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\$4

Bond insurer business booming

By JUDY GREENWALD

Financial guarantee insurers are happily floating in the wake of what is turning out to be the biggest year yet for municipal bond issuance.

And not only is municipal bond issuance up, but the percentage of insured bonds has increased as well, as more municipalities turn to financial guarantee insurers to help sell their bonds.

The need for infrastructure improvements, along with investors' desire for security in an uncertain economic environment, is driving both trends.

At the same time, asset-backed securities and international business account for most of the financial

guarantee insurers' new volume, and the days when muni bonds claimed a majority of their business are probably gone forever.

Asset-backed securities, though, generate more losses than do municipal bonds. An area of particular concern to some observers is corporate debt obligations, which are securitized pools of debt obligations, and Enhanced Equipment Trust Certificates, which are bonds issued by airlines and secured by groups of specific aircraft.

Financial guarantee insurers say, though, that these deals are structured so they are well protected against any but the most devastating losses.

Meanwhile, the business continues to grow.

See **MUNI BONDS**/page 23



PHOTO: ZUMA PRESS

Projects such as the construction of the Las Vegas Monorail are fueling growth in the municipal bond insurance market.

Several big deals struck to settle asbestos claims

By DOUGLAS McLEOD

Year-end 2002 is bringing a spate of mass settlement agreements between asbestos defendants and claimants through the use of bankruptcy trusts, though some of the proposed deals are likely to be challenged, and their ultimate success remains to be seen.

Babcock & Wilcox Co. last Thursday announced an agreement in which it would resolve current and future asbestos liabilities by setting up a trust funded with stock in its parent company and an assignment of Babcock's rights to insurance recoveries. The Babcock plan came only a day after Houston-based Haliburton Co. reported a deal in which it would pay claimants about \$4 billion as part of a prepackaged bankruptcy filing by two of its subsidiaries.

Meanwhile, Saddle Brook, N.J.-based Sealed Air Corp. announced a settlement last month, and other agreements currently are being forged by Honeywell International Inc. and ABB Ltd.'s Combustion Engineering Inc. unit.

Lawyers cite a variety of reasons for the apparent surge of

settlement proposals, ranging from concern among plaintiffs' lawyers about the threat of asbestos reform legislation in a Republican-controlled Congress to pressures imposed by bankruptcy court deadlines. Some say the deals, in the works for months, aren't driven by any common cause and only coincidentally have come to fruition at roughly the same time.

Several of those involved, including the defendant companies themselves, acknowledge that the agreements have a long way to go. Among other hurdles, they must be approved by the bankruptcy courts, and some will face challenges from various parties, including plaintiffs' lawyers unhappy with a given deal's terms and insurers, which in several cases are expected to bear a large share of the financial burden.

Insurer objections

London market insurers, in particular, will object to settlements that do not follow their requirements that settlement amounts be "reasonable" and

See **SETTLEMENTS**/page 26

All claimants must be screened under federal law

By JOANNE WOJCIK

Many insurers and self-insured employers are unaware that they face potential fines and civil penalties for failing to screen the names of claimants against government lists of potential terrorists.

Although the property/casualty industry was exempted from the USA PATRIOT Act of 2001—which requires financial services companies to perform such screening to spot money laundering activities that finance terrorism—they are not exempt from a 1979 screening law that gained renewed emphasis in the wake of the Sept. 11, 2001, terrorist attacks.

All insurers, as well as self-insured employers and third-party claims administrators, are subject to the prohibition on financial transactions with individuals or entities named on a special list created by

the Office of Foreign Asset Control.

Many insurance industry executives think that the OFAC list is part of the USA PATRIOT Act and that they are therefore exempt from its requirements, but it is a separate law, said Kathleen Jensen, insurance services counsel for the National Assn. of Independent Insurers in Des Plaines, Ill.

"It's two separate things. OFAC has nothing to do with money-laundering," she said.

Under the USA PATRIOT Act, formally the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, all financial institutions must establish controls against money laundering to prevent the financing of terrorism. The legislation originally would have applied to all insurers, but the NAII and other insurance

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International

Aussie libel ruling expands liability

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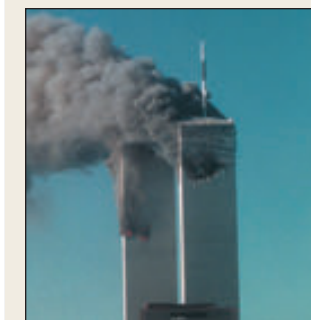
Late News

N.Y. asbestos claimants must show ailments

Asbestos liability claimants in New York County must meet minimum medical criteria before their cases will be placed on an active court docket, a judge has ruled. The judge noted that only 2,000 of the 21,000 asbestos claimants in the county suffer from asbestos-related malignant diseases. In addition, "a small percentage" of the remainder suffers from "sustained functionally impairing asbestosis." By driving defendants into bankruptcy, the many claims by unimpaired or minimally impaired claimants can impede seriously ill claimants from recovering damages, the judge wrote.

Endurance unveils IPO, new reinsurer unit

Endurance Specialty Holdings Ltd. plans to raise about \$200 million through an initial public offering to provide capital to its underwriting subsidiaries and to repay debt. Endurance also announced the formation of Endurance Reinsurance Corp. of America, a Tarrytown, N.Y.-based reinsurer that will underwrite excess-of-loss, pro rata, workers compensation, surety and other specialty reinsurance risks.



Judge's ruling sends WTC dispute to trial

Units of Chubb Corp., American International Group Inc. and Zurich Financial Services Group must go to trial to determine whether they should pay Silverstein Properties Inc. one \$3.55 billion policy limit or two for the destruction of the World Trade Center, a federal judge ruled. The judge rejected the insurers' request for summary judgment that the coverage they provided was bound under a policy form drafted by Willis Group

See **LATE NEWS**/next page

Inside

Conning sees end to managed care era

Managed care may be losing its prominence in the health care arena, signaling that dramatic changes in the health care market lie ahead, a new study contends. **Page 4**

Dubious achievement awards for 2002

Paul Winston doles out awards for the most notable—and notorious—events of 2002. **Page 6**

Ups and downs in benefits

For benefit managers, the past year has seen its share of pluses and minuses, says this week's editorial. **Page 8**

Politicos need cover for reputational risk

The scandal over the remarks made by Sen. Trent Lott show the need among many politicians for a special kind of coverage to help them transfer reputational risks, writes Senior Editor Rodd Zolkos in Commentary. **Page 20**

U.K. pension proposals draw criticism

U.K. government reform proposals to make contributions to occupational pension plans compulsory are receiving a mixed response from pension experts. **Page 21**

Insurer CEO pens tell-all

If Jack Welch can write a blockbuster, why not Almost Donothing, muses the creation of Myron and Jodi Picoult. **Page 28**

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REPORTING WEEKLY ON CORPORATE RISK, EMPLOYEE BENEFIT AND MANAGED HEALTH CARE NEWS

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CONTINUED FROM PAGE ONE
Holdings Ltd. Earlier this year, the judge ruled that the Sept. 11, 2001, attack that destroyed the World Trade Center was one event under the terms of the Willis form.

Airline DVT cases yield contradictory rulings

In Australia, the Victoria State Supreme Court has ruled that an airline passenger who suffered deep-vein thrombosis can sue British Airways P.L.C. and Qantas Airways Ltd. The judge ruled that DVT, which has been linked to spending long periods in cramped conditions, could be considered an "accident" under the terms of the Warsaw Convention, which governs airlines' liability in international flights. In a similar case in the United Kingdom, victims of DVT sought to bring a group action against 29 airlines. But the judge in that case ruled that DVT was not an accident under the convention.



PHOTO: AP/WIDE WORLD

Winter storms in the Carolinas and elsewhere will cost insurers at least \$360 million.

Winter storm losses hit \$360 million: PCS

North Carolina bore the brunt of an early December winter storm that caused an estimated \$360 million in insured property damage, the Insurance Services Office Inc.'s Property Claim Services unit reported. North Carolina sustained an estimated \$230 million in insured property damage. South Carolina suffered \$60 million in losses; New York, \$40 million; Pennsylvania, \$20

Late News

million; and Virginia, \$10 million. The storm's losses brought estimated insured property losses for the fourth quarter of 2002 so far to about \$1.3 billion.

MRM proposes debt restructuring

Mutual Risk Management Ltd. has filed a proposed scheme of arrangement in Bermuda to restructure \$198 million of its debt, as part of efforts to separate its ongoing captive management and brokerage operations from its defunct program business. Under the scheme, creditors—including banks and debenture holders—would own the majority of the ongoing business, which would be renamed IAS Park Ltd.

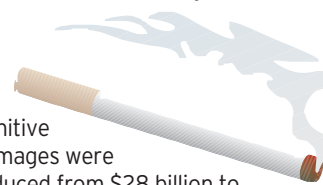
Workplace injury, illness reach record low

The rate of workplace illnesses and injuries hit a record low in 2001, according to the Bureau of Labor Statistics. Private employers reported 5.2 million workplace injuries and illnesses last year, according to BLS. The workplace injury and illness rate fell to 5.7

cases per the equivalent of 100 full-time employees last year from a 6.1 case rate in 2000. Last year's rate was about half that registered in the early 1970s, when BLS first reported such data.

Philip Morris says reduced award still high

Philip Morris Cos. Inc. said it will continue its appeal of an award to a sick smoker even though the



punitive damages were reduced from \$28 billion to \$28 million. The cigarette maker said the damages still are out of line with the \$850,000 compensatory award a state court jury in Los Angeles granted in October to Betty Bullock, who blames her lung cancer on cigarettes.

SCPIE, Goshawk enter reinsurance deal

Los Angeles-based SCPIE Holdings Inc., a health care liability insurer for physicians, medical groups and

health care facilities, said it has reached a quota-share reinsurance agreement with London-based Goshawk Insurance Holdings P.L.C. that will permit it to focus on its core business. Under terms of the transaction, Goshawk Re will assume 98% of SCPIE's June 30, 2002, unearned premiums and future written premiums related to its assumed reinsurance business for the 2001 and 2002 underwriting years.

S&P, Moody's downgrade Kemper

Standard & Poor's Corp. and Moody's Investors Service have downgraded the Kemper Insurance Cos. intercompany pool. S&P downgraded Kemper to BBB- from A, citing weak operating results, among other factors. Moody's downgraded Kemper to Baa1 from Baa1, citing the insurer's "strained capital position."

Briefly noted

The Freberg Group, a Denver-based managing general agency, will merge Jan. 1, 2003, with Glen Allen, Va.-based Hilb, Rogal & Hamilton Co. Freberg derives about half of its annual revenues of more than \$10 million from its Freberg Environmental unit, which will continue to operate separately....Peoria, Ill.-based **RLI Corp.** has priced its previously announced offering of 4.8 million common shares at \$25.25 per share. The property/casualty insurer expects net proceeds of about \$115 million from the offering, which is expected to close Dec. 26. RLI said it will use proceeds to fund subsidiary growth, pay down its line of credit and reduce its reliance on reinsurance....A federal appeals court has reduced a \$32 million bad-faith award against **Farmers Insurance Group** to about \$4 million. The award stems from Farmers treatment of mold-related claims in Texas.

