

CIGNA selling retirement savings operations / 3

Punitive award ignores high court guidance / 3

Business Insurance

www.businessinsurance.com

November 24, 2003

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\$4

St. Paul, Travelers merger to create giant Insurer would be No. 2 in commercial lines

By JUDY GREENWALD

ST. PAUL, Minn.—Risk managers should have access to a more diverse and stronger insurer as a result of the planned merger of Travelers Property Casualty Corp. and The St. Paul Cos. Inc., but at the cost of one less insurer competitor.

But observers generally agree that the deal, which is expected to create the nation's second-largest commercial insurer, with \$20 billion in net written premiums, will not have a dramatic

impact on buyers in a market that remains highly fragmented.

Most observers say that despite the size of the two operations, the integration process will be unusually smooth, in part because of both firms' extensive experience with acquisitions (see story, page 22).

In addition, some say that the deal may signal another wave of merger and acquisition activity in the insurance industry.

The tax-free, stock-for stock merger between

St. Paul, Minn.-based St. Paul and Hartford, Conn.-based Travelers is expected to close in next year's second quarter, subject to regulatory and shareholder approval. Under terms of the agreement, holders of Travelers class A and class B common stock will receive 0.4334 St. Paul common shares for each Travelers share they hold.

The combined entity, The St. Paul Travelers Cos., will be headquartered in St. Paul. The company's specialty lines operations, which will be known as St. Paul Specialty, will also be based in St. Paul, but commercial and personal lines busi-

See **MERGER**/page 22

Late News



PHOTO: MARILYN HUMPHRIES

Supporters of gay marriage celebrate last week's decision by the Massachusetts Supreme Court.

Court strikes down ban on same-sex unions

The Massachusetts Supreme Court has ruled that the state cannot ban gay marriage, opening the way for gay and lesbian couples in the state to receive the same protections and benefits as heterosexual married couples. In its 4-3 decision in *Hilary Goodridge and others vs. Department of Public Health*, the state's top court ruled that "barring an individual from the protections, benefits and obligations of civil marriage solely because that person would marry a person of the same sex violates the Massachusetts Constitution."

Industry execs disagree on market softening

Insurance industry leaders are divided as to whether the hard market is peaking, according to an informal survey by Standard & Poor's Corp. While 53% of those attending the 2003 Annual Executive Conference for the Property/Casualty Industry in New York last week say they think the hard market will continue into 2004 as rates and terms hold firm, 47% said there has been softening in property reinsurance and that commercial lines have peaked, suggesting the worst may be over for insurance buyers.

RIMS touts TRIA's positive effects

The Terrorism Risk Insurance Act is a "success," according to the Risk & Insurance Management Society Inc. But RIMS remains "concerned that the stable reinsurance market" that supporters had hoped would arise after TRIA's enactment will not develop as the measure's framers had hoped when they set a Dec. 31, 2005, sunset for the program. TRIA, enacted late last year, allows

See **LATE NEWS**/page 23

Receiver sues Reciprocal's former execs Racketeering alleged

By DOUGLAS McLEOD

RICHMOND, Va.—The former top managers and others involved with an insolvent Virginia malpractice insurance group are denying charges that they conspired to conceal growing financial problems that led to the group's January collapse.

Virginia Insurance Commissioner Alfred W. Gross, who is the deputy receiver for Reciprocal of America, filed a 121-page complaint leveling racketeering charges against former ROA executives, ROA reinsurer General Reinsurance Corp., auditor PricewaterhouseCoopers L.L.P., actuarial consultant Milliman USA Inc. and several others.

The suit alleges that the defendants participated in schemes designed to evade regulatory scrutiny and cover up ROA's deteriorating financial condition by entering into undisclosed reinsurance arrangements, recording false assets in the insurer's books and doctoring ROA's reserve levels.

"As financial disaster loomed as a real

See **ROA**/page 6



PHOTO: KRT

Senate Majority Leader Bill Frist, R-Tenn., flanked by Speaker of the House Dennis Hastert, R-Ill., left, and Sen. Charles Grassley, R-Iowa, discusses legislation that would add a prescription drug benefit to the Medicare program.

New options to cut prescription costs

Employers win relief on Medicare drug bill

By JERRY GEISEL

WASHINGTON—Employers with retiree health care plans would gain enormous financial relief under Medicare prescription drug legislation nearing final congressional approval.

The relief, included in the measure that would add a prescription drug benefit to the federal

Medicare program, would be provided in several ways.

In the most direct way, employers that retain prescription drug coverage actuarially equivalent to what Medicare provides would receive tax-free payments from the government equal to 28% of the cost of the prescriptions they pay for each

See **MEDICARE**/page 21

International

LONDON MARKET CONSIDERING GUIDELINES TO STREAMLINE RUNOFF CLAIMS

CIGNA selling pension unit to focus on health care

By SALLY ROBERTS

PHILADELPHIA—CIGNA Corp. is selling its retirement business operation to Prudential Financial Inc. in a \$2.1 billion cash deal that will allow the Philadelphia-based company to strengthen its capital and to focus on its health care and related insurance programs.

CIGNA said last week that it has signed a definitive agreement to sell its retirement operation, which manages defined contribution, defined benefit and nonqualified pension plan business, to Newark, N.J.-based Prudential.



The deal excludes CIGNA's corporate life insurance business and its investment management operations, for which CIGNA executives will continue to explore options, the company said.

The deal is expected to close by March 31, 2004.

CIGNA announced in late July that it was exploring "strategic alternatives" for its retirement and investment services business, including divesting the business or placing it with a separate operating company with its own financial ratings

(BI, Aug. 4).

In a conference call to analysts last

week, H. Edward Hanway, chairman and chief executive officer of CIGNA, said the company "has a long and successful history in the retirement business, and it has generated good results for CIGNA over the years. However, we have concluded that greater shareholder value will be realized through the sale of this business and reinvestment of the proceeds in (other) areas."

"We believe the interests of the customers will be well served by this transaction, as Prudential is committed to growing in the market that our retirement business has served for many years," Mr. Hanway said.

"This transaction with CIGNA builds on our presence in the retirement market by adding significant scale and capabilities," Arthur Ryan, See CIGNA/page 20

National Assn. of Independent Insurers annual meeting

Security seen as key issue in reinsurance renewals

By JUDY GREENWALD

ATLANTA—Security is the top issue on the minds of insurers, reinsurers and intermediaries as they enter into the January renewals.

In particular, the implications for the industry of Philadelphia-based PMA Capital Corp.'s situation was a major topic of discussion at the National Assn. of Independent Insurers' annual meeting in Atlanta earlier this month. PMA Corp. has announced that, with a \$97.5 million charge in the third quarter to strengthen reserves, it has been downgraded to B++ by A.M. Best Co. and will stop writing reinsurance.

Observers say they anticipate more downgrades, and many expect a subsequent further decline in

the number of reinsurers in the market as well.

Meanwhile, there is a consensus that the market will remain hard at least through 2004.

For the January renewals, reinsurer and intermediary executives say they expect property rates to be flat to down slightly, while stable or increased rates are generally expected in casualty lines.

Overall, despite worries about security, downgrades and reserve hikes, the tone of the NAII meeting, where many reinsurers, insurers and intermediaries meet to negotiate their January renewals, was optimistic, say observers.

The mood was "pretty upbeat," said Patrick J. Denzer, president and co-chief executive officer of reinsurance intermediary John B. Collins

Associates in Minneapolis.

"I'd say it was relatively positive," agreed David Priebe, managing director of reinsurance intermediary Guy Carpenter & Co. Inc.'s specialty practice group in New York. It seems people are "really getting focused" and looking to see how they can put together their 2004 programs. A number of new market participants are also taking a more active role as they pick up the shortfalls created by the reinsurers that have left the market, said Mr. Priebe.

There has been a more-intense focus on security, though. Roderick P. Thaler, executive vp and national director at reinsurance intermediary Willis Re in New York, said, "I think there's a big focus on security, obvi-

See NAII/page 20



Royalties for offshore natural gas operations are at the center of a case that resulted in a punitive damage award of \$11.8 billion against Exxon Mobil.

Big punitive award rekindles debate over tort reform

By MARK A. HOFMANN

An Alabama jury's decision to slap an \$11.8 billion punitive damage award on Exxon Mobil Corp. underscores the need for closer judicial scrutiny of punitive damages, say tort reform proponents.

Juries need to be instructed more carefully about the Supreme Court's decision earlier this year in *State Farm vs. Campbell*, they say. That decision held that, under most circumstances, a punitive damage award of double-digit multiples of the underlying compensatory awards crosses the boundary into unconstitutional territory (BI, April 14).

Jurors also need to be reminded that they should not take the relative wealth of a defendant into account when determining punitive damages, say reform advocates.

A lawyer representing the state, however, said that the *State Farm* ruling does not neces-

sarily apply in the Exxon Mobil case and that the jurors were free to award punitive damages that reflected the potential future gain that any fraudulent conduct might have achieved.

A spokesman for the Assn. of Trial Lawyers of America in Washington said that pro-tort reform groups that cite *State Farm vs. Campbell* to criticize the Alabama punitive damage award "don't understand the *State Farm vs. Campbell* decision, and they also don't trust the American people who do their patriotic duty by sitting on juries, listening to all the evidence on all sides and making intelligent decisions." He added that the decision did not draw a "bright line" separating acceptable from unacceptable punitive damage multiples of compensatory damages. "As a matter of fact, the case could be interpreted to say that lower courts should increase punitive damages in some cases where appropriate."

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Inside Business Insurance

Uncertainties cited in keeping market firm

Insurance industry executives at the PLUS conference said uncertainties, such as terrorism risks, are keeping coverage prices up. Page 4

Calif. wildfire claims to top \$2 billion: PCS

Recent wildfires in California are thought to have caused \$2.04 billion in insured property damage. Page 4

Industry cooking up a hearty feast

Paul Winston considers the menu at the insurance industry's Thanksgiving dinner. Page 6

Courts must follow justices' lead

The Supreme Court's recent guidance on punitive damages seems to have fallen on deaf ears in Alabama. Page 8



Lloyd's to adopt U.K. GAAP in 2005

Lloyd's of London will retire its traditional three-year accounting system in 2005, as part of efforts to modernize the market. Page 17

Online

- The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.
- Searchable **directories** of all the listings of industry vendors found in BI's Market Sourcebook.
- New **Opinion Poll** for readers: Do you think the St. Paul/Travelers merger signals the beginning of another round of major consolidation in the property/casualty insurance industry?

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REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS.

Stopgap pension bill moves forward

By JERRY GEISEL

WASHINGTON—Congress is one step closer to passing stopgap pension funding reform legislation as a compromise on a controversial bailout issue may be nearing.

Tax legislation passed last week by the House of Representatives includes pension provisions to let employers use the four-year weighted interest rate on long-term investment-grade corporate bonds to value plan liabilities in 2004 and 2005.

The use of the corporate bond-linked index in that period is expected to cut employers' pension plan contributions by more than \$25 billion compared with the cur-

rent methodology, which uses the yield on 30-year Treasury bonds. Employers have long complained that the T-bond yield is artificially low, which inflates pension plan liabilities and forces plan sponsors to contribute far more than is necessary to their plans.

The two-year switch to the use of the corporate-bond index is intended to give legislators time to develop and enact a comprehensive funding reform measure.

In a possible compromise over what has become an issue with the Bush administration, H.R. 3521 would limit special funding relief to one industry—commercial airlines.

Under that relief provision, com-

mercial airlines would be largely shielded from a current law that requires employers with underfunded plans—generally those that are less than 90% funded—to accelerate contributions to the plans.

Commercial airlines for 2004 and 2005 would be required to make only 20% of the so-called deficit reduction contribution that would otherwise apply. That special-interest funding relief would save the nation's financially strapped airlines hundreds of millions of dollars in pension contributions and is being welcomed by them.

"United, along with many other companies, supports the efforts in Congress to modify this accelerated

timetable and smooth out pension contributions in the short term," said Jack Brace, executive vp and chief financial officer at United Airlines' Elk Grove Village, Ill.-based parent, UAL Corp., in a statement. United's pension plans are underfunded by \$6 billion to \$7 billion.

House congressional leaders have their misgivings about extending funding relief to any one industry but say it may be necessary to reach a compromise with the Senate.

"Certainly, it is a last-resort approach. I would prefer not to single out any one industry for...relief, but enough of our Senate colleagues feel differently and we are nearly out of time," said House Education

and the Workforce Committee Chairman John Boehner, R-Ohio.

In the Senate, a Finance Committee-passed bill has drawn fire because it would exempt for the next three years any employer from the DRC if its plans were not subject to the DRC in 2000.

The Pension Benefit Guaranty Corp. has warned that a blanket DRC exemption would significantly increase plan underfunding, exposing the already financially weakened agency to even bigger losses.

The House bill to limit the exemption to one industry would reduce the PBGC's potential exposure while aiding the politically powerful airline industry, observers say.

16th annual PLUS Conference

Underwriting uncertainties marking market

By MARK A. HOFMANN

PHILADELPHIA—The current casualty insurance marketplace is not likely to soften significantly in the short term, according to a panel of top property/casualty insurance industry executives.

That was just one of several assessments of issues present and future offered by the execu-

John Degnan, vice chairman of Chubb Corp. in Warren, N.J., said the insurer is continuing to see what he called "healthy double-digit" rate increases for most lines. The insurance industry's outlook will "continue to improve" over the next 18 to 24 months, he predicted.

But reinsurers across the world have "been hit very hard," particularly by the terrorist attacks of Sept. 11, 2001, said Joseph Brandon, chairman and chief executive officer of General Reinsurance Corp. in Stamford, Conn.

Indeed, because of market woes, some reinsurers seem unwilling to pay claims, said Roger E. Egan, president of Marsh Inc. in New York. "The whole claims-paying attitude is an issue," he said.

Gen Re's Mr. Brandon added, "it's amazing that we see people who continue to do business with folks who aren't going to pay them."

"If you make an underwriting mistake, you get to write the check," he said.

Turning back to the primary market, Mr. Degnan said that even some regional brokers are worried about the viability of long-term relations with insurers. The "failure of another major company" would definitely have an impact on the duration of the hard market.

Another uncertainty is terrorism, which Mr. Degnan called a "fundamentally un-underwritable risk." He said that TRIA provides a partial solution by providing a federal backstop to help pay the costs of future terrorist attacks, but he said the law does not address the underlying un-

See **MARKET**/page 12

Losses from wildfires to top \$2 billion

JERSEY CITY, N.J.—Wildfires that ravaged large portions of Southern California in late October and early November caused an estimated \$2.04 billion in insured property damage, the Insurance Services Office Inc.'s Property Claim Services unit said Monday.

That makes the blazes, which burned from Oct. 25 to Nov. 4, the most costly California wildfires of recent history, surpassing the 1991 Oakland fires, which caused estimated insured losses of \$1.7 billion in 991 dollars.

The Cedar fire, which ravaged homes and businesses east of San Diego before being contained on Nov. 4, will account for about \$1.06 billion in insured property damage, according to PCS.

Another fire, known as Old Fort, joined with two other fires in the San Bernardino area to cause an additional estimated \$975 million in insured property damage before it was contained on Nov. 3.

—By Mark A. Hofmann



A retiree in San Diego searches the ruins of his home following deadly wildfires that devastated parts of Southern California.

