructure outsourcing, application outsourcing and business process outsourcing.

## Affiliated Computer Services Inc.

**HEADQUARTERS:** Dallas

**WEB SITE:** [www.acs-inc.com](http://www.acs-inc.com)

**RELEVANT DATA:** ACS has more than 65,000 employees supporting client operations in nearly 100 countries.

**WHAT THEY OFFER:** Customized IT outsourcing solutions from ACS range from large-scale mainframe processing centers to desktop computers. In the business process outsourcing area, ACS leverages proprietary workflow systems and process re-engineering with its own staffing, delivery and compensation models.

## Computer Sciences Corp.

**HEADQUARTERS:** Falls Church, Va.

**WEB SITE:** [www.csc.com](http://www.csc.com)

**RELEVANT DATA:** CSC has more than 5,000 full-time employees dedicated to delivering outsourcing services to nearly 150 insurance companies.

**WHAT THEY OFFER:** CSC business process and IT outsourcing provides a broad range of services for insurance companies ranging from IT outsourcing and full back-office operations to customer support and the ability to provide services via the Web to agents. Insurers can select all services, operating as a virtual insurer, or strategically pick and choose based on core competencies and business objectives.

## IBM Global Services

**HEADQUARTERS:** Armonk, N.Y.

**WEB SITE:** [www.ibm.com](http://www.ibm.com)

**RELEVANT DATA:** More than 190,000 professionals in approximately 160 countries; IBM Global Services revenue totaled \$54.14 billion in 2007.

**WHAT THEY OFFER:** Data center outsourcing services offer client companies the ability to choose a tailored outsourcing solution to meet their needs to provide cost-effective, flexible service options that help clients meet changing business demands, sustain growth and protect existing technology investments. The managed application servers component of IBM Data Center Outsourcing Services offers a solution to businesses requiring a broader selection of platforms, services and technical expertise than they possess in-house.

## Unisys Corp.

**HEADQUARTERS:** Blue Bell, Pa.

**WEB SITE:** [www.unisys.com](http://www.unisys.com)

**RELEVANT DATA:** Unisys has 37,000 employees serving clients in 100 countries and more than 400 insurance companies around the world.

**WHAT THEY OFFER:** Through its global insurance outsourcing centers, Unisys provides supporting IT infrastructure and manages business-process workflow, migrating operations to handle multicurrency capabilities, changing regulatory requirements and other market factors.





**ANDERSON BAKER** is president of New Orleans-based insurance agency Gillis, Ellis & Baker Inc.

## Win big with service regardless of market

**W**hat does customer service mean to you? For some, it means talking to a live person while reserving a plane ticket. For others, it's being able to return an item after losing the receipt. For most, it's simply hearing, "Have a good day."

For the insurance business, it means insurers and agencies provide a level of service that exceeds expectations, and one that includes products that customers might not even know they need.

During my 25 years as an insurance agent and now as an owner of a 40-person agency in New Orleans, I've seen a steady decrease in the level of loss control and risk management services provided by the insurers we deal with. Their insureds and our clients are often left on their own to figure out how to prevent losses or reduce loss severity.

It's time to change that.

For smaller insureds, those paying less than \$250,000 per year, insurers used to routinely provide a menu of services such as building inspections, job site safety reviews and vehicle safety programs. Now these services are reserved for much larger accounts.

Smaller insureds typically don't employ risk safety officers, let alone full-time risk managers. The loss control services provided by insurers added value to the insurance transaction. Agencies were able to coordinate the delivery of these services to the insured without incurring any expense.

Insureds' need for these services is no less today than 20 years ago. The scarcity of offerings by the companies gives agencies a tremendous opportunity to fill this void and establish a stronger agency-insured bond.

The level of service an agency delivers should not be determined by the competition. So few agencies offer these services that a forward-thinking agency can create a new playing field. The pioneers in this area can change the rules of the game. Insureds will begin to expect more from the relationship. Agencies that just sell insurance will not be able to compete in this arena. This will become even more the case as agency commissions are reduced.

The real fun for the first mover in any business is often being able to define the market and create demand. There are many loss control and risk management services that agen-

cies can provide to their clients, including defensive driver training, contract analysis, building valuation and CPR training.

Agencies can provide services that the insurers either never did provide or no longer make available. This allows agencies with loss control and risk management services to enjoy a different relationship with their clients. They are no longer mere peddlers of insurance.

It's important that agencies provide these services directly and not outsource them. Otherwise, the insured will see the agency as simply a commissioned sales agent for yet another product. Also, third-party providers typically don't take a long-term view, and won't work to integrate their programs with overall risk management strategies.

Insureds are often surprised to receive this level of service, but soon grow to expect it. While it's not necessarily a barrier to exiting a relationship, it certainly changes the equation as the insured evaluates other agencies.

**AGENCIES CAN PROVIDE** services that the insurers either never did provide or no longer make available. They are no longer mere peddlers of insurance.

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Our agency dedicates nearly 5% of revenues to these services, demonstrating to our clients that we believe in the services' value as part of their risk management programs.

Agencies can prosper offering these services, regardless of which way the market is moving. As rates go down, risk management strategy becomes a value the agency can offer to retain an account. In such a market, the agent might even be able to charge for the services to offset the loss of revenue associated with lower rates.

When premiums rise, the agency can absorb the costs associated with delivering risk management services. The insured will usually see the value of the combination of the higher premium and the services, justifying the relationship with the agency at a higher premium.

Our larger, regional peers already provide these services. Smaller agencies who are the first movers in their areas will be rewarded. ■

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**Publishing: Dec. 29**  
**Ad Close: Dec. 3**

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## 2009

November 2008



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November 2008

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# The new balancing act

COVER STORY | By Mark Bruno

Companies might have spent the past several years revamping and fine-tuning their benefits offerings, but in a matter of months, it's become crystal clear that there are still some major cracks in the employer-sponsored benefits system. Trillions of dollars have vanished from retirement plans in a blink. Millions of older workers say they are now unable—or are simply too fearful—to retire. Scores of corporations are saddled, once again, with underfunded pension plans and may soon be burdened with their largest pension deficits ever. And at a time when they can afford it the least, both employers and employees are still trying to cope with soaring health-care costs.

It's a bleak scenario no matter how it's spun and represents the downside of trying to do the right thing for employees. After all, benefits are not mandatory; they are precisely what they are described to be: benefits.

All of these latest developments, of course, are the ravages of an unrelenting economic downturn that's being billed as the most severe financial crisis since the Great Depression. Incredibly, it's occurring only a year after equity markets were hitting all-time highs nearly every day—way back when many baby boomers saw retirement as a reality (if not a certainty), as opposed to just a fleeting fantasy.

It underscores, in grand fashion, just how vulnerable companies and their workers' benefits still are to volatile and unpredictable economic conditions. There are clearly few places to hide, and employee benefits are far from immune to the turmoil, no matter how sophisticated the employer may be.

For better or worse, however, economic dis-

locations often serve as the catalysts for change, and benefits are clearly a candidate for alterations.

When companies are looking for ways to stop the bleeding and mend their bottom lines in trying times, benefits often become a logical target.

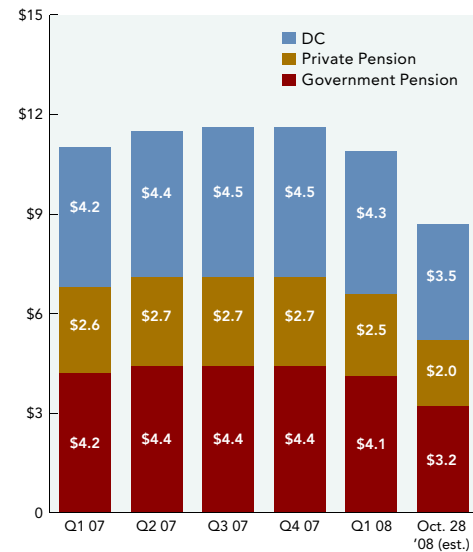
And with a new president in place, seemingly every benefit issue—whether it's reforming the health-care system or firming up 401(k)s—will be on the table when Congress kicks off a new session.

"Employers need to be mindful of the risks, not just the costs, that are associated with any changes made to their benefits platform in the near term," said Cecil Hemingway, executive vice president and head of the retirement practice at Aon Consulting. "Quick fixes can have long-term business implications well beyond the next financial statement or the next election."

Some implications, he added, will have an

## THE SHRINKING PENSION

Amounts invested in each type of retirement plan, in trillions.



Sources: Investment Company Institute, Hewitt Associates, Bloomberg LP, Pensions & Investments

impact on areas like cash flow at companies that may currently have underfunded defined benefit plans. The decision to make larger than required contributions now may erode an employer's cash position in the short term. But it may also protect an employer from being forced to freeze its pension plan later if a downturn leads to an even larger deficit while making that deficit harder to plug.

Well beyond the balance sheet, of course, any adjustments that companies make to their benefits now will also have a tremendous influence on the way employers manage their work forces over the next several years. With fewer older workers now expected to begin their retirements, it'll be a balancing act for employers as they attempt to retain the workers they want most—while also find-

ing a way to part with the ones that don't offer enough bang for the buck.

At the same time, with few companies planning to increase workers' cash compensation at the moment, benefits will be the best weapon employers have in the war to attract new talent. If two companies are offering a worker essentially the same salary, yet one will contribute nearly three times as much to the prospective employee's 401(k), which is more likely to win that battle?

Compelling benefits will also go a long way toward keeping top workers in-house, particularly if employers can craft packages that are not only competitive, but thoughtful and employee-friendly too. Whether it's offering flexible working arrangements, or putting wellness programs in place, the companies that cater to their employees' specific needs will make it through these times with fewer bumps and bruises than those that are less flexible.

While there's no such thing as the perfect benefits platform, we've compiled a blueprint for these best practices in our first-ever *Crain Benefits Outlook*. It addresses the most critical issues that will confront any senior executive who has some level of responsibility for a company's benefits. It represents the best thinking of four expert Crain publications—*Business Insurance*, *Financial Week*, *Pensions & Investments* and *Workforce Management*—and offers the perspective and advice of leaders at companies of all sizes, across every industry.

Few will be able to afford the cost of doing it all.

But none will be able to withstand the cost of getting it wrong.

CBO

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## Thought Leader Jeremy Grantham

### Getting bullish, but no need to rush things

Jeremy Grantham has been a renowned wet blanket in the face of irrational exuberance for decades. Lately, however, the chairman of Boston-based money manager GMO LLC—which had \$126 billion in assets under management as of June 30—has been sounding uncharacteristically giddy, even as the plunge of global equity markets left his counterparts at other firms gnashing their teeth and rending their garments.

Mr. Grantham for years has dismissed most mainstream investment opportunities as wildly overpriced. But the once-maniac markets have turned depressive. In the space of just over a year, the Dow Jones industrial average fell to an intraday low of 7,773.71 on Oct. 10, 2008, from a record close of 14,164.53 on Oct. 9, 2007.

**Crain's Benefits Outlook:** What advice would you give corporate executives now with regard to their retirement plans?

**Jeremy Grantham:** I would tell (them) to recognize that there are bargains now,

that markets have overreacted. Catching a falling knife is never without pain, but the prime directive is to buy cheap assets.

**CBO:** So, there's reason for cheer?

**Mr. Grantham:** U.S. pension funds are crying in their soup now, but they can at least find some solace in the fact that, for the first time in 20 years, we're looking at all global equities being modestly cheap. Some are substantially cheap.

**CBO:** Should corporate retirement plans be jumping into equities? The S&P 500 is already below your 975 estimate of fair value.

**Mr. Grantham:** They should phase back into equities with all deliberate slowness, as opposed to deliberate speed. Markets historically have overshot on the downside by 20% or more. It could be 2010 before the market hits bottom. If there's a meltdown, then all bets are off, and (the market could hit bottom) in a matter of days or weeks, because in a panic, prices are not sensible in any way.

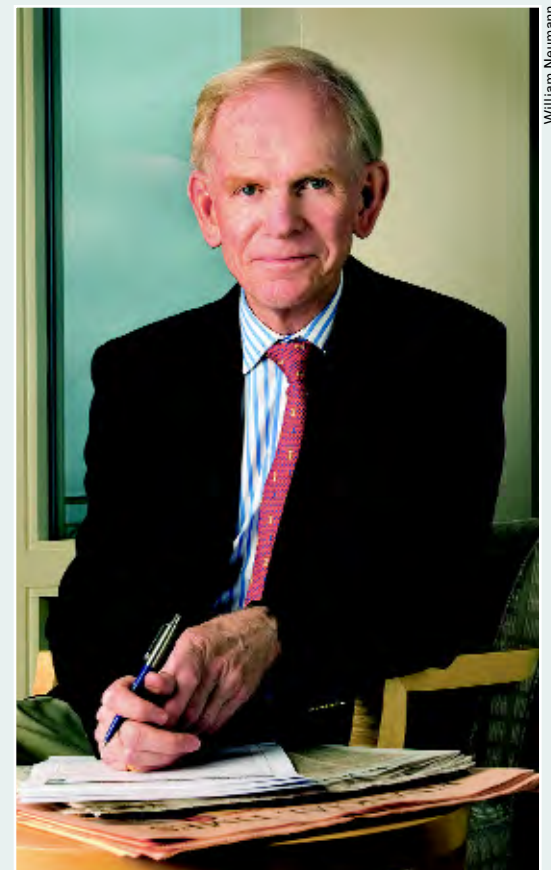
**CBO:** What kind of hangover do you see resulting from the market mayhem of the past few months?

**Mr. Grantham:** We'll see a lower allocation to equities, people reconsidering the virtues of racy hedge funds and private equity deals, a more conservative tone to all financial activities. All of these things are pretty well baked into the pie—greater conservatism on a very broad front that will last for a number of years.

**CBO:** And portfolio construction?

**Mr. Grantham:** People will have a much more realistic view of how hard it is to generate alpha—a completely different view of risk, and the idea of liquidity. Most of the private equity returns turned out to be just simple, crude leverage, at the client's risk. The typical hedge fund made money by picking up nickels in front of a steam roller, and a lot of them are flattened to prove it. This will lead to very profound long-run changes.

—Douglas Appell/Pensions & Investments



William Neumann



WORKERS ARE CLINGING TO THEIR

JOB—AND BENEFITS—WELL INTO THEIR SENIOR YEARS.

FORWARD-THINKING COMPANIES NEED TO EXAMINE HOW

THEY CAN BEST KEEP THEIR AGING TALENT ENGAGED.

# When workers won't leave

**EMPLOYMENT** | By Jessica Marquez and Mark Bruno

BEFORE LARRY BENSON INTERVIEWED for his current graphic designer position at SEIU-Healthcare Workers West, he dyed his gray hair brown.

That's because on one of Mr. Benson's previous job interviews, the 22-year-old woman meeting with him couldn't stop staring at it, he recalls.

"She just stared at my head the entire time and then finished by telling me that I was too senior for the position," he said.

Mr. Benson, 52, joined SEIU-Healthcare Workers West in March after looking for a job for more than a year. Before that, he had been a freelance graphic designer for 15 years, making six figures. But in 2004, he lost his two biggest clients, and ended up mainly living off his savings until he got his current position.

Today, Mr. Benson, who lives with his partner in Oakland, Calif., can't even bring himself to look at his retirement statements. And he said he is thrilled that he got a job that pays for full health-care benefits and offers a pension, because he will probably be there well into his 70s.

"I used to think that would be at 68 at the latest, but now I don't even think that's possible now," he said about retirement. "I plan on working here a long time."

Mr. Benson is among a growing number of older workers delaying retirement, either because they actually can't retire or they're simply too skittish to do so right now.

Epic swings in the financial markets, like the ones recorded in September and October, will have that effect on workers, especially when they're accompanied by forecasts of a prolonged recession that pepper the front pages of newspapers on an almost daily basis.

Private sector and public retirement plans have seen their assets decline by roughly \$2 trillion, according to a testimony given to the House of Representatives in October by Peter R. Orszag, director of the Congressional Budget Office.

"Retiring in this kind of economic environment turns unrealized losses into actual losses," said Brian Graff, executive director and CEO of the American Society of Pension Professionals and Actuaries. "Why would you cash out at all now, when you could keep earning an income and wait until your nest egg becomes whole again?"

More than any other reason, this fear of being financially unprepared for retirement is what's turning corporate America's work forces grayer by the day. A recent AARP survey of 1,500 workers 45 to 74 found that 64% of respondents say they will continue to work because of financial needs. Today, more than half of the labor force is 60 to 64, up from 43% in 1986, according to the Economic Policy Institute.

For employers, this trend can be good or bad news.

Older workers are more highly compensated and carry higher health-care costs than their younger counterparts. The medical claims for employees 61 to 65 and their dependents hovers close to \$8,000 annually, compared with \$3,000 for workers 31 to 35, according to Towers Perrin.

But the baby-boom generation also accounts for a huge chunk of the country's work force, and many companies are faced with the prospects of a talent shortage upon their exit. That some boomers want to stay on the job is the silver lining for many corporations.

That's why companies such as IBM Corp., Devon Energy Corp. and paper company PH Glatfelter Co. are sizing up their benefits platforms and seeing how they could be used to appropriately manage and satisfy their aging work forces.

"We're hardly anxious to have our older workers leave," said Gregory Paradiso, director of compensation and benefits at Glatfelter, which is based in York, Pa., and whose 3,000-strong work force has an average age of 49.

The trick for companies is to retain the experienced workers they want and need, while offering tools so older workers who are not high performers can retire when they are ready, experts say.

"To keep everyone is very expensive," said Jamie Hale, a senior work-force planning consultant at Watson Wyatt Worldwide in Dallas. "It really is a balancing act to retain those older employees they want, while encouraging others to move on."

## BENEFITS TOOLS

Whether it's offering wellness programs, financial education classes or phased retirement options, to name a few measures, employers are searching for ways to keep many of their older workers engaged while keeping their own costs down. At the same time, these companies also must have benefits offerings in place that can help older workers retire when they are ready.

At Devon Energy, which has offered a traditional defined benefit pension plan to its workers for years, the company recently rolled out a "Super 401(k)" option, in which employees are eligible to receive a company match like no other. Not only can the plan help older workers save enough for their retirement if they opt in, but it can also help the company compete for younger workers against energy giants such as Chevron Corp. and Royal Dutch Shell PLC, said Frank Rudolph, senior vice president of human resources at Devon Energy in Oklahoma City.

The new Devon plan matches employees' contributions with cash, not company



**DYEING FOR WORK:** Larry Benson got rid of his gray locks before his SEIU interview.

stock, which encourages workers to have a more broadly diversified 401(k) right off the bat. But it also matches its employees' contributions dollar for dollar, a generous match that only about 20% of companies offer, according to the Profit Sharing/401(k) Council of America.