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Online this week:

- **Searchable directories** of all the listings found in *BI's* Market Sourcebook.
- **New Commentary** from Paul Winston, Rodd Zolkos and Myron Picoult.
- **The Datebook** calendar lists upcoming industry meetings and events and lets you add your own.
- **The Online Forum** allows readers to exchange ideas and information.

Large states ignore the NAIC's efforts to promote uniform implementation

States' laws clash with federal terror act

By MEG FLETCHER

KANSAS CITY, Mo.—Individual state insurance departments are making some progress in uniformly implementing the new federal Terrorism Risk Insurance Act, but they still face hurdles that are frustrating to policyholders and industry representatives.

The Kansas City, Mo.-based National Assn. of Insurance Commissioners has sought to encourage uniformity by adopting a bulletin outlining voluntary filing procedures and urging states to use it, subject to their own regulatory requirements.

More than a dozen smaller jurisdictions already have adopted the bulletin, and those numbers are expected to triple soon, an industry observer said. An NAIC spokeswoman said, though, it was too soon to make such an estimate.

But that demonstration of unifor-

mity doesn't eliminate a major hurdle. That is caused by several states that emphasize they can still apply their own laws, which may conflict with the federal law.

"There is a tremendous amount of confusion" about the intent of

ing the NAIC's quarterly meeting earlier this month in San Diego.

Those states, based on 2001 premium volume, are led by California, New York, Texas and Florida. Collectively, they write nearly 40% of the nation's total property/casu-

tations for terrorism risks.

Currently, Florida continues to ban terrorism exclusions for admitted insurers, said Insurance Commissioner and Treasurer Tom Gallagher. As a result, policyholders automatically have terrorism coverage and "don't have a choice" under the federal law. In addition, in an interview at the NAIC meeting, Mr. Gallagher said that he will not consider any insurer filings for terrorism exclusions.

Commissioners from Georgia and New York indicated, though, that they would consider insurer filings related to terrorism coverage on a case-by-case basis but thus far have not accepted any. Policyholders in those states continue to have coverage for some terrorism-related losses.

Meanwhile, Texas' Mr. Montemayor said he expects that his department will allow for "consumer

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Insurance Commissioner Tom Gallagher says policyholders in Florida 'don't have a choice' under the federal law; they automatically have terrorism coverage.

federal lawmakers and the response of states, especially large ones, to the new law, said Texas Insurance Commissioner Jose Montemayor. His comments followed a private meeting with other commissioners from large states that was held dur-

ing the NAIC's quarterly meeting earlier this month in San Diego.

Heretofore, those large states and Georgia declined to participate in an NAIC-sponsored initiative in which 46 jurisdictions allowed insurers to adopt some coverage limi-

Medicare drugs top Congress' health agenda

By MARK A. HOFMANN

WASHINGTON—Employer-related health care issues are likely to rank lower on the next Congress' health care agenda than the creation of a Medicare prescription drug benefit.

In fact, when asked to name their top health care priority for the new Congress that convenes next month, each member of a panel of Capitol Hill and administration policy experts cited Medicare in general or a Medicare prescription drug benefit in particular. They offered that assessment during a briefing sponsored by the nonpartisan Alliance for Health Reform last week.

But the prescription drug benefit

is far from the only substantive health care issue that lawmakers are likely to deal with in the months ahead. One senior administration official went so far as to say that he's "optimistic" that the new Congress will prove to be one of the most important in terms of health care in several decades.

The administration

wants to give patients and their physicians greater control of their health care, said Bobby Jindal, assistant secretary for

planning and evaluation in the Department of Health and Human Services. To address the problem of the uninsured, the administration

wants to create refundable tax credits that would allow families that don't qualify for Medicaid to buy coverage, he said.

Medical liability reform is also likely to come before lawmakers

again, said Dean Rosen, Republican staff director of the Senate Subcommittee on Public Health. There's an "increasing recognition we're at a crisis point" regarding

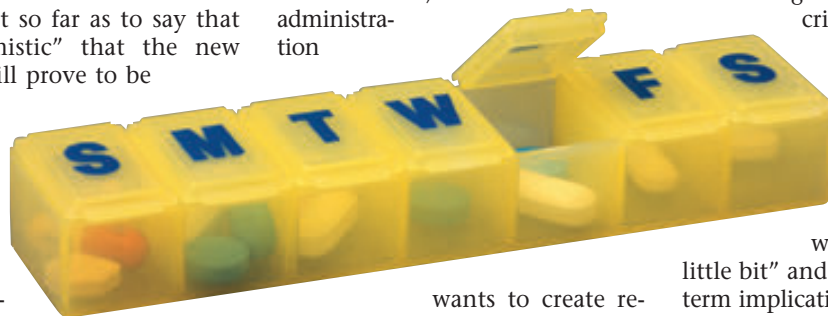
medical liability in a number of states, said Mr. Rosen.

Mr. Rosen also said that his boss—Sen. Bill Frist, R-Tenn.—wants to "step back a little bit" and consider the longer-term implications of health care issues. Sen. Frist, a physician who has emerged as one of the Hill's leading voices on health care, wants to take into account what the health care system should look like 10, 15 or 20

years from now, said Mr. Rosen. Sen. Frist appears likely to become Senate majority leader when Republicans assume control of the Senate next month.

Linda Fishman, health policy director for Sen. Charles Grassley, R-Iowa, warned that even though the Republicans will enjoy a slim Senate majority, the Senate's "rules make it very difficult to get anything done" without 60 votes behind a bill—the minimum number necessary to cut off a filibuster. As a result, her boss will be emphasizing bi- or tripartisanism, seeking the support of Sen. Jim Jeffords, I-Vt., as well as Democrats.

Medical liability reform did not
See **HEALTH**/page 24



2002 Annual Executive Conference for the Property/Casualty Industry

Exposures forcing insurers to keep rates high, CEO says

By GAVIN SOUTER

NEW YORK—Risk managers should expect increased insurance rates in just about every line of property/casualty insurance for the foreseeable future, according to several senior insurance executives.

While rates have increased substantially over the past two years, often they are still inadequate and need to increase further, they say.

Insurers are still grappling with low interest rates and poor underwriting results from the late 1990s, and the current lack of capacity in many lines is unlikely to change anytime soon, the executives say.

And despite the passage of the

federal terrorism insurance backstop, insurers are still facing a substantial increase in terrorism exposures, they say.

Although rates have increased in most classes of business, they have, so far, risen only to the levels they were at in 1992, said Maurice R. Greenberg, chairman and chief executive officer of American International Group Inc. in New York.

**STANDARD
& POOR'S**



"And, at the same time, loss costs exploded between 1997 and 2000," Mr. Greenberg said at the 2002 Annual Executive Conference for the Property/Casualty Industry, sponsored by Standard & Poor's Corp. and the Black Diamond Group in New York earlier this month.

During that period, juries increased damages awards dramatically as they perceived that, in the thriving economy, companies could comfortably afford to pay the awards, he said. "The asset bubble burst, but the liability bubble didn't," Mr. Greenberg said.

As a result of the increased loss costs, many insurers are increasing their reserves, and they are

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2002 Annual Executive Conference for the Property/Casualty Industry

Corporate governance focus may reduce investor suits

By MICHAEL PRINCE

NEW YORK—Growing attention to corporate governance ultimately should help companies by bolstering their relationship with shareholders and reducing their exposure to securities suits, according to a panel of experts.

New rules created by federal regulators and stock exchanges to promote proper corporate governance will aid shareholders, and corporations "will be stronger for it," said Michael Useem, professor at The Wharton School in Philadelphia, who in August was named adviser to Tyco International Ltd. to develop a best practices corporate governance policy.

Recent high-profile accounting scandals have spurred increased attention to corporate governance among both U.S. companies and regulators. As a result, in the next year "many companies will have in place a much stronger system of governance," Mr. Useem told attendees at the 2002 Annual Executive Conference for the Property/Casualty Industry sponsored by Standard & Poor's Corp. and the Black Diamond Group in New York earlier this month.

But it's not always easy for investors and other outsiders to assess a company's commitment to corporate governance, said Andrea Esposito, managing director at Standard & Poor's Corp. in

New York. To correct this, S&P in October launched a new service that examines a company's governance practices—and its overall "culture" of governance—and produces a score for use by outside investors. Companies can also use the service to obtain an outside evaluation of their own governance and financial disclosure practices, she said.

Ultimately, sound corporate governance will lead to better results for shareholders and fewer securities-related suits, the panelists said. Ms. Esposito said that research has shown that companies with good governance tend to have more stable earnings per share.

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PHOTO: COURTESY OF BETHLEHEM STEEL

Bethlehem Steel is resisting a plan by the Pension Benefit Guaranty Corp. to take over the company's massively underfunded pension plan.

Steelmaker girds for fight with PBGC on plan takeover

By JERRY GEISEL

WASHINGTON—The Pension Benefit Guaranty Corp. says it intends to take over and terminate, effective Wednesday, Bethlehem Steel Corp.'s massively underfunded pension plan, but Bethlehem says it will oppose the action as premature.

Termination of the Bethlehem plan, which has long been expected, will saddle the PBGC with, by far, its biggest loss ever. The plan has about 95,000 participants and is underfunded by \$4.3 billion, with \$3.5 billion in assets and \$7.8 billion in obligations. The PBGC, which does not guarantee all promised benefits, expects to be liable for about \$3.7 billion.

That loss is more than double what had been the PBGC's biggest claim: \$1.7 billion in benefit obligations it took on in its March termination of several pension plans sponsored by failed steelmaker LTV Corp.

The PBGC said the termination is necessary because Bethlehem no longer can afford the plan, which would otherwise continue to accrue more liabilities. "We had to act now to prevent even larger losses down

the road," said PBGC Executive Director Steve Kandarian.

Bethlehem, which is in Chapter 11 proceedings, earlier said it cannot afford to make needed plan contributions, which it now estimates to be \$190 million next year and nearly \$1 billion in 2004.

But Bethlehem, though it knew plan termination was inevitable, says it will resist the Dec. 18 termination date.

If the pension plan is terminated on that date, many plan participants will be ineligible for special early pension benefits and a health insurance tax break Congress created this year as part of trade legislation, Bethlehem said. The trade law provides individuals 55 or older who are receiving pension benefits through the PBGC with a 65% federal tax credit to be applied toward the purchase of health insurance coverage.

Bethlehem Chairman and Chief Executive Officer Steve Miller said he wants to work with the PBGC to modify the termination date. The PBGC opposes a change in the date, an agency spokesman said. A Bethlehem spokeswoman said she expects the disagreement to go to court.



Study sees passing of managed-care era

By MICHAEL PRINCE

The era of managed care may be coming to an end, causing health care to undergo dramatic changes, including increased government intervention, a recent study predicts.