Casualty Actuarial Society annual meeting

Loss of management control often to blame in insolvencies

By MICHAEL BRADFORD

NEW ORLEANS—A rash of insurer insolvencies in recent years has revealed the symptoms that often lead to the failures, a rating agency director says.

There is a loss of control at the top in many insolvencies, said Laline Carvalho, director, financial services ratings group, at Standard & Poor's in New York. Management teams changed, leading to confusion, and underwriting pens went to managing general agencies and underwriters with no "skin in the game" as a way to build market share, she said.

Ms. Carvalho, speaking as a panelist during a discussion at the Arlington, Va.-based Casualty Actuarial

Society's annual meeting in New Orleans earlier this month, said a lack of proper "communications channels" also marks weak insurance and reinsurance companies.

"One company we have dealt with that had huge losses," she recalled, had a previous management structure that had the company divided into operating silos, none of

which knew what the others were writing. At times, brokers who had business rejected by one department were able to successfully place it with another underwriter at the same insurer, Ms. Carvalho said.

Actuaries at many insurers, failed or not, are not getting a complete picture of the business written by the company, she said. Good underwriters know whether the coverage on their books is "good business or bad business," Ms. Carvalho suggested. "I'm not sure that information is always going to the actuary."

Other companies, though, have realized that oversight and begun to require that an actuary sign off on every risk, she emphasized.

Michael A. Coutu, chief executive officer of runoff management company Kenning Financial Advisors L.L.C. in Stamford, Conn., who was recently named acting president and CEO of Kemper Insurance Cos. in Long Grove, Ill., said during his presentation on the panel that the actuary's role as part of a company's

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Continued coverage on page 13

tives at the 16th annual Professional Liability Underwriting Society conference in Philadelphia earlier this month. Others included predictions that Congress will not extend the Terrorism Risk Insurance Act before it expires in 2005 and that the current effort to reform the asbestos liability system will fail.

Current market conditions are likely to continue because the industry is focused on underwriting profitability, said Susan Rivera, president of ACE INA Holdings Inc. in Philadelphia. Insurers want to understand underlying loss costs, she said. She also predicted that underwriters will face new issues, particularly as plaintiffs bars try to find new areas of litigation.



Coverage continues on page 19

Errors & omissions

• A story in the Nov. 17 issue, "Unusual Reinsurer Targets U.S. Market," misspelled the surname of Rob Esson, who is senior manager-glob-

al insurance markets with the National Assn. of Insurance Commissioners' International Insurers Department.

ROA: Receiver sues ex-leaders

Continued from page 1

possibility, the efforts to prevent insurance regulators and others from discovering the frailty of the enterprise dominated the focus of ROA's management and their co-conspirators, with lamentable consequences," charges the suit, filed earlier this month in U.S. District Court in Richmond.

Jonathan Schraub, a lawyer for three of the named ROA executives, dismissed the allegations against his clients as "factually untrue" and argued that many of the actions outlined in the complaint are normal insurance industry practices.

"Ninety-eight percent of this complaint, when you wring it out, is the way the insurance industry works," said Mr. Schraub, a partner with Sands, Anderson, Marks & Miller in McLean, Va. "It's patently

'Ninety-eight percent of this complaint, when you wring it out, is the way the insurance industry works....It's patently unfair.'

*Jonathan Schraub
Sands, Anderson, Marks & Miller*

unfair."

"Our conduct in regard to a long-term relationship with a longtime client was at all times proper," Richard McCarty, vp and assistant general counsel with General Re in Stamford, Conn., said of ROA. "We certainly do not think there was any improper behavior by (Gen Re) and its employees."

A spokesman for PricewaterhouseCoopers called the charges "baseless" and added that "we are disappointed that the receiver has chosen to sue the firm, particularly since he alleges that PricewaterhouseCoopers was misled."

A spokesman for Seattle-based Milliman declined to comment.

Glen Allen, Va.-based ROA, which wrote medical and legal malpractice coverage in several states, was ordered into receivership in January. At the time of the receivership action, ROA's liabilities exceeded its assets by about \$200 million, Virginia regulators say. ROA's surplus had been eroded not only by rising malpractice and workers compensation claims but also by problems collecting from a Bermuda-based captive, First Virginia Reinsurance Ltd.

Regulators obtained a liquidation order against ROA in June.

The actions prompted the Tennessee Department of Commerce and Insurance to take similar steps against three Tennessee-domiciled risk retention groups that reinsured virtually all of their business with ROA and were under common management with the Virginia-based insurer. The three RRGs, now in liquidation, are American National Lawyers Insurance Reciprocal, Doctors Insurance Reciprocal and The Reciprocal Alliance.

The insolvencies led policyholders of the three RRGs earlier this

year to file their own class-action racketeering complaints against ROA executives, General Re, PricewaterhouseCoopers and Milliman. Those suits have been consolidated in U.S. District Court in Memphis, Tenn.

The Virginia insurance commissioner's wide-ranging lawsuit names many of the same defendants as the consolidated action. In addition to Gen Re and ROA's auditor and actuarial consultant, they include:

- Kenneth R. Patterson, former president and chief executive officer of ROA; John W. Crews, former executive vp and general counsel, and Mr. Crews' Richmond-based firm, Crews & Hancock; Judith A. Kelley and Carolyn B. Hudgins, former ROA executive vps; and Gordon D. McLean, a former ROA president.

Charles F. Witthoefft, a Richmond lawyer representing Mr. Patterson and Ms. Hudgins, declined to comment on their behalf.

Mr. Crews, Ms. Kelley and Mr. McLean are represented by Mr. Schraub.

- Bermuda-based Atlantic Security Ltd., which managed First Virginia Re, and Atlantic Security Senior Vp Richard Witkowski.

Colin James, Atlantic Security's president, denied that the firm participated in the alleged actions and said of Reciprocal of America that "it was a very professionally run company that unfortunately got hit with a landslide of physician claims" along with other malpractice insurers. "We never saw anything that was remotely fraudulent," Mr. James said.

Mr. Witkowski could not be reached.

- Charlotte, N.C.-based Wachovia Bank N.A., which maintained a trust account for First Virginia Re and which loaned \$10 million in 2001 to ROA management company The Reciprocal Group.

A Wachovia spokeswoman declined to comment on the suit.

According to the complaint, the defendants worked together to carry out a number of alleged schemes to hide ROA's deteriorating financial condition over several years leading up to its January collapse.

Several of the allegations involve purportedly undisclosed side agreements to reinsurance contracts between ROA and Gen Re, its principal reinsurer.

Gen Re, among other things, acted as a fronting reinsurer on business that ROA "passed through" to First Virginia Re, which, in turn, set up claims trust accounts for Gen Re's benefit, according to the complaint. Rising losses and underfunding of the First Virginia Re trusts led to a 2000 side deal, the suit says, in which ROA and Gen Re agreed to an aggregate cap on Gen Re's liability for risks passed through to First Virginia Re under several in-force treaties.

The aggregate cap—for which ROA received no consideration but which substantially increased its exposure to losses—was not disclosed to regulators, and ROA officials falsely reported in the insurer's

2000 annual statement that ROA had no such limitations in its treaties, Virginia regulators charge.

Mr. Schraub, the lawyer for three ROA executives, countered that there is "nothing unusual or nefarious" about side agreements in reinsurance contracts and denied that ROA concealed any information

According to the complaint, the defendants worked together to carry out a number of alleged schemes to hide ROA's deteriorating financial condition over several years leading up to its January collapse.

that regulators were entitled to.

"Nothing was done that was in any meaningful sense 'undisclosed,'" Mr. Schraub said.

Other alleged schemes outlined in the complaint include:

- ROA's false reporting of millions of dollars of payments due General Re in 2000 and 2001 as ROA assets.

- Arbitrary reductions of ROA loss reserves aimed at keeping ROA's risk-based capital ratio above the level that would trigger regulatory action.

In November 2001, for example, ROA officials ordered back-dated writedowns of reserves on 109 large claims that resulted in a \$25.8 million reduction of the insurer's loss reserves in its Sept. 30, 2001, quarterly statement, the suit charges.

- Misappropriation of several million dollars from First Virginia Re trust accounts to make payments on a \$10 million loan to ROA and manager The Reciprocal Group by Wachovia Bank.

ROA managers, Atlantic Security and Wachovia concocted a complex series of transactions to tap the trust accounts and other sources of funds to repay the loan after Virginia regulators—concerned about ROA's financial condition—denied it permission to make the payments directly, the suit charges.

Mr. Schraub denied any impropriety in the loan repayments. "The money that was used to repay debt was properly used," he said.

The effect of all of the alleged schemes, Virginia regulators charge, was to steadily inflate ROA's reported surplus between 2000 and late 2002.

As of Sept. 30, 2000, ROA had artificially boosted its surplus by at least \$5.4 million through reserve writedowns, the suit says. By the same point in 2002, the insurer's surplus was overstated by at least \$42.5 million, regulators charge.

By the end of last year, the Virginia insurance department had concluded that ROA's surplus—which the insurer reported to be \$47 million as of Sept. 30, 2002—actually amounted to only \$3.7 million. Regulators soon moved to place ROA in receivership.

Paul Winston

Industry facing movable feast

Later this week, we will celebrate the holiday of Thanksgiving in the United States. This day is set aside from work and school for families around the country to give thanks for our many blessings. For many of us, this holiday is marked by watching the Detroit Lions on television and re-enacting the pilgrims' fondness for gluttony and overcooked fowl.

It can also be a time for the insurance industry to give thanks for its many blessings. As insurers gather around the Thanksgiving table this year, they surely will give thanks for the bounty before them. On the menu will be:

Turkey. Representing the industry's capital, this bird isn't as big as it was in the 1990s. In fact, this

year's turkey is a lot leaner, which means there isn't much excess meat anymore, resulting in smaller portions for all and certainly no leftovers.

Adverse conditions at the turkey farms in recent years, in the form of stock market declines, plummeting interest rates, catastrophe losses, company collapses and reserve additions, have shaved many pounds from this year's bird.

But it could be worse. Thankfully, there have been some efforts to bulk up today's comparatively scrawny fowl. New hormone therapies developed in Bermuda and London, in particular, have made strides at replenishing some of the meat lost in recent years.

Stuffing. Pound for pound, the industry has less meat to carve today compared with recent years, but the turkey's cavity is paradoxically larger than ever. This requires ever-greater amounts of stuffing in the form of reserve additions.

The industry's chefs keep cooking up new batches to try to fill the hole caused by growing liabilities for asbestos, workers comp and various other casualty lines where liabilities have far outstripped the original premium that was charged. And yet, there still isn't enough to go around. This is all the more distressing for the chefs, because the rating agencies invited to the table seem almost implacable in their demands for extra helpings.

Green vegetables. Thankfully, there is no shortage of green vegetables to go around. They might taste bad, but everyone knows they are good for you. So it is with the industry's underwriting discipline: It might not be the tastiest thing to swallow, but it balances the diet and improves the industry's health. In fact, why not have another serving?

Mashed potatoes. While the

casualty side of the business might be regarded as unpalatable to the industry, thank goodness for a serving of plain, bland and dependable property results this year. Sure, there may be the occasional lump caused by a catastrophe or two, and Texas insurers unfortunately got a moldy batch of spuds, but otherwise it's a welcome addition to the industry's plate.

Of course, given recent dietary fads, there are bound to be some at this year's table who have jumped on the Atkins diet bandwagon. This means they have decided to only consume a diet of casualty risks and must, therefore, eschew any starchy property risks. Supposedly this will

make them thinner and healthier, but there is something to be said for the merits of a balanced diet.

Gravy. As with any Thanksgiving dinner, distasteful menu selections can always be enhanced with an ample serving of rich gravy. Small bits of turkey, dry blobs of stuffing and lumpy potatoes all go down better with a ladle of

savory earnings. After several years in which the industry's chefs have burned the gravy, this year many seem to have managed to produce extra tureens of profits this year. Enjoy it while it lasts.

Of course, those who have too much stuffing on their plates to consume this year will find it tends to soak up almost any quantity of gravy.

Dessert. Ah, you can almost taste it, can't you? After polishing off a meal like this, the industry waits with forks poised for dessert to be served. As the finale to this Thanksgiving meal, the industry is hoping to enjoy some specialties of the congressional dining room that are as closely guarded as the recipes for Mrs. Fields Cookies. The industry has asked—nay, pleaded with—members of Congress to give it the recipes for pumpkin pie a la class-action reform and mincemeat pie a la asbestos reform.

Unfortunately, at this late hour, it appears that those requests have been denied. As a result, the industry will one again have to settle for a Thanksgiving dessert of a bright Jell-O mold, topped with Cool Whip. Somehow, it's just not as satisfying, not to mention artificially flavored.

Of course, industry executives can always hope that their wishes will be granted and they'll be served a more scrumptious dessert at Christmas.

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Paul Winston

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ADVERTISING: Boston: 617-292-4856; Chicago: 312-649-5276; New York: 212-210-0133; Los Angeles: 323-370-2456
COMMUNICATIONS: New York: 212-210-0132
SUBSCRIPTIONS: Detroit: 888-446-1422
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Published weekly at 360 N. Michigan Ave., Chicago, Ill. 60601-3806, Fax: 312-280-3174, biweb@crain.com. Offices: 711 Third Ave., New York, N.Y. 10017-5806, Fax: 212-210-0704; 71121 Minkler St., Abita Springs, La. 70420; Fax: 985-871-4006; Suite 814, National Press Building, Washington, D.C. 20045-1801, Fax: 202-638-3155; 6500 Wilshire Blvd., Suite 2300, Los Angeles, Calif. 90048-4947, Fa: 323-655-8157; 967 Bermuda Court, Sunnyvale, Calif. 94086-6750, Fax: 408-774-1155; 34 Southwark Bridge Road, London SE1 9EU, Fax: 207-457-1440; 8157 N. Torrey Place, Tucson, Ariz. 85743, Fax: 520-579-3476; 777 E. Speer Blvd., Denver, Colo. 80203-4214; Fax: 303-733-2244; 11133 W. 108th St., Overland Park, Kan. 66210, Fax: 312-280-3174, 77 Franklin St., Suite 809, Boston, Mass. 02110-1510; Fax: 212-210-0704 \$4 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). Rudolf Von Bartsch, circulation manager. Four weeks' notice required for change of address. Send subscription correspondence to Circulation Department, *Business Insurance*, 711 Third Avenue, New York, N.Y. 10017-5806. Microfilm copies available: University Microfilms, 300 Zeeb Road, Ann Arbor, Mich. 48103. Microfiche copies: Bell & Howell, Micro Photo Division, Old Mansfield Road, Wooster, Ohio 44691. Portions of the editorial content of this issue are available for reprint or reproduction in other media. For reprints or reprint permission: Karen Brown Tucker, *Business Insurance*, 360 N. Michigan Ave., Chicago, Ill. 60601-3806, 312-649-5319, Fax: 312-280-3174.