Then comes the matching program on steroids: For workers who spend five years at Devon, the company matches 401(k) contributions on up to 11% of pay. For those who stick around for five to nine years, they get up to 14% of annual pay matched, while workers with 10 to 14 years of service earn a match on as much as 18% of their compensation. And workers who have been with Devon for 15 years or more are eligible for a company match up to 22% of their annual pay. The matching contribution is based on an employee's total years of service at Devon, not from their service since the introduction of the plan.

Put in perspective, most companies match 50 cents on each dollar contributed up to the first 6% of pay, according to the Profit Sharing 401(k) Council.

Not all companies, of course, will go to such extremes. But there are other ways that employers can tweak their benefits to satisfy a significant portion of their older workers.

"Companies need to rely on fringe benefits to keep older workers engaged because they can't offer the standard benefits like health-care and retirement benefits to just their high performers," Ms. Hale said. "So they are looking at other kinds of benefits to retain these workers."

## WELLNESS = COST CONTROL

Recognizing that their work forces are getting older, many companies are targeting their wellness programs to address issues that older workers may be confronting, such as arthritis, certain cancers and heart disease,

said Dr. Bruce Hochstadt, a principal with Mercer LLC, New York, in its health and productivity management practice.

In January, Sperian Protection started offering free colonoscopies to every worker and pre-retiree older than 50. The Paris-based company, which makes personal protective equipment, had been offering its 1,600 U.S. employees other types of screenings, including mammograms and prostate tests, as well as free preventive care, such as annual physicals, immunizations and lab work.

"Our employees know we're serious about detecting things early," said Michael Vittoria, Sperian's vice president of human resources. "We are all being challenged as employers to keep our talent in-house and to keep them healthy."

Sperian invests in preventive screening because these costs can be less expensive than paying for the acute care of one major cancer case, Mr. Vittoria said. The company's employees are mostly in their mid-40s, an age when many health issues begin to arise, he added.

Sperian expects 120 employees to have colonoscopies this year—a screening done every five years after age 50. A major communication effort is under way to increase the number of screenings by 50% in 2009.

And although these preventive measures haven't decreased health-care costs, they have slowed them, Mr. Vittoria said. The company saw double-digit percentage increases earlier this decade. In 2007, health-care costs rose 2.6%, to \$8.8 million. This year, Sperian projects costs will rise only 1.8%, to just above \$9 million.

"Prevention does pay off, even with an older work force," Mr. Vittoria said.

Meanwhile, the concept of offering more flexible retirement packages—such as allowing older employees to work part time but still

CONTINUED ON PAGE 6

**more online**  
Sidebar: The benefits of phased retirement  
See [www.crainbenefits.com](http://www.crainbenefits.com)

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# Workers

CONTINUED FROM PAGE 6

draw a pension—appears to be gaining in appeal for some corporations. “It’s hardly commonplace and there’s no real model for offering phased retirement benefits right now,” said Byron Beebe, U.S. retirement practice leader at consulting firm Hewitt Associates LLC, Lincolnshire, Ill. “But it makes a great deal of sense for both employers and employees at this point, and it will get more consideration.”

## INCENTIVE TO RETIRE

For another lesson in how to encourage older workers to retire, private employers can look to universities, which have taken a somewhat counterintuitive approach.

Studies have shown that in academia, many employees put off retirement specifically because of concerns about health-care costs after they leave their jobs.

This trend was leaving colleges and universities in a bind. “You end up with inflexibility and the inability to infuse new ideas into the organization because you can’t recruit,” said Bill Detwiler, associate vice president of HR and business services at Southern Methodist University in Dallas.

But continuing to offer health care to retirees was becoming too much of a burden for organizations such as SMU, particularly after accounting rule changes in 1993 that now require employers to deduct the estimated future costs of retiree health benefits from profits.

That’s why SMU is one of 51 institutions that over the past three years have signed up with Emeriti Retirement Health Solutions, a nonprofit that allows employees and colleges to set aside money that retirees can use for health-care expenses.

The program, which is administered by Aetna, works this way: When employees turn 40, the colleges contribute at least 0.5% of their aggregate annual pay into a voluntary employee beneficiary association, a tax-free trust. Employees also contribute—either vol-

## Incentive to delay retirement already included in DB plans

IF EMPLOYERS ARE GOING to use retirement benefits to provide incentives to employees to defer retirement, defined benefit plans offer a better mechanism than defined contribution plans. Even without modifying the design, a defined benefit plan generally has a built-in incentive for working longer.

“In a defined benefit plan, the later part of your career is when the most significant increase in your benefits occurs, particularly defined benefit plans that base pensions over the final average earnings of the last five years of employment,” F. Pierce Noble, Dallas-based worldwide partner of Mercer LLC, said in an interview.

“By delaying retirement—if you are in a final-pay pension plan—you can impact the benefit you will receive. If you work another year, the retirement income will go up.”

With most defined contribution plans,

working longer is no special incentive for employees, he said, because with few exceptions, the employer match stays the same.

“If you continue to work, you don’t have to draw down on your defined contribution plan, so you preserve the balance for future times.”

On the employer side, the actuarial calculations and funding issues of a defined benefit plan could be affected by employees deferring retirement. So far, however,

neither Mr. Noble nor Joel Rich, retirement practice leader at Sibson Consulting in New York, has seen anything beyond anecdotal evidence that employees are staying longer. As a result, Mr. Rich said, “I don’t think

there has been an impact on plan design.” Sibson is a human resources consulting division of Segal Co., New York.

From an actuarial standpoint, the extent employees defer retirement would lead to gains or losses in the plan. “If a lot of employees don’t retire in plans that have early retirement supplements, there would be gains to the plan,” Mr. Rich said.

Would changes in retirement timing change a defined benefit plan’s asset allocation? “It could in theory,” Mr. Rich said. “Say you have a defined benefit plan with a lump-sum (payout) option. If you expect a bunch of employees to take advantage of the lump sum, the company might invest (plan assets) in something less subject to market fluctuations,” or vice versa.

In general, qualified (defined benefit) plans could have provisions to encourage or discourage early retirement, Mr. Rich said. The plans are not set up to offer incentives for deferring retirement beyond normal retirement age, he noted.

—Barry B. Burr/Pensions & Investments



F. Pierce Noble

untarily or on a mandatory basis, depending on the college’s policy—to an account. Employees can invest the money in mutual funds managed by Fidelity Investments.

When employees reach 65 and are eligible for Medicare, they withdraw the money tax-free to pay for one of six supplemental insurance plans offered through Aetna, or for premiums on an outside plan. The premiums through Emeriti on average range from \$60 to \$250 per month per individual.

SMU implemented Emeriti in January and mandates that employees begin contributing \$40 per month into the program once they turn 40. Their contributions increase by 4% annually, and SMU matches the contribution, Mr. Detwiler said.

The advantage of making the contribution mandatory is twofold, he said: First, the employees will have more savings for health-care costs when they retire; also, mandatory con-

tributions are tax-free under Emeriti.

So far, 1,300 of SMU’s 2,100 benefits-eligible employees have begun participating in the program and 500 have retired on it. The university is spending \$1.1 million a year, but it projects that in the long term the program will cost less than its old retiree health-care program, Mr. Detwiler said.

## LOOKING AHEAD

As more workers like Mr. Benson delay retirement, some experts question whether some companies that are anticipating a talent shortage may actually find themselves with too many experienced workers.

Watson Wyatt’s Ms. Hale, for one, doesn’t believe that the talent shortage facing many employers will disappear anytime soon. “Most of these companies don’t want to keep older workers for 10 more years; they just want them for another three,” she said. “In

the foreseeable future, this talent shortage will play a role in their benefit design.”

But if it does become an issue, offering older workers the option of taking phased retirement will be a key strategy.

At Glatfelter, Mr. Paradiso said that although the company hasn’t implemented any phased retirement benefits, officials are talking about doing something soon. For now, Glatfelter is still benefiting from having its older workers stay put. But it may take several years before maintaining a graying work force on a full-time basis becomes problematic. “That’s when a phased retirement benefit can become a real solution,” Mr. Paradiso said. **CBO**

Jessica Marquez is a reporter with Workforce Management in New York. Contact her at [jmarquez@workforce.com](mailto:jmarquez@workforce.com). Mark Bruno is a reporter with Financial Week in New York. Contact him at [mbruno@financialweek.com](mailto:mbruno@financialweek.com).

## Thought Leader Jill Smart

# Flexible schedules are ‘key’ at Accenture

Jill Smart, chief human resources officer at professional services consultancy Accenture, knows all too well how tough the life of an Accenture road warrior can be. Calling between meetings in Helsinki, Finland, on a Monday afternoon, Ms. Smart described how over the next three days she would be meeting with clients there, going to Munich, Germany, the following day and then stopping in Milan, Italy, for an executive meeting before returning home to Chicago.

That’s a fairly typical schedule for many of Accenture’s 178,000 employees. That’s also why Ms. Smart believes flexible work arrangements—like part-time work and job sharing—are key to keeping Accenture’s people productive and engaged.

**Crain’s Benefits Outlook:** What are some of the more unique flexible work programs that Accenture offers?

**Jill Smart:** We have our Future Leave program, which is an unpaid, self-funded sabbatical program where an employee can take up to three months off work and continue to receive benefits. So if an employee knows that they want to do this, they have Accenture withhold part of their salaries and apply it to an account that they can tap when they are off.

Another program we have is called Hours That Help, where employees can donate vacation time to other employees who are experiencing a personal crisis and need more time off.

**CBO:** Why is offering flexible work arrangements important to Accenture’s bottom line?

**Ms. Smart:** What we sell is the knowledge capital that our people have. So if our people aren’t engaged and productive, then our product won’t be of the quality that it needs to be.

**CBO:** Does Accenture view flexible work arrangements as a benefit?

**Ms. Smart:** We consider flexible work to be part of our employee value proposition. There is benefit with a big “B” and benefit with a little “b,” and we see this falling under the latter. People view this as a perk.

**CBO:** What’s the difference between a benefit and a perk?

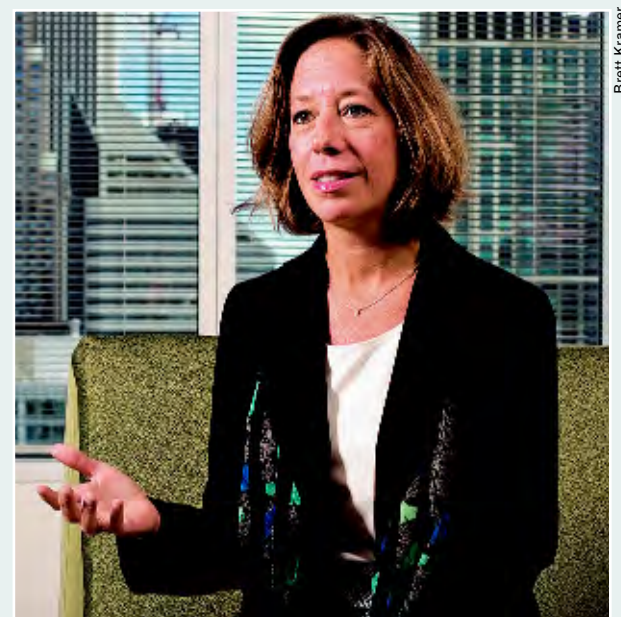
**Ms. Smart:** I think there are certain benefits that people are entitled to, like health care. We offer those benefits to attract the talent we need. With flexible work arrangements, we are going the extra mile to entice them more and to help employees be more productive.

**CBO:** You bring up the interesting issue of entitlement. Many companies are hesitant to offer flexible work because they worry that their employees will feel that they are entitled to it. How does Accenture make sure that doesn’t happen?

**Ms. Smart:** We talk openly with our employees about the fact that if this doesn’t work for our clients, then it doesn’t work for our business. We make it a point to always explain the business reasons why we can or can’t do something. They might not like it, but at least they understand it.

**CBO:** How often do you re-evaluate employees’ flexible work arrangements?

**Ms. Smart:** Most of our programs have a maximum timetable. For example, under our Future Leave program, employees can take up to three months off. If we have someone who is working part time, we re-evaluate that continuously.



Brett Kramer

**CBO:** What are the biggest challenges involved with offering flexible work arrangements?

**Ms. Smart:** One is making sure that we are consistently applying the criteria. We make sure that we are thorough yet simple with how we explain the programs and who is eligible.

Another challenge is making sure that the dialogue about employees’ options is happening. If a new employee comes in and a career counselor tells her about our flexible transition program for moms coming back to work after maternity leave, it might not register with her if she isn’t married and doesn’t have kids. So we need to make sure those conversations are going on also when they are relevant for the employees.

—Jessica Marquez/Workforce Management

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THE OBAMA ADMINISTRATION WILL HAVE A MAJOR INFLUENCE IN SHAPING LEGISLATION ON HEALTH CARE, RETIREMENT PLANS AND FAMILY LEAVE POLICIES.

# Change is coming...to benefits

**COVER STORY** | By Jerry Geisel, Doug Halonen and Mark Schoeff Jr.

WASHINGTON—When Barack Obama assumes the presidency in January, the employee benefits legislative landscape in Washington will change dramatically.

For the first time since the early 1990s, the nation's top elected official will be committed to moving the country close to universal health insurance coverage.

"This will be a president whose vision is one of a move towards universal coverage, with the federal government playing a much larger, though not an exclusive, role," said Frank McArdle, a consultant with Hewitt Associates Inc. in Washington.

The stage also is set for consideration of legislative initiatives that could have a major impact on corporate retirement savings plans. In addition, some say the chances increase significantly that Congress will pass legislation to expand the Family and Medical Leave Act—the first major piece of legislation to clear Congress the last time a Democrat was in the White House.

Also in store could be an expansion of a huge federal/state program that provides health insurance coverage for millions of children in lower-income families, while lawmakers may be looking—as a potential revenue-raiser—at ways to trim a rapidly growing federal program through which millions of Medicare beneficiaries receive coverage from commercial health insurers (*see story on opposite page*).

To be sure, while the legislative landscape may have changed, that by no means guarantees passage of employee benefit-related initiatives backed by the incoming president. Benefit experts haven't forgotten, for example, the lofty and numerous predictions of sweeping health-care reform legislation following the election of Bill Clinton in 1992. What couldn't have been predicted then were a series of political and policy mistakes by Mr. Clinton and then-First Lady Hillary Clinton that effectively killed the chances for reform (*see story, page 10*).

As in 1992, though, health reform is expected to be a major priority of the incoming administration. On the campaign trail, Sen. Obama outlined his vision: a system along the lines of a 2006 Massachusetts law that has moved the Bay State very close to universal health insurance coverage.

Like Massachusetts, Sen. Obama backs a system in which employers—except for smaller firms—would have to offer coverage meeting certain standards or pay a fee that would be used to fund coverage for the uninsured. Lower-income uninsured individuals would have their premiums subsidized by the federal government, with the government contracting with insurers to offer coverage.

While such a program may be Sen. Obama's current broad vision, that isn't to say that he won't be open to change. Unlike the Clintons, who believed they could force their health care reform plan through Congress without support from key legislative leaders, Sen. Obama, who has spent four years in the U.S. Senate, appears far more willing to work with the legislative branch to develop a consensus.

"He understands that health-care reform can't be engineered top-down. It has to be an inclusive process in which the administration



JEWEL SAMAD/AFP/GETTY IMAGES

works with legislators and major stakeholders," said Paul Dennett, senior vp-health reform for the American Benefits Council in Washington.

Although Sen. Obama may be wiser in the ways of Washington than the last Democrat was when he entered the White House, no one is yet banking on enactment of a Massachusetts-type coverage law.

"While there may be interest, there is not a consensus. And as to an employer mandate, the great majority of employers will fight that tooth and nail," said James Gelfand, senior health care policy manager at the U.S. Chamber of Commerce in Washington.

At the same time, some business groups

worry that one of the Bush administration's signature health-care measures—tax-favored health savings accounts linked to high-deductible health insurance plans—face an uncertain future under President-elect Obama.

Many congressional Democrats, especially those in the House of Representatives, are no fans of HSAs, which employers have embraced as a way to provide lower-cost coverage. The House in the last session approved a bill that effectively would have increased the costs associated with administering HSAs.

But the Senate never considered that measure, at least in part due to veto threats by President Bush.

While Sen. Obama has said little about

HSAs, at a minimum he lacks President Bush's enthusiasm for the arrangements. And that could embolden congressional opponents to press for legislation to curb, if not kill, the appeal of HSAs.

"It could be a death by a thousand cuts," said the Chamber's Mr. Gelfand.

Others, though, doubt that legislators, fearful of a public backlash, will want to put HSAs on their reform agenda.

"I don't see them going away. While I don't see anything being done to make them more attractive, I also don't see how Congress would want to antagonize" the 6 million people enrolled in health plans linked to HSAs, said Steve Raetzman, a senior consultant with Watson Wyatt Worldwide in Arlington, Va.

## RETIREMENT PLAN MANDATE

On the retirement side, a key proposal by Sen. Obama would require many employers for the first time ever to offer their workers a retirement plan.

Sen. Obama's retirement plan mandate essentially would require all employers that have been in business for two years, have at least 11 employees and don't already offer a work-sponsored plan to provide an automatic individual retirement account program to their employees.

Employees could opt out of the program. But for employees who opt in, the employer would have to automatically deduct IRA contributions from the employees' paychecks.

Another major Obama retirement proposal would dramatically expand the federal government's existing saver's credit to provide a refundable annual tax credit to families earning less than \$75,000 a year. The refundable tax credit would be for half of the first \$1,000 that the workers contribute to retirement plans each year. Up to \$500 would be automatically contributed to their retirement accounts.

The existing saver's credit, which is not refundable, is limited to families earning at most \$53,000 a year. But, under the program's sliding credit scale, families earning \$53,000 receive a maximum credit of only 10% for the first \$1,000 they contribute to a 401(k) plan or IRA. Families earning less can receive a credit of up to 50% of the first \$1,000 contributed. Because the credit is not refundable, workers at the lowest end of the earnings spectrum who pay no taxes would get no benefit.

Proponents contend that the automatic IRA program would dramatically increase the number of workers covered by retirement plans, because more than half of the estimated 78 million workers currently without work-based retirement plans would be eligible for the new IRAs.

In addition, proponents contend that Sen. Obama's expansion of the saver's credit would dramatically increase the nation's pool of retirement savings.

"Despite the current financial downturn, there's a broad recognition that these two initiatives, by promoting broad-based saving, are the kind of fundamental improvements that should contribute, along with many other measures, to a healthier economy in the long term," said Mark Iwry, a nonresident senior

fellow at the Brookings Institution, a Washington think tank. Mr. Iwry, one of the key architects of the automatic IRA proposal, was an adviser to the Obama campaign.

Nonetheless, prospects for an automatic IRA mandate are at best uncertain, in part because retirement benefits are completely voluntary for employers, and employer groups want to keep it that way.

A mandate "is a very troubling precedent," said Ed Ferrigno, vp-Washington affairs for the Profit Sharing/401k Council of America.

"There will be pushback," added Kathryn Ricard, vp-retirement policy for the ERISA Industry Committee, a Washington-based benefits lobbying group.