The study, released Dec. 4 by Conning Research & Consulting Inc., concludes that, with health care costs skyrocketing, managed care plans registering strong profits and the number of uninsured on the increase, there exists the strong possibility of significant change in how health care is delivered.

"Conning senses the emergence

of a 'backlash' against the plans," according to the study, which is entitled "Managed Care Industry Overview."

The managed care industry is now uneasily situated between its well-publicized past and a hard-to-read future, said Robert Booz, vp, health and managed care, and principal author of the study for Conning in Hartford, Conn.

Rising costs have forced many small employers to drop health insurance benefits and many employees to decline coverage, pushing up the number of uninsured, Mr. Booz said. "Managed care has not demon-

strated a prolonged ability to control expenses," he said.

As a result, the era of managed care may be passing, Mr. Booz said. "This generation of products is nearing the end of its product life cycle," he said.

"Is managed care still relevant?" Mr. Booz asked. Still, he acknowledged that no good alternative has yet emerged.

The most noteworthy successor is consumer-driven plans, Mr. Booz said, but this model has been slow to catch on.

Furthermore, the consumer-driven approach—in which an employ-

er provides funds for employees to spend in conjunction with a high-deductible health care plan and value-buying tools—has not yet been proved to lower costs, he said.

Mr. Booz said he is concerned that the plans may save money in the short term by giving users an incentive to delay treatment; delaying treatment, he said, might result in small health problems becoming big ones that drive up health care costs in the long term.

Despite Mr. Booz's reservations, the study states that, "with continued escalation in health care costs, this approach cannot be disregarded."

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'Government intervention, while not a foregone conclusion, is an increasing likelihood. ... It's clearly an agenda item.'

*Robert Booz
Conning Research
& Consulting Inc.*

Managed care, to its credit, has succeeded in eliminating unnecessary treatment from the system, Mr. Booz said.

But any reduction in utilization from now on will simply mean cutting into needed care, he said. "Managed care has brought us to a plateau," he said.

Given such developments, greater government intervention is likely, the Conning study states.

"Against the backdrop of increasing plan profits, employers and individuals struggle with higher prices and the number of uninsured grows—more dramatically in 2001 than in any other year. Conning expects more near-term regulatory constraints to be placed on managed care plans' rate increases," the study says.

Mr. Booz noted that the chances of government intervention have increased with Republican control of the Senate. With both houses of Congress and the White House controlled by Republicans, there is a strong possibility of the passage of some type of health care reform plan.

"Government intervention, while not a foregone conclusion, is an increasing likelihood," he said. "It's clearly an agenda item."

Mr. Booz said that he is not optimistic about the future of the current managed care organizations. "Do they have the product lines that people want and employers will buy and can afford to buy?" he questioned.

Managed care organizations have become too homogenized, he said. Each offers virtually the same products as the others, creating "a managed care commodity mindset" among buyers, he said.

The study, "Managed Care Industry Overview," is available at the price of \$2,500 per copy, by telephoning Conning Research & Consulting Inc., at 888-707-1177.

Plan costs polarizing workers

As health costs surge, some plan options are a luxury

By SARAH A. KLEIN

CHICAGO—In a week, Gerald J. Osher will do what many of his fellow physicians wish they could. He will turn his booming Lake Forest, Ill., medical practice into the equivalent of a members-only club.

He's already notified his patients that the first 500 or so willing to pay an annual fee of \$1,800 to see him will remain in his practice. The others must find new doctors at the beginning of the new year.

In the tony Chicago suburb, Dr. Osher has found no shortage of takers for the unconventional arrangement.

Many of his patients are willing to pay the fee, as well as the \$25 he plans to charge for every office visit, out of their own pockets because they share his desire to create a practice that guarantees them more time to see him and the ability to make same-day appointments.

"Even those who opted not to sign up looked me in the eye and said, 'Doc, I understand what you are doing,'" the 48-year-old internist says.

Dr. Osher—one of a handful of local physicians contemplating or committing to this practice structure—is the first to concede that his approach to medicine will work only in areas with a sufficient base of well-heeled patients to support a practice from their own bank accounts, rather than an employer's insurance policy.

And while he has agreed to keep seeing nearly 100 patients who can't afford the fee, he's sensitive to the likely criticism that he's engaging in a form of elitism, in which those with money have access to highly personalized service, while those with employer-provided insurance continue to receive care he found intolerable for his own patients: long waits for appointments and doctors rushing off so they can see as many 40 patients per day.

Indeed, the contrast in health care between those who have the money to pay for it out of pocket and those who don't is growing starker as employers, struggling to cope with double-digit premium increases, boost the amount that workers must pay for coverage.

"There is really no alternative to managing the cost," says Amy Myself, vp of human resources at Chicago-based hardware cooperative TruServ Corp., which provides insurance for 3,800 employees around the country.

The cost of choice

The solutions many employers have pursued—capping benefits at low levels, increasing co-payments and limiting access to doctors—have made a dent in rising costs. But they have also created a divide within the insured population. Choice is increasingly a luxury that only the more affluent can afford.

Take as an example the health insurance program for Chicago Public Schools teachers and administrative staff. Funded by local property taxes

and the state, CPS provides benefits to 43,000 of its 45,000 benefit-eligible employees and to another 42,000 spouses and children.

CPS charges single employees roughly 1.3% of their salary for health care benefits, while employees choosing spouse or family coverage are charged a few dollars more per pay period. It's a system that ensures access to health insurance at a modest cost.

Employees in the program choose between a health maintenance organization run by Louisville, Ky.-based Humana Inc.—which promises to cover nearly every possible illness in full or with modest, \$10 co-payments—and a more complex product administered by Blue Cross & Blue Shield of Illinois.

Called BlueChoice, the latter offers access to nearly all local physicians and hospitals but demands substantial co-payments and places low limits on yearly and lifetime payouts.

It is, in essence, an excellent health insurance plan for someone who is never sick, but much less desirable for someone with a long-standing relationship with an out-

'The way benefits are structured, the out-of-pocket expense is really regressive.'

J. Scott Wayne
Mercer Human Resource
Consulting Inc.

of-network doctor, a chronic condition that requires specialist care or who experiences a catastrophic event. The plan illustrates how having access to the doctor of your choice can represent a substantial out-of-pocket expense—a cost that falls more heavily on lower-income workers.

Here's why: Under the CPS plan, Teacher A, a single man with, say, uncontrolled diabetes who fears he may run up against BlueChoice's \$1-million lifetime coverage limit is advised to consider the HMO option, which has no lifetime limit and \$10 co-payments for lab work and office visits.

The problem: Humana's panel of doctors and hospitals is one-fifth the size of BlueChoice's preferred provider panel and does not include Northwestern Memorial Hospital, Rush-Presbyterian-St. Luke's Medical Center or the University of Chicago Hospitals—three of the area's top medical facilities.

If Teacher A selects BlueChoice, he gets access to a deeper pool of physicians and hospitals, but he must pay co-payments on everything from doctor visits and lab work to hospital stays.

The same lifetime limit that gives a patient with a chronic condition pause about opting for the freedoms of BlueChoice similarly would give pause to anyone suffering from a mental illness. The CPS plan limits payments for in-patient care to \$25,000 per year and

\$100,000 in a lifetime; expenses beyond that are billed to the employee. Many of those employees earn too much to qualify for public aid but not enough to pay for tens of thousands of dollars in uncovered medical expenses.

A regressive expense

Georgette Hampton, director of risk and benefits management at CPS, says employees who are close to reaching the BlueChoice limit are steered toward the Humana product.

She also says that in her five years at CPS, she has not encountered an employee who tapped out the \$25,000 annual limit inpatient mental health benefit. If that occurred, "we have the option of making exceptions (to the limit)," Ms. Hampton says.

At lower income levels, co-payments can be limiting and costly.

"The way benefits are structured, the out-of-pocket expense is really regressive," says J. Scott Wayne, leader of the health care and group benefits practice at Mercer Human Resource Consulting Inc. in Chicago. In 2005, Mercer projects that employees earning \$25,000 or less will spend 16% of their pay on out-of-pocket health plan costs, up from 7% in 2001—whereas employees earning \$60,000 will spend only 6%, up from 3%.

If the options seem few and the out-of-pocket costs potentially high at CPS, one of the Chicago area's largest employers, things will be even tighter at many local small businesses, which have been hard-hit by health care premium increases. Some are choosing to drop the benefit altogether.

The number of small businesses with fewer than 200 employees offering health insurance fell to 62% this year from 67% in 2000, according to the Kaiser Family Foundation and Health Research and Educational Trust. Only half of the smallest companies—those with three to nine workers—continue to offer coverage, the study found.

Small and large employers that continue to provide benefits are still tinkering with ways to shift more of the cost to employees, says J. William Gimbel IV, managing director of Bensman Associates Ltd., an insurance brokerage in Northfield, Ill.

Annual deductibles have risen from \$1,000 for an individual to \$1,500. Some employees who once met their deductibles by combining co-payments for in-network and out-of-network services now must meet a separate deductible for both.

"Little things like that add up," Mr. Gimbel says.

Mercer predicts that the growing disparity in out-of-pocket expenses will increasingly become a public relations issue for employers and a political issue for public officials.

Sarah A. Klein is a reporter for *Crain's Chicago Business*, a sister publication of *Business Insurance*.

Paul Winston

The good, bad and ugly of 2002

The end is near!

The end of the year, that is. For many, it is a time for reflection on the past 12 months and an opportunity to recognize noteworthy (and not so noteworthy) achievements.

The media promulgates this exercise year after year by printing their lists of the best movies, books, songs, games, people, etc. of the year. This column is no different, as it presents what I regard as some notable and notorious developments during 2002:

The Gramm Leach Bliley It Was Fun While it Lasted Award: To Citigroup, which this year dumped Travelers on the street without an umbrella, apparently deciding that insurance and financial services don't mix, after all.

The Linda Blair Spinning Head Award: To the many insurance companies that passionately argued for a federal terrorism backstop all year long but then, soon after it passed in late November, began to decry the complexity of actually complying with the law and offering coverage.

The Linda Blair Spinning Head Award (honorable mention): To those risk managers who took the credit for low insurance costs during the prolonged soft market but then had to admit pricing was beyond their control when the cycle turned.

The I Got Mine Award: To all the asbestos plaintiffs without evidence of a disease who settled their claims in the final weeks of 2002 before potential federal reforms take shape in the new year.

The You Can Keep Yours Award: To the IRS, for allowing unused health reimbursement account balances to be rolled over.

The Strength in Numbers Regulatory Award: To the more than 35 states that met the reciprocity requirements set by federal law, blocking creation of a National Assn. of Registered Agents & Brokers. Despite meeting the numerical threshold, some of the country's largest states, however, including California, Florida, New York, Pennsylvania and Washington, have not complied with the law.

The Strength in Numbers Regulatory Award (honorable mention): To the state insurance departments that approved the Insurance Services Office Inc.'s terrorism insurance exclusion, even though some of the largest states and ones with arguably greater terrorism exposures—including New York—did not.