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Editorial

Asleep at the bench in Alabama

SOMETIMES PEOPLE just don't pay attention. That's true even when the Supreme Court is doing the talking. Such selective attention is the only charitable explanation we can imagine for an Alabama jury's decision a few days ago to slap a punitive damage award more than 180 times the underlying compensatory damage award on a corporate defendant. As we report on page 3, the case involved an ongoing dispute over the payment of natural gas royalties. The jury said that Exxon Mobil Corp. had been willfully shorting the state of Alabama in its payment

of royalties—a charge Exxon Mobil denies. That a jury in such a case would order the defendant to pay compensatory damages is reasonable enough. That it would order the defendant to pay better than 180 times those compensatory damages in punitive damages is not reasonable in the least. In fact, it's an invitation for, if not an outright rejection of the award, at least a drastic reduction of it. And that's how it should be. After all, not even a year has gone by since the Supreme Court held in *State Farm vs. Campbell* that, under

most circumstances, a punitive damage award of double-digit multiples of the underlying compensatory damage award won't pass constitutional muster. Note that the court said that it takes only double-digit multiples—not the sort of triple-digit multiples seen in the Exxon Mobil case—to raise serious constitutional questions. While that's not a legal bright line, it's not exactly a smear of invisible ink, either. It certainly ought to be clear enough to give a jury pause before it levies an award of the size seen in the case in Alabama. Exxon Mobil has already said it

will appeal the verdict. Regardless of the specifics of the case, they'll be performing a public service by doing so. Using punitive damage awards far in excess of what the Supreme Court has deemed acceptable to send a message is a waste of judicial resources. We hope the Alabama Supreme Court hears the Exxon Mobil appeal with all due speed and scrutinizes the punitive damage award very carefully in light of the *Campbell* decision. When the Supreme Court speaks, someone should listen. If juries won't, then it's up to the judges to make up for the attention deficit.

A dose of common sense

ON MORE THAN ONE occasion, we have asked the question: What is the value of a health care plan that doesn't include coverage for prescription drug expenses? Finally, Congress seems to have gotten the message, as House and Senate negotiators have agreed on a landmark legislative package that, starting in 2006, would add a prescription drug benefit to Medicare. The change would mark the biggest expansion of the federal program since it was established 38 years ago. As we see it, this is one of those rare situations where the major players in the retiree health care arena—the government, retirees, health plans and employers—all

should benefit. For the government, adding a prescription drug benefit could, over the long run, save—rather than cost—it money. If they have coverage for at least a portion of drug costs, Medicare beneficiaries are more likely to fill prescriptions and take medications that could improve their health status and help them to avert much more costly medical treatments. Retirees themselves, of course, would benefit, because they would be much less exposed financially to big prescription drug bills. For health plans, the legislation revamps the system through which the government pays them for providing health care coverage to Medicare-eligible retirees, increas-

ing the likelihood that they can compete in the big and growing elderly market. And for employers, as we report on page 1, the legislation gives them rich financial incentives to retain their prescription drug benefit programs for retired workers. This, we think, is a wise move on the part of lawmakers. With 40 million people in Medicare and eligible for the new benefit, keeping even a few million people in their former employers' health care programs may take a significant administrative burden off Medicare at a time when it most needs that relief. We hope legislators now move to give the legislation final approval and send it to President Bush for his certain signature.

Letters to the Editor

U.S. collateral rules offer important protections

To the editor: *Business Insurance* got it right the first time: Rushing to relax collateral requirements is not in commercial policyholders' best interests, as you suggested in your Oct. 27 editorial, "Reconsider Collateralization Requirements." Let the National Assn. of Insurance Commissioners perform the studies of the accounting and enforceability of judgment provisions around the world. Harmonization is a critical prerequisite for the consideration of collateral reduction. The European Union was recently reported as not yet being able to agree on a definition of "solvency." What could be more basic to insurance regulation? E.U. accounting rules have been delayed until 2007. Negotiations on treaties to provide enforceable judgments won't be begin until December, and ratification must follow. Need I say more? The editorial also used an analogy that just doesn't fit. Comparing collateral requirements for alien reinsurers in the same breath as countersignature requirements is akin to considering lifeboats in the same breath as rearranging deck chairs. Many elements of state regulation are antiquated, protectionist in the negative sense and in need of change. Collateral requirements are definitely protectionist, but in the context below. Collateral requirements are protectionist of ceding companies that need to collect reinsurance recoverables in a timely manner to pay claims. Collateral ensures the solvency of those companies and that ceding companies will be able to enforce judgments against reinsurers abroad, if necessary. Also, companies need to have a degree of certainty that the reinsurers' financial statements accurately reflect their solvency status. This permits comparisons among alien and U.S.-based reinsurers, provided there is a level playing field of

Schillerstrom



Business Insurance welcomes letters to the editor. The section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters. Please send your letters to: Letters to the Editor, *Business Insurance*, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; fax: 312-280-3174; e-mail: pwinston@crain.com

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Ask a Casualty Actuary

Discerning when a trend isn't—and is—real

By Richard E. Sherman

Q: What are the biggest hazards in gauging trends in claim data?

A: One is seeing a trend in data when there really isn't one. The data is clearly going up or going down, and we have reasons to suspect it should be doing that, so we become sold on the reality of it.

The problem is that most data will naturally bounce around, and the degree to which it will do that for no other reason than sheer random variation can be greater than the magnitude of the substantive changes. Such variation is like bad static that can fuzz up a



radio broadcast. This is particularly true for small to medium-size risk management programs.

Here's a case in point. Suppose you typically have an average of 100 workers compensation claims a year, made up of 75 medical-only claims and 25 time-loss claims.

The latter account for the real dollars, so your bonus is partly tied to drops in time-loss counts. You look at the number of time-loss claims during each of the past three years: 31, 24 and 17. That's a fairly convincing trend, so you tout it to management as proof of your effectiveness, even though you can't see how you could have caused claims to drop that much. You get a healthy bonus. The next year, there are 34 claims, and you are in hot water. In reality, these kinds of variations could be due purely to random fluctuations.

Picture Diligent Dave and Lazy Larry as risk managers of two large divisions in a huge corporation. Each division averaged 25 time-loss claims per year before they became competing risk managers. By all rights, Dave's diligent efforts should cause a 10% reduction in claims, while Larry's neglectful ways should result in a 5% increase. How often will Larry be chosen as risk manager of the year over Dave, based on changes in claim frequency? Using a simple simulation model, it can be shown that this will occur about 30% of the time. Chance fluctuations are a frustrating complication to the task of performance measurement.

Now suppose there really has not been any change in the expected number of claims over recent years, and there won't be any changes in future years either. And yet Larry and Dave are not aware of this. They each provide a forecast of the number of time-loss claims for next year. Being more sophisticated, Dave fits a trend line through

the number of claims for the past three years to develop his forecast. Being lazy and not well educated, Larry simply takes the average number of claims over the past three years. Which one will provide the more accurate forecast more often?

As it turns out, Larry's estimate will be closer to the underlying claim count about 72% of the time. The average error in Larry's forecast is only 2.4 claims, vs. an average error in Dave's forecast of 6.2 claims. And Larry's estimate is noticeably off (e.g., by more than five claims) only 10% of the time, compared with 50% of the time for Dave's sophisticated trended estimate. Larry's estimate is quite far off (e.g., by more than 10 claims) only 0.2% of the time, vs. an astonishing 20% of the time for Dave's. So in this situation, the Simple Simon straight average estimate is the better one about three times out of four, and it is far less subject to being dramatically incorrect.

Another major hazard is missing a trend that is actually taking place. Suppose there has been a steady drop in claim frequency. In year one, the expected number of claims is 25, but then it drops by two claims a year for every year after that (i.e., 23, 21, 19). One would think the trend method would pick this up. Again using a simple simulation model, it can be shown that about 30% of the time, the fitted trend line will indicate an upward trend in this situation! Furthermore, the average estimate is more accurate than the trended one about two times out of three,

and it is far less likely to be dramatically incorrect.

To estimate the average deviation from expected due to chance, take the square root of the average number of time-loss claims for recent years. If the average count is 25, the average random deviation is 5. If it is 100, the average deviation is 10. If 500, 22.4. So, the average percentage deviation drops from 20% to 10% to 4.5% as the expected number of claims increases from 25 to 100 to 500.

Just as the law of large numbers makes data analysis more reliable when there are many claims, the law of small numbers makes conclusions drawn from thin data rather shaky.

Would you like advice from an experienced colleague on a risk management, benefits management or actuarial problem? Three regular features in the Perspective section of Business Insurance can give you some answers.

Ask A Casualty Actuary answers written questions from readers on risk and benefits management issues and actuarial problems.

This month's column on actuarial issues in the casualty field is written by Richard E. Sherman, president of Richard E. Sherman & Associates Inc. in Ashland, Ore.

Address your questions to ASK, Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601. Please give us your name, title and employer; however, Business Insurance will consider unsigned letters.

Don't ignore risks when jobs are outsourced

By Bob Ditmore

By the end of 2004, one out of 10 information technology vendor and service-provider jobs now based in the United States will be moved overseas to emerging markets such as India and Russia.

That figure comes from a recent report issued by The Gartner Group, a nationally recognized IT research and advisory firm. This movement of jobs to foreign countries, known as outsourcing, has exploded in popularity during the last 10 years.

Companies have discovered they can hire foreign workers to perform programming and other IT-related jobs for less money than they would pay domestic workers.

And it's not just IT jobs that are being outsourced to foreign countries.

Manufacturing, telecommunications, engineering and human resources are also migrating to other lands.

While companies incur huge savings by sending jobs overseas, there are significant risks involved when outsourcing any business function. Such risks relate to telecommunications functionality, geopolitical issues, protection of sensitive information and unusual events. It's important that chief executive officers, chief financial officers and risk managers prepare

It's crucial that companies evaluate and assess each of their functions and develop policies and procedures that will help lessen the impact of an outsourcing malfunction.

and plan for these risks to minimize their impact on business operations.

The potential for a telecommunications breakdown is great for businesses involved in or considering outsourcing, as today most information is sent through telecommunications lines. If such a line is destroyed, it could put your company out of business, at least for a time. But if the proper risk management tools are in place, the situation will be much easier to handle. It is important to examine your methods of communicating and to ensure that a backup is in place. Don't rely on one method of communication.

The potential for political unrest exists in many countries that are desirable outlets for outsourcing, such as Russia and India. If you're outsourcing to a foreign country, it's important to plan for the possibility of war and the impact such a conflict would have on your business. In addition, you should plan for a worst-case scenario. What would you do if the country were taken off the map? Where would you perform the outsourced functions? How would you protect your facility and its contents and your intellectual property? Where would you relocate your business?

Your business probably has a significant amount of sensitive information on file. This can include company trade secrets and

business plans, and the critical business know-how that accompanies them. The safeguarding of such information is a concern in the United States. Threats such as information theft by company insiders, former employees and computer hackers abound. However, the legal standards and business practices governing whether and how sensitive information should be guarded vary around the world. If you outsource, do you know what standards apply? Do you understand what safeguards are in place at the offshore location, both for employees and for outside hackers? Are you prepared to respond to an incident in a foreign country? How would your business handle a potential public relations crisis?

The recent outbreak of severe acute respiratory syndrome affected several companies that outsourced functions, especially those based in China. But the effects of SARS were felt in the United States, too. Companies that had employees working in China when the SARS outbreak occurred had to move those employees back to the United States or have them quarantined. In addition, companies in the United States that received packages from China were concerned about opening them in case the disease could spread. The SARS outbreak shows the importance of planning for unusual and unexpected events.

Companies need to understand the flow of their business and how each function or operation could be affected by an unusual event.

In addition, companies that outsource overseas need to develop disaster recovery plans, if they haven't already. Such plans force companies to examine possible risks, and they are crucial if companies want to purchase insurance to cover property, liability or business interruption exposures. Also, it's a good idea to have a backup should anything go wrong with your infrastructure, your business partners or your distribution channels. In addition to a backup, you might want to consider drawing up a contract with the company responsible for securing the outsourcing. The terms of the contract and the shifting of the risk can be governed by that document.

The outsourcing trend is expected to continue well into the future. And, it's likely that, in the next 10 to 20 years, most businesses will outsource at least one function of their operation. That's why it's crucial that companies evaluate and assess each of their functions and develop policies and procedures that will help lessen the impact of an outsourcing malfunction. Purchasing insurance—whether it's property, liability or business interruption coverage—is only one part of the equation. While insurance can help cover the costs of an outsourcing malfunction, it won't protect a company's reputation. And, in the end, that may be more valuable than anything else.

Bob Ditmore is vp-underwriting services at the St. Paul Cos. Inc. in St. Paul, Minn.

Red flags help to spot possible comp fraud

By Jerry Landsman

Workers compensation fraud is the fastest-growing segment of insurance fraud in the United States today. It is estimated that workers comp fraud alone costs the insurance



industry \$5 billion annually and that 25% of all claims filed are fraudulent. Claimant fraud, which includes false and exaggerated claims, makes up the bulk of money stolen from business owners and the workers comp system.

Who pays for this crime? We all do. First in line to absorb the cost of claimant fraud are policyholders. In fact, approximately 8% of all premium dollars paid by business owners go to cover the cost of workers comp fraud. That's because insurance companies must pass their losses along to policyholders in the form of higher premiums. This added expense then forces business owners to increase their prices in order to cover the expense of higher premiums. Finally, consumers pay more for

goods and services.

There are ways to combat claimant fraud and reduce costs for everybody. Business owners and risk managers, especially, can fight fraud and possibly reduce their workers comp premiums.

First, understand what defines claimant fraud. Second, understand why some claimants commit fraud. And third, learn to spot the red flags fraudsters wave right under your nose.

Claimant fraud is the most familiar type of fraud. It includes faked injuries, injuries not suffered on the job, exaggerated injuries and claimants working while collecting benefits.

Often, claimant fraud injuries take the form of soft-tissue traumas such as headaches, whiplash or muscle strains, because these types of conditions are difficult to disprove. It also includes multiple claims filed under various aliases.

The workers comp system, which is designed to be a no-fault system, gives an injured worker every benefit of the doubt in establishing compensability for an on-the-job injury. Through the current system, workers and their families receive cash benefits for lost income and are insulated from medical costs associated with workplace injuries. This benevolence, however, leaves the workers comp system vulnerable to fraud.

An employee can be motivated to commit fraud because of greed or simply because he or she is enticed by the opportunity to receive "easy" money—up to 66% of the

employee's weekly pay, tax-free.

Knowing the indicators of claimant fraud can help your company detect fraudulent behavior before it spirals out of control and costs everyone a lot of time and money. Teach employees, especially management personnel, how to identify the red flags of claimant fraud.

The list below identifies some of the more common red flags of claimant fraud. Remember, though, that the presence of one or more of these items does not mean there is fraud involved in the claim, only that the claim may warrant a closer look and referral for investigation.

- Consider these flags:
- Employee:
 - Is too familiar with the workers comp system.
 - Has an attorney the day of the injury.
 - Is disgruntled, on probation, facing layoff or ready to retire.
 - Is employed in seasonal work that is about to end.
 - Has a poor attendance record.
 - Is new on the job.
 - Changes doctors when return to work is noted.
 - Produces a Social Security number that does not belong to him or her.
 - Reports his or her home address as a post office box, hotel or motel.
 - Cannot be reached at his or her home phone number.
 - Delays reporting the injury for four

weeks or more.

- Has rehabilitation or medical reports that provide a physical description inconsistent with the injury.
- Protests return to work, doesn't seem to improve.
- Has problems with work relationships.
- Has financial difficulties.
- Was seen working elsewhere while on disability.
- Reported accident:
 - Was not witnessed by anyone, not even co-workers.
 - Was rumored to be staged, to have never occurred or to have occurred elsewhere.
 - Occurred late Friday or shortly after the employee arrived at work on Monday.
 - Occurred in an area where the employee would not normally be working.
 - Occurred at an odd time.
 - Has only vague or inconsistent details.
 - Occurred after termination or layoff.