Along with fears about the mandatory nature of the proposal, there is also concern that automatic IRAs could spur some employers to drop existing 401(k) plans.

That's because an automatic IRA could be easier to administer and present less regulatory red tape to employers that offer 401(k) plans, particularly to those that provide minimal or no matching contributions.

"There's a potential for a significant crowd-out of existing pensions, particularly 401(k)s," said Mark Warshawsky, director of retirement research at Watson Wyatt Worldwide in Arlington, Va.

Mr. Obama's proposal to revamp the existing saver's credit, meanwhile, is also expected to be resisted by free-market Republicans on Capitol Hill.

"Some people call it a refundable tax credit and other people call it welfare," said Bill Sweetnam, a partner with The Groom Law Group in Washington.

At least two retirement-related proposals promoted by Sen. Obama, however, could become law even before the president-elect officially steps into the Oval Office Jan. 20.

The first would temporarily suspend the required minimum distribution from retirement plans in the year when participants turn 70½. The proposal aims to protect participants from having to withdraw retirement savings in a down market. For those who need to take the distributions, however, the proposal would provide a tax break, Mr. Iwry said.

Sen. Obama's second proposal would suspend the existing 10% tax penalty on plan hardship withdrawals for up to 15% or \$10,000, whichever is less, in 2009.



**Sen. Obama "understands that health-care reform can't be engineered top-down. It has to be an inclusive process."** — Paul Dennett

Both of Mr. Obama's retirement plan proposals have largely been included in a package of legislation that a coalition of employer groups is lobbying for, seeking relief from the new funding requirements of the Pension Protection Act of 2006 at least through next year. The coalition's plan is to include relief from the act's funding requirement in economic stimulus legislation, or any other measure that Congress considers in a lame-duck session.

"This is urgent," an ABC spokesman said. "We're going to pursue every avenue available to get this passed before the end of the year," he added.

#### EXPANDING FMLA

Although President-elect Barack Obama did not give issues in employee leave top billing in his quest for the White House,



**"There's a potential for a significant crowd-out of existing pensions, particularly 401(k)s."**

— Mark Warshawsky

there is little doubt he will pursue them.

He has indicated strong support for expanding the Family and Medical Leave Act to encompass more companies and more reasons for time off—such as parent/teacher conferences. He also backs mandatory paid sick days.

Even if reviving the moribund economy consumes the launch of the Obama administration, leave legislation could gain traction quickly, thanks to increased Democratic majorities in Congress and its limited impact on the federal budget.

"Obama has been thinking in enough detail on these policies," said Vicky Lovell, acting director of research at the Institute for Women's Policy Research in Washington. "There are bills that have been introduced. There's been a lot of outreach in the House and the Senate to educate policymakers."

The bill that could move quickly is the Healthy Families Act, which would require companies with 15 or more employees to provide seven paid sick days annually or a prorated amount for part-time workers. The Senate measure has 24 co-sponsors, including Sen. Obama, while the House version has 106.

Business groups are leery about how the bill would affect employers that provide paid time off. Under PTO systems, which are growing in popularity, an employer does not differentiate between a vacation day and a sick day.

Mike Peterson, director of labor and employment policy at the HR Policy Association in Washington, said the bill would discourage the use of paid time off.

"It would inhibit the flexibility of a company in designing its benefit plans," Mr. Peterson said. "In its present form, the measure has a lot of sharp edges that need to be smoothed out."

How the Healthy Families Act would mesh with established PTO policies is not clear, according to Jocelyn Frye, general counsel at the National Partnership for Women and Families in Washington.

"There's not a clean answer to it," Ms. Frye said. "It will depend on how the employer's programs are constructed."

Business and advocacy groups engaged in tough but successful negotiations in the current Congress over a measure to ensure parity between mental health and other medical conditions and another bill to expand the Americans with Disabilities Act. Both have become law.

A similar process may be followed on paid sick days. But—if the most recent developments at the state level on the issue are a guide—the bill is not a slam dunk, even with Sen. Obama in the White House. Democratic Ohio Gov. Ted Strickland, in the face of fierce business community objections, took off the ballot this fall an initiative that would have required Buckeye State employers to provide paid sick days. He pledged support for a federal measure. **CBO**

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## Medicare Advantage a target for cuts

WASHINGTON—The Obama administration is likely to tackle modest Medicare cuts next year with the help of congressional Democrats while putting off consideration of changes in the Social Security program, experts said.

The twin entitlement programs for older Americans face soaring expenses that could bankrupt the programs in the decades ahead. The first wave of baby boomers reaches normal retirement age in 2011.

One program certain to get the new administration's attention is Medicare Advantage, which provides coverage through private health care insurers rather than directly from the government.

Payments to the private insurance program were 13% higher last year than the per-capita costs of traditional fee-for-service Medicare, according to the independent Medicare Payment Advisory Commission. During the campaign, Sen. Obama targeted this program for possible reductions.

Cuts in Medicare Advantage also could be used to restore scheduled reductions in fees paid to doctors who treat Medicare beneficiaries and expand the State Children's Health Insurance Program. During the last

congressional session, legislators approved bills to expand SCHIP eligibility, but President George W. Bush vetoed those measures. During the campaign, Sen. Obama supported the expansion.

"Medicare is one place you can get some budget savings for other purposes," said American Enterprise Institute fellow Joseph Antos, former deputy chief of staff at the Department of Health and Human Services.

"There's a good chance of it being implemented because even the health insurance companies that might resist cuts in Medicare Advantage can see the handwriting on the wall," he said.

Sen. Obama also has said the federal government should negotiate lower drug prices as well as import lower-cost drugs, which they are restricted from doing under the 2003 law that added a prescription drug benefit—known as Part D—to the Medicare program.

In addition, he has supported closing the "doughnut hole" in Medicare's Part D prescription drug program. That's the gap in coverage after the first \$2,510 of prescription drug costs are incurred and before the

\$5,726 expense mark is reached.

"While the idea of closing the gap is appealing to many, it would be incredibly expensive, and I suspect it would be a pretty tough sell," Mr. Antos said.

Although Sen. Obama hasn't addressed this issue, AARP Policy Director John Rother said the new administration would have to consider how to make treatment of heart disease, cancer and other chronic conditions more efficient. They account for three-quarters of Medicare expenditures, he said.

Medicare, which provides coverage for Americans 65 and over as well as the disabled, faces insolvency by 2019, based on current projections. Medicare spending has nearly doubled over the last seven years to \$431.5 billion in 2007.

Social Security, which is in better shape than Medicare, isn't expected to exhaust its resources until 2041.

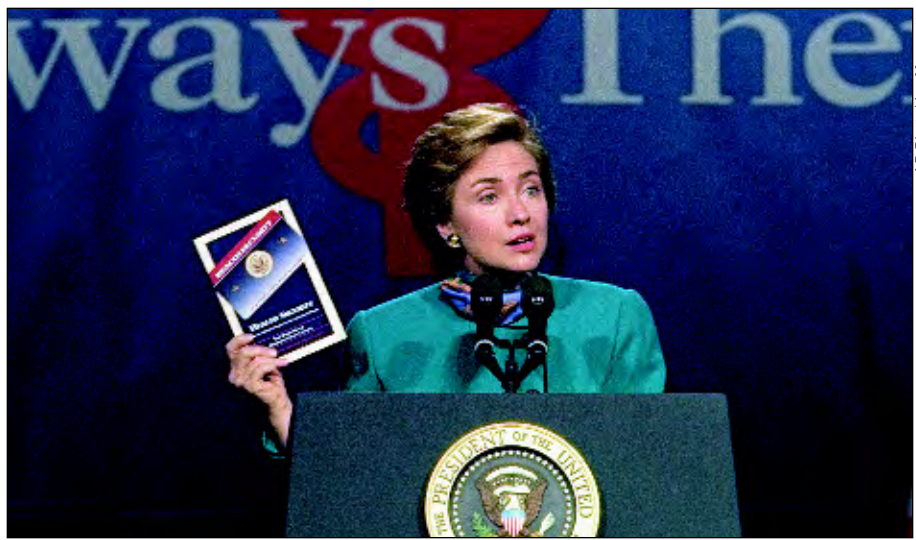
Sen. Obama has called for raising Social Security payroll taxes by 2% to 4% for those making over \$250,000 rather than cutting benefits or privatizing the program. The tax currently applies only to the first \$102,000 of income.



**MEDICARE:** American Enterprise Institute fellow Joseph Antos says Medicare is an area to look at for budget savings.

"This does a little bit to help Social Security but doesn't come close to fixing the whole problem," Andrew Biggs, former deputy commissioner of the Social Security Administration, said. "But there's not a huge amount of public pressure."

—Neil Roland/*Financial Week*



**COMEDY OF ERRORS:** Hillary and Bill Clinton's mistakes doomed reform in 1993.

## Planning major reforms? A guide to what *not* to do

BILL CLINTON'S ELECTION IN 1992 and the crashing failure of his universal health insurance reform package—initially considered a near slam dunk—illustrate that predicting the impact of results of national elections is not a science.

Indeed, back in 1992, the stars seemed aligned for passage of sweeping health-care reform legislation. As a presidential candidate, Mr. Clinton made clear that health-care reform would be a top priority if he was elected. Also significantly aiding the chances was that Democrats controlled both chambers of Congress as well as the key committees through which health-care reform would move.

The Clinton vision was for health care to be provided through government cooperatives, rather than employers and insurers.

Mr. Clinton's first step—naming then-first lady Hillary Rodham Clinton to chair the presidential task force that would develop the reform legislation—initially was considered savvy. Instead, it was a blunder, and the first of many that ultimately would derail the reform drive. While Hillary Clinton undoubtedly had great intellectual ability, unequal access to President Clinton and a real interest in health-care reform, she was lacking in other areas.

Except for a brief stint in Washington during the early 1970s as a staffer on a congressional committee during the Watergate scandal, Hillary Clinton had spent most of her adult life in Arkansas. She lacked contacts or relationships with members of Congress who, in time, would control the fate of reform legislation.

Hillary Clinton also was responsible for the establishment of what became a more than 500-member task force to develop—in great secrecy—the administration's health-care reform package.

That decision was at odds with the way major pieces of legislation typically are developed: A small number of administration staffers produces a broad framework, while Congress, as the legislative branch, and working closely with the executive branch, fills in the pieces. That approach not only follows Congress' role as the legislative branch, but also gives lawmakers ownership in legislative proposals.

Yet another mistake—shared by both Clintons—was the appointment of long-time acquaintance Ira Magaziner to run the health-care task force. Business groups, for example, complained about how the imperious Mr. Magaziner ignored their views, while reporters and congressional staffers said they were kept out of

the loop.

Mistakes continued. Instead of producing a reform outline, the task force published a 1,362-page super-detailed bill, which quickly was derided for its bulk. Meanwhile, legislators, who were kept out of the drafting process, began to develop their own proposals, which quickly splintered the reform drive.

### POLITICAL MISSTEPS

Then, Hillary Clinton made perhaps the biggest mistake of all, violating a basic rule of politics: Either ignore or try to work with opponents.

Instead, she chose to bash health insurers when the industry—provoked by what it said were unfair attacks by the administration—sponsored a series of ads in which a couple, known as “Harry and Louise,” discussed at their kitchen table the problems with the Clinton health-care package.

Enraged, Hillary Clinton lashed out, giving the ad campaign publicity, recalled Bill Gradison, then-president of the Health Insurance Association of America, which sponsored the ads. This was publicity and attention no amount of money could buy.

By coincidence or other factors, whatever support there was for the administration package dried up, and last-ditch efforts to develop alternatives ran aground.

When it became clear as the congressional session was ending in October 1994 that the administration's effort had failed, George Mitchell, then the Senate majority leader and a longtime Maine Democratic senator, blamed “special-interest” lobbying.

But President Clinton, in a sentence, got to the heart of the matter. Maybe, he said, “We bit off more than we could chew.”

Applying that lesson, the administration's involvement in health-care issues in the ensuing years concentrated on more modest objectives. Taking on the issues in smaller bites proved to be much more successful.

Indeed, between 1996 and the end of Mr. Clinton's second term in 2000, federal legislators passed four modest health-care reform measures, including the Health Insurance Portability and Accountability Act, which made it easier for employees to change jobs without fear of losing health insurance and another—expanded at the end of the most recent congressional session—that banned discriminatory annual and lifetime coverage limits for mental health disorders.

—Jerry Geisel/*Business Insurance*

>>>>>>>>> THE PERFECT 401(K) DOESN'T EXIST, OF COURSE. BUT MORE COMPANIES ARE GETTING THERE. SEE HOW SEVERAL COMPANIES ARE HELPING WORKERS PUT THEIR SAVINGS EFFORTS ON THE RIGHT TRACK.

# 401(k), new and improved

**RETIREMENT** | By Ilana Polyak

THE 401(K) TURNED 27 this year, and like any young adult, it went through its bad-boy phase, where guidance was absent, fees were high and solid investment choices were paltry. But over the last few years, more companies have helped the 401(k) and other defined contribution plans grow up by adding wise features like auto enrollment, auto escalation, default options and targeted investment advice.

“The defined benefit plan was totally paternalistic,” said David Wray, president of the Profit Sharing/401k Council of America, Chicago. “And then the initial 401(k) was totally nonpaternalist. What's happening is the defined contribution plan is now swinging in the middle between the two.”

Employees in 401(k)s are still ultimately responsible for their retirement security, of course, but forward-thinking companies are offering their workers more than bare-bones tools to make the most of these programs. They're implementing designs that make it easy for workers to get on the right savings track from the beginning.

### MORE PATERNALISM

Not surprisingly, large companies with defined benefit plans—either open or frozen—tend to be more inclined to sweep their employees into auto enrollment, auto escalation and default investment schemes, which leave very little room to not do the right thing. Other firms are getting the hint, too, and 44% of them now employ auto enrollment, according to Hewitt Associates in Lincolnshire, Ill.

Devon Energy Corp. of Oklahoma City gave employees the option to give up their pension plans and go into a “super 401(k)” this past year. Those who chose to stay in the defined benefit plan could still access the regular 401(k) plan, but employees who opted out would have one of the best offerings

around, with generous employer contribution levels, auto everything and low fees. (To be sure, the aim is to reduce the company's future pension liabilities.)

“Our sense was since we're going to this super 401(k), we're giving the employee flexibility and control over retirement, but we're also giving them responsibility,” said Paul Poley, vice president of human resources. “If we're going to shift some of that risk, we had an obligation to better manage that risk.”

That's the conclusion that executives at AmeriHealth Mercy Family of Companies, which provides managed care to Medicaid programs, came to as well. In addition to the company's cash balance pension program, as of Jan. 1, employees were automatically enrolled in the 401(k) plan. Officials at Philadelphia-based AmeriHealth spent three months educating employees about the importance of retirement saving and how auto enrollment would work—then went ahead and implemented it anyway.

“We really thought it was important for us to take that step,” said Jeanie Hefferman, senior director of human resources benefits, adding that for many employees the cash balance plan wouldn't provide adequate retirement savings. “Our experience tells us that it's not that people don't want to save; they're just apathetic about it. So we figured we'd do it for them.”

There was a 14% increase in participation since the first of the year, Ms. Hefferman reports. One worker even wrote Ms. Hefferman a personal note to say that after working for the company for 13 years and not participating in the 401(k), the automatic enrollment forced her into the program.

### MORE AUTOMATION

Companies vary on how much they should strong-arm employees. A typical approach is to auto enroll workers at the level where they

## Innovator Prudential

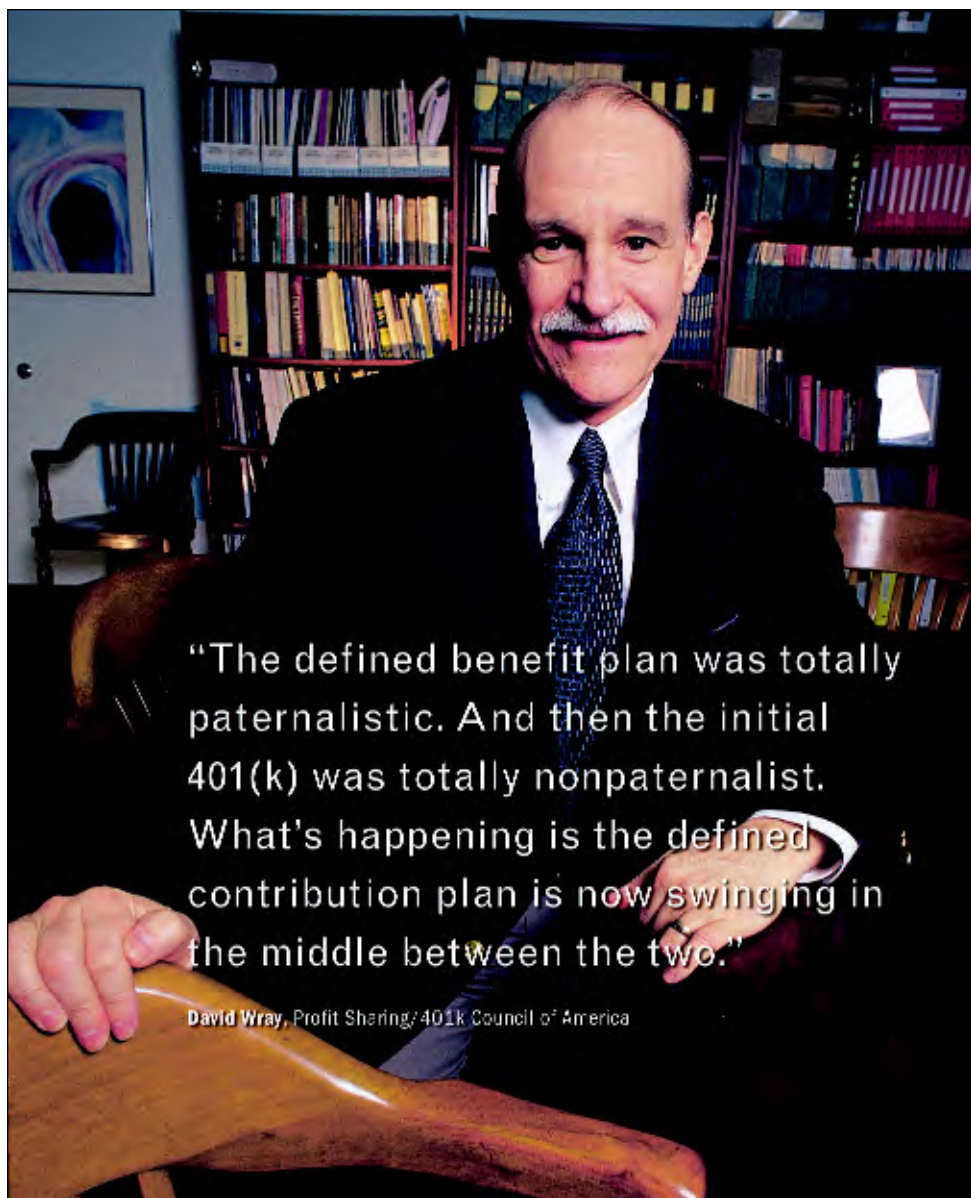
# Cutting-edge programs help Pru deliver best to workers

**P**rudential Financial Inc., Newark, N.J., is helping its 20,000 U.S. employees manage their retirement plans during these volatile economic times.