The You'll Prefer the Climate in Cuba Award: To employees who

currently pay nothing for their health insurance but complain—and even threaten to strike—over employer efforts to require them to contribute to premiums.

The Diversify Your Portfolio Award: To professional liability insurers that are exposed to Enron-related liabilities because of writing both D&O coverage for the failed energy company and E&O coverage for its failed auditor, Arthur Andersen L.L.P.

The Correlated Risk Award: For all those proponents of risk securitization who claimed that insurance provides any portfolio with the benefits of uncorrelated risk yet found that the insurance market meltdown correlated almost perfectly with a capital market downturn.

The Ghost of Brandywine Award: To attorneys representing policyholders with claims against Equitas who now are claiming Lloyd's of London did not have the authority to create the runoff reinsurer in 1996.

The Five-Fingered Discount Award: To New Jersey lawmakers who tapped a state guaranty fund to try to balance their budget.

The Marie Antoinette Award: To the European companies that decided that the best way to commence solving the financial problems they faced was to sack their CEOs.

The Did You Say Something? Award: To the Pension Benefit Guaranty Corp., which ignored loud calls from employer groups in recent years to lower their premiums because of the PBGC's hefty surplus.

The Dante Alighieri Poetry Award: To the American Tort Reform Assn., for publicizing the lyrical phrase "judicial hellholes."

The Keelhauled Award: To the U.S. and European lawmakers who decided in the early 1990s that single-hulled oil tankers were unreasonably at risk of spills but gave shipowners until 2015 to scrap them.

The Code Blue Award: To the medical malpractice insurers and reinsurers that withdrew from the market. Do surgeons leave the operating room when things get hairy?

And, finally:

The Breath of Fresh Air Award: To the California Superior Court that slashed three zeros from the \$28 billion punitive damages award a jury ordered tobacco companies to pay a lifelong smoker. It's a start.

Editor Paul Winston can be reached at pwinston@crain.com.



Paul Winston

Business Insurance

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Editorial

Benefits gains, losses offer hope for '03

FOR BENEFIT MANAGERS, 2002 clearly was a year of pluses and minuses.

The most obvious minus was health care costs, whose annual double-digit increases continue to accelerate and pose a severe threat to corporate profitability and, with that, employees' jobs.

The outlook for 2003 isn't much better, as benefit managers expect costs to rise roughly at this year's nearly 15% increase.

Yet, it isn't all bad news on the health care front. Employers, after being lulled into complacency during the late 1990s when competition among managed care organizations kept costs stable, are taking a closer look at the design of their plans to better control costs.

Through design changes, such as setting up health reimbursement accounts linked to high-deductible plans, employees will be more exposed to costs and should use services more carefully. And that, in turn, may begin to cool what has become torrid health care inflation.

Also on the minus side is the de-

terioration in pension plan funding. Much of that deterioration is due to the bear equities market, which has caused the value of plan assets to fall. Low interest rates also are to blame, as falling interest rate assumptions, which are set by the government, raise liabilities.

With funding levels dropping, employers now face the prospect of making massive contributions to their pension plans at the worst possible time—when their own revenues and profits are declining.

But it would be wrong to say that there weren't positives on the pension front. Indeed, the biggest, we think, was the role exercised by both legislators and regulators on benefit issues.

Legislators have likely shelved patient protection legislation once and for all. While there is no question the behavior of some managed care organizations may have once been cause for federal intervention, that day has long passed.

Many organizations have cleaned up their act, and states have passed measures to improve enrollees'

rights. At this point, a federal patient protection law is more about pumping money to the plaintiffs bar than improving enrollees' rights, and we're glad Congress came to recognize that.

Similarly, Congress wisely did not overreact to the Enron Corp. debacle, in which Enron's 401(k) plan participants lost about \$1 billion in plan assets that had been invested in Enron stock.

Some members pushed for severe limits on the amount of account balances that could be invested in company stock. Such an approach would have had the effect of drying up corporate matching contributions, which ultimately would have punished employees.

The step Congress did take—requiring employers to provide a reasonable amount of advance notice when plan transactions, such as selling company stock, can't be conducted—was a modest one. But it may set the stage for further reforms next year.

And regulators, for the most part, acted wisely on benefit issues. For

example, the Internal Revenue Service gave its blessing to employer-funded health reimbursement accounts, which is certain to give a boost to arrangements that many feel could better control costs.

In another regulatory plus, the Department of Health and Human Services approved a three-year demonstration project to allow Medicare beneficiaries to receive coverage through preferred provider organizations.

On the pension regulatory side, the IRS and the Treasury Department, in a victory for common sense, finally recognized that the basic design of cash balance pension plans—giving participants the same pay and interest credits—does not violate age discrimination law.

Regrettably, the IRS and the Treasury Department didn't give such a clear endorsement for other pension hybrid designs, most notably pension equity plans, which we believe are not age discriminatory.

But, with enough employer input, we hope fair rules for other hybrids will become a reality in 2003.

Letters to the Editor

Risk managers' role is overrated

To the editor: Not to kick good people that are being downsized, but many of the so-called risk managers in business today are almost totally worthless.

I do not know what has been worse the last 20 years, dealing with these self-avowed mental giants or trying to survive the market's vicis-

situdes. I will make the following proposition: Show me any company with a risk management department espousing enterprise risk management and I will uncover waste.

I can guarantee (personally) a large decrease in expenses and overhead by eliminating this department and incorporating its functions where they belong. For too long the attitude of most risk management practitioners has been to tell others "to eat cake."

The test of this was the terrorist

attacks of Sept. 11, 2001. Risk management practitioners failed this awful exam abysmally, and they still have learned very little from it. Did I miss it or was the World Trade Center not bombed by terrorists in 1991 and the only reason it did not go down then is they used insufficient explosives? How could a risk management department not have this high on their list of possible exposures requiring risk transfer?

Risk managers? Bah, humbug!

Bill Ford
Birmingham, Ala.

Companies see the value that risk managers bring

To the editor: I must take exception to Joanne Wojcik's Dec. 9 Commentary wherein she refers to the "image" of corporate risk managers as the "Rodney Dangerfields of corporate America." While it is certainly true that risk managers must command "respect," we are, in general, not wanting in that area.

Demonstrating value to the organization is, of course, critical to every employee's success, but most risk managers do so regularly. Otherwise they would not survive in this current business climate. Are some risk managers taking it on the chin as a result of this hard market? Certainly they are, but I believe such instances are few and far between and that those dismissals more often are a function of short-sighted management. Astute and progressive companies recognize the value that good risk management brings to their firms.

Our job is to make sure key decisionmakers know what we do and to achieve "enterprisewide respect." This is accomplished with many of the techniques Ms. Wojcik mentioned, but others of those recommendations seemed trite at best.

Can risk managers polish their image? Certainly. Every manager has the opportunity for improvement, but risk managers are no Rodney Dangerfields, and if anything is needed now, it's long-term support for a function critical to business success.

Christopher E. Mandel
President
Risk & Insurance Management Society Inc.
New York

Schillerstrom



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Spotlight

Benefits: Year in Review

Benefit managers sum up another tough year

By **MICHAEL PRINCE**
and **SALLY ROBERTS**

Rising health care costs—and what to do about them—continued to be the main issue on the minds of benefit managers in 2002.

The health care cost trends in 2002 were shocking, said Arleane Soto Baltrusitis, vp of benefits at American Express Co. in New York. “2002 was much worse than we ever expected,” Ms. Baltrusitis said.

“It has truly been an area of concern for all benefit managers, because we have not seen diminishment in the cost of the plans,” said Jeffrey W. Pettegrew, vp-risk management and insurance for Westaff Inc. in Walnut Creek, Calif.

As health care costs continue to escalate, benefits managers are making changes they hope will provide some relief.

After Westaff experienced a 20% rise in its prescription drug

costs, Mr. Pettegrew changed the company’s drug plan for 2003.

‘2002 was much worse than we ever expected.’

*Arleane Soto Baltrusitis
American Express Co.*

“The greatest cost-saving device was to go to a mandatory mail-order prescription plan for maintenance drugs,” he said. “We estimate we will achieve approximately a 20% savings for both the employer and, in many cases, for employees.”

Denver Water expects its self-insured preferred provider organization plan costs to increase next year by 15%, said James E. Crockett, manager of risk and benefits for the city water au-

thority. As a result, Denver Water will increase employees’ co-payment and deductible levels next year, Mr. Crockett said.

“We’re obviously hopeful that, through wellness and trying to develop a cost consciousness with our employees, we will reduce, to some extent, rising health care costs,” he said.

Ms. Baltrusitis said that American Express in the past has instituted a three-tier drug plan and passed health care costs on to employees. But that strategy has run its course, and the company will undertake a total re-examination of its health care program next year, with an eye toward making changes for 2004, she said.

“We cannot continue to keep shifting costs,” Ms. Baltrusitis said.

And the rising cost of health care programs has taken a toll on other areas of companies’ benefit plans, benefit managers say.

With so much money spent on health plans, employers

See **BENEFITS**/page 12

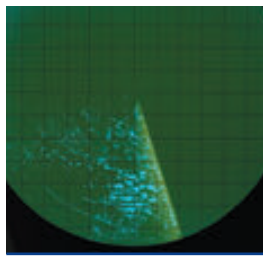
Top 10 employee benefit stories of 2002

1



Group health care costs continue to soar for employers

6



Patient protection legislation disappears from congressional radar screen

2



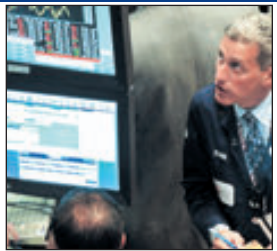
Congress moves to protect 401(k) plan participants in wake of Enron debacle

7



Treasury Department issues new rules for cash balance pension plans

3



Pension plans are battered by a weak economy and stock market declines

8



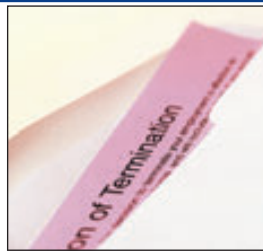
Feds allow PPOs to offer coverage to Medicare beneficiaries

4



Government gives green light to employer-funded health reimbursement accounts

9



Congress agrees to subsidize COBRA premiums for certain laid-off workers

5



CIGNA Corp. battles big problems in its health care business

10



Supreme Court rules ERISA doesn't pre-empt state-mandated HMO reviews

Recapping the year's top benefits stories begins on page 12

Top benefits newsmakers page 16

2002 timeline of benefits events page 18

Benefits: Summing up another difficult year

Continued from page 10

now have to better balance the costs and value of other benefit programs, said Michael Kriner, director of benefits at NCR Corp. in Dayton, Ohio.

Indeed, Ms. Baltrusitis said that dealing with the problem of rising health care costs is taking time and money away from other projects. "Health care will consume a great deal of our time next year," she said.

"It continues to be more challenging as costs increase," Mr. Kriner said.

For example, rising health care costs have made it more difficult to implement long-term programs such as disease management or health and welfare programs, Mr. Kriner pointed out. Employers' appetite "for these kind of investments is becoming more challenging," he said.