The best way to fight fraud is to prevent it. Simply adjust your company's fraud radar and you can help to sound the alarm whenever one or more red flags of fraud appear. Your company's vigilance might just prove to be one of the most effective cost-saving initiatives of the year.

Jerry Landsman is director-fraud operations for the Injured Workers Insurance Fund in Towson, Md.

ERISA doesn't allow retiree choice on plan cashout

Legal briefs

The Employee Retirement Income Security Act does not allow a plan participant with more than \$5,000 in benefits to choose to be cashed out, the 1st U.S. Circuit Court of Appeals ruled.

Thomas Twomey was a Delta Air Lines Inc. pilot for more than 28 years. As of his 60th birthday in 1986, federal regulations prohibited him from flying as a captain or copilot/first officer. In August 1985, Delta sent information regarding his retirement benefits to Mr. Twomey's home address. In June 1986, Delta sent an application for benefits to the same address. The package was returned unclaimed. In July 1986, another package was sent to an alternate address and signed for by

someone other than Mr. Twomey. Mr. Twomey did not contact Delta for nine years. In 1995, at his request, an application for retirement benefits was sent to a New Hampshire address. This package was returned marked "Box Closed." Subsequently, information was sent to Mr. Twomey's counsel. Finally, on Feb. 17, 1997, Mr. Twomey submitted an application to Delta. The next day, Delta sent him a lump-sum payment of \$1,071,567, and monthly benefits payments began effective

March 1999. Mr. Twomey was dissatisfied with the lump sum and wanted interest and lost profits totaling \$930,513. His administrative appeal was unsuccessful and a federal trial court also ruled against him.

On appeal, Mr. Twomey argued that terms of the plan allowed for payment of interest. But the court said ERISA requires a participant to consent before being cashed out when the present value of the benefit is more than \$5,000. According to the court, ERISA does not allow a participant to choose to be cashed out. Furthermore, the court said the interest provisions of ERISA did not apply to Mr. Twomey's situation because the plan did not cash him out. "Instead," the court observed, "the lump-sum Twomey requested was merely the retroactive payment of his accumulated benefits." The trial court decision was affirmed.

Twomey vs. Delta Air Lines Pilots Pension Plan, 1st U.S. Circuit Court of Appeals, May 7, 2003 (BI/05/O.-\$10)

Inoculation injuries compensable

In a case of first impression, the District of Columbia Court of Appeals ruled that a workers compensation claimant's injuries resulting from an inoculation required for employment occurred in the course of employment.

Paul Thielke was injured in 1960 in a chemical explosion that required brain surgery. He recovered with no convulsions or behavioral changes. He graduated from college and held jobs as a compensation analyst. He suffered no seizure disorders after the accident up to 1992.

In 1992, Washington Hospital Center hired him as a compensation analyst. Scheduled to begin work Feb. 10, 1992, he was required to receive a measles, mumps and rubella vacci-

nation. Within days of the vaccination, Mr. Thielke began experiencing numerous symptoms, including delirium and disorientation. He reported to work but symptoms, including seizures, continued. Although he was able to return to work, he continued to have occasional episodes of fainting without warning. Mr. Thielke applied for temporary total disability benefits. Between 1992 and the workers compensation hearing, he had more than 39 seizure episodes. The Department of Employment Services awarded Mr. Thielke benefits, concluding there was sufficient evidence to establish that the MMR inoculation caused the seizures. The employer appealed.

On appeal, the employer argued that there was no employer-employee relationship between it and Mr. Thielke on Feb. 3, 1992, when he received the MMR vaccination, and that the pre-employment vaccination was not an event that arose during the course of his employment. According to the employer, Mr. Thielke was not an employee at the time of the inoculation because he had not yet reported to work. However, the court said that but for his employment, Mr. Thielke had no obligation to obtain the vaccination and was inoculated at the behest of the employer. The court affirmed the award of benefits.

Washington Hospital Center vs. Department of Employment Services, District of Columbia Court of Appeals, April 24, 2003 (BI/04/O.-\$10)

These abstracts were prepared by Mayo H. Stiegler. Copies of these decisions are available, at \$10 each, by sending a check payable to Mayo H. Stiegler, to Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601-3806. Please provide the listed number for each opinion ordered.

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- Send us a letter describing the topic you would like to address. Briefly describe what you want to say and accomplish in

the article.

- You will receive from us an acceptance or a rejection of your article idea.
- If accepted, we will respond with comments and request the full article, which generally should be no more than 800 words long.
- All articles are to be accompanied by a photograph of the author and a brief biography.
- We will notify you of any questions we have about your article and any substantial editing we think is necessary.
- All authors must assign the copyright on the article to Business Insurance.
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Market: Softening not seen

Continued from page 4

deriving problem. That's a "fundamental challenge that we have not yet conquered," he said.

Mr. Brandon called TRIA a "very incomplete solution." He added, "I think we all have to assume that TRIA will not be renewed at the end of 2005," and he said that companies will have to be "forward-thinking" to deal with an environment without TRIA.

In addition, another piece of legislation of considerable interest to insurers—a measure that would change the way victims of asbestos-related diseases are compensated—won't even get to the Senate floor, predicted Mr. Degnan. There's "no chance" of liability asbestos reform passing until after next year's general elections, he said. If President Bush is defeated, there will be no chance of any federal tort reforms at all, he said.

The idea of replacing the current litigation-based system for compensating victims of asbestos-related disease "was a nonstarter from the beginning," said Mr. Degnan, noting that the insurance industry itself has been divided over the issue. A bill narrowly approved by the Senate Judiciary Committee in July lost insurer support when last-minute amendments increased the amount of money insurers would have to pay into the proposed trust fund to well over \$50 billion at a minimum. Insurers had said they would not be willing to pay more than \$45 billion. They have since agreed to pay slightly more than \$46 billion into the fund, provided that they would face no contingent liabilities if the fund ran short of cash in the future.

"There's no way you're going to get 60 votes" to end debate on the asbestos bill and move it to a final vote, Mr. Brandon said.

When asked about the biggest issues facing the industry, the panelists gave varied answers.

Mr. Degnan cited asbestos and terrorism and said insurers must respond more effectively to the trial bar and speak with a unified voice.

Marsh's Mr. Egan called for "reaffirmation of this promise to pay" that he had cited earlier. In addition, underwriters must better differentiate among risks in the current rising rate environment, he said.

Gen Re's Mr. Brandon also cited underwriting as a key issue. Underwriting must be brought back as a "craft" he said, because insurers and reinsurers can no longer rely on investment income.

ACE INA's Ms. Rivera said that "accumulation management" of risks is critical for insurers. They have to look at the potential catastrophic events that the industry faces and underwrite accordingly.

Todd Buchholz, chairman and chief investment officer of Victoria Capital Management L.L.C., moderated the session.

16th annual PLUS conference

Cyberrisk exposures challenge insurers

By MARK A. HOFMANN

PHILADELPHIA—A massive "cyberhurricane" tearing across the Internet would be unlike any previous catastrophe faced by the property/casualty insurance industry.

In fact, "it's going to rank up there with terrorism as a challenge for the insurance industry," said Bradley S. Gow, vp in ACE USA's professional risk division in Philadelphia. Mr. Gow moderated an educational session on cyberrisks

at the Professional Liability Underwriting Society's 16th annual international conference in Philadelphia earlier this month.

In the past, catastrophes have had some physical limitation, therefore restraining insurers' ultimate exposure, he said. But with the advent of the Internet, "the insurance industry theoretically faces the possibility of catastrophic loss with no physical limitations," said Mr. Gow. As a result, the insurance industry faces the challenge of bringing together sufficient capaci-

ty to meet the demand for cyber-insurance over the next five years, he said.

Paul Nicholas underscored the serious nature of the cybersecurity exposure. "Every day, someone tests a weapon in cyberspace," said Mr. Nicholas, who is director for critical infrastructure protection for the federal Homeland Security Council in Washington.

Mr. Nicholas, a self-described "professional worrier," said that he doesn't lose sleep over a "teenager with a bad haircut and bad social

life" threatening the integrity of the Internet. Instead, he worries more about more powerful forces—including organized crime—launching assaults in cyberspace.

Mr. Nicholas said that one of the government's primary concerns is an organized attack that could cause economic or security disruption. He said that the weapons needed to mount an attack are widely available and would-be attackers are becoming more technically proficient.

Continued on next page



Continued from previous page

The government's cybersecurity program involves preventing cyberattacks against critical infrastructure, reducing national vulnerability to cyber-attack and minimizing the damage and recovery time from attacks that occur, said Mr. Nicholas.

"We have a storm coming of some sort" in cyberspace, he predicted. The storm could stem from some sort of accident or a virus that gets out of control and wreaks far more havoc than imagined, or it could stem from some other deliberate act, he said.

"Do we have a risk transfer market in place" that would allow the country to continue operating if a cyber-attack occurred? he asked.

Mr. Nicholas said that a partnership is possible between what he called "the analytical minds of the

'We have a storm coming of some sort' in cyberspace, which could stem from some sort of accident or a virus.

Paul Nicholas
Homeland Security Council

risk management community" and federal homeland security experts. "We need an analytical model" to understand the implications of the cyberthreat. "We can't wait to build an actuarial table," he said; we need

to begin acting now.

There is a market for cyberrisks, pointed out Richard Reed, vp and product lines manager for Chubb Commercial Insurance in Whitehouse Station, N.J. Risk managers, brokers, insurers and reinsurers are all "becoming much more aware of the exposures," Mr. Reed said. But underwriting and claims expertise need to be built up, he said.

Harrison Oelrich, managing director at Guy Carpenter & Co. in New York, said that coverage is being severely curtailed under traditional policies. That has led to the creation of stand-alone policies for cyberrisk, he said.

The total available marketwide limits on stand-alone cyberrisk policies currently stand at about \$250

million, he said. Mr. Oelrich added, though, that it's "very unlikely" that limits of more than \$100 million would be available to any single policyholder.

"The exposures are very poorly understood," said Robert Hammesfahr, a partner in the Chicago office of Philadelphia-based Cozen O'Connor. Both technology and law dealing with cyberrisk are constantly changing.

The claims, though, are real. These include denial of service and virus cases, theft of intellectual property and hacking claims, and privacy litigation.

Because these claims are "new and uncertain," they're very expensive to defend, Mr. Hammesfahr said.

16th annual PLUS Conference

Governance legislation increasing exposure to D&O suits

By MARK A. HOFMANN

PHILADELPHIA—Although neither Sen. Paul Sarbanes, D-Md., nor Rep. Mike Oxley, R-Ohio, was anywhere near Philadelphia at the time, their presence was almost palpable at a recent conference of liability underwriters in the City of Brotherly Love.

That's because Sen. Sarbanes—former chairman of the Senate Banking Committee—and Rep. Oxley—chairman of the House Financial Services Committee—crafted one of the most sweeping financial services regulation laws last year in response to a spate of corporate meltdowns and instances of financial chicanery. The Sarbanes-Oxley Act, which became law in July 2002, subjects corporations to numerous new reporting and auditing requirements, thus opening corporate directors and officers to new liabilities. So it came as no surprise that the impact of Sarbanes-Oxley would be a hot topic—perhaps the hot topic—at the 16th annual international conference of the Professional Liability Underwriting Society in Philadelphia earlier this month.

Crafted last year in response to a spate of corporate meltdowns and instances of financial chicanery, the Sarbanes-Oxley Act subjects corporations to numerous new reporting and auditing requirements.

Enactment of Sarbanes-Oxley made it seem as though "corporate malfeasance was behind us," Arthur Levitt, former chairman of the Securities and Exchange Commission, said in the conference's opening address.

Mr. Levitt said the act helped rid corporate boardrooms of what he called a "clubby atmosphere" that encouraged looking the other way when corporate misbehavior occurred. But despite the new atmosphere, little more than a year after the law's enactment, Wall Street is embroiled in a mutual funds scandal, said Mr. Levitt. That scandal isn't likely to end soon and, in fact, the known mutual fund scandals are "just the tip of the iceberg," he said.

See ACT/next page



Gary Bridgeford, Director—Corporate Risk Management
Johnson Controls, Inc.

In a just-in-time world, "downtime" can mean "time's up."

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Act: D&O exposures growing

Continued from previous page

The New York Stock Exchange "is facing the greatest crisis of its existence," giving rise to such questions as who should regulate the Big Board and how the exchange itself should function, said Mr. Levitt. "Seeds of mistrust in the market have been planted and are already taking root," he said.

Mr. Levitt said the markets need

nothing less than a "whole new generation of leadership" to create a new culture in which conflicts of interest are not exploited. Accountability, increased oversight and enhanced transparency are all needed to resolve the problems, he said.

But Mr. Levitt was less emphatic about the need for tort reform after being asked about the importance of the matter. Tort reform, he said, was

"one of the most difficult questions I had to deal with in Washington." Mr. Levitt said that he himself

The New York Stock Exchange 'is facing the greatest crisis of its existence,' giving rise to such questions as who should regulate the Big Board. 'Seeds of mistrust in the market have been planted and are already taking root.'

Arthur Levitt

had been "the victim of irresponsible plaintiffs" at various times in his career. But he said that he also believes that the "basic protections" of investors include the right to seek redress in the courts.

He said that perhaps the most significant civil justice development of the past few years has been the willingness of judges to reject unfounded lawsuits. But Mr. Levitt added that he believes any additional reforms must be considered very carefully.

Sarbanes-Oxley also came up during a panel discussion of insurance

industry leaders (see story, page 4).

Susan Rivera, president of ACE INA Holdings in Philadelphia, said that much of what the insurance industry does involves looking at the past to predict the future. Because of Sarbanes-Oxley, Ms. Rivera said, "hopefully, we'll see some more accountability at the top."

"A lot of bad corporate behavior that occurred in the bubble years is coming to light," said Joseph Brandon, chairman and chief executive officer of General Re Corp. in Stamford, Conn.

"No one reserved for the current mutual funds scandal, and how long these revelations go on" is not known, Mr. Brandon said.

"You're underwriting human character and behavior," he said.

But a panelist participating in another discussion dealing solely with the impact of Sarbanes-Oxley warned that it will take quite a bit of litigation to determine the act's impact.

"This was written in about a week and half," said Stephen A. Radin, a partner in Weil, Gotshal & Manges L.L.P.'s securities litigation department in New York. As a result, key questions—such as what constitutes the "improper conduct" that is sufficient to require executives to return bonuses they received because of improper conduct—remain unanswered, he said.

"It's a lawyer's dream, in the sense that everything has to be litigated," Mr. Radin said.

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Products & Services

PERFORMAX offers consumer health plan

BALTIMORE—PERFORMAX, an administrator of self-funded health and benefit plans, has launched a consumer-driven health plan designed to encourage employees to consider quality and cost when seeking health care.

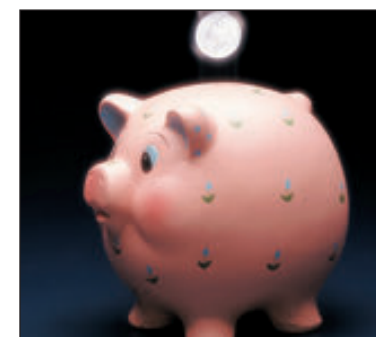
PERFORMAX Consumer Care provides educational tools and informational resources to help workers understand the health care system and become more knowledgeable consumers. It aims to lower health care spending and give companies more control over rising health care costs.