Combining innovative vehicles to help guarantee retirement income and dynamic communication, the company has been able to successfully manage its \$5.3 billion defined contribution plan.

It has embraced all the latest features, including automatic enrollment and automatic increases in deferrals, according to Sharon Taylor, Prudential Financial executive vice president of human resources.

New participant accounts are invested in a balanced fund as the qualified default investment for diversification. The company also provides a match of 100% of employee



"The defined benefit plan was totally paternalistic. And then the initial 401(k) was totally nonpaternalist. What's happening is the defined contribution plan is now swinging in the middle between the two."

David Wray, Profit Sharing/401k Council of America

are eligible for the full employer match. But some view that move as too intrusive.

"Auto enrollment isn't a slam dunk for every company," said Robyn Credico, national director of Watson Wyatt's defined contribution practice. "It may get good participation rates, but you may lower the overall savings rate."

Barbara Marder, global defined contribution leader with Mercer agrees. "What research has shown," she said, "is that if you just have auto enrollment and you bring people in at 3%, they may never change it."

That's why when Con-Way, the freight transportation company based in San Mateo, Calif., froze its defined benefit plan and beefed up its 401(k) in January this year, company executives wanted to make sure employees were contributing a meaningful percentage. They set the amount at 6%.

"In April 2007, when we told the employees that we were going to auto enroll them, we had an intensive communication campaign that went along with it," said Leslie Lund-

berg, vice president of human resources. Since then, Ms. Lundberg notes, the company has a 97% "stickiness" rate for assets staying put. Employees contribute an average of 7.5% of pay.

When the switch to the new 401(k) plan happened, all employees—not just new hires—were subject to auto enrollment.

The way to get employees up to the right contribution level, said both Ms. Credico and Ms. Marder, might be auto escalation features alongside auto enrollment. But plan sponsors sometimes shy away from telling employees to kick in even more if they've already auto enrolled them.

Not AmeriHealth Mercy. "We time the (yearly) 1% increase on the heels of our merit cycle so people are less likely to opt out," Ms. Hefferman said.

#### MORE CONTRIBUTIONS

It doesn't take an advanced mathematics degree to know that the more money invested for retirement, the more available at re-

contributions up to 4% of pay, with 2% placed in company stock. The plan offers 18 investment options. Ms. Taylor said Pru's approach is proactive, not paternalistic.

"Few employees rebel against or opt out of automatic increase or enrollment," Ms. Taylor said. "We've taken it to the streets in terms of educating our employees on these programs and features, and shown them these are convenience features."

A new program, IncomeFlex, guarantees retirement income for employees 50 and older. "This is a special program, a cutting-edge new offering," she said. "Participants have guaranteed income withdrawal benefits of 4% or 5% of a

locked-in starting withdrawal balance that is theirs to receive for the rest of their life—whether or not their market account depletes itself."

Unlike an annuity, IncomeFlex allows participants to take advantage of equity market upturns and downturns, as participants can choose at their birthday each year the highest of either current market value of investments, highest birthday value or the guaranteed income of 5% per year as the income base.

"Over time of participation, we track account balances on their birthday, market values and guaranteed appreciation of the account. So at the point in time the person is ready to lock in and draw bene-

fits, the person will receive the highest of any of those three amounts. This protects the employees against longevity risk."

As an additional feature and at additional cost, the employee at withdrawal can elect to have his spouse continue to receive guaranteed income should the spouse outlive the employee. The program is still being rolled out to participants. So far, 300 have enrolled.

—John D'Antona Jr./  
Pensions & Investments

more online  
Hear Sharon Taylor discuss Prudential's programs.  
Go to [crainsbenefits.com/taylor](http://crainsbenefits.com/taylor)



PROACTIVE: Prudential's Sharon Taylor.

tirement. Yet not all companies are able to offer significant amounts.

The best contribution rates mimic those of traditional retirement plans.

At IBM Corp., Armonk, N.Y., there is a three-tier contribution system. For employees close to retirement, the firm matches 100% up to 6% of pay plus 4% automatically, totaling 10%. For midcareer employees, the automatic contribution is 2% and new-to-IBM workers get 1%.

Con-Way also bases contributions on service: Employees with less than 10 years' service get 3% of pay, those with 10 to 20 years receive 4% and those with 20 or more get 5% on top of the 50% match on the first 3%.

Devon Energy has one of the most generous contribution levels. On top of the 100% match for the first 3%, Devon throws 8% into the super 401(k) to encourage employees to leave the pension plan.

#### MORE TARGET-DATE FUNDS

Since the Pension Protection Act of 2006 designated target-date and lifecycle funds as qualified default investment alternatives, or QDIAs, money has been pouring into these vehicles. Target-date funds hold some \$200 billion today, up from \$103 billion in 2004, according to the Investment Company Institute.

"A lot of (employer) investment committees want younger people taking on more risk and older people taking on less risk," said Steve Utkus, director of Vanguard's Center for Retirement Research, Malvern, Pa.

Before the PPA gave the nod to target-date funds, most companies defaulted employees into money-market and stable value funds, which aren't considered aggressive enough for most workers.

"The retirement-date funds are geared toward the person who doesn't want to mess around with making investment choices," said Ms. Lundberg of Con-Way.

She estimates about 90% of new 401(k) money at Con-Way goes into target-date funds from T. Rowe Price Associates Inc., Baltimore. About a third of Con-Way's \$1 billion in 401(k) assets is in such offerings.

Even with target-date funds, there's a good deal of tinkering from companies.

"The big trend is customized target-date funds," said Ms. Credico of Watson Wyatt, though she notes it's mainly plans of \$500 million or more that can afford to do so.

Customized funds can take into account the characteristics of plan participants. If the employer also has a pension plan, employees might be able to take on more equity risk in their 401(k) investments because of the pension's fixed-income investments.

#### MORE ATTENTION TO FEES

If companies weren't concerned about keeping fees low, they certainly are taking up the cause now that regulators have trained

their focus on the issue. In August, the Department of Labor issued a new proposal on fee disclosure in 401(k) plans.

And several high-profile lawsuits alleging needlessly high fees are in the courts, including suits fronted by Wal-Mart Stores Inc. and The Boeing Co. employees.

Corporate executives are taking note. "Companies are benchmarking their fees to understand what they're paying and where they are vs. the market," Watson Wyatt's Ms. Credico said. "Then if they're paying over the market rate, they're revisiting the fund lineup first to see if there are less expensive options."

To be sure, large companies, those with more than \$500 million in their plans, are in a better position to negotiate with vendors because they bring such volume to the table.

"But small companies that don't have economies of scale have to use expensive arrangements," Mr. Wray of the Profit Sharing Council said, adding that it's unusual to see a firm with less than \$500,000 in plan assets run a plan for less than 0.30%, though 2% is fairly common as well.

IBM, often called the gold standard of 401(k) plans, charges employees an average of 0.10% in fees for their investment options.

ExxonMobil, in Irving, Texas, goes even further. Fees on its 401(k) plan are only 0.01% for investments from Northern Trust. The firm picks up the administration fees, said a company spokesman.

#### MORE ADVICE

For years, companies shied away from anything that bordered on individual advice. Now, some 49% of companies provide advice, according to the Profit Sharing Council.

The advice runs the gamut from online programs such as those offered by Financial Engines to managed accounts to face-to-face sit-downs with investment counselors.

"Small companies tend to go for one-on-one advice," Mr. Wray said. "Larger firms typically use some kind of online or telephone method."

Why? Mr. Wray said large companies often have workers in several locations. They want to make sure advice is consistent.

And it is expensive. It can add up to one percentage point to overall plan expenses.

At Demco Inc., a Madison, Wis.-based maker of library and educational furniture and supplies with 400 employees, advice takes the form of one-on-one sessions. The company works with Michael Francis, a financial planner in Madison, who makes a presentation about retirement investing to workers. Then employees are encouraged to sign up for individual sessions.

Advice adds 0.05% to 0.15% to a plan's overall costs, he said. Employees aren't forced to use it, but they pay for it anyway. **CBO**

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# Miracle cure or poison pill?

**HEALTH CARE** | By Joanne Wojcik

CONSUMER-DRIVEN HEALTH PLANS, typically a combination of high-deductible medical insurance coupled with a health savings account, are capturing employers' attention as a way to curb runaway benefit costs.

The idea has been embraced by many health economists and benefit consultants, who see such consumerism as a solution to the nation's health-care cost crisis. They attribute the crisis largely to overutilization by benefit plan members exercising little or no discretion in health-care purchasing decisions.

But critics contend CDHPs encourage members to forgo essential medical care, including preventive screenings and maintenance medication for chronic conditions. They also charge that, because the plans put the onus on members to pay for health-care services, they discriminate against less healthy and lower-paid workers.

As a result of this early tension, initial enrollment in CDHPs lagged that of managed care plans—considered the last “silver bullet” to cure the nation's enduring health-care malaise—when they were introduced. Enrollment in the first HMOs totaled about 3 million after the first year, compared with 1.5 million enrolled in CDHPs as many as four years after their launch.

“The market penetration, considering how long they've been in the market, is not as high as it was projected to be,” said Sara Collins, assistant vice president at the New York-based Commonwealth Fund, which has been studying CDHPs in conjunction with the

Washington-based Employee Benefits Research Institute.

But that changed in 2008, when word of the some early plans' success at holding down costs started to spread among the employer community. Not only do CDHPs cost employers 20% less than other health plans, but also the year-to-year rate of increase in those costs is lower, averaging just 3.5% compared with 6.1% for other plans, according to the 2007 National Survey of Employer-Sponsored Benefit Plans by Mercer LLC.

## BUILDING POPULARITY

In the early days of CDHPs, the consumer-driven approach usually linked a health reimbursement account, or HRA, to a high-deductible plan.

Under current tax laws, HRAs can be funded solely by an employer on a pay-as-you-go basis. In some cases, employers allowed members to roll over unspent funds in the HRAs at year-end, but the HRA was the property of the employer and not portable.

Passage of the Medicare Prescription Drug Improvement and Modernization Act of 2003 created another funding option for these newfangled CDHPs: health savings accounts. The advantage of the HSA over the HRA was that it could be funded with pretax contributions from both the employer and the employee.

It was thought that because employees' own money was at risk, employees would be more stingy about how they used the funds in

their HSAs. And because HSAs were the property of the employees, they could take the money with them when they changed jobs or retired. Money remaining in the HSA also could be used to pay post-retirement insurance premiums. Employees also could invest HSA account balances much like they do their 401(k) retirement plan assets.

Another development also helped to boost the appeal of CDHPs: To keep health benefit premium increases at bay, many employers had been raising deductibles on preferred provider organization plans, almost to the point where CDHPs were beginning to look like an attractive alternative. Why enroll in a PPO with a \$1,000 deductible and higher premiums when you could enroll in a CDHP with a \$1,100 deductible, lower premiums and perhaps a \$500 contribution from your employer to help offset the deductible?

Today, 5.5 million people are enrolled in consumer-driven plans, 3.2 million of whom have HSAs, according to the Kaiser Family Foundation/Health Research & Educational Trust survey released in September. Although PPOs continue to dominate the employer market, covering 58% of covered workers, the percentage enrolled in CDHPs had surged to 8% in 2008 from 5% in 2007 and 4% in 2006, the survey found. Some 20% of U.S. workers are enrolled in health maintenance organizations, 12% in point-of-service plans and 2% in traditional indemnity plans.

While the survey reported that growth was strongest among small businesses—those with fewer than 200 workers—where 13% are now enrolled in this type of plan, up from 8% in 2007, today more than half of large

employers offer CDHPs as an option, according to Tom Billet, a senior consultant with Watson Wyatt Worldwide in Stamford, Conn.

“They're going to get a share of the market, and that share will continue to grow,” he predicts.

Mercer projects that 19% of employers with 10 or more employees will offer HSA-eligible CDHPs in 2009.

“Now that the concept has been validated, more employers are taking a look at CDHPs,” said Jay Savan, a principal with consultant Towers Perrin in St. Louis. “They see HSAs as a way to reduce overhead while not reducing benefits.”

To encourage more employees to enroll in these lower-cost plans, some employers are offering generous financial incentives that significantly shrink those high deductibles that were the hallmark of the early CDHPs.

At Towson, Md.-based Black & Decker Corp., for example, employees who enroll their families receive \$1,000 from the company to reduce the \$3,000 deductible to \$2,000. Then, the difference in the employee premium contribution lowers the deductible amount by another \$1,744, bringing it to just \$256—less than half the \$650 family deductible for the company's PPO plan.

Employers are able to offer such generous incentives because premiums for CDHPs are significantly less than for other types of plans. On average, employers pay a total of \$8,291 annually toward the cost of family coverage for a consumer-driven health plan with an HSA, including a \$1,522 contribution to the account, according to the research from KFF/HRET. In comparison, employers on av-

## Innovator PepsiCo

# The Pepsi challenge: Sustaining employee participation in wellness

**P**epsiCo Inc. might be better known as a global purveyor of soda and chips, but it's quickly shaping up as a model for corporate wellness as well.

Since rolling out “HealthRoads” in September 2004, the Purchase, N.Y.-based food-and-beverage giant has made impressive strides in employee health improvement and health-care cost control:

- More than 60% of the company's 82,000 benefits-eligible employees and spouses in the United States have taken a personal health assessment, and 60% of these reduced or eliminated at least one health risk, Pepsi officials said. In all, the company has reduced or eliminated more than 46,000 health risks.

- In 2007, Pepsi introduced a new smoking-cessation program tied to a \$600 health benefits surcharge on self-proclaimed smokers who don't take part. Participation spiked tenfold, and the quit rate rose from 20% to 34%.

- Since 2004, the annual rate of increase in Pepsi's health-care costs has dropped four percentage points. Health-care costs are rising at a rate below the national trend—in the low single digits. Although wellness is just one plank in Pepsi's overall strategy for managing these costs, executives say it

is making a difference.

“We're seeing ... our employees much more engaged in terms of physical fitness and understanding nutrition, so there's actually a cultural shift from a health perspective,” said Maria Sharpe, Pepsi's senior vice president for compensation and benefits.

HealthRoads also garnered support from senior management, which recognized the program as a concrete way to demonstrate Pepsi's commitment to “cherish” its employees, said Greg Heaslip, Pepsi's vice president of benefits.

LuAnn Heinen, vice president and director of the National Business Group on Health's Institute on the Costs and Health Effects of Obesity, Minneapolis, said Pepsi's program is impressive in its design and incentives, as well as how it has been communicated.

“What makes all of these programs succeed is when they figure out how to put something together that speaks to their population and whatever subgroups there are, so it seems to me that (Pepsi) had really thought that through,” she said.

Pepsi's wellness guide runs 30 pages and is chock full of opportunities and financial incentives for employees to man-

## HEALTHROADS HIGHLIGHTS

Program	Incentive
Personal health assessment	Earn up to \$100 in rewards
Wellness coaching (Six- or 12-month programs)	Earn up to \$100 in rewards
Healthy pregnancy	Receive a \$50 savings bond for baby and qualify to participate in a \$1,500 raffle
Weight management	Earn up to \$25 in rewards
Exercise	Earn up to \$25 in rewards
Healthy eating	Earn up to \$25 in rewards
Stress management	Earn up to \$25 in rewards
Smoking cessation	Avoid \$600 surcharge for smoking and earn up to \$100 in rewards for successful program completion
Annual maximum: \$250 in rewards per employee and \$500 per family	

age and improve their health, including fitness, nutrition and stress management programs, and access to a wellness coach. An individual can earn up to \$250 a year in rewards, an amount that doubles if both the employee and their spouse or partner participate.

Pepsi is working with an outside expert to calculate the program's return on investment, Mr. Heaslip said. He expects that work to yield a methodology that other companies may use to determine ROI for their programs.

Sustaining momentum over time remains the greatest challenge, and Pepsi has responded by constantly reviewing and revamping its offerings and incentives. Initially, employees earned \$50 for taking a personal health assessment. That amount was later doubled to draw more interest.

“I think that's one of the keys,” Ms. Sharpe said. “You can't just introduce it and expect participation to remain steady. We retool it on an ongoing basis and reinvent it all the time.”

The company also is seeking to bolster grass-roots support for HealthRoads. It will assist wellness committees at various Pepsi work sites in developing local programming such as a health fair or walkathon.

“Those are the kinds of things that start to create a culture of wellness in the locations where our people work that will ultimately sustain this program going forward,” Mr. Heaslip said.

—Karen Pallarito/Business Insurance



**REINVENT:** PepsiCo's Maria Sharpe

# Employers use incentives to push CDHPs

EMPLOYERS ARE TRYING to lure more employees into consumer-driven health plans by baiting them with lower premium cost sharing and greater contributions to their health savings accounts.

In some cases, the lower employee premium contributions coupled with the larger HSA contributions ensure that employees who enroll in CDHPs will pay less out of pocket than if they enroll in a traditional preferred provider organization plan.

And because the premiums employers pay for consumer-driven health plans are lower, too, it's a win-win for all concerned, health benefits experts say.

"We're pushing it heavily," said Raymond Brusca, vice president of benefits at Black & Decker Corp. in Towson, Md., referring to the company's high-deductible CDHP, which it introduced this year.

Although deductibles are

\$1,500 for single employees and \$3,000 for couples and families, Black & Decker's contribution to the health savings account lowers those deductibles to \$1,000 and \$2,000, respectively. The lower payroll contribution required by employees for the consumer-driven health plan reduces the out-of-pocket expense even further. Since single coverage costs Black & Decker \$611 less per year than PPO coverage, their deductible essentially falls to just \$389, which is slightly higher than the \$325 annual PPO deductible.

The outcome is more attractive for families. Because their annual premium contributions for the CDHP are \$1,744 less than for the PPO, deductibles for couples and families that enroll in the consumer-driven health plan fall to just \$256, far less than the \$650 their PPO deductible would be.

Black & Decker is currently undergoing open enrollment, so it won't know until next month whether the incentives worked. But for employees who do the math, "it's a no-brainer," said Mr. Brusca, who is hoping to boost Black & Decker's CDHP enrollment to 25% in 2009 from 4% this year.

Although Black & Decker hasn't yet seen its savings figures for last year, which was the first year it offered its consumer-driven health plan, Mr. Brusca is confident they will be significant.

"Hopefully costs will be lower because of behavioral change and not due to adverse selection (younger, healthier workers opting for CDHPs). We're going to find that out this year," he said.