Looking for new ideas

Because traditional cost-control strategies—principally managed

care and changes in plan design—have not kept costs in check, employers have sought new approaches, said Laurel Pickering, executive director of the New York Business Group on Health.

"Because it is so bad, they are starting to think about costs in different ways," she said.

One of the most-discussed strategies is the consumer-driven approach.

"I think we saw a lot of exploration over consumer-driven plans," Ms. Pickering said.

Such plans generally involve high-deductible coverage combined with an employer-funded health care spending account, which employees use to pay for health care services.

The plans aim to foster a "consumerist" mentality among plan participants, by making them more aware of the actual cost of health care services.

Employers have also realized that changing plan design and pushing more costs onto employees has its limits and that other strategies are

needed, Ms. Pickering said.

Employers want to "address the root of the problems," she said.

Health care quality is drawing greater attention in light of rising costs, Ms. Pickering noted. "Poor quality is costing them money, and (employers) need to lead the charge

'Retiree health continues to be in jeopardy...For those people considering early retirement, if they're not eligible for Medicare, some of them are going to find a difficult time getting coverage.'

Jeffrey W. Pettegrew
Westaff Inc.

to improve it," she said.

But it's not clear whether efforts to improve quality have had much success, said Ralph Kimmich, director of benefits and compensation

for Southwest Airlines in Dallas.

Mr. Kimmich said he's not convinced that "health care providers and hospitals, in particular, are really making any progress in reducing medical errors."

"I think a lot of them are doing things, but I'm not sure it's manifested itself into any type of improvement," he said.

Mr. Kimmich said he also wonders whether "health care providers are...going to open up in terms of providing outcomes data, so if we're ever really going to pursue any type of consumer-driven health care, we can have the information that we need to make those choices."

Other concerns

Although benefit managers' primary worry is the cost of providing coverage to active employees, retiree health care is also a concern.

"Retiree health continues to be in jeopardy," Mr. Pettegrew said. "For those people considering early retirement, if they're not eligible for Medicare, some of them are going

to find a difficult time getting coverage," he said.

"So many of these retirement plans are underfunded and/or are being drastically changed or, in some cases, deleted. That's something we haven't seen as a great concern for our company, but it's going to be a huge concern for a number of companies out there," Mr. Pettegrew said.

In addition, consolidation among hospitals has become a concern for Southwest's Mr. Kimmich.

"That's a cost issue, because it gives them much more leverage, but it's a choice issue as well," he said. "I don't know what I can do about it, but it's something I look at and something I have to at least be aware of," he said.

Looking beyond health care, Denver Water's Mr. Crockett said that he's concerned about rising retirement plan costs.

"Big national employers have gone from overfunded pension plans to underfunded pension plans in a very short period of time," he said.

Ever-climbing health care costs top the year's news

1 Health care costs soar

Another year, another double-digit health care cost increase.

For employers, the news has become depressingly familiar, with costs again rising steeply and no relief in sight. Health care costs for active employees rose, on average, by 14.7% this year, topping last year's 11.2% increase, according to a sur-



vey conducted by Mercer Human Resource Consulting.

Health care benefit plan costs now have risen for five consecutive years, and the increases have grown each year.

And, this year, no region of the

country or type of plan was immune.

Buffeted by this trend, employers have sought ways to keep costs in check. Perhaps the most common strategy has been shifting a greater portion of costs to employees, by increasing participants' premium contributions, raising deductibles and imposing higher copayments. In addition, many employers have introduced tiered copayment structures for prescription drug plans, as escalating drug costs continue to play a major role in driving up health care costs overall.

Meanwhile, other employers have looked beyond traditional managed care, turning to the consumer-driven health plans now being offered by an increasing number of companies.

Such plans generally involve high-deductible coverage combined with individual health care spending accounts, into which an employer makes an annual contribution.

Employees, who may carry over unused funds from year to year, are given information on the cost and quality of health care services, encouraging them to shop around and spend their funds judiciously.

Perhaps what scares employers the most about the ongoing cost increases is the lack of answers.

The last time costs surged at such a pace, employers jumped into managed care, which succeeded in holding down costs during the mid- and late 1990s. But now, with a growing number of consultants saying that managed care has run its course, employers are left grasping for a new solution.

The cloud of rising health care costs may have a silver lining, but employers are still looking for it.

—By Michael Prince

2 401(k) protection

Political squabbling prevented the enactment this year of comprehensive legislation to reduce the financial impact of corporate failures on 401(k) plan participants' account balances.



But Congress did take a couple of small reform steps, with the stage set for further action in 2003.

Much of the legislative activity stemmed from the high-profile failure of Enron Corp., whose 401(k) participants collectively lost nearly \$1 billion in assets invested in company stock.

The Bush administration responded quickly with a proposal aimed at correcting what it saw as

plan-design flaws that exacerbated the impact of Enron's demise on 401(k) plan participants.

For example, Enron matched employees' salary deferrals only in company stock, and it required employees to hold those shares until age 50.

The result of that plan design—one used by many employers—was that not only did Enron employees have a high concentration of plan investments in company stock but they also were locked into those investments. The administration remedy was to allow 401(k) plan participants to sell stock contributed as a match after three years.

Another perceived flaw was that companies were not required to give employees advance notice of temporary plan shutdowns in which employees cannot conduct normal transactions. The Bush administration proposed a 30-day notice requirement.

Finally, the administration recommended a change in federal law to make it easier for employers to

arrange for employees to receive investment advice. According to the administration, had Enron employees been better informed on the importance of diversification, they would not have invested so heavily in Enron stock.

The House of Representatives largely adopted this package, as did the Senate Finance Committee. But the Senate Health, Education, Labor and Pensions Committee took a different approach, adding requirements that drew significant opposition.

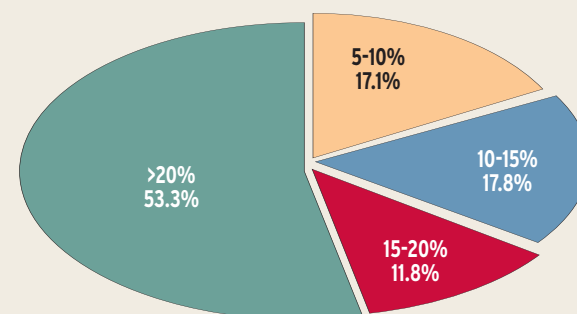
Despite promises to the contrary, the Senate Democratic leadership declined to bring up either measure.

But Congress, as part of a broad corporate governance and accounting reform measure, did adopt one of the administration's recommendations: the requirement that employers give 30 days' advance notice of plan blackouts and bar top executives from selling shares during those periods.

—By Jerry Geisel

2002 Opinions

How much are your health insurance plan costs going up this year?



December 23, 2002

3 Pensions battered

Nothing better illustrates how fast things can change than the financial condition of most corporate pension plans and the federal insurance program that guarantees their benefits.

Two years ago, most pension plans were in terrific shape, with assets far exceeding promised benefits, largely due to years of double-digit investment return increases. Indeed, returns were so robust that some employers made no contributions to their plans for half a dozen years or so.

recently as two years ago.

Some groups, though, are proposing steps that would ameliorate the problem. The ERISA Industry Committee this year began a lobbying campaign to convince Congress to pass legislation to allow employers to use higher interest rate assumptions in valuing plan liabilities, the effect of which would reduce plan contributions.

ERIC is recommending that plan liabilities be calculated with an index tied to interest rates paid on long-term, high-quality corporate bonds. Liabilities now are measured through an index tied to the interest rate on 30-year Treasury bonds.

—By Jerry Geisel

Continued on next page

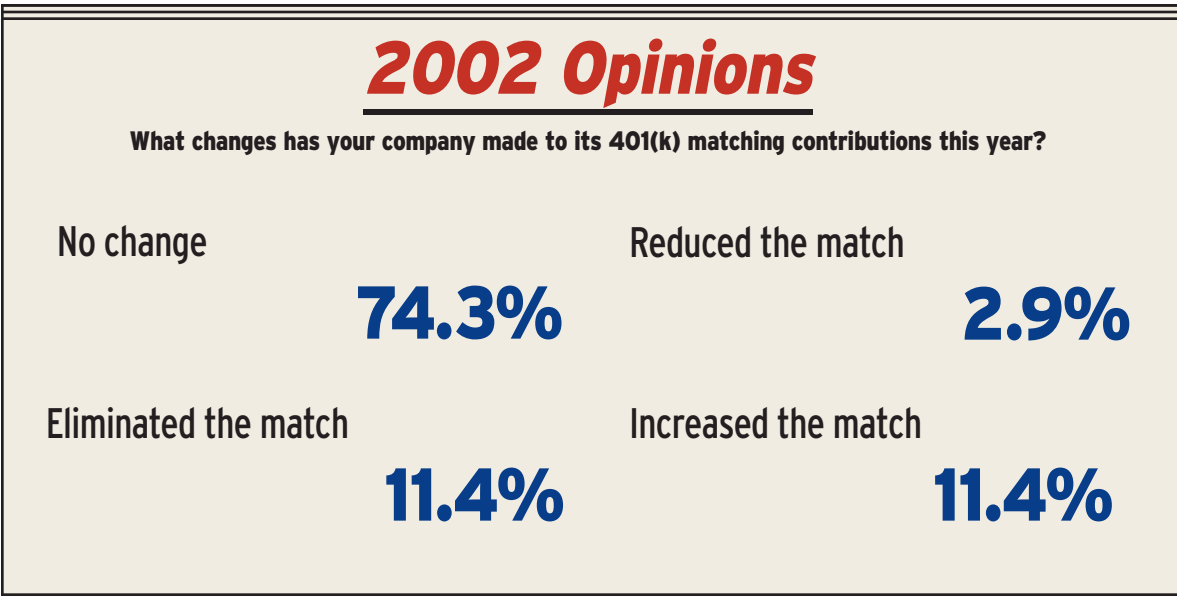


But now, following three years of poor investment results, employers have to make massive contributions to their pension plans to comply with federal funding rules.

The poor return on investments isn't the only reason for the decline in funded levels. Just as investment returns have fallen, so have interest rates, which employers use to value plan liabilities. A 1% decline in interest rates can, for funding purposes, increase plan liabilities by roughly 10% to 15%.

This could not have come at a worse time for employers, who will have to pump more money into their pension plans when, due to the recession, they can least afford it.