The Consumer Care product can be offered as a stand-alone plan or side by side with traditional plans.

More information is available in the press room section of www.getperformax.com or from the company at 410-986-2000.

Ceridian services include financial planning

MINNEAPOLIS—Ceridian has introduced new services to help employees with midlife and retirement planning.



Financial planning services are among those offered and include saving strategies, estate planning, credit management, investing and others.

Employees can also use the services to design a roadmap for the nonfinancial aspects of their midlife and retirement, such as relocating, traveling, volunteering and continuing their education.

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services unit.

The new unit, called Applied Risk Management Solutions, offers risk identification, risk analysis, risk control and risk financing services.

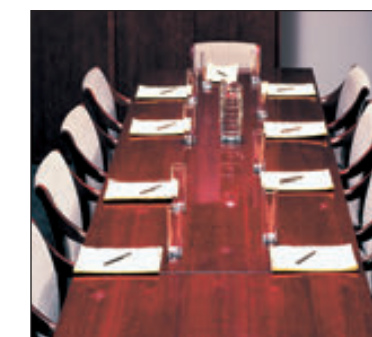
The service primarily is aimed at companies that need risk management expertise but prefer not to hire a full-time risk manager.

More information is available at www.cybersure.com.

Chubb booklet offers Sarbanes-Oxley guide

WARREN, N.J.—A guide to help independent directors understand their expanding roles and risks associated with serving on corporate boards is available from Chubb Corp.

The 35-page booklet, "Loss Prevention Guidelines for Independent Directors," addresses corporate governance best practices in light of the Sarbanes-Oxley Act. "After Sarbanes-Oxley, independent directors want to know what is expected of them,"



according to a statement by Andrew Pritchard, assistant vp of Chubb & Son Inc. and worldwide manager for personal directors liability insurance at Chubb Specialty Insurance. "This guide can help them understand their responsibilities and navigate the evolving role of independent directors."

The guide also can be used by corporate managers who want a better understanding of issues related to corporate governance and independent directors. There is a section on selecting, recruiting and retaining directors.

A free copy of the book is available by calling 866-282-9001 and requesting Form No. 14-01-0679.

16th annual PLUS Conference

2,000 attend conference

PHILADELPHIA—About 2,000 people attended the Professional Liability Underwriting Society's 16th annual international conference, held Nov. 9-11 in Philadelphia.

Minneapolis-based PLUS was founded in 1986 and is a nonprofit organization open to people interested in the promotion and development of the professional liability industry. The society seeks to

enhance the professionalism of its members through education and other endeavors. It also publishes a

monthly journal and sponsors the Registered Professional Liability Underwriter professional designation program.

PLUS' next conference is scheduled for Nov. 3-5 in San Diego. For more information on the society, visit www.plusweb.org.



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7. Attract new talent to the business by supporting the tuition for students of risk management and insurance: \$1.7 million in scholarships have been granted to 278 students to date.
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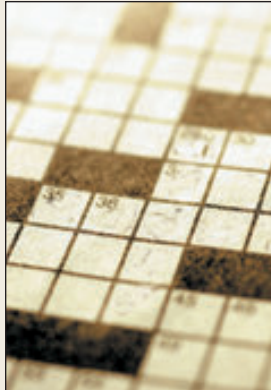
Between the Lines

Compiled by Joanne Wojcik



Puzzle gets comp message across, down

The Wall Street Journal's Nov. 14 crossword puzzle was "complicated" in more ways than one.



Eight of the 104 puzzle clues asked wordsmiths to identify the unusual types of work-related ailments for which various employees might file claims. For example:

- A claim from "an impatient banjo player" could be for "itchy fingers."
- A "courageous trumpeter" could assert a claim for a "stiff upper lip."
- And a claim from "an ignored edge-of-the-road worker" could be for a "cold shoulder."

According to industry sources, WSJ puzzle master Manny Nosowsky was inspired to give the wordgame an occupational injury theme by his wife, Debby Nosowsky, a former Fireman's Fund Insurance Co. employee and a national expert on workers comp who now works as a consultant in San Francisco.

Channeling recruiting efforts

Westfield Group is resurrecting a televised academic quiz show to give scholastic achievement the kind of media showcase usually reserved for athletics, according to the company's president, Roger McManus.

By sponsoring "Academic Challenge," which had been a fixture on northeast Ohio television for more than 35 years until it was canceled in 1999, the Westfield Center, Ohio-based property/casualty insurer also will be in a position to spot the next generation of insurance industry talent before they've made other career plans.

And if the company doesn't find enough talent on the stage, it could shift its recruitment efforts to the links, as golf seems to be a prerequisite for joining the insurance industry. The insurer is the host and title sponsor of the Westfield Junior PGA Championship, an event that brings many of the nation's top junior golfers to northeast Ohio.

Eyes on the road, please

Everyone knows it's not safe to drink and drive, but does that also apply when the beverage is coffee?

It did for a Denver man last week when he veered off a mountain road while reaching for his commuter cup. The man was knocked unconscious after his sport utility vehicle swerved off U.S. 285 and down a 260-foot embankment during his early morning commute. He later told police he had unhooked his seat belt to reach his coffee mug, briefly taking his eyes off the road.

After regaining consciousness several hours after the accident, the driver found himself late for work and hunched in the back of his SUV. He crawled into the front seat and used his cellular telephone to summon police.

Eating and drinking distracts 71.4% of drivers, according to a recent study by the University of North Carolina Highway Safety Research Center. Reaching for something or leaning away from the steering wheel distracts 97.1% of subjects, the study also found.

Statistically, the Denver commuter probably would have had a better chance of maintaining control of his vehicle had he skipped the java and picked up his cell phone instead, which researchers found distracts only 30.0% of drivers.

Waiting to inhale

A Regina, Saskatchewan, resident has filed a claim with Saskatchewan Government Insurance seeking reimbursement under his homeowners policy for the cost of a supply of medical marijuana allegedly stolen from his home.

The claim may be the first of its kind since new rules permitting the use of marijuana for medicinal purposes became effective in Canada last summer, authorities say.

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

Letters to the Editor

Continued from page 8

regulation.

Collateral requirements are protectionist of those companies that do not buy reinsurance from alien reinsurers. These companies still pay into the guaranty fund system. These same companies contribute guaranty fund payments for the insurer when it becomes insolvent because of the insolvency of that insurer's reinsurer. Also, companies make guaranty fund payments for insolvent insurers unable to collect reinsurance recoverables from alien reinsurers because of the difficulties in obtaining judgments.

The NAIC Insolvency Task Force addressed this very issue in its comments to the Reinsurance Task Force about enforceability of judgments against alien reinsurers.

As referenced in your publication (*BI*, Sept. 29) in a letter to NAIC President Mike Pickens, Jeffrey D. Kovar of the U.S. State Department said, "Our best information is that law and practice in most foreign countries is not generally favorable to the prompt, predictable enforcement of U.S. civil judgments." This is a nice way of saying you don't know if your U.S. judgment will be enforced abroad...or when.

Collateral requirements are protectionist of claimants and commercial policyholders who rely on the insurance promise itself: that an insurer will be around to pay claims when they come due.

Consumer protection via solvency gets to the heart of insurance regulation. Who wants to go to a claimant and say, "Too bad, your insurer's reinsurer didn't post enough collateral to pay your claim"?

Michael G. Koziol
Senior Director and Counsel
National Assn. of
Independent Insurers
Des Plaines, Ill.

Letter about RRGs took a narrow view

To the editor: Charles McAlear, in his letter to *BI* of Nov. 17, states, "I hope RRGs get a fair review by regulators, by the public and by all those in the insurance and risk management business." Yet he focuses on the insolvency of one risk retention group—National Warranty Insurance Co. RRG—in an attempt to impugn the entire industry, which could not be more unfair.

To provide a "fair review," it is helpful to look at important facts about RRG operation since the passage of the federal law that permits the groups to operate. The Risk Retention Reporter, which published its 200th issue this month, is committed to this endeavor.

The facts show that the rates of insolvencies for property/casualty insurers and RRGs are comparable. From 1987 to 2002, RRGs failed at an average annual rate of 1.1%, compared with 1.0% for traditional insurers, based on comparisons of RRG insolvencies with those of traditional insurers in A.M. Best Co. studies.

As for RRGs that no longer operate, here are the facts, as of September 2003: In the 17-year period since passage of the 1986 Liability Risk Retention Act, 200 RRGs have formed, of which 121 are operational. Of the 79 that no longer operate, 19 never became operational, 13 reorganized and operate in other forms, 29 voluntarily ceased operations and went into runoff, and 18 were declared insolvent and placed into liquidation.

Of the 200 RRGs formed under the LRRRA since 1987, 162—or 81%—have been regulated as captives. Of those 162, only six have become insolvent. In contrast, of the 38 RRGs that were not regulated under captive laws, a total of 12—or 31.6%—became insolvent.

These data suggest that RRGs regulated in captive domiciles in which regulators typically have greater experience and expertise are much less likely to become insolvent.

National Warranty, an RRG formed under the 1981 Products Liability Risk Retention Act and grandfathered in under the 1986 amendments, was regulated by the Cayman Islands and not by a state. With the exception of one RRG, all other RRGs today are regulated by states.

The Liability Risk Retention Act has been and continues to be a successful "experiment," providing an alternative risk financing mechanism to the nation's commercial insureds, who are increasingly faced with the unavailability and unaffordability of liability insurance coverage.

Karen Cutts
Managing Editor/Publisher
Risk Retention Reporter
Pasadena, Calif.

Letters to the Editor

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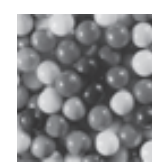
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London market protocol would validate small-value commutations for reinsurance recovery

Runoff claims payment simplified

By CAROLYN ALDRED

LONDON—A commutations agreement intended to speed up claims payments by insurers in runoff is scheduled to begin in the London market in January.

A "recoverability of commutations" protocol, put together by the Assn. of Run Off Companies, provides guidelines on how commutations should be recoverable from a reinsurance policy.

Currently, there is no legal obligation for a reinsurer or retrocessionaire to automatically make payments to a cedent insurer or reinsurer for payments made to an insured as part of a commutation agreement, particularly for outstanding and incurred but not re-

ported claims.

The aim of the protocol is to speed up, control and simplify claims processing where a commutation is involved, according to David McGuigan, chairman of London-based ARC.

"At the moment, every single commutation has to be referred to the reinsurers. Under the protocol, small-value commutations wouldn't have to go to reinsurers individually," said Mr. McGuigan, an independent runoff consultant.

The protocol will contain a schedule of maximum commutation percentages allowed, which will vary according to the type of contract, the type of business and the year of loss.

In addition, any commutation

that exceeds £50,000 (\$84,360) in an underwriting must be referred to the reinsurer.

While reinsurers will still have no obligation to stand behind the commutations if they do not sign up to the agreement, many reinsurers in the London market participate as insurers, reinsurers and retrocessionaires on different risks and so may be encouraged to sign on to the protocol.

According to ARC, its members have asked for a protocol "because reinsurers are increasingly suggesting that commutations are not valid payments of claims—and are therefore not recoverable from reinsurers."

The protocol provides a mechanism to avoid many years of expen-

sive arbitration or litigation and would be of huge benefit for the entire market, said Mr. McGuigan.

Commutations are being increasingly used by insurers or reinsurers that are forced to go into runoff or that choose to run off parts of their business.

"Commutations are a standard tool in achieving finality," said Cheryl Sheridan, director of marketing for specialist runoff manager Global Resource Managers Ltd., a London-based unit of CNA.

While a company may be able to minimize and finalize its payments through a commutation with a policyholder, though, it often faces difficulty collecting from its reinsurers, she noted.

See **RUNOFF**/next page

World Updates

SCOR replaces CEO of U.S. arm

Henry Klecan has been appointed president and chief executive officer of SCOR U.S., the New York-based U.S. arm of French reinsurer SCOR S.A. Mr. Klecan succeeds Jerome Faure, the current president and CEO of SCOR U.S. and managing director of its nonlife treaties division, who will leave the company at the end of the year. "Henry Klecan's assignment is to continue restoring the profitability of the U.S. business, while restructuring the old portfolio," SCOR said in a statement. The entire SCOR group is undergoing a turnaround plan following a series of losses.

ZFS posts profit for nine months

Zurich Financial Services Group has reported a profit of \$1.40 billion for the first nine months of 2003, compared with a loss of \$2.79 billion in the year-earlier period. The loss in the prior-year period stemmed largely from \$2.8 billion of special charges related to restructuring of Zurich, Switzerland-based ZFS. The insurer's gross written premiums rose by 13% to \$13.37 billion. ZFS said its profits for the first nine months of 2003 were boosted by improved claims and expense management, firm rates in most insurance classes and a "modest recovery in global equity markets."

RSA records loss on reserve boost

Royal & SunAlliance Insurance Group P.L.C. has reported a £146 million (\$243.2 million) aftertax loss for the first nine months of 2003, compared with a £156 million loss (\$245 million) for the comparable period in 2002. London-based RSA blamed the loss largely on a £500 million (\$833 million) reserve boost, announced in October, that relates mainly to its U.S. business. RSA's net premiums written for the first nine months dropped 17%, to £5.13 billion (\$8.55 billion). The company announced earlier this year that it was transferring a large portion of its U.S. business to Travelers Property Casualty Corp. as part of a turnaround plan (*BI*, Sept. 8).

Briefly noted

Standard & Poor's Corp. has revised its outlook on the **Italian nonlife and life insurance markets** to stable from negative... **Wellington Underwriting Agencies Ltd.** said its syndicate 2020 would make a 15% to 20% loss on its £499.4 million (\$745.6 million) of capacity for the 2001 year of account, which is the next to close. Wellington said it expects the syndicate to record a profit for 2002.

Buyer, broker, insurer need mutual understanding

Cooperation brings price consistency

By SARAH VEYSEY

LONDON—Risk managers, brokers and insurers should work closely together to ensure that price volatility is reduced and insurance products provide good value for buyers, a risk manager and insurer said.

If risk managers improve their presentation of their risks and work to gain a greater understanding of the underwriting

rather than the level of risk management, he said.

They spoke at the Institute of Economic Affairs' "The Future of General Insurance" conference in London earlier this month.

In the tripartite relationship among risk managers, brokers and insurance companies, the bond between risk manager and insurer has sometimes been a weak link, said Nick Chown, risk manager for the Metropolitan Police in London and chairman of the Assn. of Insurance & Risk Managers.

"There is a need for two-way understanding—underwriters must understand the needs of the policyholders, but also the policyholder must understand what the insurance market is looking for," said Mr. Chown.

"We need to engender a better understanding between the two," he said. "If risk management is being undertaken in a robust manner, there ought to be a way in which that can reduce the volatility in insurance pricing."

There are now many standards and codes that risk managers can follow and use to demonstrate the reduction of risk in their corporations, said Mr. Chown, citing examples such as the so-called Turnbull corporate governance guidelines and the Health and Safety Exec-

See **IEA**/next page



process, they should be rewarded with more consistent pricing and coverage that is better suited to their individual needs, they said.

But market forces are still strong, a broker added. Many insurers still underwrite risks based on the availability of capacity



PHOTO: COURTESY OF LLOYD'S

Most of Lloyd's business is transacted in the underwriting room at its building at One Lime St. in London.