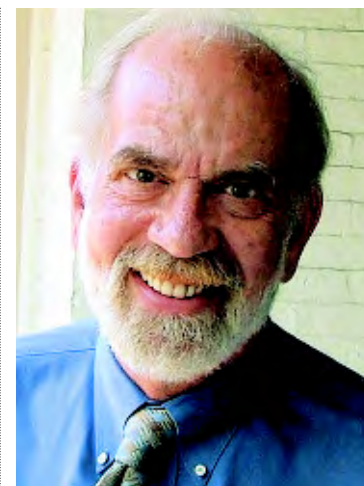
Greg Scandlen, director of Consumers for Health Care Choices, a Hagerstown, Md.-based organization that merged in April with the Heartland Institute in Chicago,

believes that increasing enrollment in CDHPs is helping to curb medical inflation nationwide. He pointed to this year's Kaiser Family Foundation/Health Research and Educational Trust report as evidence of that.

The study, which was released in September 2008, found that employer health care costs rose 5% from 2007 to 2008, compared with 6.1% in 2007 and 7.7% in 2006. At the same time, enrollment in consumer-driven health plans grew to 13% in 2008, up from 10% in 2007 and 7% in 2006.

"One of the contributing factors of these trends has got to be the rise of consumer-driven health care," Mr. Scandlen asserted. "The premium advantage of a consumer-driven plan is dramatic."

Indeed, while the KFF/HRET study found that total PPO premiums—including both employer and employee contributions—av-



**INFLATION FIGHTER:** Greg Scandlen says CDHPs have helped keep medical costs down across the nation.

eraged \$4,802 for individuals and \$12,937 for families last year, the total average cost of CDHPs was just \$3,527 for individuals and \$9,101 for families.

—Joanne Wojcik/  
Business Insurance

erage contribute \$9,495 toward the cost of family coverage in non-CDHPs.

Because CDHPs cost about 20% less than PPOs on average, employers save more as enrollment rises, said Beth Umland, director of research at Mercer in New York.

CDHP advocates are hoping that as current economic conditions strain employees' personal budgets, more might consider these health plans as a viable option.

## SKIPPING PREVENTION

But some CDHP critics have raised concerns that members of consumer-driven plans might cut back on preventive care and other essential medical services such as maintenance medications used to manage chronic conditions.

A November 2006 study by the Kaiser Family Foundation found that CDHP members were less likely (73% vs. 85%) than their non-CDHP counterparts to have received any health-care services since enrolling in their current plan. They also are less likely (63% vs. 74%) to have had a medical checkup.

A survey by Watson Wyatt Worldwide found that, in many cases, plan members were waiting to see a doctor until they developed two or more health conditions.

A study conducted by researchers at the University of Oregon that was published in the July/August 2008 issue of *Health Affairs* examining patterns in prescription drug use among CDHP members found that individuals in CDHPs were much more likely than those with other coverage to discontinue use of anti-hypertensives, which lower blood pressure, and statins, which lower cholesterol.

"Patients still don't know how to decide what's a high-value treatment," said Meredith Rosenthal, associate professor of health economics and policy at Harvard University in Cambridge, Mass., who has been studying medical care utilization by CDHP members.

Because of CDHP's high deductibles, plan members "have the same incentive to cut back on high-value care as they do on low-value care," she said. "So you will see lower utilization in CDHPs. Whether that's an improvement is a little unclear, because it seems that they cut back on important things like medication for hypertension."

To counteract this unintended consequence, employers and health plans are enhancing benefit communications to remind plan members of the importance of seeking



"The market penetration, considering how long they've been in the market, is not as high as it was projected to be."

—Sara Collins,  
Commonwealth Fund



"Patients still don't know how to decide what's a high-value treatment. . . . They cut back on important things like medication for hypertension."

—Meredith Rosenthal,  
Harvard University



"CDHP members are not going to great lengths to find great deals. They're using the network just like the PPO members."

—Elizabeth Dudek,  
Thomson Reuters

preventive care. Some 62% now cover all of a defined set of preventive services, up sharply from 45% in 2006, according to Mercer's Ms. Umland. Another 16% cover preventive services at 100% up to a defined dollar limit per year. Only 15% treat preventive care the same as any other covered expense, she found.

So far, the stepped-up communications, coupled with financial incentives, appear to be working. At CIGNA Corp., for example, members of its CDHP were 2% more likely to seek preventive care services in their first year of enrollment, but 12% to 16% were more likely to seek the services in their second year, according to Meg Woolley, director of Choice Fund product management based in Bloomfield, Conn.

CDHP critics contend another reason the plans cost less is because they attract mostly the healthy and wealthy, an assertion supported by the Commonwealth/EBRI research. Adults in CDHPs are less likely to have chronic health conditions or to smoke,

and are more likely to exercise than are people in more comprehensive plans.

And, a Government Accountability Office report from May 2008 found that taxpayers with HSAs had average adjusted gross incomes of \$139,000 in 2005, compared with just \$57,000 for those enrolled in other types of health plans. The EBRI/Commonwealth Fund study found a similar trend: In 2007, 31% of adults in CDHPs had incomes of \$100,000 or more, up from 22% in 2005; just 19% of adults in CDHPs were in households with incomes under \$50,000, down from 33% in 2005. But Minnetonka, Minn.-based UnitedHealth Group is finding that these plans are not the exclusive domain of high wage earners, according to Meredith Baratz, vice president of market solutions for UHC's CDH portfolio. She said an analysis of more than 200,000 of UHC's 1.4 million members enrolled in HSA-eligible health plans during 2006—the last period for which a full year of data was available—showed that enrollment

rates were highest among lower-income individuals, defined as those earning less than \$25,000 per year. Those individuals represent 64% of UHC's book of CDHP business.

And even if the plan members do have lower health risk scores than members of other health plans, that doesn't necessarily mean they'll use fewer health-care services, according to Elizabeth Dudek, vice president of practice leadership at Thomson Reuters in Ann Arbor, Mich. Her research of CDHPs has shown that while statistically the plans may attract healthier workers, once they are enrolled, they use more medical services than would be expected of that population.

"Our data on 260,000 CDHP members shows their risk score is 80, which means, you would expect them to have costs equal to 80% of the costs for the overall average of the population," Ms. Dudek explained.

But when the medical and prescription drug utilization of the group is measured against the norm, it's at 109%, not 80%, she said. In addition, actual costs average \$3,157 per CDHP plan member, about 10% higher than projected average per-member costs for that population of \$2,884.

In addition, the amount CDHP members spend on individual services is about the same as for PPO plan members, she said.

"That tells me that the CDHP members are not going to great lengths to find great deals. They're using the network just like the PPO members," Ms. Dudek said.

The only area where CDHP members showed lower utilization was in inpatient services, she said, "but they're still higher than their risk suggests they should be."

But even if CDHPs initially attract healthier workers, that doesn't mean they always will. A report by Seattle-based Milliman Inc. reminds that "CDHPs are not the first health-care option whose early adopters are healthier. . . . This trend is consistent with historical models of change in health-care options, in particular HMOs and managed care."

And just as has happened with enrollment in managed care plans, "with time and further enrollment growth, some of the favorable risk difference between CDHPs and other plans may diminish," Milliman's April 2008 Consumer-driven Impact Study predicts. **CBO**

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>>>>>>>>>> MORE AND MORE MULTINATIONAL COMPANIES ARE TRYING TO CENTRALIZE THEIR HEALTH AND RETIREMENT BENEFITS TO SAVE MONEY AND MANAGE RISK BETTER.

# In search of equilibrium

GLOBAL BENEFITS | By Ed Fraenheim and Thao Hua



Erik Unger

## Thought Leader John W. Rogers Jr. Stay focused on markets, but remember to keep calm

John W. Rogers Jr., chairman and chief executive officer of Ariel Capital Management LLC, Chicago, worked as a vendor during high school and college at Wrigley Field, home of the Chicago Cubs baseball team, and Comiskey Park, home of the rival Chicago White Sox. Hawking Cokes and hot dogs in the stands during games, his appreciation of the value of money was shaped from those who had earned it—the fans. A graduate of Princeton University, Mr. Rogers founded Ariel in 1983 and developed its fundamental value equity investment style. The firm has become a household name among institutional investors, and has \$11 billion under management. Mr. Rogers spoke about how he thinks investors should behave during times of market crisis and what he believes the future holds for stocks.

**Crain's Benefits Outlook:** What advice do you give corporate executives with retirement plans now?

**John. Rogers:** I tell the CEO, CFO, the person who oversees the plan to make sure you have a (chief investment officer) who really is laser-focused on the markets, someone who has passion for the markets, and someone who has a gift of picking portfolio managers, because that is a really hard thing to do. ... So you want to make sure you've got that in your leadership overseeing your pension plan. I tell people if you are not sure you've got someone like that, then I think maybe you should think about outsourcing it.

**CBO:** What should plans with some sophistication do now in regard to their strategic investment policy and asset allocation?

**Mr. Rogers:** I think it's critically important in times of most turmoil and most dramatic shifts for pension fund executives to stay calm while everyone else is crazed and unnerved. It's important to not make big dramatic moves during the midst of this type of historic, once-in-a-lifetime panic that's out there in the market. The amount of fear out there is extraordinary. So it is ... critical ... to not make any dramatic shifts or changes while everyone around you is getting unnerved.

**CBO:** So pension funds should stay the course?

**Mr. Rogers:** I do think if anything at this

time, it is probably a time to make sure you are being true to your asset allocation vision. You want to stay the course. By staying the course, it also means if all of a sudden you are underallocated in domestic equities because of the (market) decline, having the courage and conviction to be buying while everyone else is selling. I think it is really important and fits in nicely with what Warren Buffett said ... reminding (investors) to be aggressive when everybody else is nervous. It is a powerful point he made. It's good to remind yourself of that during a period like this.

**CBO:** You feel strongly a fund should rebalance?

**Mr. Rogers:** Exactly. It's the most uncomfortable thing to do. It's the right thing to do. You have to be able to take advantage of the bargain prices, the cheapness of (equities) as you rebalance.

**CBO:** Don't change your strategic plan?

**Mr. Rogers:** Yes, that's what I want to make clear. By staying the course, that means you should be rebalancing with discipline and consistency. Don't sit on your hands waiting for the dust to settle. You will miss the opportunity. That's why you have that strategic plan to have that asset allocation in place so when the headlines do get crazy and are screaming and fear is out there, you have your plan ... and are able to execute around it while other people are out there flailing around not knowing what do. But if you have that direction, stick with it. You will be really happy you did two, three years from now.

**CBO:** What do you see in the market going forward?

**Mr. Rogers:** It will take awhile (to rebound). I don't think it will be an instant snapback. But I do think ... this is the cheapest I've seen the stock market in the last 25 years, and I really believe when you can take advantage of these bargain prices you are going to have a nice recovery from here. And so I wouldn't be surprised (to see) the market bounce back 10% to 15% and then slowly but surely build a base as the economy recovers. As always, the market will come back and recover well before the economy actually does.

—Barry B. Burr/Pensions & Investments

STANDARDIZING EMPLOYMENT BENEFITS globally may be a good idea, but it can be tricky.

Just ask Dena Regan, senior manager of global benefits at communications technology company JDS Uniphase Corp.

A couple years ago, Ms. Regan's team noticed that the firm's French operations provided differing levels of benefits to employees. But Ms. Regan's group ran into resistance when it sought to consolidate five medical plans.

Eventually, JDS Uniphase, with headquarters in Milpitas, Calif., coordinated the plans last year, making benefits to all French employees consistent. But it took the government to move things along. Ms. Regan said French officials required that the plans be harmonized when the firm consolidated different legal entities for tax purposes.

"This helped open the door with our French colleagues," Ms. Regan said, "where we were perceived as helpful instead of intrusive."

Multinational employers these days are pushing to standardize employment benefits around the globe. A more centralized approach to health, welfare and retirement benefits can help ensure that firms comply with regulations. Companies also are keen to align benefits with overall corporate goals. Risk management and cost cutting also play a role, especially in retirement and health benefits.

But global standardization of employment benefits has its limits, including cultural and legal roadblocks. And in the future, employers may have to offer more personalized fringe benefits to employees wherever they are.

"A one-size-fits-all set of benefits isn't going to work," said Gareth Williams, partner with consulting firm Mercer in Chicago.

### IMPORTANCE EMERGING

Employment benefits continue to be a major part of compensation around the world, and are growing in importance. Some



David Toerge

**CONSOLIDATING PLANS:** Dena Regan got some help from the French government.

emerging economies are revising their tax codes to make employer-provided benefits attractive, in part because public retirement systems face insolvency, said Robert Wesselkamper, practice director of international consulting at advisory firm Watson Wyatt Worldwide, Washington.

And employees around the world are calling for employer-provided health insurance that provides better services than the government-sponsored plans present in many nations.

"Supplemental medical benefits are fast becoming the most-valued supplemental employment benefit provided in the world," Mr. Wesselkamper said.

As benefits expand, companies are seeking to design and standardize them globally. "The trend is much more of a centralized approach" compared with five or 10 years ago, said Mauro Canori, a divisional human resources leader at pharmaceutical firm Merck

## Some turn to outsourcers to run the benefits show

WHEN IT COMES to the technology to manage global benefits programs, outsourcing is in.

Companies can buy software to administer employment benefits in various countries from vendors such as Oracle and SAP. But experts say global companies are turning to benefits consultants such as Mercer LLC and Hewitt Associates Inc. to manage health and retirement benefits, including the technology behind those programs. Benefit rules around the world are complex and change frequently, and companies pre-

fer to avoid all of the employee calls and questions about benefits programs, said Jason Averbook, chief executive officer of HR technology consulting firm Knowledge Infusion in Minneapolis.

"The trend is to outsource benefits," Mr. Averbook said.

Benefits outsourcers act as intermediaries between companies and service providers such as health insurance companies and investment firms. Whether or not a company uses a benefits outsourcer, delivering benefits to employees typically requires a soft-

# Shift away from defined benefit gains momentum

DETERMINED TO REDUCE their retirement benefits risk, global employers continue to move away from defined benefit plans.

The need by multinational companies to better manage pension risk internationally is partly driven by government regulations, including those in the U.S., which require firms to follow stricter standards when accounting for pension assets and liabilities on the financial statements.

In addition, business competitiveness is increasingly tied to the risks associated with a defined benefit plan, according to consultants.

The degree to which employers offer these traditional plans varies around the globe. But even in nations where most pension assets are in defined benefit plans, companies are pushing to at least introduce hybrids that combine elements of defined benefit and defined contribution programs.

Take the Netherlands, in which more than 90% of all pension assets are still DB. Because of strong social pressure from unions and others, a hybrid approach known as a collective DC plan tends to be the preferred route of many companies there. Collective DC plans vary, but they generally allow companies to negotiate a fixed amount of contributions annually.

As a result, employees accept more associated investment risks. For example, if funding levels of the pension plan falls below a certain level because of market movements, employees may see their benefits reduced. Akzo Nobel NV, Amsterdam, and Royal DSM NV, Heerlen, were among the first to implement such programs in 2005 and 2006, respectively, and others have moved in this direction.

"We have already seen the evolution from final-salary (DB) plans to career-average (DB) plans," said Jaap



**DB SHIFT:** Career-average plans are becoming the norm, Jaap Maassen says.

Maassen, vice chairman of the European Federation for Retirement Provision, Brussels. In addition, most of the career-average plans now have some form of conditional indexation, which are measures to link pension payments to inflation. "I don't know of any company that offers unconditional indexation any more," Mr. Maassen added.

Moved by similar cost pressures, coupled with international accounting trends, U.K. companies have been further ahead in the conversion toward defined contribution plans.

Some companies are taking more dramatic steps to move beyond traditional pension plans. They are paying insurance com-

panies to assume partial or complete liability for their DB plans.

From Jan. 1 to Sept. 10, about £5 billion (\$9 billion) in pension liabilities were transferred to insurance companies from corporate sponsors in the U.K., according to data from Mercer LLC. That's nearly double the approximately £2.8 billion (\$5.04 billion) in pension liabilities transferred in all of 2007.

"The buyout market is very confined to the U.K.," said Kevin McLaughlin, a London-based principal in the financial strategy group at Mercer. "A lot of drivers are specific to the U.K., particularly around longevity developments. Most (U.K. DB) plans are closed to new entrants. Over time, they are confronted with legacy pension and compensation issues. Then you have big changes in the regulatory environment."

Some trends in the pensions industry tend to follow developments in the general global benefits sector. A stronger focus on corporate governance is among them, said Christopher Mayo, senior consultant at Watson Wyatt Worldwide in London. The introduction of more flexible packages that combine pension with other benefits such as health care and holidays is becoming more common globally. Portability, both within and across nations, is another key feature.

"As much as possible, multinational companies are looking to achieve some degree of consistency on an international scale," Mr. Mayo said.

Such efforts are as pertinent in the pension industry as in other benefit areas. International Business Machines Corp., based in Armonk, N.Y., froze all its defined benefit plans in the U.S. as of Jan. 1, 2008, and moved employees into a beefed-up defined contribution plan. Overseas, where legal and social pressures discourage company officials to make similar moves, IBM executives have severely modified defined benefit plans. In the U.K., for example, IBM officials have reduced by about half the rate of growth in pensionable earnings while at the same time offering more incentives for employees to switch to hybrid plans.

Hybrid plans vary widely. In general, however, they have lower guarantees and shift more investment risk to employees. IBM officials declined to comment for this article, according to spokesman Chris Steel.

—*Thao Hua/Pensions & Investments*

& Co. Inc., Whitehouse Station, N.J., and executive committee member of the Brookfield, Wis.-based International Foundation of Employee Benefit Plans education group.

Nearly 50% of organizations have a centralized approach to global benefits management, according to a study published last year by the research group. Just 13% have a decentralized structure, and 38% use a hybrid method. What's more, 38% of organizations expect to become more centralized in their global benefits management, but the remaining 62% anticipate no change in structure.

Larger employers want "greater transparency," said Chris Burns, head of the global employee benefits practice at insurance broker Willis Group Holdings Ltd., New York. One reason, Mr. Burns said, is compliance. The Sarbanes-Oxley Act in the United States, for example, has pushed companies to have a tight grip on their financial reporting, including expenses. But large companies can struggle for insight into the costs of their employment benefits around the globe, he said.

Thanks in part to acquisitions and mergers, organizations may not know all of the benefits their various country units provide.

The quest for a more coherent corporate strategy also is behind the benefits-standardization trend. As the information age erodes barriers between countries, many firms are seeking to create a more consistent brand experience globally. And that extends to the employment brand. Mr. Canori said companies frequently pick their ideal level of global benefits, such as the 70th percentile—meaning that in each country they operate, they will aim to offer benefits better than those offered by 70% of employers in that nation.

## CENTRALIZING BENEFITS

Cost savings and risk reduction also help explain the shift to central management of global employment benefits.

On the pensions side, the switch to defined contribution plans from defined benefit programs is continuing on a global scale. In the past several years, a company's ability to con-

duct business transactions—and therefore, its competitiveness—is increasingly affected by the risks linked to operating a defined benefit plan, consultants say. As a result, more multinational companies are trying to find ways to reduce their defined benefit pension liabilities.