For some employers, those massive contributions are more than they can afford. The Pension Benefit Guaranty Corp., in a little more than a year, has absorbed—just from the steel industry—\$6 billion in losses after taking over underfunded plans from failed or financially troubled companies in that industry. Those huge losses have all but wiped out the PBGC's surplus, which stood at nearly \$10 billion as



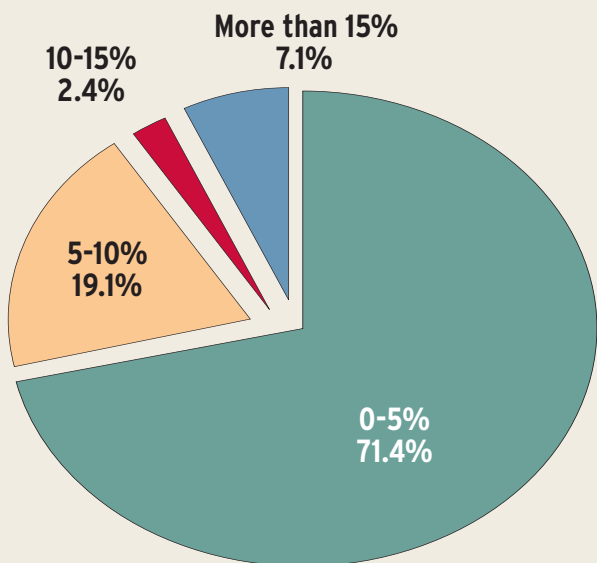
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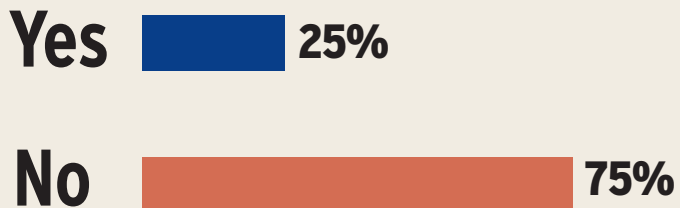
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2002 Opinions

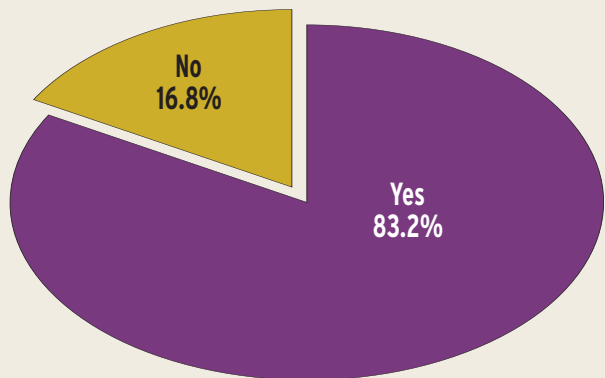
What percentage of eligible employees at your company takes FMLA leave during the year?



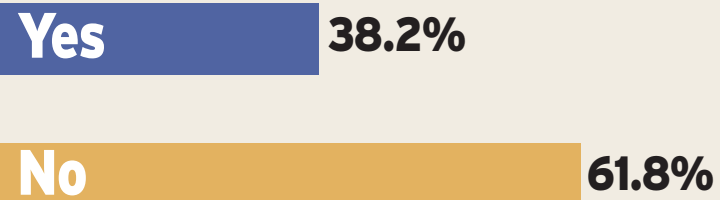
Should the government subsidize COBRA premiums for workers who lost their jobs because of foreign competition?



Should the Medicare program be expanded to add a prescription drug benefit?



Do you think a single-payer health care system, like the Canadian one, would do a better job of controlling costs and providing coverage than the U.S. system?



Continued from previous page

4 Green light to HRAs

This year's issuance of long-awaited guidance from the Internal Revenue Service on health care reimbursement accounts is expected to spur more growth in consumer-driven health plans, and perhaps even stimulate other innovative plan designs.



HRAs, sometimes called personal care spending accounts, are the cornerstone of consumer-driven health plans. They are funded solely by employers and can be used only to reimburse actual health care-related expenses.

Before the IRS' ruling, which was made in June, it had been unclear whether the funds remaining in the accounts at year-end could roll over into subsequent years, a unique feature of the consumer-driven health plan model.

Besides promoting the development of consumer-driven health plans, the ruling allowing rollovers could make it possible for employers to offer health care "vouchers," some benefits experts say.

Because the IRS ruling allows an employee to use the HRA to pay insurance premiums and does not cap the amount that an employer can put into the account, the employer could, theoretically, put its annual health care contribution into an HRA that the employee could use to purchase health insurance, suggested Mark Tierney, chairman of the board of eBenX, a Minneapolis-based firm that provides technology to its defined contribution plan vendor Benu.

The revenue ruling, which had been sought by a group of employers and vendors promoting the consumer-driven health plan model, is a reflection of the Bush administration's goal of speeding up the delivery of benefits rules to help employers, according to William Sweetnam, the Treasury Department's benefits tax counsel.

Although employers in the past have often complained about the lack of accessibility of government benefits officials, the door is now open, Mr. Sweetnam said at a con-

ference in Washington held less than a month after the IRS ruling.

—By Joanne Wojcik

5 CIGNA's low earnings

Insurance giant CIGNA Corp. made headlines in 2002 when it revealed that poor underwriting and customer service in its health care operations would lead to lower earnings for 2002 and 2003.

The revelation—coupled with more than \$1 billion in nonrecurring, unrelated earnings charges for the third quarter—sent CIGNA's stock price reeling, which triggered a shareholder lawsuit and an informal inquiry by the Securities and Exchange Commission.

CIGNA also said that its service and underwriting problems would reduce its Jan. 1, 2003, enrollment by between 4% and 5%, to about 12.7 million lives.

In conference calls to analysts, executives at the Philadelphia-based insurer said they believe they had targeted the right issues and had initiated plans to aid its ailing health care operations. These plans include strengthening its organizational structure, underwriting, medical cost management and customer service.

"We clearly didn't have the right leadership in our health care operation," CIGNA Chief Executive Officer H. Edward Hanway said to analysts. "We also didn't execute well on our fundamentals, including our service, transformation project management, spending and underwriting."



Specifically, CIGNA said it severely underpriced its experience-rated indemnity book of business in 2002, which resulted in a \$100 million shortfall in third-quarter operating income.

In addition to poor underwriting, CIGNA acknowledged that its customer service had lapsed in 2002. The insurer had laid off a number of service employees at the start of the year, and a systems upgrade initiative did not produce the service improvements CIGNA had expected.

CIGNA executives said that it

plans to return staffing to satisfactory levels and will continue to move forward with its technology initiative despite the setbacks.

In terms of leadership changes, CIGNA hired Patrick E. Welch, former chairman, president and CEO of Montpelier, Vt.-based National Life Group, to replace William M. Pastore as president of CIGNA HealthCare at the end of May. Since assuming his new post, Mr. Welch has made a number of management changes within CIGNA HealthCare.

—By Sally Roberts



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2002 Newsmakers

10 who made headlines in employee benefits in 2002

Eager to reduce the risk of political fallout, **President George Bush** moved quickly following the failure of Enron Corp. The December 2001 collapse of the Houston-based energy firm reduced to virtually nothing the value of Enron stock held in employees' 401(k) accounts that had once been worth \$1 billion.



President Bush

In February, President Bush proposed a series of reforms, including allowing plan participants to sell company stock contributed as a match after three years; giving employees advance notice of blackouts during which plan transactions could not be conducted; and barring top executives, during blackouts, from selling company stock held outside savings plans. These reforms, President Bush said, were needed to ensure that money put aside in 401(k) and other savings plans would indeed be available for retirement.

In numerous speeches, President Bush

pressed for enactment of these reforms. Congress approved the blackout provisions as part of broad corporate governance and accounting reform legislation; due to political squabbling, though, it declined to do more. That makes it nearly certain that the issue will return on both the president's and Congress' agenda next year.

When Hewitt Associates Inc., the second-largest benefit consultant in the world and the biggest in the United States, needed capital to keep growing, the obvious option was an initial public offering.

But the move was not taken lightly. For more than 60 years, the firm had been privately held. Going public would certainly raise money but could also alter the culture that had driven its growth. Also weighing into the decision was the realization that 2002 was not the best time to jump into the stock market.



Mr. Gifford

But under the leadership of **Dale Gifford**, Hewitt's chief executive officer since 1992, the firm went public. Completed in June, the sale of 11.2 million shares of stock raised more than \$200 million for the Lincolnshire, Ill.-based consultant and benefit and human resource outsourcing firm.

Mr. Gifford is no stranger to achievement at Hewitt. He helped spearhead the company's growth in revenues from \$280 million in 1992 to more than \$1.7 billion in 2002.

So far, the move has been a rousing success, with the stock closing at \$32.33 per share on Dec. 17, a 70% increase from its opening price of \$19 per share.

In October, CIGNA Corp. Chairman and Chief Executive Officer **H. Edward Hanway** acknowledged that, due to poor underwriting and customer service in the company's health care operations, CIGNA had to



Mr. Hanway

lower its earnings forecast for year-end 2002 and 2003.

The news sent the Philadelphia-based insurer's stock plummeting, triggering a shareholder lawsuit and an informal inquiry into the company by the U.S. Securities and Exchange Commission.

It also raised questions about the company's ability to weather the storm.

In conference calls to analysts, Mr. Hanway said that CIGNA has targeted the right issues and is addressing the health care unit's performance problems. As part of this effort, CIGNA will begin an initiative that includes strengthening its organizational structure, underwriting, medical cost management and customer service.

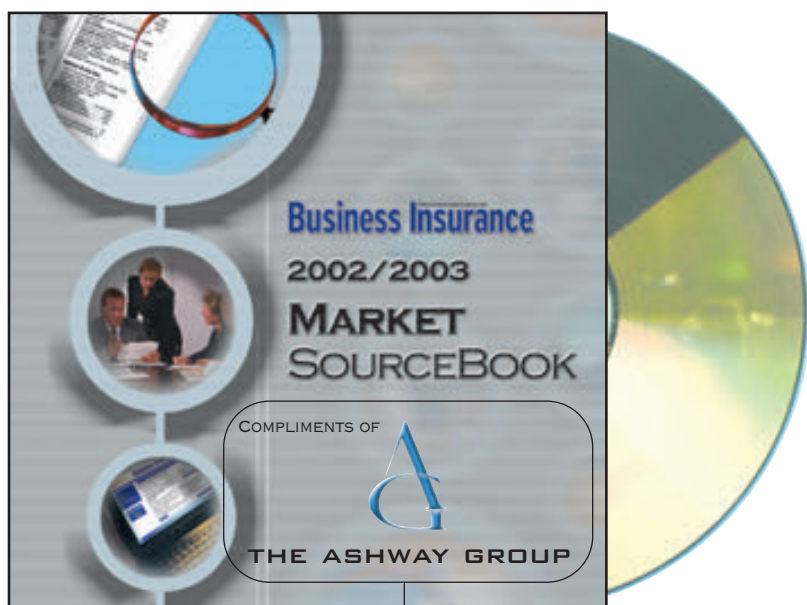
"I characterize 2003 as a rebuilding year," Mr. Hanway told analysts. Beyond 2003, "we expect to improve our market position and resume profitable growth," he said.

As president and chief executive officer of the American Assn. of Health Plans, **Karen Ignagni** has long enjoyed the highest of profiles among opponents of a so-called patients' bill of rights, and this year was no exception.

Ms. Ignagni has consistently held that such

Continued on next page

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Continued from previous page

patient protection legislation would do nothing to protect patients and quite a bit to make health care more expensive by increasing health plan liability. She argued that the real issue is making sure that consumers have access to affordable health care, particularly in a time of economic uncertainty and rising health care costs.