Lloyd's switches to U.K. GAAP in bid for more transparency

LONDON—Lloyd's of London will adopt U.K. generally accepted accounting principles in 2005, marking the end of the market's traditional three-year system, Lloyd's said Tuesday.

The move to annual accounting was part of a series of reforms designed to modernize the Lloyd's market. Since those changes were adopted in 2002, Lloyd's has published accounts on both an annual and a three-year basis.

In announcing the decision to use U.K. GAAP beginning Jan. 1, 2005, Lloyd's said it plans eventually to implement proposed standards developed by the International Accounting Standards Board but will delay that move until there is "more clarity on the proposed standard on accounting for insurance contracts." The proposed IASB standards are designed to harmonize European Union accounting rules (*BI*, Aug. 18).

Andrew Moss, director of finance at Lloyd's, said that the use of annu-

al accounting would increase the transparency of Lloyd's accounts.

"Moving to annual accounting from three-year accounting, which has been unique to this market, will make it easier for the industry to compare Lloyd's performance to our peers," Mr. Moss said in a statement.

"It is a positive step in line with Lloyd's commitment to create greater transparency. We will work closely with the market and the accounting profession to ensure the change is implemented smoothly, and we are grateful for their positive input to date."

Under the three-year accounting system, all premiums, claims and associated expenses are accounted in the year in which a policy incepts, and the underwriting result is reported when the so-called year-of-account closes at the end of three years. Under that system, the 2001 year of account will close at the end of this year.

—By Sarah Veysey

IEA: Cooperation brings more price consistency

Continued from previous page
utive's HSE65 standard, among others.

For example, there is a link between business interruption insurance and business continuity planning, he explained. If risk managers follow a standard such as the government-published Publicly Available Specification 56, which deals with business continuity planning, this provides assurance not only for their own companies that there is a standard in place but it also can provide assurance to underwriters. It is "a means of satisfying insurers that you have the risk management capability to reduce risk to the level where insurers are prepared to take on the risk," he noted.

Insurance buyers must attempt to better quantify their exposures and have a better understanding of whether the risks they face are insurable or not, said David Mc-

Callum, U.K. director of specialist business at Royal & SunAlliance Insurance Group P.L.C. in London.

"Clients need a much greater appreciation of the wider risks; understanding their entire risk profile is the order of the day," he said.

Risk managers, underwriters and the brokers that support them have to be to quantify and then understand other risks such as corporate fraud, brand risks and corporate manslaughter, among other things, he said.

Insurers are recognizing that relationship management is important, said Mr. McCallum, and they are beginning to tailor coverage much more to customer needs.

Underwriters are also putting more effort into informing buyers of their requirements, he said, and they are working closely with organizations such as AIRMIC and the London-based Institute of Risk

Management.

Mr. McCallum advised insurance buyers to benchmark the performance of their insurers against their competition.

'It seems that, for the past 10 years, we have allowed investment income to be the tail that wags the dog.'

Alan Punter
Aon Ltd.

"Researching and understanding customer needs will become a key factor in insurer differentiation," he noted.

And Mr. McCallum predicted that, as new regulatory and compliance requirements encourage greater risk assessment, emphasis

would be put more on the value of insurance and the coverage it offers than will be put on the price. "We can expect to see a move away from price-fascination towards clearly articulated propositions," he said.

But there are still underwriters who do not take into account buyers' risk management expertise when pricing insurance, according to Alan Punter, managing director of Aon Ltd. in London.

"Pricing is determined by commercial forces; it is supply and demand," he said. "The buyer likes to think they will get an individual price recognizing their past experiences and good risk management, but not all underwriters take this approach."

Some underwriters, noted Mr. Punter, take the view that "they need a pot of premium to pay a pot of claims."

There is too great a focus on price as opposed to value, he said.

Pricing does have to follow some basic principles, Mr. Punter noted. The insurer has to charge a price that is higher than the expected losses and expenses; otherwise, it wouldn't make a profit, he said. Investment income is also factored in, he said.

"But it seems that, for the past 10 years, we have allowed investment income to be the tail that wags the dog," he said.

The insurance industry is currently facing several challenges, Mr. Punter said. Insurers need to contain their own risk exposure so that risks remain insurable, he said. Frictional costs must be reduced and contract clarity and certainty improved, he added. And there is a "need to ensure that policyholders continue to get cover that is affordable," he said.

Runoff: Pact aimed at speeding claims payments

Continued from previous page

"Once a company is in runoff, it finds it very hard to collect its reinsurance claims, as reinsurers focus their cash flow on live clients," said Mr. McGuigan, pointing out that this creates a cash flow crunch and a claims payment slowdown throughout the chain to the original policyholders.

A protocol that would allow claims to flow more freely would benefit the whole market, particularly a market such as London,

where companies often are cedents, reinsurers and retrocessionaires, he noted.

"The ARC commutation protocol is an excellent initiative to codify the issue of dealing with commuted losses," said Stephen Hartigan, a director of London-based JTW Reinsurance Consultants.

While some reinsurers benefit in the short term by refusing to pay claims agreed to in commutations between their cedents and their insureds, such a protocol will avoid

expensive disputes over commutation, he said.

It will also improve the reputation of the market and address some of the concerns expressed by regulators such as the United Kingdom's Financial Services Authority over unresolved claims in the market, said Mr. Hartigan.

London's reputation is being damaged because of the way it is dealing with claims on past business, he said, pointing out that it is crucial that reforms in the London

market should focus on the runoff market as well as the on-going business sector.

The growing scale of the runoff sector in the United Kingdom was highlighted in a recent report on the current size of the U.K. company runoff market, conducted by KPMG L.L.P. (U.K.).

According to the KPMG survey, published this fall, at the end of 2002, liabilities in the continuing U.K. nonlife sector totaled £86.1 billion pounds (\$138.58 billion),

while liabilities in the runoff market totaled £33.3 billion (\$53.60 billion).

Members of ARC, which was formed in 1998, include insurers and reinsurers now in runoff or with books of discontinued business, lawyers, actuaries, receivers and liquidators, as well as growing numbers of runoff consulting firms.

The organization hopes that the protocol will offer the "growing and increasingly important arena (of

See **RUNOFF**/next page

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Runoff: Claims payment pact

Continued from previous page
discontinued business) the opportunity of greater cooperation with better results all round. It is a significant development as it fosters agreement between the organizations that sign up to it."

According to ARC, signatories to the protocol will "agree to accept commutations, schemes of arrangements and policy buybacks as being recoverable in reinsurance collections, if handled within the specified parameters laid out in the protocol."

Mr. McGuigan would not comment on which companies had

agreed to sign up to the protocol, but he noted that interest was "widespread" and not contained to just the London market.

If sufficient companies sign up, a full list of signatories would be published in January, when the protocol is introduced, Mr. McGuigan said.

The protocol would be suitable for books of business containing similar sorts of claims, said Ms. Sheridan, noting that it would be hard to apply a general protocol for "large or contentious books of business containing different classes of business."

Ms. Sheridan said she values the work ARC is doing but points out that "there is so much money involved that there won't be an easy solution."

ARC is a forum "for talking and discussing issues and to try and avoid some of the worst litigation, and the commutation protocol is an example of this," explained Jonathan Drake, a partner in the London-based law firm of Clyde & Co.

However, "disputes will still continue," Mr. Drake said, pointing out that in the "runoff arena, cash is king."

Failures: Management to blame

Continued from page 4
management team can mean the difference in an insurer's success or failure.

"That doesn't mean a company is going to succeed" simply because the actuary is involved, he explained. "But, I assure you, if (the actuary) is not part of the team, it will fail."

The recent history of insolvencies shows certain types of companies fail more often, Ms. Carvalho pointed out.

Property/casualty companies have been much more apt to fail than life/health underwriters, she noted. "In fact, in 2002," Ms. Carvalho said, "the number of insolvencies was 39, compared to 35 in 2002. Of those 39, 28 were property/casualty writers."

And, she emphasized, size does matter when it comes to insurance company failures. Insurers with assets of less than \$25 million make up half of the insurance market but represent two-thirds of insolvencies, according to Ms. Carvalho.

There would be more insolvencies, she said, if not for "strong parent companies that have infused capital into weaker subsidiaries." Reinsurers in the United States that are owned by larger reinsurance groups are an example of companies that have been propped up with capital infusions by parents, Ms. Carvalho said.

Companies that write business in a concentrated geographic area are more prone to the effects of an unfavorable regulatory environment and sometimes fail, she noted.

Workers compensation insurers in California provide examples of underwriters that have written large amounts of business in a region and suffered large losses under that jurisdiction's regulatory environment, Ms. Carvalho explained.

Heavy-handed regulation is not necessarily the answer to stopping failures, another speaker said.

Vincent L. Laurenzano, insurance financial consultant with the law

'Companies should be free to fail. Any regulatory scheme designed to prevent all insolvencies would be just too intrusive and would stifle innovation and competition as well.'

Vincent L. Laurenzano
Stroock & Stroock & Lavan L.L.P.

firm Stroock & Stroock & Lavan L.L.P. in New York, said regulations protecting insurers should go only so far.

"I believe the regulatory system should not be designed to eliminate all insolvencies," said Mr. Laurenzano, who held positions of regulatory authority in New York before joining the law firm.

"Companies should be free to fail. Any regulatory scheme designed to prevent all insolvencies would be just too intrusive and would stifle innovation and competition as well," he said.

Failures, though, are expensive and troublesome, said David G. Hartman, senior vp and chief actuary at Chubb Corp. in Warren, N.J., and moderator of the discussion.

"Economic theory says that failures are good," allowing stronger companies to flourish and ridding the marketplace of weak players, Mr. Hartman said.

"But when you look at the insurance industry, we're quite a bit different than most of corporate America. And that's because, when a policyholder buys a policy from an insurance company, they're dealing in a trust arrangement. They are trusting that the company promises to pay any losses that occur in the future that are covered by the policy that's been purchased," he said.

Guaranty funds are in place to pay claims when insurance companies can't, Mr. Hartman noted. "But even with that system, there definitely are costs," he said. Claims take longer to settle than they do through insurers and "you rarely get 100 cents on the dollar" when claims are paid by guaranty funds, he said.

Ms. Carvalho said that although S&P has a negative outlook on the insurance industry, for the moment it is "overall a fairly healthy industry."

Through 2002, "the median rating for the industry is in the single A range," she pointed out, and those that have failed over the past 10 years have mostly held noninvestment grade ratings of BB and lower.

CAS annual meeting

Industry not ready to meet obligations of Sarbanes-Oxley, panelists warn

By MICHAEL BRADFORD

NEW ORLEANS—Insurers and other companies that are not well along with plans to comply with the 2002 Sarbanes-Oxley Act had better get moving, a panel of experts warns.

Many companies will be scrambling to meet the requirements laid out in Section 404 of the act, insurance industry experts noted at the Casualty Actuarial Society's annual meeting in New Orleans last month. That portion of the corporate governance and financial disclosure legislation requires companies to have identified by the end of next year all the significant processes that can affect financial statements and to have methods in place to ensure the integrity of their financial reporting on a regular basis.

"It wasn't until 14 or 15 months ago that Section 404 became an issue," as its complexity became known, said Howard L. Mosbacher, senior vp, general auditor and chief information security officer at the Hartford Financial Services Group Inc. in Hartford, Conn. The section originally was written to become effective at the end of 2003. "Fortunately, it's been pushed back 12 months," he said, and companies have more time to meet the requirements.

Mr. Mosbacher said the "impact and effort in complying with Section 404 is greater than first appreciated." He warned that meeting its requirements "will not be episodic," as many first thought, but "an ongoing effort. Regulations make it very clear that it's a management issue to deal with on a quarterly basis."

Another panelist said many insurers are behind in their efforts to comply with the section's requirements.

"Our industry, in particular, is not well-prepared at all for Sarbanes-Oxley," said Patricia A. Teufel, a principal with KPMG L.L.P. in Hartford, Conn.

"Companies have devoted major efforts to preparing for Sarbanes-Oxley, and many companies are making significant progress," she said. "But I personally see the actuarial processes as being delayed in terms of where companies are focusing, and, at risk in terms of being fully documented" and tested

to ensure that that management's financial controls are adequate, Ms. Teufel noted.

Some companies will, at the end of 2004, release qualified opinions "as to internal controls," she predicted, adding that "it is my personal belief that we will not have served the public well if there are not some qualified opinions issued."

Mr. Mosbacher said most of the large companies he communicates with are well along in developing processes to comply with the act. "Some areas of the companies are further ahead than others, as you might expect," he remarked.

But, Mr. Mosbacher added, "I would not be surprised...if some of the smaller companies have problems. I would think the financial

'I would not be surprised...if some of the smaller companies have problems. I would think the financial burden, as well as the manpower burden, might be overwhelming.'

Howard L. Mosbacher
Hartford Financial
Services Group Inc.

burden, as well as the manpower burden, might be overwhelming."

Peter M. Licht, senior manager at PricewaterhouseCoopers L.L.P. in New York, said he has seen a "variety of preparedness."

The panelists emphasized that the financial disclosure and reporting require-

ments in Sarbanes-Oxley apply to any process that has a significant or material impact on a financial statement. For insurers, that includes coverage pricing, claims reserving or any other actuarial activity that shows up in financial statements, he noted.

But, a "huge area" not affected by Sarbanes-Oxley is operational risk, according to Ms. Teufel. While many believe "it's operational risk that gets companies into trouble," she said, the act is instead concerned with such processes as underwriting, which ties directly to reserves and other areas that impact financial statements.

Most companies plan to be finished documenting significant processes by the end of this year or the first quarter of 2004, according to Mr. Mosbacher. "Most will be going into mock testing after that so that any weakness can be identified and corrected in time. If organizations are not in a position to finish their documentation in the next three to four months, I think there will be an issue there."

The discussion was moderated by Robert A. Anker, formerly president and chief operating officer of American States Insurance Co. in Indianapolis.

Casualty Actuarial Society attracts 775

NEW ORLEANS—Great food, jazz and record heat welcomed attendees to the Casualty Actuarial Society's recent annual meeting in New Orleans.

The 775 registrants mostly enjoyed the New Orleans Marriott's air conditioning during the day as temperatures reached the 80s, thankfully without the city's infamous and sometimes stifling humidity. The meeting, held Nov. 9-12, featured



PHOTO: ONOTMC

general sessions on underwriting cycles, the Sarbanes-Oxley Act and insurer failures. In addition, educational sessions and workshops covered a variety of actuarial and insurance topics.

Next year, the CAS will hold its annual meeting Nov. 14-17 at the Queen Elizabeth Hotel in Montreal. Information is available from the society at 703-276-3100 or by e-mail at meetings@casact.org.

CIGNA: Selling off retirement business

Continued from page 3

chairman and CEO of Prudential Financial, said in a statement. "This is an excellent fit that will strengthen a business we want to grow."

As of Sept. 30, CIGNA's retirement business, which is headquartered in Hartford, Conn., had \$50 billion in retirement account value, approximately 1.1 million defined contribution plan participants and about

'This transaction with CIGNA builds on our presence in the retirement market by adding significant scale and capabilities.'

Arthur Ryan
Prudential Financial Inc.

700,000 defined benefit annuitants and participants, according to Prudential Financial. Prudential Retirement had 1.1 million defined contribution participants and 600,000 defined benefit annuitants, with \$67 billion in retirement account values as of Sept. 30.