"In the long term, it's inevitable that employers will continue to look for ways to shift more of the (pension) cost to employees," said Christopher Mayo, senior consultant at Watson Wyatt Worldwide.

Even in countries such as the Netherlands, where more than 90% of all pension assets are still defined benefit plans, defined contribution approaches are beginning to appear, usually as "hybrid" plans that combine elements of both schemes.

Some companies are going further by paying insurance companies to take the defined benefit plans off their hands, either in part or in whole. Known as a buyout or a buy-in, depending on the structure of the insurance-based agreement, such transactions allow companies to effectively remove the risks associated with their DB pension assets and liabilities from their balance sheets.

In the realm of health-care benefits, parsing expenses has emerged as a priority for firms, given the growing demand for medical benefits combined with rising health-care costs around the globe. To combat those costs, larger companies are starting to launch employee wellness programs in countries beyond the United States, said Willis Group's Mr. Burns.

Companies also are turning to health insurance providers with an international reach. One is Maxis, which offers coverage in 74 countries and is a partnership of insurance company MetLife Inc., New York, and financial services firm AXA Group, New York. Rudy Bethea, vice president of multinational solutions at MetLife, said tapping a multinational network like Maxis can save a company 2% to 3% in medical costs.

Yet another factor fueling the centralization of employee benefits is the growth in cross-national assignments. "Employers have to come up with ways to lock in standards for mobile employees," Mr. Bethea said.

## HURDLING OBSTACLES

But global companies can go only so far in normalizing their employee benefits. Cultural differences set limits. So do government regulations, which vary around the globe. Ms. Regan said that in China the length of a marriage-leave benefit depends on the age of the bride, with older women getting a longer leave.

Uneven labor-market conditions also get in the way of a uniform benefits policy. Battles for talent in a particular country may call for a higher level of benefits than that set by the overall company strategy. "There may be circumstances where you need to de-link from the global standard in order to meet the hot market's challenges," said Mr. Wesselkamper of Watson Wyatt.

If anything, companies need to prepare to let employees select highly personal combinations of benefits. Mr. Williams of Mercer said workers at different stages of life may want to select varying benefits, such as tuition reimbursement for a business degree early in their careers and elder care when they are tending to aging parents.

Even if companies succeed in creating more centralized benefit policies, the global approach has a potential catch if the benefits are not uniform around the world: higher employee expectations everywhere. Ms. Regan said workers in one country may clamor for the best benefits offered in another, such as longer vacations. "Be careful what you wish for," she said.

CBO

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ware system that exchanges data with providers.

If a firm wants to manage global benefits internally, it can use software from a number of vendors. SAP software for benefits management, for example, is built to comply with regulations in nearly 50 countries, said SAP Vice President David Ludlow. The software allows customers to set up different benefits programs, such as defined contribu-



Jason Averbook

tion retirement plans and health insurance benefits, and includes technology to let employees enroll in benefits over the Web.

Running benefits software in-house gives firms greater ability to sift through information to spot cost-saving trends, said Lois

Schwartz, a Marietta, Ga.-based consultant who helps companies put SAP benefits software in place. "You have control of your own data," she said.

Others argue that outsourcing can allow for smart data analysis. Mercer, for example, says its data management and reporting tools enable clients "to take an in-depth, real-time look at the data and analytics of your entire benefits program."

Outsourcers also tout online options for employees. Hewitt says it helps employees make sound health-care decisions through online tools such as health plan comparison charts and health savings account estimators.

—*Ed Frauenheim/Workforce Management*



THE FUTURE OF DEFINED BENEFIT PLANS IS IN DOUBT. THE ODDS ARE STACKED AGAINST THEIR SURVIVAL. AND THOSE COMPANIES THAT DECIDE TO KEEP THEM FACE SOME IMPORTANT CHOICES.

# The bumpy road for DB plans

**PENSIONS** | By Christine Williamson and Drew Carter

THREE HOT PENSION ISSUES that got even hotter because of the huge financial crisis will preoccupy corporate executives over the next three years.

The first could be the hardest: Keep or freeze the defined benefit plan.

Myriad pressures—including volatile investment returns and their unnerving impact on balance sheets, the cost of ever-rising participant longevity, and peer pressure from industry competitors and companies' own boards of directors—will continue to goad corporate executives into ending traditional defined benefit plans in favor of defined contribution and hybrid cash balance plans.

Second on the list are pension liabilities. If a defined benefit plan is frozen—and in some cases, even if it isn't—corporations likely will search for ways to move pension liabilities off their balance sheets and on to someone else's.

Industry experts agree that U.S. regulations probably won't ever allow companies to unload pension liabilities on another company—a money manager, for instance—as is the case in the United Kingdom and Europe. But they think regulators eventually will permit insurers to create products that let corporations transfer pension liability risk, although the cost of that risk transfer might be prohibitive.

Finally, if the decision is to keep the defined benefit plan, corporate financial executives will be completely focused on asset-management to meet pension funding requirements and smooth volatility.

Two approaches will prevail, according to financial executives. Those overseeing well-funded plans will manage assets to meet liabilities, known as liability-driven investing. Executives at companies with less well-funded plans will seek to maximize investment returns through the use of alternative investments, such as private equity, hedge funds, infrastructure, real estate and commodities.

"Anything that happens in the next three years with regard to defined benefit plans will be heavily influenced by the requirements of the Pension Protection Act of 2006," said Michael Hall, director, investment strategy, at money manager Russell Investments in Tacoma, Wash.

The PPA requires defined benefit plan sponsors to maintain higher funding levels, to value plan assets at market value quarterly and to account for the value of those assets on their corporate balance sheets, among other things.

"Pension plan sponsors used to have very long-term investment horizons, but that has really changed under PPA. Now with the requirement to mark to market under the Financial Accounting Standards Board, PPA re-

ally forces you to pay attention" to short-term investment returns, said William F. Quinn, chairman of American Beacon Advisors, which oversees the \$9.1 billion pension fund of American Airlines Inc. in Fort Worth, Texas. Mr. Quinn also is chairman of the Committee on Investment of Employee Benefit Assets in Bethesda, Md., an association representing corporate defined benefit plans.

"The No. 1 thing PPA did was to force defined benefit plans to pay attention to their funding and contribution levels," said Russell's Mr. Hall. "Quarterly performance determines whether the corporation must make a cash contribution to the plan and makes it a potential source of balance sheet volatility."

That volatility and the other regulatory changes wrought by the PPA will push more corporations to close their defined benefit plans, sources agreed.

For example, the PPA will force even frozen plans to be fully funded. Because those plans typically have declining liability levels, some will eventually have surplus assets. Once the assets are in the plan, "there's not a real good way" to get the money out, said Robert J. "Bob" Leone, a principal in the Minneapolis office of Hewitt Associates LLC. He estimated that 30% to 40% of Fortune 500 companies' defined benefit plans are frozen.

## TRENDS DOWN

"The fundamental question for society is whether we want to save corporate defined benefit plans. Every financial incentive is pointed toward their elimination. All trends now are toward winding down defined benefit plans," said Joe Craven, the New York-based senior vice president of American Century Investments in Kansas City, Mo.

Messrs. Craven and Quinn agreed that the only industries likely to preserve defined benefit plans en masse are those with large, strong unions.

Other pension veterans are even more pessimistic.

"In my view, there's really one issue, and that's retirement plans as we know them are going to be obsolete," said John Myers, retired president and chief executive officer of GE Asset Management Inc., which manages the defined benefit plan of General Electric Co. in Fairfield, Conn. Mr. Myers spent two decades managing the now \$60 billion GE pension fund.

"It will be a slow, downward death spiral" for defined benefit plans, Mr. Myers said.

Tim Barron, president and CEO of consultant Rogerscasey Inc. in Darien, Conn., said U.S. industries "will have to get more intelligent about how they offer benefits."

"I think corporations may unite to offer strong defined benefit plans, along the lines



"The fundamental question for society is whether we want to save corporate defined benefit plans. Every financial incentive is pointed toward their elimination. All trends now are toward winding down defined benefit plans."

—Joe Craven, American Century Investments

of multiemployer pension plans or Australian superannuation schemes," Mr. Barron said.

"These industry plans will be attractive because they will keep these companies competitive with each other and the rest of the world, and it will definitely be cheaper for companies to pool the liability risk. It will be less expensive for these companies to self-insure than to pay an insurance company a 1.5% annuity fee to assume the liability risk," he said.

Mr. Barron was referring to the practice becoming popular with European corporate pension plans of insuring themselves against pension liability risk or selling their pension liability. In the U.S. corporate executives have talked about transferring pension liabilities, but widespread adoption is unlikely because of the cost.

"No one will go to full neutralization, the full assumption of liabilities, because the insurance will be so expensive," said American Century's Mr. Craven.

Barbara Novick, vice chairman of asset management giant BlackRock Inc. in New York, agreed. She noted that while insurance companies "are saying this will be a really big business, a pension close-out is not a trivial decision."

Ms. Novick said larger companies with small "orphaned" plans—defined benefit plans from acquired companies that are now closed to new participants—may find the idea of passing the liability on to another party appealing and affordable. But for larger defined benefit plans, the proposition probably is too expensive in this interest-rate environment, she said.

Sunny Patpatia, president and chief executive officer of Patpatia & Associates LLC in Berkeley, Calif., a management consulting firm focused on the asset management industry, agrees that cost is an issue. He also said that the Department of Labor would be unlikely to allow a corporation to transfer all of its liability to an insurer.

However, Mr. Patpatia said his firm is researching ways to pass some pension liability from a company he wouldn't name to an insurer, thus removing that portion of the liability from the balance sheet.

Meanwhile, among executives at companies that keep their defined benefit plans, "what's most important to them is not writing any more checks for the pension plans," said Alan Dorsey, managing director and alternative investment strategist, Neuberger Investment Management in New York.

"This really brings the focus back to (investment) performance in order to bring up the funded status. Pension executives struggle

with a yin and yang between wanting to immunize their risk when the market dips and making up performance when markets improve," Mr. Dorsey said.

Well-funded defined benefit plans are inclined to reduce their risk of equity volatility by using more long-bond swaps and more low volatility hedge funds of funds, he said. Less well-funded or underfunded plans are more likely to seek returns uncorrelated to equity markets by investing directly in hedge funds, private equity and portable alpha approaches. Sources said U.S. pension executives also might try to emulate their European counterparts by trying to find ways to hedge longevity risk, or sell that risk to the market. Russell's Mr. Hall, for example, said he thinks U.S. corporate plan executives will figure out a way to use derivatives to get rid of that risk.

"I think executives will try to set up a kind of mortality swap using the Goldman Sachs mortality index. It could be a trade you set up with an insurance company, but the trick will be making sure there are enough parties out there who want to be on the other side of the risk," Mr. Hall said.

## FALLING RETURNS

American Beacon's Mr. Quinn said the biggest challenge will be meeting the funds' 8% to 10% return expectations. "It is much harder to achieve those levels than it used to be. People clearly are looking for other places to find return."

To deal with lower expected returns, Mr. Quinn said he and his staff are upping the private equity allocation and actively seeking opportunistic investments in hedge funds, portable alpha, infrastructure and other absolute return strategies less correlated to stocks and bonds. And like many corporate pension plans, liability-driven investments play an important part in matching returns to future pension liabilities, he said.

Some experts believe that defined benefit plans will survive and possibly enjoy a revival.

"As employers feel the pain of an aging work force, they will see the value of (defined benefit) plans," said Armand Yambao, principal at Ennis, Knupp + Associates Inc., Chicago.

"It won't be the 1970s version" of a defined benefit plan, said Carl Hess, global head of investment consulting at Watson Wyatt Worldwide in New York. "It'll be DB 2.0." **CBO**

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## THE THREE ISSUES

1

Should you keep your defined benefit plan, or freeze it?

2

Where do pension liabilities fit on your balance sheet—or do they at all?

3

Keeping defined benefit plans funded will mean devotion to asset management.

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COMPANIES ARE TURNING TO WELLNESS PROGRAMS USING MADISON AVENUE METHODS TO HELP KEEP A LID ON SOARING HEALTH-CARE COSTS. HOWEVER, THE JURY IS STILL OUT ON THEIR SUCCESS

# Trying to hit a moving target

**HEALTH CARE** | By Jeremy Smerd

THE SAME STRATEGIES that helped super-size the American work force are being used to slim it down.

Employers and the health-care management companies they hire are using data on consumer behavior to cost effectively identify employees with health risks and craft a message that can get them to change their unhealthy ways.

"This is what the tobacco and food companies do to us all day long," said Betsy Barbeau, senior vice president for health and wellness at Boston-based Health Dialog Services Corp., a health-care management and data company. "They don't just think about age and gender; they know what else we buy and what our habits may be, and they use (the knowledge) to create advertising that gets us to buy their product. We are trying to take Madison Avenue sophistication about engaging the consumer market and (use) it to engage our members and our clients."

Hit by rising health-care costs, employers are increasingly turning to wellness programs to try to improve employees' health. Yet the corporate return on investment in wellness programs remains elusive. Just as hard is ascertaining whether the health-care dollars spent actually do improve people's health.

One problem may be the way those dollars are spent. A recent survey by the National Association of Manufacturing and the ERISA Industry Council of 242 companies showed that half of employers with wellness programs use incentives, most commonly premium reductions, cash and bonuses, health-account contributions and gift cards.

Many employers use incentives to encour-



age employees to fill out health-risk assessments, which are questionnaires about health habits and medical conditions. The assessments are used to determine employee health risks, which are in turn used to steer people into a wellness program that can improve their health.

While a lot of money and effort are going toward getting people into wellness programs, little is done to keep them there. "The most serious challenge reported for health management is maintaining employee motivation over time," the survey said. "This was true both for companies using incentives and for companies not using incentives."

"It's not that (incentives) don't work, it's just that behavior change is really hard," said Lu-Ann Heinen, vice president at the National Business Group on Health in Washington. "It's really important to us and our work to understand what will be effective, because a lot of employers are putting a lot of investment and attention into this issue."

Health experts believe that companies may rely too heavily on financial incentives to get people to enroll in programs, while doing little to keep them involved long enough to change their behavior. That, after all, is the ultimate measure of a program's success.

"We're seeing people get involved in disease-management programs, but they drop out very soon," said Stephanie Pronk, vice president of health-management solutions at Ingenix Inc., an Eden Prairie, Minn.-based health-analytics company and a subsidiary of UnitedHealth Group Inc. "If you have a lot of dropouts, you won't see any return on investment."

A recent Hewitt Associates survey of 248 employers showed that although more than half offered smoking-cessation and weight-loss programs, fewer than 5% of employees eligible to enroll actually participated.

Now, companies are trying a new tack to change people's behavior: treating employees the way a marketer would.

"As a breed of animals, we don't work when

it's just the stick or the carrot," said Emma Gilding, president of In:Site, a cultural anthropology think tank that is part of Omnicom Inc., a New York-based marketing company. "We need a complex system of encouragement, more than just 'It'll cost you more or less.'"

People know they need to lose weight or quit smoking. Although monetary incentives can pique interest, they often do not sustain engagement. When used wisely, marketing tools, which look at how people actually behave rather than how they should behave, can tap into a person's internal logic—their decision-making process—to steer them into programs that help them live healthier lifestyles.

The first step is to understand the audience as individuals, not just as people with health risks, said Ms. Gilding.

Health-data companies such as Health Dialog and Ingenix say their methods offer a solution. Health Dialog said it has developed a

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## Innovator Boeing

### Hopes soaring for Seattle test program

**N**early two years after employees at Boeing Co. fought the company's plan to create a network of what it called "high-performance doctors," management is in the midst of another experiment to change the way employees receive health care.

The Chicago-based aircraft maker has pilot projects at three Seattle-area outpatient clinics that, if successful, would improve care for people with more severe chronic illnesses. Boeing's model, known generally as the "medical home," is being adopted by several large employers throughout the country—including IBM Corp., Armonk, N.Y., and Hannaford Brothers Co., Portland, Maine—as a more effective way to provide and pay for primary care.

"We don't reward a system in which comprehensive coordinated care and robust prevention ... (are) valued," said Paul Grundy, director of health-care technology and strategic initiatives for IBM.

The medical home could change that. Though no exact definition exists for it, the medical-home concept generally involves paying primary-care doctors extra to spend more time managing a patient's health. These efforts include:

- coordinating care among a patient's team of specialists;
- providing patients with immediate phone, e-mail and in-person access to health-care professionals;
- using electronic health-care records to avoid errors and



REUTERS/Robert Sorbo

duplication of services;

- following commonly accepted guidelines of care; and
- using a team of primary-care doctors to evaluate and improve patient care.

The hope is that paying doctors more to provide better health care for sicker people will improve patient health and reduce overall health-care costs.

Boeing's effort applies lessons learned in a hospital intensive care unit. The company is developing three pilot programs at outpatient clinics in the Seattle area—Virginia Mason Medical Center, Valley Medical Center and the Everett Clinic.

The clinics will first work with 700 Boeing employees and

their dependents before the company determines whether to expand the pilot programs.

The clinics are following a model known as the ambulatory intensive care unit, or AICU, which focuses on patients with more serious chronic illnesses. These patients tend to account for a larger share of a company's health-care costs.

"If one has a young and well population, the opportunity to save money and improve health through a primary-care medical home is going to be a lot less than for a severely chronically ill population," said Arnold Milstein, medical director of the Pacific Business Group on Health, a San Francisco health-care coalition. Mr. Milstein, who also holds the title of U.S. health-care thought leader at Mercer Health & Benefits LLC, helped develop the AICU.

Pranav Kothari, co-founder of Renaissance Health Inc., a medical consulting firm in Cambridge, Mass., helped develop the AICU model and is working with Boeing on the pilot project. Though unable to comment specifically on Boeing, Mr. Kothari said the half-dozen AICU pilot projects he works with throughout the country—all sponsored by employers or unions—are designed to identify patients who have or are at risk of developing chronic illnesses or have complex medical needs, and thereby would incur significant health-care costs.

"We had the insight that (chronically) sick people need a different type of care" than a person who sees a doctor because they are momentarily sick, Mr. Kothari said.

Boeing and others working with Mr. Kothari haven't made their results public. But Mr. Kothari described early results of the care that clinics provide as "meaningfully optimistic."

—Jeremy Smerd/Workforce Management

## Thought Leader Paul Grundy

# IBM model stressing prevention, access

**P**aul Grundy, director of health-care technology and strategic initiatives for IBM Corp., believes employers have found a way to give employees the kind of medical care that keeps them healthy, rather than treats them only when they're sick. The patient-centered medical-home model focuses on providing people with better access to primary care doctors. A group led by IBM formed the Patient-Centered Primary Care Collaborative to help primary-care doctors provide more thorough and better-coordinated medical care.

**Crain's Benefits Outlook:** You said medical homes address fundamental problems with the health-care system that employers have largely ignored. What do you mean by that?