Once again, someone was listening. Congress failed to reconcile the differences between competing House and Senate patient protection bills and left the issue for the next Congress, if it opts to deal with it again.

And if it does, Ms. Ignagni will be ready, making every effort to focus debate on enhancing health care availability rather than expanding health plan liability. After all, she has a perfect record to defend.

No other Pension Benefit Guaranty Corp. executive director has seen the fortunes of the agency decline so precipitously as has **Steve Kandarian**.

When Mr. Kandarian, an investment banker and economist, came to Washington last year to run the PBGC, the agency enjoyed a hefty \$7.5 billion surplus, the result of a strong economy for many years, high investment returns and a lack of big pension plan failures.

That changed quickly. In March, the PBGC was hit with a \$1.6 billion loss—then its biggest ever—with its takeover of the pension plans of failed steelmaker LTV Corp. By June, the surplus had dwindled to about \$4.8 billion. With the expected termination of Bethlehem Steel Corp.'s pension plan, announced last week, and the assumption of the plan's \$3.7 billion in liabilities, the PBGC's surplus is likely about gone.

Amid the deterioration in the PBGC's financial position, Mr. Kandarian urges calm, noting that the negative economic factors that have hammered the PBGC—a recession, the fall in the stock market and low interest rates—will not remain indefinitely.

Still, Mr. Kandarian said some changes might be in order, including the agency's standing as a creditor in bankruptcy and its liability for so-called plan shutdown benefits.

When Aetna Inc. was sick, it called upon a doctor to make a house call.

It took a while, but it appears that Aetna, under the leadership of **Dr. John Rowe**, is recuperating and may once again become profitable.

It has been no quick recovery for the Hartford, Conn.-based managed care company. Dr. Rowe, the chairman and chief executive officer, joined the company in 2000, after leading New York's Mt. Sinai NYU Health. Aetna bled red ink through most of 2001 and ended the year with an announcement of massive job cuts.



Ms. Ignagni



Mr. Kandarian



Dr. Rowe

But 2002 has seen signs that Aetna is getting back on its feet. While job cuts have continued, prices have risen, the company has dropped unprofitable business and the losses have ended. Aetna posted more than \$200 million in combined net earnings for the second and third quarters of 2002, though a large charge in the first quarter has left the company in the red for the entire year.

With price hikes continuing into 2003, the "new Aetna"—smaller and possibly, stronger—might actually show a profit.

Rep. Bernard Sanders has never hid his distaste for cash balance pension plans, and this year was no exception.

This month, Rep. Sanders labeled Treasury Department cash balance regulations an "early Christmas present" from the Bush administration to Fortune 500 campaign contributors, in the "form of a multibillion-dollar corporate pension raid." Earlier, Rep. Sanders tried, unsuccessfully, to stop the Treasury Department from issuing guidance on how employers are to value account balances when employees leave. And he was responsible for the release of cash balance plan design information employers provided in confidence to the U.S. Labor Department's Office of Inspector General.

Rep. Sanders



It is unlikely that cash balance attacks from the Vermont Independent will cease any time soon, given his most recent description of the plans—"a device to skirt federal anti-age discrimination laws" and a way for CEOs to beef up "the bottom line by robbing their employees."

Medicare beneficiaries, just like employees at many companies, should have more than just a few types of health care plans to choose from, according to Department of Health and Human Services **Secretary Tommy Thompson**.

As part of that pledge to expand choices, Mr. Thompson approved a demonstration project in 2002 that, beginning next year, will allow Medicare beneficiaries to receive coverage through preferred provider organizations. In all, 17 PPOs will be available in 23 states, where 11 million beneficiaries live.

"Greater access and more choices in health care are key goals of the Bush administration's plan to improve and strengthen Medicare," said Mr. Thompson, who previously served as governor of Wisconsin.

Benefit experts applaud the administration initiative but say that the success of the PPO project will depend on how much money Congress is willing to pump into the program.

While the PPO project is important, it pales in comparison to Mr. Thompson's and the Bush administration's next venture in expanding Medicare: adding coverage for prescription drugs.

While a "catch-up" provision that Congress included in a big tax bill it passed last year gave older employees the opportunity to put more money into their 401(k) plans, it also presented a big administrative hassle for multistate employers. The money would go into the plans tax-free under federal law but would

be taxed under state law, creating huge recordkeeping problems.

The ERISA Industry Committee and its president, **Mark Ugoretz**, quickly saw the problem, though, and began an aggressive lobbying campaign to convince nonconforming states to mesh their laws with the federal statute. In the end, every major state conformed its law to the federal statute. It was, Mr. Ugoretz says, "a remarkably successful effort."



Mr. Ugoretz

With that campaign concluded, Mr. Ugoretz is preparing for an even bigger challenge—convincing Congress to allow employers to use more liberal interest rate assumptions in valuing pension liabilities.

A plane crash in October tragically ended the life of **Sen. Paul Wellstone** and, with it, the efforts of the Minnesota Democrat to broaden insurance coverage for mental disorders.

For much of his two terms in the Senate, Sen. Wellstone crusaded for mental health care benefits parity, arguing that equitable

coverage for mental disorders was only fair. "We should treat this illness as any other illness," he said.

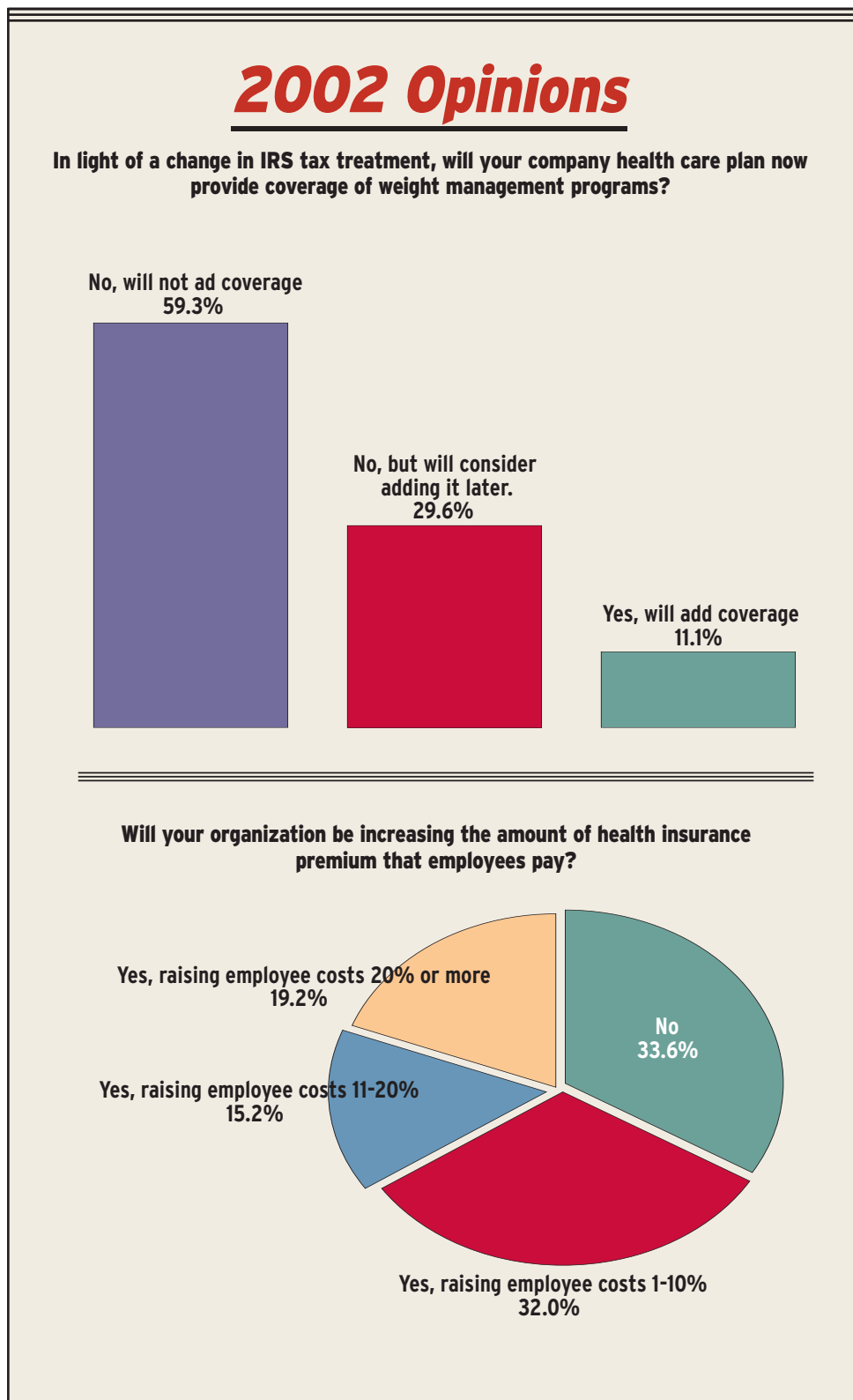
His efforts to expand coverage, along with his partner in the legislative struggle, Sen. Pete Domenici, R-N.M., were partially successful in 1996, when Congress enacted a measure that banned discriminatory annual and lifetime dollar caps for mental disorders in group health plans.

But that measure, Sen. Wellstone recognized, was only a first step, and last year he and Sen. Domenici introduced a bill mandating total parity in group health care plans for mental disorders. The bill won Senate approval but languished in a congressional conference committee amid objections from conservative House Republicans concerned about the cost implications.

Later efforts to find a compromise failed, even with President Bush saying he supported parity. But many believe the issue, even without Sen. Wellstone, is certain to return next year.



Sen. Wellstone



2002 developments in employee benefit programs

January

CIGNA Corp. unveils plans to cut 2,000 jobs as part of a restructuring of its health care, life and disability units. The insurer says the move will reduce its workforce by 4.5% and save the company up to \$55 million. However, the cuts later contribute to significant service problems.

Internet-based enrollment has become the dominant way to enroll employees in benefit programs, a study by Hewitt Associates L.L.C. shows. Among employers offering the choice of online enrollment, 70% of employees opted to enroll using the Internet in 2001, up from 51% in 2000. Call-center enrollment and voice response systems, by contrast, decreased in popularity.

February

Responding to the Enron Corp. debacle, the Bush administration proposes reforms to protect employee 401(k) plan savings. Among other things, the administration recommends allowing employees to divest company-contributed stock after three years and giving employees at least 30 days advance notice before "blackout" periods, in which plan participants cannot conduct transactions. Congress later agrees, as part of a corporate governance and accounting reform measure, to the blackout notification requirement.

Agribusiness giant Archer Daniels Midland Co. asks the Labor Department for permission to use its Vermont captive to reinsure group life benefits. If approved, ADM's captive benefit funding proposal could help pave the way for other employers to do the same.