CIGNA plans to use the proceeds from the sale to support and strengthen subsidiary and parent company ratings, which may include adjusting capitalization levels, Michael W. Bell, CIGNA's executive vp and chief financial officer, said during the conference call. In addition, the proceeds would be used to increase CIGNA's cash position, ensuring its financial flexibility, he said.

After addressing the first two priorities, CIGNA would use the remaining proceeds to support the

growth of its core business, to reduce debt and to repurchase shares, Mr. Bell said.

Once the deal is complete, John Y. Kim, president of CIGNA Retirement & Investment Services, will serve as president of the combined retirement business. Scott Sleyster, who currently heads Prudential Retirement, will lead the combined defined contribution, defined benefit administration and total retirement outsourcing business.

The sale would help CIGNA "to address their liquidity and financial flexibility issues by giving them that cash infusion, which is very positive," said Christian Miles, an analyst with A.M. Best Co. He noted, however, that by selling its retirement business, CIGNA is losing a "very stable and well-performing" operation, which has traditionally lifted the parent company's ratings.

Following the deal's announcement, Best downgraded the financial strength rating of Connecticut General Life Insurance Co. and several of CIGNA's other life and health care subsidiaries to A- from A. In addition, the rating agency downgraded eight health care units to B++ from A-, while affirming the financial strength ratings of other subsidiaries.

Under terms of the agreement, the sale price will be reduced by \$250 million if the financial strength rating of Connecticut General is downgraded to BBB+ by Standard & Poor's Corp. or to Baa1 by Moody's Investors Service before the sale closes. In addition, Prudential can terminate the deal if the ratings are reduced below those levels, CIGNA said, noting that such action is unlikely. Connecticut General currently has an A rating from S&P and an A2 rating from Moody's.

NAIL: Security a top issue

Continued from page 3

ously, in the wake of the announced charges of PMA Re, and people are waiting for the other shoe to drop, with perhaps other reinsurers taking charges for reserve increases."

"Each year, it's more of a topic," said Paul Karon, president of reinsurance intermediary Benfield Blanch Inc. in Minneapolis.

"Every cedent is having a discussion" about security, said Mr. Priebe. Many insurers are setting limits on the business they will place with any one counterparty. There is also an increased interest in diversity so that insurers do not become overconcentrated with particular reinsurers, he said. Insurers are also seeking security through approaches that include collateralization and letters of credit, he said.

Every ceding company is reviewing its list of acceptable reinsurers and is "certainly concerned about the security that's out there," said Patrick Mailloux, president and CEO of Armonk, N.Y.-based Swiss Reinsurance America Corp.

Some companies are shortening their approved lists, said Collins' Mr. Denzer. Others are giving reinsurers the opportunity to collateralize in order to remain on their approved lists.

Insurers are paring down their lists of acceptable reinsurers "to those they trust will be around," agreed Randall S. Jensen, president of New York-based Arthur J. Gallagher Intermediaries Inc. Security is now the No. 1 issue, "and it looks like it will be for some time to come," he said.

Buyers are also increasing their retentions and purchasing less reinsurance because of security concerns, said John Berger, president and CEO of Chubb Re in Bernardville, N.J.

Observers expect more downgrades.

"I would say that, certainly, there'll be continued downgrades of reinsurers," said Swiss Re's Mr. Mailloux. "There's still quite a lot of pain out there," he said.

Tim Carroll, president and CEO of Barrington, Ill.-based GE Reinsurance Corp., a unit of Employers Reinsurance Corp., agreed. "I think there's probably more rating downgrades to come," he said.

This will be a continuing area of focus through this year, "and probably the next two years," said Mr. Carroll. Meanwhile, he said, the obvious question concerning reserve strengthening is whether "everybody really stepped up" or more strengthening is likely. If the latter is the case, "some can survive, and some companies cannot," he said.

Many observers expect the number of reinsurers to diminish.

There definitely will be further exits from the business, said Mr. Thaler, who observed that the industry has averaged a few each year over the last decade. It is reasonable to conclude that each year a few reinsurers will continue to stop trading as separate entities, either because they will be acquired or go into runoff, said Mr. Thaler.

"There probably will be some ad-

ditional reinsurers who will re-trench or withdraw from the business," agreed Guy Carpenters' Mr. Priebe.

Mr. Berger said, though, that there are not too many "weak players" remaining. "The list of reinsurers to worry about is a pretty small list," he said.

Significant merger and acquisition activity is unlikely.

"The issue of past major liabilities is such no one is willing to take on potential liabilities," said Mr. Priebe. There may be more deals, though, in which reinsurers obtain access rights for renewal business.

Mr. Priebe said he also does not expect a significant increase in new companies, though some specialty operations may be formed.

ERC's Mr. Carroll agreed. "My sense is, capital providers may well feel the best opportunity is past," in terms of the cycle, for any major

'I would say that, certainly, there'll be continued downgrades of reinsurers. There's still quite a lot of pain out there.'

Patrick Mailloux
Swiss Reinsurance America Corp.

new companies to be formed. There may be, for instance, a new \$150 million Lloyd's operation, "but the new billion-dollar operation—I struggle to see that taking off."

Meanwhile, no major problems are emerging with the January renewals, say executives.

Things are coming together as expected, said Mr. Priebe. There appears to be sufficient capacity to meet cedents' needs "pretty much in all lines," although errors and omissions coverage, directors and officers liability and medical malpractice remain challenging and difficult, he said.

The general consensus on rates is "it's going to be flat to slightly down," said Steven K. Bolland, president of reinsurance intermediary Gill & Roeser Inc. in New York.

For some lines, rates rose more quickly than others, and "they are likely to come back a little quicker as well," said Mr. Bolland. For other lines of business, there will not be any reductions because rates "haven't quite got there yet," he said.

Mr. Bolland said he is surprised at the market's resilience, given that the hard market is entering its third round of January renewals. While there is some pressure building to soften rates, "to date, it appears to have been held in check," he said.

Primary rates for most lines are still going up, said Mr. Berger, so there is "enough money in the pot for everybody." At the same time, the flight to quality continues, he said. The strong companies will do well while the newer companies will be pressed to keep rates up, he predicted.

Collins' Mr. Denzer said property rates are softening, maybe more on the primary than the reinsurance

side, while in casualty, there are no major rate increases, although pricing will remain firm.

Kevin B. Davidson, president, direct facultative, for Princeton, N.J.-based American Re-Insurance Co., said, in the facultative area, property plateaued earlier than he had expected, while casualty lines have not increased "to the magnitude anticipated."

Observers say they expect the hard market to continue at least through 2004.

William O'Donnell, president and CEO of ERC's Americas direct business unit, said that while about \$30 billion of new capital has entered the primary and reinsurance industry since Jan. 1, 2001, "it is still very small by comparison" to the estimated \$241 billion that has left. That means the market is likely to stay stable "for some period of time," he said.

Mr. O'Donnell said he believes reinsurers will continue to focus on the fundamentals of reinsurance underwriting for the immediate future. "There are enough experienced reinsurers in the market" that will make responsible underwriting decisions, he said.

"You can't erase the damage done over a decade in a couple of years," said Terry Van Gilder, CEO of Morristown, N.J.-based Toa Reinsurance Co. of America.

Mr. Van Gilder said he hopes the industry has more time to repair the damage done by the soft market. It will "not do anyone any good to have a market that's in turmoil," he said.

Mr. Thaler said the extent to which there will be "successive waves of reserve increases by reinsurers," coupled with any kind of natural catastrophes, can elongate the hard market.

The reinsurance industry "is in a fragile state, and while some brokers may be prophesying a return to a soft-market environment, I do not see that happening across the board within the next two years. Certainly not within the next year, although there could be selective improvements in rates for certain of the best clients within given lines or business," while certain lines, such as D&O and professional liability, "will remain firm well into 2005," said Mr. Thaler.

Mr. Bolland said the market will definitely stay hard in 2004, and there is a "good possibility" business will continue to be profitable in 2005 as well. "I don't see severe downward pressure at the moment," he said. Furthermore, the number of reinsurers that have left the business means the remaining reinsurers have business to write without having to compete on price.

It will be another two to five years before the market turns soft again, predicted Andreas Beerli, CEO of Armonk, N.Y.-based Swiss Re America Corp.

"Obviously, there's a lot of players out there that have been wounded," said Gallagher's Mr. Jensen. Logically, he said, the hard market "should go on for at least several more years."

NOTICE OF POTENTIALLY INVALID INSURANCE UNITED RESTAURANT SERVICES/URSC

Lloyd's has discovered that certain restaurant package policy documentation reflecting insurance coverage in California reportedly placed through United Restaurant Services and/or URSC may not be valid. Lloyd's asks that any restaurant holding a package, liability or property insurance policy containing Lloyd's name reportedly obtained either directly or indirectly through United Restaurant Services, URSC or URSC-Surplus Lines contact Lloyd's in order to verify the validity of that coverage. Please fax the declarations page of the policy, with your name and contact information to:

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Medicare: Relief for employers

Continued from page 1

Medicare-eligible retiree, after a \$250 deductible with a \$5,000 ceiling. Aside from the subsidy, prescription drug costs paid by the employer would continue to be fully tax-deductible.

The subsidy would begin in 2006, the same year Medicare would be expanded, under the legislation, to provide a prescription drug benefit. That benefit, after a \$250 deductible, would pay 75% of prescription drug expenses up to \$2,250 and 95% of expenses above \$3,600.

The employer subsidy, which would total more than \$70 billion over a 10-year period, would provide financial relief from benefit costs that lawmakers rarely have provided employers.

"How long has it been since there has been benefits legislation enacted that has saved employers money?" asked Joe Martingale, health care strategy leader for Watson Wyatt Worldwide in New York.

"By any measure, it will be a significant amount of money," added Frank McArdle, a consultant in the Washington office of Hewitt Associates Inc.

That direct financial subsidy—which benefit experts say would appeal most to employers that, because of labor agreements, can't al-

ter or terminate retiree health care plans—is just one way the landmark legislation could save money for employers providing retiree health care benefits.

The legislation also would beef up payment rates for private health care plans, such as preferred provider organizations and health maintenance organizations, that agree to provide coverage, including prescription drug benefits, to Medicare-eligible retirees.

Employers might find it less costly to pay the premiums to these newly dubbed Medicare Advantage Plans than to provide coverage through their own plans that supplement Medicare.

That type of strategy is not new. Many employers, starting in the late 1980s, began to contract with HMOs to provide health care coverage to retired workers who opted out of the traditional Medicare program. The payment rates HMOs received from the government often were so generous that the HMOs could provide rich benefits and charge beneficiaries a very low premium, if any.

As a result, employers that could convince their retirees to leave their Medicare supplemental plans and join HMOs could save a significant amount of money. But that cost-saving strategy began to dry up in

recent years, as government payment rates failed to keep up with health care costs, forcing the HMOs to boost premiums, cut benefits and, in many cases, withdraw from markets.

But, with the heftier payment rates the legislation would provide, "more plans may again step up to the plate" and re-enter the Medicare market, revitalizing that retiree health care coverage option for employers, said Mary Case, a principal with Mellon Human Resources & Investor Solutions in New York.

Yet other employers may reap savings by scaling back prescription drug plans for retirees by simply fill-

ing in coverage gaps or eliminating the coverage altogether and paying on behalf of retirees the roughly \$35 monthly premium Medicare would charge for the prescription drug benefit.

"There will be a wide range of options for employers to consider and evaluate," said Barbara Bald, a principal with the Human Resources unit of PricewaterhouseCoopers L.L.P. in New York.

RETIREE HEALTH CARE COVERAGE ERODING

Percentage of large employers offering coverage to retirees*

Year	Pre-65 retirees	Medicare-eligible retirees
2002	72%	61%
1998	76%	67%
1994	79%	71%
1992	85%	78%

*For employers with at least 5,000 employees
Source: Hewitt Associates Inc.

Path cleared for HRA debit card use

By JERRY GEISEL

WASHINGTON—The rich financial incentives the Medicare prescription drug bill provides to employers with retiree health care plans is not the only reason employers are cheering the legislation.

Employers also are welcoming a provision, which was part of the House bill and which the confer-

ees incorporated in the compromise bill, that would remove a major roadblock to widespread employer adoption of debit cards for flexible spending and health reimbursement accounts.

The measure makes clear that employers or their third-party claims administrators do not have to send out an Internal Revenue Service Form 1099 to providers receiving payments

through debit card transactions.

In an earlier ruling that legitimized the use of debit cards for electronically paying expenses, such as copayments for physician office visits, the IRS said Form 1099 would have to be furnished to providers receiving at least \$600 in debit card transactions from FSA and HRA participants. Debit card vendors said the re-

See **DEBIT CARDS**/next page

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Debit cards: Path clear for HRA use

Continued from previous page

requirement would be impossible to meet for a variety of reasons (BI, Sept. 1).

The IRS later said it was reviewing the 1099 requirement but has not taken any formal steps to revoke it.

If the compromise Medicare drug bill passes, as is expected, many more employers would likely adopt the cards, which can save employers money and reduce the paperwork associated with spending accounts, vendors say.

"This is great news. The removal of this barrier will give a huge boost to the cards," said Donna Porritt, senior vp with Evolva Benefits Inc. in Avon, Conn., which markets a debit card called the Benny Card.

Separately, the drug benefit legislation drops a provision contained in the earlier House-passed version that would have allowed FSA participants to roll over up to \$500 in unused account balances for the following year.

The final bill also drops a provision in the Senate-passed version that would make clear that

retiree health care plans are not subject to the Age Discrimination in Employment Act.

That provision had been sought by employers as a means to negate a three-year-old federal appeals court decision that said employers could be sued under ADEA for providing smaller benefits to Medicare-eligible retirees than to younger retirees.

AARP, the Washington-based advocacy organization for individuals age 50 and over, fought the provision, saying it would give employers the green light to cut or terminate retiree health care benefits. The conference report accompanying the measure, though, includes language that "the intent of Congress is that employers should not be prevented from providing voluntary benefits to retirees only until they become eligible" for Medicare.

In addition, the Equal Employment Opportunity Commission has proposed regulations that would exempt retiree health care plans from the ADEA. The EEOC has not given any indication when it will finalize the regulations.

Common management, acquisition experience bode well Easy integration anticipated

By JUDY GREENWALD

ST. PAUL, Minn.—St. Paul Cos. Inc. Chairman and Chief Executive Officer Jay S. Fishman's background running the Travelers Property Casualty Corp., as well as both companies' acquisition experience is expected to result in a smooth integration as the two companies merge, say most observers.

They note that Mr. Fishman, who joined St. Paul in 2001, was formerly Travelers' chairman, president and CEO.

"It's a bit unusual and probably in their favor" that Mr. Fishman is familiar with both entities, said John Iten, a director at Standard & Poor's Corp. in New York.

Furthermore, Mr. Fishman brought several key Travelers people with him when he moved to St. Paul, said Mr. Iten. "From that perspective, the integration might not be as rocky as it would be with some other organizations, where the cultures were more different, and you didn't have this commonality of management," he said.

In addition, both companies have extensive experience integrating businesses, including St. Paul's 1998 acquisition of USF&G Corp. and Travelers' 1995 acquisition of Aetna Inc.'s property/casualty business, analysts and other observers

say.

"Management has been through this before," said Karen Horvath, a vp with Oldwick, N.J.-based A.M. Best Co. "That's a good thing. They can look back and say, 'I wish I'd done this before' and 'Let me pay attention to that this time.' They've got some benefit of hindsight."