**Paul Grundy:** I can buy a damn good amputation for my diabetic, but what I can't get is a good system in place to prevent my diabetic from needing the amputation. We don't reward a system in which comprehensive coordinated care and robust prevention are valued. We have no new docs going into family medicine—or very few—because not only is it not economic, but also they're treated like dirt.

They are really demoralized. What they can provide doesn't seem to be valued.

**CBO:** Talk a little about what kind of change medical homes represent and what IBM is doing.

**Mr. Grundy:** Each patient has an ongoing relationship with a personal physician. It's a team approach. The personal physician leads a team of individuals who provide care. It's comprehensive. The personal physician is responsible for everything. It's coordinated. There is quality and safety in place. There's technology—the electronic medical record,

and evidence-based decision making that's underneath this. It expands access. It allows a doctor and a patient to encounter each other. They can interact over the phone and e-mail; they have open access.

**CBO:** How do you take an employer through the process of implementing this model?

**Mr. Grundy:** There are many employers already doing this. And it's relatively easy to do if you buy care yourself. Harrah's (Entertainment Co.) in Atlantic City, Reno and in Las Vegas set up clinics around those towns available to their employees and dependents. And that is where they go to get primary care. They hire physicians, and they pay them competitive wages to provide comprehensive coordinated care with electronic medical records. That's a medical home. And I would describe that as a closed system because it's not open to everybody.

**CBO:** And is what IBM is doing an open system?

**Mr. Grundy:** IBM made the decision—a difficult decision—that we wanted to transform a site not around some of our plants, but we wanted to transform the whole system and buy this for every employee in every ZIP code. We have 605 of our employees that don't work in any concentration at all; they work all over the country. So ... though we do have large concentrations of employee populations, we decided at a very high level that we really wanted to change this across the (organization's) ecosystem.

We formed the Patient-Centered Primary Care Collaborative. We've got all of primary care engaged. We have all national health plans engaged. We have 70 million lives of large employers plus many large unions and not-for-profit con-



Mike McGregor

sumer groups engaged.

At the local level, where we do have a concentration of patients, we are working with physician organizations and third-party administrators to roll out a community-based medical home open to anybody. In the mid-Hudson region (north of New York City) we have close to 100,000 lives. The physicians will deliver robust primary care to anybody who lives here. It's a transformation of a community practice, not just to employees. We use the same doctors that everybody else in the mid-Hudson uses. We're trying to transform the level of care for all patients.

—Jeremy Smerd/Workforce Management

## Wellness

CONTINUED FROM PAGE 19

predictive model that uses health-claims data in combination with demographic “psychographic data,” as Ms. Barbeau put it, to capture people's attitudes.

The model identifies those likely to be smokers, overweight or at risk of heart disease and other health problems. Among Health Dialog's first clients for this new service is health insurance company Health Net, which will use it on its 2.5 million members. The data could make it unnecessary for payers to use precious health-care dollars on incentives to get employees to fill out health-risk assessments.

“We know blue-collar workers smoke at twice the rate of the general population,” said Ms. Barbeau. “We don't need an HRA to tell us that.”

### DATA ANALYSIS TOOL

Ingenix said it has developed a data analysis tool that helps companies more effectively communicate with employees in a way that motivates them to improve their lifestyles. Consumer data is not about specific individuals, but is gathered down to the ZIP code plus-four area, which equals a group of about 20 houses. From that and other data sets, marketers glean information, for example, on the neighborhood a person lives in, the value of his house, whether he buys sports equipment, whether he eats a lot of fast food and the kind of car he drives.

Lifestyle information can say as much about what motivates people as it can define their risk of having a heart attack. Neither Health Dialog nor Ingenix would disclose its methods, but marketing and health-care experts said the thousands of consumer data sets that marketers have developed can help paint an accurate portrait of how a person behaves. Marketers have sliced and diced Americans into groups such as “blue-collar backbone” and “affluent suburbia,” each with its own messaging.

“You work hard. You deserve to take care of yourself” might be an example of a message for those with pickup trucks, compared with “You deserve this. Take care of yourself today” for people who drive Volvos.

Understanding the audience helps not only to identify at-risk employees but also helps to craft an incentive that speaks to a person's needs, said Ms. Pronk. When Ingenix tested its tool, which is not quite a year old, Ms. Pronk said employees stayed involved in their employer's wellness program longer.

RedBrick Health Inc., a client of Ingenix, has used the marketing data to more effectively manage wellness programs. Using consumer data such as what magazines people subscribe to, for example, RedBrick can customize a message that gets an employee's attention, said Kyle Rolfing, RedBrick president.

One of RedBrick's clients is Welch Allyn Inc., a manufacturer of medical diagnostics in Skaneateles Falls, N.Y., with 1,500 employees and dependents. Welch Allyn has had many wellness programs over the past 15 years: online health screening, free flu shots, mammograms, telephone counseling, weight-loss programs and a fitness center. All of them were operated independently by different vendors; none shared data with one another. Before RedBrick took over the management of the programs a year ago, the company offered \$300 off its health premiums to employees who filled out a health-risk assessment.

Jeff Viviano, senior manager for HR operations and technology, said the incentive was high enough to get people to fill out the assessment, but the company had no idea whether it led them to change their behavior.

Now the company has divided the \$300 differently and set about the harder task of changing people's lifestyles. The company still pays employees to complete the HRA, but the amount they receive has dropped to \$100. This may mean fewer Welch Allyn employees will fill out an HRA, Mr. Viviano said. But those who do may be drawn into wellness programs by the lure of a new incentive—money that formerly was used to get people to fill out the health-risk assessment.

Marketing data help RedBrick communicate a message about a person's health that motivates them. “If a person subscribes to Golf magazine, we can customize messaging to use golf to get their attention,” Mr. Rolfing said.

Mr. Rolfing said the company's approach combines three things: communicating with the employee in a way that speaks to their interests; customizing health choices that meet their needs and interests; and tying how much a person pays for health premiums based on their participation in a wellness program.

“There's not an unlimited pool of dollars to put into incentives,” Mr. Viviano said. “So clearly, understanding consumer preference is important going forward, though we don't yet have any evidence to see whether it's working.”

Eventually Welch Allyn wants to pay people for reaching or maintaining their health goals. Getting people to lead healthier lives, after all, is the ultimate goal. However, it also is exactly what unnerves many employers, who worry about becoming too paternalistic toward employees or crossing legal lines.

“Because incentives is such a new area, the liabilities on these things is just not completely clear,” said Tiffani Hiudt, an attorney in At-



“As a breed of animals, we don't work when it's just the stick or the carrot.”

—Emma Gilding, In:Site

lanta for Fisher & Phillips LLP.

Ms. Hiudt said offering incentives for participating carries little legal risk. And the Health Insurance Portability and Accountability Act provides guidelines to employers offering incentives based on achievements, with many states offering their own laws on how restrictive employers can be. She advises employers who tie an incentive to a health goal to offer all employees the possibility of attaining a goal that is within their reach.

### CONVENIENCE FACTOR

The underlying lesson is that wellness programs are more effective if they “meet the consumer where they're at,” Ms. Pronk said.

Often that means designing programs that are convenient. Developing a workplace culture that supports healthy living is an inexpensive first place to start, said Patricia Benson, director of the health-management program at the University of Louisville in Kentucky.

The school is working with its food vendor to make healthy food less expensive and easier to buy. Also, the school's president hosts weekly jogs. If you want his ear, you have to run alongside him. Half of the school's 6,000 employees participate in a wellness program.

Knowing that people stick to lifestyle changes when they are supported by peers with similar interests, General Mills Inc. in Minneapolis helps employees start fitness groups so they can work out together. The company uses its annual sales meeting to host a health fair where people get checked for blood pressure, cholesterol and other basic measures of health.

CBO

Jeremy Smerd is a reporter for Workforce Management in New York. Contact him at [jsmerd@workforce.com](mailto:jsmerd@workforce.com).

### more online

Sidebar: Legal hurdles abound in wellness plans  
Sidebar: Getting the message right is essential  
Sidebar: Employers seek better measures of ROI  
See [crainsbenefits.com](http://crainsbenefits.com)



THE OPTION USED TO BE FAVORED BY MOSTLY NEW MOTHERS. NOW

A WHOLE NEW BREED OF EMPLOYEES—AND THEIR BOSSES—ARE EMBRACING NEW AND

DIFFERENT WAYS TO WORK.

# Flextime for everyone

**WORKPLACE** | By Jessica Marquez

WHEN STEPHEN FISHER accepted a consulting position at KPMG LLP in the fall of 2005, he figured his days of playing professional soccer were over.

Mr. Fisher, who was 23 at the time, had spent his first two years out of college playing soccer for Pennsylvania's Harrisburg City Islanders. But he started to feel that it was time to buckle down and to put his degree to use.

Once soccer season began the following spring, however, he lamented to his boss that he missed playing. His boss's reaction shocked Mr. Fisher. "He suggested talking to the partners about my doing an alternate work schedule," he said.

Mr. Fisher works full time in KPMG's Philadelphia and New York offices from September to March. During soccer season, he practices in the morning, and then works in the Harrisburg, Pa., office from noon to 6 p.m.

Employers, meet the new breed of flexible worker. Flexible work has traditionally been the domain of working mothers, but tomorrow's companies will have to craft work schedules to cater to the varying needs of their work forces. Whether it's baby boomers looking to reduce their workloads, Gen Xers juggling family and work, or Generation Yers like Mr. Fisher who want their work lives to revolve around personal ambitions, today's work force is more vocal than ever about the desire for greater flexibility.

Lack of work/life balance is among the top five reasons employees of all ages would consider leaving their current employer, accord-

ing to a recent survey from benefits consulting firm Watson Wyatt Worldwide.

"In the next five years, many companies are going to realize that unless they offer a menu of flexible work options to employees, they aren't going to have the talent they need to compete," said Charlie Grantham, executive producer of the Work Design Collaborative, a Prescott, Ariz.-based consortium that focuses on defining the future of work.

Yet companies can't merely create a formal policy around flexible work, said Kathie Lingle, director of the Alliance of Work-Life Progress, a division of WorldatWork, a Scottsdale, Ariz.-based HR association that provides education in compensation and benefits areas.

Companies have to establish a culture around these programs, which should entail training, investing in IT systems and making sure their performance-management programs take into account employees' work arrangements, she said.

KPMG came to this realization about eight years ago after executives noticed the demand for better work/life balance was coming up repeatedly in employee surveys, said Barbara Wankoff, national director of the company's workplace solutions group.

The New York-based accounting and consulting company offered flexible work arrangements to its 22,000 U.S. employees, but was pretty quiet about it, allowing flex work only on a case-by-case basis. But over the past few years, Ms. Wankoff and her team have introduced a number of tools to make it easier for employees

to request flexible work arrangements.

For example, KPMG has published a guide for employees to use when requesting to change their work schedule or location, Ms. Wankoff said. The guide suggests that employees write up a formal proposal explaining the flexibility they are seeking, how they will meet their responsibilities, how their teams will be able to reach them, what kinds of resources they might need and how the company can measure the success of the arrangement.

KPMG recommends that supervisors check in with employees every six months about these arrangements, which is a critical piece of offering flexible work, she said.

"As our business changes, we may need to change," Ms. Wankoff said. For employees who transition to reduced hours, it's essential that KPMG keep tabs on how that employee's workload is being covered, she said. "If you have other people carrying the workload, it's not going to be sustainable for a long period of time."

Similarly, executives at New York-based Deloitte Consulting LLP are trying to ingrain the conversation about flexible work into employees' annual performance evaluations—so much so that what they're doing is not even considered flexible work, said Cathy Benko, Deloitte's chief talent officer. "The problem with flexible work arrangements is that they are viewed as the exception to the workplace standard," Ms. Benko said. "People's careers are not taken into account."

Through a new program called "mass career customization," each Deloitte employee

is given a profile showing where he or she is in relation to four categories: pace, workload, location/schedule and role. "This profile gets embedded into the employee's career development," Ms. Benko said.

The thinking is that all employees, throughout their careers, will want to "dial up or dial down" in these categories. For example, a mother might want to scale back her hours for a few years while her children are young, but then be ready to take on new responsibilities once they are in school.

By establishing this profile, Deloitte employees can discuss the option of doing either, which makes the conversation not just about reducing workload, but also about accepting more responsibility, Ms. Benko said.

Deloitte had been piloting mass career customization for the past two years with 20% of its U.S. work force. Of the 7,700 employees who participated in the pilot, 30% showed interest in dialing up or down, 13% ended up applying to do so, and 9% were approved. The company expects to have profiles in place for all 38,000 U.S. employees in the next nine months, Ms. Benko said.

Executives at Deloitte and KPMG agree that the biggest hurdle they face with their programs is a cultural one. For KPMG, it's making sure that managers have meaningful discussions with employees who are asking for flexible work arrangements, Ms. Wankoff said. "It's not just agreeing to exactly what the employee wants, but not just saying no, either," she said.

At Deloitte, there was concern that all employees would want to dial down, Ms. Benko said. But during the pilot, dial-up requests outnumbered dial-down requests 3-to-1. And the number of women and men who wanted flexible arrangements was about the same, Ms. Benko said. That means there is progress toward proving that the desire for work flexibly isn't just a women's issue, Ms. Benko believes.

"Women are definitely the canary in the corporate coal mine when it comes to flexible work," she said. "But we think we are making progress in that regard."

**CBO**

*Jessica Marquez is a reporter for Workforce Management in New York. Contact her at [jmarquez@workforce.com](mailto:jmarquez@workforce.com).*

## Innovators Best Buy

# Changing a company's culture, not just its schedules, pays off

**M**any organizations are pitching their flexible work programs, but no company has taken the idea as far as Best Buy Co. Inc. Corporate employees of the Minneapolis-based electronics retailer can work anytime, anywhere. Meetings are optional. There are no schedules.

This might sound like chaos, but it's actually a carefully crafted program called the Results-Only Work Environment, or ROWE.

Best Buy began implementing the program in 2002, and so far it seems to make business sense. From 2003 to 2007, 3,000 Best Buy employees—80% of the corporate work force—migrated to ROWE. From 2005 to 2007, productivity jumped 41% and voluntary turnover fell to 8% from 12%. In some corporate divisions, voluntary turnover dropped as much as 90% during that two-year period.

"That's year-over-year dollar savings of \$16 million annually from turnover alone," said Jody Thompson, a former HR manager at Best Buy.

ROWE is the brainchild of Ms. Thompson and Cali Ressler, both of whom were human

resources managers at Best Buy in 2002. At that time, Ms. Ressler and Ms. Thompson were charged with making a flexible work program from the corporate office available to everyone.

"We realized that the flexible work program was successful in that employee engagement was up, productivity was higher, but the problem was the participants were being viewed as 'not working,'" Ms. Ressler said.

Participants of flexible work arrangements often encounter negative reactions from managers, colleagues or even family members who don't view them as really working because they aren't in the office working traditional hours, Ms. Ressler and Ms. Thompson said. So the two set out to create a program in which everyone would be evaluated based solely on their results, not on how long they worked.

"The issue with flexible work is that it's still about a schedule, and ROWE is not about schedules. It's about cultural change," Ms. Thompson said.

Changing a culture is much more difficult



**FINDING A BETTER WAY:** Best Buy's Jody Thompson, top, and Cali Ressler.

than simply changing people's schedules, so Ms. Ressler and Ms. Thompson, who now run a consulting company called CultureRx, have created a program to help companies implement ROWE. The transition to ROWE can take as long as six months, and there are numerous steps to the process, Ms. Thompson said.

At Best Buy, Ms. Thompson and Ms.

Ressler started out by conducting a "culture audit," to establish a baseline for how employees perceive their work environment. They repeated the audit four months later.

In the meantime, executives held leadership education to get all of Best Buy's executives on board with what ROWE was about.

In the second phase of the transition, Ms. Ressler and Ms. Thompson brought in all corporate employees and talked to them about the philosophy of ROWE.

The second phase included training on how managers could still maintain control in the ROWE model.

In the third phase, teams were left to their own devices. Ms. Ressler and Ms. Thompson followed up four months later with a culture check to see how everyone was doing.

Fifteen companies have bought ROWE kits from CultureRx. J.A. Counter & Associates Inc., a 20-employee investment management company in Richmond, Wis., migrated completely to ROWE. And CultureRx is in discussions with an undisclosed Fortune 100 company to implement ROWE.

Ms. Ressler and Ms. Thompson insist they aren't discouraged that large employers aren't yet breaking down their doors to implement ROWE. "We know that it will take two or three decades for ROWE to become status quo," Ms. Thompson said. "But social change takes time."

—Jessica Marquez/Workforce Management



PLANS ARE ON A COLLISION COURSE WITH A RAPIDLY AGING WORK FORCE AND A SOARING FEDERAL DEFICIT.

# Warning: storms brewing

**BENEFITS DATA BANK** | Research & analysis by Fay Hansen

**T**HE PARTICULAR DYNAMICS of the current economic downturn, with its dramatic drop in equity values and steep rise in financial risk, place an unprecedented strain on benefit plans.

Employer spending for major benefits programs will hit approximately \$2.4 trillion by the end of 2008. Half of that amount will go to retirement benefits that are bound up in equities markets and the broader world of investment and finance; 45 percent will be consumed by health benefit costs that are rising at nearly double the rate of general inflation.

A full month before the October stock market crash, CFOs ranked benefit costs as their top price pressure concern, ahead of energy and raw materials prices, according to a Grant Thornton survey.

Those same CFOs are now looking at significant pension deficits, gutted 401(k) balances and higher health benefit costs.

With real employee earnings already down 2.5% from a year ago, deep wage cuts are not feasible. Benefit cuts will have to suffice, and with U.S. unemployment projected to hit 7% by mid-2009, employees will swallow them.

The downturn will take a toll on both the number of employers willing to sponsor defined benefit plans and the number of employees willing to participate in defined contribution plans.

Even before the October wipeout, asset returns for a moderate-risk pension asset portfolio fell by 6.7% for the first nine months of the year.

The downturn is likely to accelerate employer plans to shift more health benefit costs to employees. However, increased employee costs will, in turn, sharpen the uptick in 401(k) hardship withdrawals and cut into 401(k) contributions and participation rates. Automatic enrollment, default deferral rates and step-up provisions may come under pressure as employees pull back from all voluntary payroll deductions.

In addition, with the federal deficit heading back into record-breaking territory, preferential tax provisions for benefits are likely to come under increased scrutiny. These provisions will cost the federal government \$348 billion in fiscal year 2009, more than one-third of the total tax revenue lost to all special provisions.