"These are companies who know how to do acquisitions," said Michael Lewis, senior insurance analyst with UBS Warburg in New York. "The fact that it's being done on a Travelers-St. Paul platform gives me more comfort for a successful integration than if it was two other companies."

The absence of a huge overlap in St. Paul's and Travelers' product lines should also help ensure a smooth transition, said David P. Carlon, Boston-based director of insurance solutions at FileNet Corp., a software firm. "The turf battles will be less," he said.

"We expect the deal to go very smoothly," said Marita Zuraitis, St. Paul's president and CEO-commercial lines, who has also been named the merger's transition leader. "We have a successful track record integrating businesses, not only from a renewal rights offering standpoint, which folks have done lately, but also merger integrations, so there's

a lot of experience there."

In addition, "both companies have demonstrated overall management strengths and were well regarded in the marketplace," said Ms. Zuraitis. Both insurers provide their agents and brokers with services, are customer-focused, performance-based and nimble as well as expense-conscious, he said, "so I don't see any reason why it shouldn't go very smoothly. It's my hope to make it as seamless as possible."

But Mark Charron, a principal with Deloitte & Touche L.L.P. in Hartford, Conn., who described the merger as "Minnesota nice meets Connecticut insurance establishment," predicted the integration would be a "bit of a challenge."

Although both organizations have significant management talent, the merger of the two companies' cultures "will ultimately determine how successful they're going to be financially, and right now, I think you've got two different cultures" that reflect the companies' different market focuses.

And while both companies are experienced in making deals, "the other deals are probably more on the acquisition side rather than creating a merger of equals like they're trying to do," which is a "lot more challenging," said Mr. Charron.

Merger: Would be No. 2 commercial insurer

Continued from page 1

nesses will be consolidated under the Travelers brand in Hartford.

St. Paul Chairman and Chief Executive Officer Jay S. Fishman will serve as CEO of the combined company. Travelers Chairman and CEO Robert I. Lipp will be the company's executive chairman until Jan. 1, 2006, when Mr. Fishman is expected to become chairman and CEO.

The combined company will have a 7.6% market share of the commercial lines business, topped only by American International Group Inc., with an 8.8% share, based on 2002 direct premium written data from Oldwick, N.J.-based A.M. Best Co. Travelers now holds the No. 3 spot—behind units of Zurich North America, including the Farmers Group—while St. Paul is No. 6.

Michael Lewis, senior insurance analyst with UBS Warburg in New York, said, "You're dealing with a pretty fragmented industry, and you're creating a company that has better size, geographic reach and shelf space on a national basis than existed before the merger, while addressing the longer-term succession issue at Travelers."

The net result, Mr. Lewis said, is that "you're creating a pretty powerful, broad-based player in the group that's financially strong, that can garner market share over an extended period of time."

The St. Paul/Travelers merger "combines two very good companies, and the outcome is a much

larger, much stronger company," said John Wicher of San Francisco-based insurance investment bank John Wicher & Associates. "I think it's indicative of where we are to a certain degree in the market cycle," he added. "I think there's a general belief that we're at the top of the cycle, that rates are softening" and that companies that can achieve the greatest cost savings and diversification in their risk portfolios will be in the best position when the soft market arrives, he said.

The deal would change the competitive picture, said John Ward, chairman and CEO of the Cincinnati-based Ward Group. "The combined company will be a much bigger competitive force that (AIG) will have to reckon with," he said. This may result in "a refinement to (AIG's) strategy now that there's a little bit more of a formidable competitor on the scene, but I think it'll be subtle."

Observers say the two operations complement one another both geographically and by product line.

Karen Davies, senior credit officer with rating agency Moody's Investors Service in New York, said there will not be significant overlap in their businesses "to the extent St. Paul is more of a specialty insurer and more of a Midwest insurer and Travelers is more of an East Coast, middle-market insurer."

The merger would mean one less competitor in the business, though.

Gerald Blanchard, risk manager for the Lansing, Mich.-based Lans-

ing Board of Water & Light, said, "I don't like the reduction in competition" involving some of the larger commercial insurers. "We're a public utility. We do need the competition...to help generate the best value," said Mr. Blanchard. "Even though these are two fine companies—and I suspect they'll be a very fine company when they get done—there's just one less of them," he said. The utility has a St. Paul policy and has worked with Travelers in the past.

CORPORATE SNAPSHOT	
Net premium written*	
St. Paul	\$7.5 billion
Travelers	\$13.1 billion
Combined	\$20.6 billion
Investment assets	
St. Paul	\$22.7 billion
Travelers	\$37.8 billion
Combined	\$60.5 billion
Employees	
St. Paul	9,700
Travelers	21,500
Combined	31,200
Licensed agents	
St. Paul	4,000
Travelers	10,500
Combined	14,500
*Projected 2003	

Marita Zuraitis, St. Paul's president and CEO-commercial lines and the merger's transition leader, said while the deal would mean one less competitor, agents and brokers "are focused on financial strength and stability right now, and I do think a stronger combination is something...they are looking for in the marketplace."

She added that "the combined company will truly have unparalleled product depth. The strength of St. Paul's specialty business, the strength of Traveler's national accounts and personal lines, and, I think, the strength that both of us have in the commercial lines really creates a strong combination" with a complementary geographic spread.

Mr. Lewis said the combined company will be able to provide a "broad-based product mix to its clients, so that should probably garner additional interest from the client base as a go-to company."

Mark Charron, a principal with Deloitte & Touche L.L.P. in Hartford, Conn., said, "The tremendous financial strength of the combined entity puts them in, obviously, a category currently occupied only by AIG. If they can create new products, if they can offer higher capacity, more capacity, then that'll be a great thing."

Furthermore, the combination "longer term will give more stability in pricing," said Jim Amen, a partner with Stamford, Conn.-based Philo Smith & Co., a boutique in-

vestment bank that specializes in insurance.

Some say the deal presages more M&A activity in the market.

John Scheid, chairman of PricewaterhouseCoopers' Americas insurance group in New York, said, "I think we will probably continue to see transactions like this in the marketplace" in 2004 and 2005. With very good profitability and premium growth in the market, "I think conditions are ripe for transactions like this to occur" although there are relatively few potential buyers.

"I don't think that this deal is easily replicable in the marketplace," said Peter Porrino, global director of insurance services at Ernst & Young L.L.P. in New York, noting that he expects more sales of renewal rights rather than "straight mergers." Insurers' balance sheets "are still too problematic for many companies to take responsibility for," he said.

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Late News

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the federal government to act as a financial backstop for private insurers faced with losses from a future terrorist attack in the United States.

Senators urge changes to class-action reforms

Four Democratic senators are calling for further changes in a class-action reform bill as a prerequisite for their support. In a letter to Senate Majority Leader Bill Frist, R-Tenn., this month, the quartet said they "support the general thrust of S. 1751"—the Class Action Fairness Act of 2003—but believe the bill goes "beyond the scope of what must be addressed" in some places. According to the four, areas that need re-examination include the criteria for removing class actions that involve plaintiffs and defendants from different states to federal court from state court; the treatment of "mass tort actions" that are not brought as class actions; and the treatment of "coupon" settlements, in which class members receive coupons for the defendant's product or service while class attorneys receive cash. Sens. Jeff Bingaman, D-N.M.; Christopher J. Dodd, D-Conn.; Mary L. Landrieu, D-La.; and Charles Schumer, D-N.Y., signed the letter to Sen. Frist.

Travelers to settle asbestos class actions

Travelers Property Casualty Corp. has reached an agreement in principle with class-action plaintiffs in all pending asbestos-related statutory direct actions. The

statutory claims allege Travelers violated state unfair claims and trade practices laws in dealing with asbestos claimants and were filed in Massachusetts, West Virginia and



other states. The settlement does not cover so-called common-law asbestos-related actions brought against Travelers in other states. The common-law claims allege the insurer had a general duty to disclose to the public the hazards presented by asbestos.

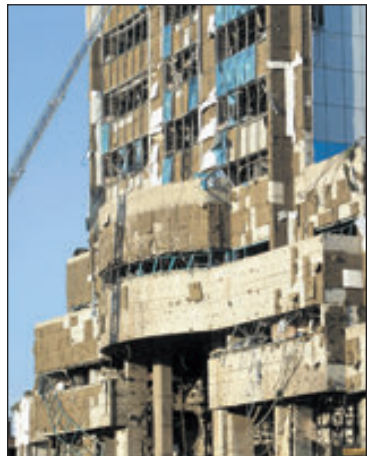


PHOTO: AFP

Bombings last week in Istanbul, Turkey, killed at least 27 and injured hundreds.

Two truck bombs kill 27 in Istanbul

Two terrorist truck bombs exploded Thursday in Istanbul, Turkey, killing at least 27 people and injuring 400. The bombs were detonated outside the British Consulate and the Turkish headquarters of U.K. bank HSBC Holdings P.L.C. Reinsurers have said

they do not expect large insured losses. Covered losses will likely be low because of the limited damage to the buildings and because terrorism is frequently excluded in Turkey, said a spokeswoman for Munich Reinsurance Co., which is based in Munich, Germany.

Louisiana names Wooley insurance commissioner

Democrat Robert Wooley was elected to a four-year term as Louisiana insurance commissioner, defeating Republican Dan Kyle, the former legislative auditor. Mr. Wooley took up the post in October 2000, after former Commissioner Jim Brown was convicted of lying to FBI agents.

S&P faults actuaries on insurer liabilities

Actuaries aren't doing a good job of assessing insurers' future liabilities, forcing rating agencies to doubt the veracity of company statements and to rely more on their own analysis, according to Standard & Poor's Corp. Reserve additions by U.S. property/casualty insurers for 2003 will likely surpass the \$22 billion total for all lines of business in 2002, which exceeded the \$11.6 billion reserve boost needed in 2001, forecasts a new report by S&P analysts.

XL unit names CEO, COO after departures

XL Capital Ltd. has named Robert Lusardi as chief executive officer of XL Weather & Energy. Previously, Mr. Lusardi was CEO of XL Financial Products & Services. David Shea was named chief operating officer of the weather unit after serving as chief

financial officer of XL Financial Products. The two replace Jeff Bortniker, CEO, and Lynda Clemmons, COO, who are leaving the Bermuda-based insurer.

House, Senate approve extension of OPIC



Both houses of Congress have approved legislation that reauthorizes the Overseas

Private Investment Corp. through Sept. 30, 2007. OPIC underwrites political risk insurance for U.S. companies doing business in developing countries.

Briefly noted

The House of Representatives voted Thursday to reauthorize the **National Flood Insurance Program** for five years. The Senate earlier approved legislation to extend the program for one year. A House/ Senate conference will have to iron out differences in the measures...**Marsh Inc.** has been granted a license to operate as an insurance broker in Macau, a special administrative region of China.

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Online Poll

[11/17 - 11/21]

Do you think health care cost increases will moderate in 2004?



Yes	19.1%
No	74.3%
Do not know	6.6%

BI Stock Index

[11/17 - 11/21]

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

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

BI Stock Index	2024.08	-0.95
Dow Jones	9628.53	-1.43
S&P 500	1035.28	-1.43

Largest gains

Trenwick Group Ltd.	13.64%
Seibels Bruce Group Inc.	10.00%
Vesta Insurance Co.	9.56%
WellChoice Inc.	6.79%
Unico American Corp.	5.30%

Largest losses

PMA Capital Corp.	-14.55%
SCOR	-9.84%
Penn-America Group Inc.	-7.03%
Travelers P/C Corp.	-6.67%
AEGON N.V.	-5.11%

Weekly change by market segment

Brokers	0.23%
Insurers/Reinsurers	-0.70%
Managed Care Organizations	0.89%

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

Exxon: Award rekindles reform debate

Continued from page 3

The case pitted Irving, Texas-based Exxon Mobil against the state of Alabama. At issue was whether the giant oil company was deliberately underpaying the state royalties on natural gas from the Mobile Bay gas field. The case, which began in 1999, first resulted in a verdict of nearly \$88 million in compensatory damages and \$3.42 billion in punitive damages, but the state Supreme Court overturned the awards on a technicality, opening the way for the trial that ended last week with a compensatory damage award of \$65.5 million and punitive damages of \$11.8 billion.

That's a larger punitive damage award than the state sought. And, ironically, had the initial case been filed a few months later than it was, the punitive damage award may have been much lower because of a 1999 tort reform that limits punitive damages in most cases that don't involve physical injury to the greater of three times compensatory damages or \$500,000.

Exxon Mobil announced within hours of the decision that it would appeal the award by the Montgomery County, Ala., jury to the state Supreme Court. In a written

statement, Exxon Mobil's lead counsel noted that the punitive damage award was more than 180 times the underlying compensatory award, adding that the punitive award "defies common sense."

The award stunned tort reform advocates, who predicted that it will be significantly reduced or overturned on appeal.

"I can't imagine that what they're being accused of merited that level of punitive damages," said Glenn Lammi, chief counsel of the Washington Legal Foundation.

"It's amazing that a jury can be allowed to issue a verdict like that. The Supreme Court made it very clear this year that punitive damages of this magnitude in basically a contract case would not be allowed," said Quentin Riegel, vp-litigation for the National Assn. of Manufacturers in Washington. "The ratio of punitive damages to actual damages is much too high."

"This is another step in what is going to be an ongoing battle between those who see *Campbell* as having steel barriers on punitive damages and those who see them made of plastic or rubber," said Victor E. Schwartz, general counsel of the Washington-based American

Tort Reform Assn. "Obviously, this verdict comes down on the rubber side, but it is clear there is likely to be a successful challenge because, in spite of the concept of potential future wrongs, the ratio exceeds nine to one. And the court said that nine-to-one ratio may be too high where compensatory damages are successful."

But Jere Beasley, a former Alabama lieutenant governor who served as one of the state's attorneys in the Exxon Mobil case, said that *Campbell* didn't apply in this case. Instead, he cited the Supreme Court's 1993 decision in *TXO Production Corp. vs. Alliance Resources Corp.*, in which the justices let stand a punitive damage award 526 times the underlying compensatory award. Mr. Beasley, founding shareholder of the Montgomery, Ala., law firm of Beasley, Allen, Crow, Methvin, Portis & Miles, P.C., said that, in that case, which also involved mineral rights and allegations of false statements, the high court permitted the consideration of "future anticipated gain—in other words, gain from your fraudulent conduct" in determining punitive damages. Mr. Beasley said that in the Exxon Mobil case, the future anticipated gain would be at

least \$950 million over the life of the lease, which expires in 2029.

Mr. Beasley also praised the jury as being "very sophisticated" and well educated.

But legal experts on the other side wondered whether the jury had been told properly what to do. "It would seem to me (that) to not waste judicial resources, the prudent thing to do would be to instruct a jury about, if not the ratio, at least give them some guidance in terms of what a legally permissible award would be," said Sherilyn Pastor, a partner in the Newark, N.J., law firm of McCarter & English L.L.P.

"The Supreme Court in *Campbell* clearly said that juries should be instructed," said Robin Conrad, senior vp in the National Chamber Litigation Center Inc. in Washington, which handles litigation for the U.S. Chamber of Commerce.

While it is essential that the lower federal and state courts apply the *State Farm* principles, it is equally necessary that juries are given proper instructions with respect to the inappropriateness of considering wealth and the proper ratios between compensatory and punitive damages, said Ms. Conrad. "This is off the charts," she said.