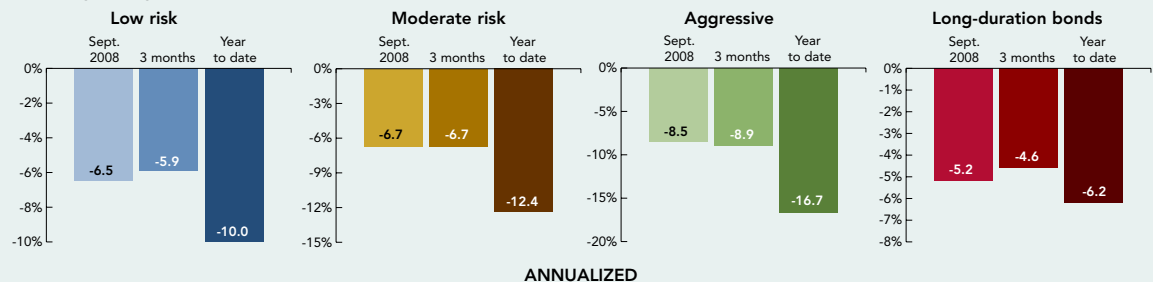
More employees are closer to retirement age than at any point in U.S. history, but the prospects for an infusion of federal spending for retirement and health-care programs have rarely been so low. The fiscal burden created by the financial bailout virtually precludes new federal spending to relieve the stress on employer-sponsored retirement and health-care benefits.

**CBO**

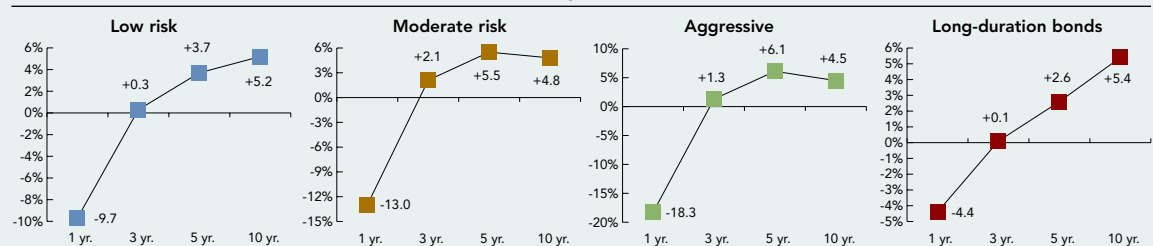
Fay Hansen is a contributing editor with Workforce Management in Cresskill, N.J. She can be reached at fhansen@workforce.com.

## PENSION ASSET RETURNS

Percentage change in benchmark portfolios



## ANNUALIZED



Note: Low risk = 30% Russell 3000, 70% Lehman Brothers Long Credit Aa Bonds; Moderate risk = 50% Russell 3000, 10% MSCI Europe, Australasia, Far East (EAFE) Index, 40% Lehman Aggregate Bonds; Aggressive = 65% Russell 3000, 15% MSCI EAFE, 20% Lehman Aggregate Bonds; Long-duration bonds = 100% Lehman Long Credit Aa Bonds  
Source: BNY Mellon (www.bnymellonassetgmt.com)

## COSTS AND PLAN CHANGES

### RESPONSIBILITY

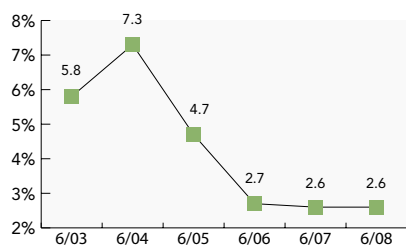
Percentage of companies reporting department responsible for administering specific benefits, 2008

	HR only	HR and other departments	Other departments	Out-sourced
Vacation/leave	75%	22%	1%	1%
Insurance benefits	74%	7%	3%	16%
Unemployment compensation	70%	9%	6%	13%
Pension/retirement	52%	10%	7%	29%
Flexible spending	45%	6%	4%	35%
Cafeteria benefits	43%	6%	4%	19%
Profit sharing	23%	8%	5%	9%
Stock plan	12%	6%	6%	9%

Source: BNA Inc. (www.bna.com)

### BENEFIT COSTS

12-month percentage changes in the Employment Cost Index for benefits, private industry, June 2003-June 2008



Source: U.S. Bureau of Labor Statistics (www.bls.gov)

### ADJUSTING BENEFITS

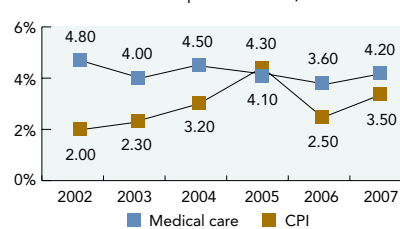
Percentage of companies reporting changes made or under consideration for benefits programs, 2008

Increase medical co-pays	54%
Move from defined benefit to defined contribution plan	39%
Introduce more baby-boomer benefits	33%
Reduce/eliminate post-retirement benefits	29%
Phased retirement programs	29%
Increase compensation to retain aging work force	20%

Note: Survey of Fortune 1000 companies; multiple responses allowed  
Source: Ernst & Young (www.ey.com)

## MEDICAL INFLATION

Percentage change in Consumer Price Index and medical care cost component of CPI, 2002-2007



Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## PLAN SPENDING

Percentage of employers reporting satisfaction with their benefit spending levels, 2008

	Spending appropriate	Should be less	Should be more
401(k)	82%	8%	10%
Nonqualified defined contribution	47%	3%	2%
Profit sharing	39%	2%	4%
Active medical/dental/life/disability	51%	44%	3%
Qualified defined benefit	41%	8%	2%
Nonqualified defined benefit	27%	5%	0%
Post-retirement medical	24%	15%	3%

Source: Deloitte (www.deloitte.com)

## HEALTH BENEFITS

### PLAN CHANGES

Percentage of employers reporting plan-design changes to health plans made in 2007 or earlier, in 2008 or planned for future

	2007 or earlier	Implementing 2008	Plan for future
Consumer-driven health plan full replacement	4.7%	5.7%	11.5%
Consumer-driven health plan as option	21.6%	20.0%	40.4%
Preventive benefits covered at 100%	53.3%	47.8%	54.8%
Internet/intranet decision-support tools	58.5%	57.9%	67.7%

Note: Survey of 1,100 employers  
Source: Aon Consulting (www.aon.com)

## EMPLOYER PRIORITIES

Employers reporting health-care priorities over the next three to five years, 2008

Utilizing data to drive strategy	67%
Offering incentives for behavior change	63%
Provide health management programs tailored to risk levels	50%

Note: Survey of 508 employers representing 8 million employees  
Source: Hewitt Associates (www.hewitt.com)

## HEALTH-CARE PARTICIPATION

Percentage of employees with access to and participating in health-care benefits, private industry, March 2008

	Access	Participation
All workers	71%	53%
Management, professional and related	86%	68%
Service	46%	29%
Sales/office	71%	51%
Natural resources/construction/maintenance	77%	62%
Production/transportation/material moving	78%	61%
Full time	85%	65%
Part time	24%	14%
Union	88%	79%
Nonunion	69%	50%

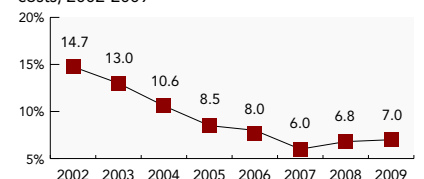
Average wage within the following percentiles:

Less than 10	25%	13%
10 to less than 25	48%	28%
25 to less than 50	77%	55%
50 to less than 75	84%	67%
75 to less than 90	88%	72%
90 or greater	91%	75%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## COST INCREASES

Median trend increases in employer health plan costs, 2002-2009



Note: Survey of 453 employers with 8.4 million employees  
Source: Watson Wyatt Worldwide (www.watsonwyattworldwide.com)

## PLAN CHANGES IN NEXT YEAR

Percentage of firms reporting likelihood of making health plan changes in the next year, 2008

	Very likely	Somewhat likely	Not too likely	Not at all likely	Don't know
Increase amount employees pay for insurance	14%	26%	23%	36%	1%
Increase office visit co-pays or coinsurance	10%	35%	22%	32%	1%
Increase deductibles	12%	29%	27%	31%	2%
Increase employee share for drug costs	9%	32%	26%	28%	4%
Offer HSA-qualified HDHP*	4%	21%	24%	50%	1%
Offer HDHP/HRA*	5%	21%	27%	45%	1%
Introduce tiered networks for office visits or hospital stays	2%	16%	37%	39%	7%
Drop coverage entirely	3%	3%	16%	78%	<1%
Restrict eligibility for coverage	1%	12%	16%	69%	1%

\*Among firms not currently offering this type of HDHP/SO  
Source: Kaiser Family Foundation (www.kff.org)

## RETIREE HEALTH

Among firms offering active employee health benefits, percentage offering retiree health benefits, by firm size and industry, 2008

	Firms with 3-199 workers	Firms with 200 workers or more
All industries	4%	31%
Agriculture/mining/construction	2%	22%
Manufacturing	1%	28%
Transportation/communications/utilities	5%	38%
Wholesale	3%	14%
Retail	3%	13%
Finance	3%	45%
Service	4%	28%
State/local government	12%	82%
Health care	8%	25%

Source: Kaiser Family Foundation (www.kff.org)

## COST SHARING

Share of premiums paid by employer and employee for family health coverage, private industry, March 2008

	Employer share	Employee share
Management, professional	72%	28%
Service	66%	34%
Sales/office	68%	32%
Natural resources/construction/maintenance	73%	27%
Production/transportation/material moving	75%	25%
Full time	71%	29%
Part time	68%	32%
Union	87%	13%
Nonunion	68%	32%

Average wage within the following percentiles:		
Less than 10	63%	37%
10 to less than 25	64%	36%
25 to less than 50	68%	32%
50 to less than 75	71%	29%
75 to less than 90	75%	25%
90 or greater	75%	25%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## OVERSEAS BENEFITS

Percentage of employers offering benefits of programs to employees outside the U.S., 2008

Prescription drug services	63%
Supplemental or wraparound plans	47%
Care management programs	24%
Health-risk assessment	20%
On-site primary care	17%
Wellness programs	14%

Note: Survey of 500 companies, primarily from the Fortune 1000, employing a total of 10 million employees  
Source: Towers Perrin (www.towersperrin.com)

## COSTS BY PLAN TYPE

Range of increases in medical costs by plan type and percentile, active employees, 2008

	Percentile		
	10th	50th	75th
All medical plans combined	-1%	6%	15%
Preferred provider organizations	-2%	6%	13%
Point-of-service plans	0%	7%	17%
Health maintenance organizations	0%	7%	15%
Account-based with health reimbursement account	0%	6%	17%
Account-based with health savings account	-1%	7%	15%

Note: Survey of 500 companies, primarily from the Fortune 1000, employing a total of 10 million employees  
Source: Towers Perrin (www.towersperrin.com)

## PLANS OFFERED

Percentage of employers offering health plans by plan type, 2008

PPO/POS	92.4%
CDH/HRA	11.3%
CDH/HSA	16.1%
HMO	79.8%
Indemnity plan	11.4%

Note: Survey of 1,100 employers  
Source: Aon Consulting (www.aon.com)

## RETIREMENT BENEFITS

### 401(K) CHANGES

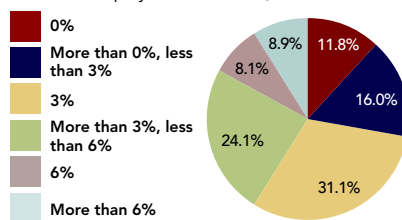
Percentage of employers reporting defined contribution features they are considering for implementation in the next two years, 2008

Target-date funds	8.1%
Automatic enrollment	23.1%
Roth feature	15.0%
Personalized Web-based retirement planning tools	8.7%
Automatic increases in defined contribution deferrals	13.0%

Note: Survey of 1,100 employers  
Source: Aon Consulting (www.aon.com)

### 401(K) MATCH

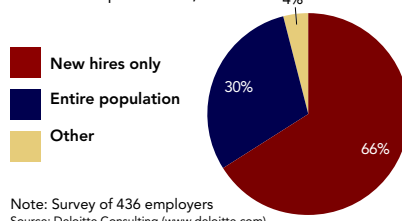
Percentage of employers reporting employer match for employee contribution, 2008



Note: Survey of 1,100 employers  
Source: Aon Consulting (www.aon.com)

### 401(K) TARGETS

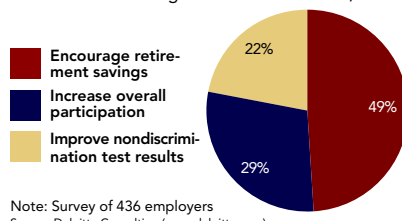
Percentage of employers reporting which population was targeted when 401(k) automatic enrollment was implemented, 2008



Note: Survey of 436 employers  
Source: Deloitte Consulting (www.deloitte.com)

### AUTOMATIC ENROLLMENT

Percentage of employers reporting their primary motivation for adding automatic enrollment, 2008



Note: Survey of 436 employers  
Source: Deloitte Consulting (www.deloitte.com)

### FAS 106 LIABILITY

Annual retiree medical costs and accumulated liability, average and select industry, average accumulated post-retirement benefit obligation per active employee, 2008

	Percentile		
	25th	50th	75th
Total	\$5,419	\$14,147	\$36,224
Chemicals	\$12,436	\$24,545	\$37,382
Energy/utilities	\$45,504	\$63,496	\$96,959
Financial services	\$4,760	\$7,970	\$14,055

Note: Survey of 500 companies, primarily from the Fortune 1000, employing a total of 10 million employees  
Source: Towers Perrin (www.towersperrin.com)

## PENSION RETURNS

Actual return on pension plan assets, S&P 500, 2004-2007

Percentile	2004	2005	2006	2007
90th	17.4%	13.5%	17.7%	16.4%
75th	14.6%	11.0%	15.5%	13.0%
50th	12.4%	8.2%	13.3%	9.6%
25th	10.9%	6.6%	11.0%	7.3%
10th	8.8%	4.8%	8.8%	5.5%

Source: Mercer (www.mercer.com)

## PENSION FUNDING

Funded status of pension plans (based on pension-benefit obligations and market value of plan assets), S&P 500, fiscal year end 2004-2007

Percentile	2004	2005	2006	2007
90th	106%	104%	113%	120%
75th	93%	93%	100%	105%
50th	83%	83%	89%	94%
25th	72%	72%	79%	85%
10th	62%	63%	70%	75%

Source: Mercer (www.mercer.com)

## ACCESS AND PARTICIPATION

Percentage of workers with access to and participation in retirement plans, private industry, March 2008 (All workers = 100 percent)

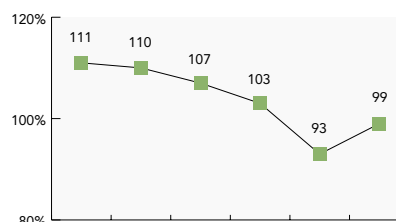
	Defined benefit		Defined contribution	
	Access	Participation	Access	Participation
All workers	21%	20%	56%	43%
Goods-producing	30%	29%	64%	50%
Service-producing	19%	18%	54%	41%
Firms with 500 workers or more	47%	45%	78%	59%
Full time	25%	24%	65%	51%
Part time	11%	10%	27%	18%
Union	69%	67%	50%	42%
Nonunion	16%	15%	57%	43%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## LEGALLY REQUIRED BENEFITS

### WORKERS' COMP RATIOS

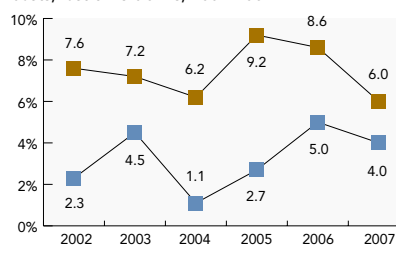
Workers' compensation calendar-year combined ratio, 2002-2007



Source: National Council on Compensation Insurance (www.ncci.com)

### WORKERS' COMP CLAIM COSTS

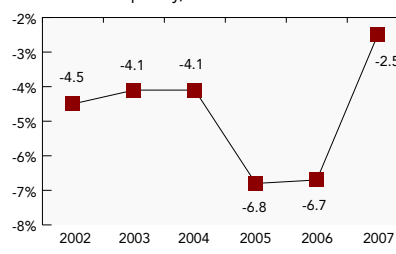
Percentage change in indemnity and medical claim costs, lost-time claims, 2002-2007



Source: National Council on Compensation Insurance (www.ncci.com)

### CLAIMS FREQUENCY

Percentage change in workers' compensation lost-time claims frequency, 2002-2007



Source: National Council on Compensation Insurance (www.ncci.com)

## OTHER BENEFITS

### DISABILITY INSURANCE

Percentage of workers with access to and participation in disability benefits, private industry, March 2008

	Access	Participation
Short-term disability	39%	36%
Long-term disability	32%	30%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## LIFE INSURANCE

Percentage of workers with access to life insurance benefits, private industry, March 2008

All workers	59%
Management/professional	76%
Service	36%
Sales/office	59%
Natural resources/construction/maintenance	56%
Production/transportation/material moving	66%
Full time	72%
Part time	16%
Union	77%
Nonunion	57%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## WORK/LIFE BALANCE

Percentage of employers that have or plan to have flexible hours for better work/life balance, 2007 and planned 2010-2015

	2007	Planned 2010-2015
Flexible working hours	67%	81%
Part-time work	64%	72%
Telework	30%	61%
Job sharing	27%	54%
Sabbaticals	25%	46%
Compensatory time	24%	40%
Parents' sabbatical	29%	36%
Employment for spouse/partner (career couple programs)	12%	25%
Headcount increase (and productivity decrease)	12%	19%

Note: Survey of 500 companies, primarily from the Fortune 1000, employing a total of 10 million employees  
Source: Towers Perrin (www.towersperrin.com)

## PAID LEAVE

Percentage of workers with access to paid-leave benefits, private industry, March 2008

	Personal leave		
	Holidays	Vacation	Personal leave
All workers	77%	78%	37%
Management/professional	89%	87%	55%
Service	52%	61%	26%
Sales/office	81%	80%	39%
Natural resources/construction/maintenance	76%	76%	26%
Production/transportation/material moving	85%	83%	32%
Full time	89%	90%	42%
Part time	40%	39%	21%
Union	85%	84%	47%
Nonunion	76%	77%	36%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## QUALITY OF LIFE

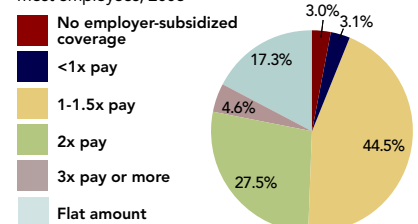
Percentage of workers with access to quality-of-life benefits, private industry, March 2008

Employer assistance for child care	15%
Employer-provided funds	3%
On-site/off-site	5%
Resource/referral services	11%
Adoption assistance	11%
Long-term-care insurance	13%
Flexible workplace	5%
Employer-provided home PC	2%
Subsidized commuting	6%
Work-related education assistance	50%
Non-work-related education assistance	15%
Wellness programs	25%
Fitness centers	13%
Employee assistance programs	42%

Source: U.S. Bureau of Labor Statistics (www.bls.gov)

## LIFE INSURANCE

Percentage of employers reporting level of employer-subsidized group-term life insurance provided to most employees, 2008



Note: Survey of 1,100 employers  
Source: Aon Consulting (www.aon.com)

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