March

Congress approves legislation that will increase for 2002 and 2003 the interest rate assumptions employers must use to value pension plan liabilities. Employers will be able to use an interest rate assumption of between 90% and 120% of the four-year weighted average of the yield on 30-year Treasury bonds. The temporary change will significantly reduce cash contributions employers have to make to their plans.

Hewitt Associates L.L.C. files a registration statement with the Securities and Exchange Commission for a proposed \$250 million initial public offering of common stock. In June, Hewitt completes its IPO and raises more

than \$200 million through the sale of its stock.

April

Participants in WorldCom Inc.'s 401(k) plan are suing the employer, charging that it directed the plan to purchase WorldCom stock despite the fact that it knew that its financial results were overstated. In the wake of a major accounting scandal, the company's stock now is virtually worthless.

The cost of participating in weight-loss programs is a tax-deductible medical expense, the Internal Revenue Service says. Obesity is medically accepted as a disease in its own right, the IRS says in ruling 2002-19. The Revenue Ruling paves the way for employees to fund the cost of weight-loss programs through pretax contributions to flexible spending accounts.

Final Labor Department regulations expand the number of people to whom employers can electronically transmit benefit plan information. Earlier regulations allowed electronic transmission of benefit plan documents, such as summary plan descriptions, only to employees within the worksite. The final rules allow electronic transmission to employees, such as telecommuters, who work outside traditional worksites.

May

Benefit groups attack as biased and misleading a report by the Labor Department's Office of Inspector General that employers are shortchanging employees in cash balance pension plans by giving them less than what they are legally entitled to when they leave. While the report says participants in plans it reviewed may be underpaid by \$17 million a year, employer groups say the findings are based on a theoretical methodology of valuing benefits that has not been adopted by federal regulators.

June

The Equal Employment Opportunity Commission says it will drop enforcement of a controversial federal appeals court ruling that said employers could not, under discrimination law, provide less generous health care benefits to Medicare-eligible retirees than to younger retirees. In dropping enforcement of the *Erie County* ruling, the EEOC says it will propose a new rule to make clear that reduc-

ing or eliminating employer-sponsored health care benefits when a retiree becomes eligible for Medicare does not violate federal age discrimination law.

As much as 30 cents of every dollar spent on health care is wasted because of administrative inefficiencies and misuse of medical services, says a new report by the Midwest Business Group on Health. Employer practices, such as negotiating with providers on the basis of price rather than provider performance, may be exacerbating the problem, the report says.

Employees don't have to forfeit unused balances in their flexible spending accounts and they can contribute to their FSAs when their employer is transferred to another company as part of an asset sale, the Internal Revenue Service says. In Revenue Ruling 2002-32, the IRS gives the green light to two designs that employers can use to keep employees' FSAs intact during asset sales.

The Employee Retirement Income Security Act does not pre-empt state laws that require health maintenance organizations to allow independent review of certain disputed claims, the U.S. Supreme Court says. In a 5-4 ruling, the high court upheld an Illinois law, which allows independent review of disputed HMO claims and requires HMOs to cover a procedure if the reviewer deems it necessary.

July

Internal Revenue Service rules give the green light to health reimbursement accounts. Those accounts, linked to high-deductible medical plans, will pass muster as long they are funded by the employer and are used to pay bona fide health care expenses. Unused amounts can be rolled over to pay for succeeding years' expenses. Benefit experts say the accounts help make employees more aware of health care costs and the need to use services more carefully.

US Airways Inc., in what is believed to be the first action of its kind, names an Aon Corp. unit to be an independent fiduciary to the airline's common stock held in its defined contribution plans. The move aims to ensure that decisions regarding US Airways stock held by the plans are made solely in the interest of plan participants.

The federal government will subsidize 65% of COBRA health care premium costs for workers who have lost their jobs due to foreign competition. The provision, included in a big trade bill, marks the first time the government has directly subsidized COBRA premiums for beneficiaries.

August

Employers must count the active military duty time of employees of called-up reservists in calculating Family and Medical Leave Act leave eligibility, the Labor Department says.

The breakdown of negotiations among supporters of patient protection legislation and the White House ensures that a compromise will not be reached before the end of the current congressional session. The key stumbling block has been the extent of damages plans should face when they improperly deny care to patients.

September

The ERISA Industry Committee advances a proposal in which pension plan sponsors would use a new index tied to interest rates

paid on long-term, high-quality corporate bonds to value pension liabilities. If adopted by Congress, the new index, which would replace the current one tied to yields on the 30-year Treasury bond, would cut employers' pension contributions by billions of dollars.

The government, in a three-year demonstration project, allows Medicare beneficiaries, beginning in 2003, to receive coverage through preferred provider organizations. PPOs will join HMOs and the traditional Medicare indemnity program in providing coverage for beneficiaries.

In the first law of its kind, a new California statute, to go into effect in July 2004, will provide employees with up to six weeks of paid leave per year to take care of a newly born or adopted child or to take care of a seriously ill child, parent or domestic partner. While employees will pay for the benefits through mandatory payroll deductions, employers complain that the law will lead to an increase in absenteeism and disrupt operations.

October

New Labor Department regulations detail the information employers must provide to 401(k) plan participants prior to plan blackouts. Among other things, the notice must include the name, address and phone number of the plan administrator or other person responsible for answering questions regarding the blackout.

Sen. Paul Wellstone, D-Minn., one of the chief congressional advocates of mental health care benefits parity legislation, dies in a small plane crash. But even with Sen. Wellstone's death, the drive for parity is expected to continue in the next congressional session.

November

Oregon voters roundly defeat a ballot initiative that would have created a single-payer health care system for the state. The proposal, supported by only 21% of voters, was strongly opposed by employers and insurers, who said the system would have been expensive and very difficult to administer.

December

Health care cost increases continue to accelerate. A new survey by Mercer Human Resource Consulting says that costs jumped nearly 15% in 2002, up from 11% in 2001 and nearly seven times greater than the rise in the consumer price index. Employers are expecting next year's cost increase to match the 2002 rise.

Long awaited Treasury Department and Internal Revenue Service proposed regulations make clear that the key features of cash balance pension plans—giving employees pay-based credits and interest on account balances—do not violate age discrimination laws. But other types of pension hybrids, such as pension equity plans, could face compliance problems.

The Pension Benefit Guaranty Corp. says it intends to takeover and terminate a massively underfunded pension plan sponsored by financially troubled Bethlehem Steel Corp. Termination of the Bethlehem plan will cost the PBGC about \$3.7 billion, by far the biggest loss in the agency's 28-year history. Bethlehem Steel, while recognizing that termination of its plan is inevitable due to its financial difficulties, wants the termination delayed so more retirees can qualify for richer benefits.

2002 Opinions

Should the federal Family and Medical Leave Act be expanded so employers are required to offer paid leave to employees?

Yes **35.5%**

No **64.5%**

Products & Services



Travelers unit offers personal D&O cover

HARTFORD, Conn.—A new policy from Travelers Bond, a division of Travelers Property Casualty Corp., offers personal asset coverage for directors and officers.

The coverage, called Broad Form PLUS+, pays when primary coverage or indemnification does not respond to a claim. Limits are available up to \$25 million.

The coverage includes differences-in-conditions features not found in some policies. The claims-made reimbursement drops down to fill coverage gaps that result from typical exclusions in many primary public company D&O policies, according to Hartford, Conn.-based Travelers Bond.

The policy also includes employment practices liability protection for directors and officers.

More information is available from Paul Brodeur at 860-954-3726.

CIGNA, Mellon team on stock plans

HARTFORD, Conn.—CIGNA Retirement & Investment Services is teaming with Mellon Investor Services to provide retirement plan sponsors with simpler administration of stock option and stock purchase plans.

The alliance will make it easier for plan participants to access their account information and complete transactions while assuming some

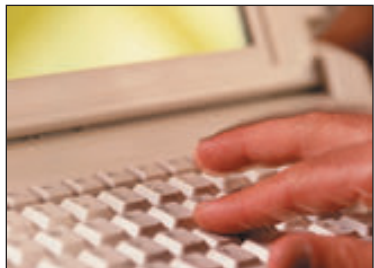
of the administrative duties from the plan sponsor, said CIGNA Retirement & Investment Services, a Hartford, Conn.-based division of CIGNA Corp.

Employees will have access to account information through a vari-



ety of channels, including the myCIGNA.com Internet portal, touch-tone telephone service and discussions with client service representatives.

Information is available from CIGNA Retirement & Health Services at 860-534-2000.



Watson Wyatt provides compensation statements

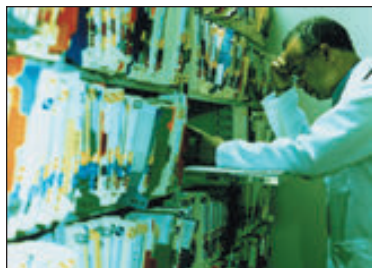
WASHINGTON—A new service from Watson Wyatt & Co. allows employees to access a real-time compensation and benefits statement online.

The service, EStatement, pulls the employee data from multiple employer and benefit provider sources. It aggregates data for the employee's compensation, retirement, health and welfare, work/family

benefits and other benefits and creates a user-friendly display. Interactive financial modeling and transaction capabilities are included, according to Washington-based Watson Wyatt.

Employees are able to use one sign-in to view all the data from a secure Web site.

More information is available by contacting Curtiss Butler at 212-251-5680 or at curtiss.butler@watsonwyatt.com.



Intracorp offers physician review

PHILADELPHIA—Intracorp has added an enhanced physician review services product to its medical management offerings to help self-funded benefit plans and claims-payers better manage claims.

The service provides objective clinical opinions by board-certified physicians to help benefits administrators and payers make claims determinations for complex and/or high-cost medical claims. For example, the service can be used to make determinations on claims for procedures that are considered experimental. It also is useful for conducting retrospective claims reviews.

Philadelphia-based Intracorp's medical experts review proposed treatments and provide opinions based on current medical literature, standards of care and professional experience. They create concise medical reports that can be easily understood by nonclinical claims staffers, Intracorp said.

More information is available from Tanya Lewis-Walls at 215-761-7136.

Commentary

'Political' risks need managing

I found myself using up a couple of my remaining vacation days early last week, putting them to good use attending to holiday chores and generally doing my best to demonstrate consumer confidence in the economy.

While it was probably the most practical use of the time, the arrangement wasn't what I consider an ideal use of days off. But, with this year's golf season apparently over in Chicago, particularly since I'm less enthusiastic than I once was about using a Phillips screwdriver to make a hole for my peg in frozen tee boxes, practicality won out.

As it turned out, spending much of a couple of days in the errand to errand had a fringe benefit, giving me plenty of time to follow one of this holiday season's hottest stories, the developing saga of Sen. Trent Lott.

Listening to bits and pieces of various daytime public-affairs programs and news commentary as I drove, I rarely heard all of any one expert's opinion. And I'm not sure I needed to. From a risk management perspective at least, the message was clear: the high value of political risk insurance.

Not political risk insurance as it's now known: those very useful products available in the market to cover multinational businesses against such real exposures as currency inconvertibility or government appropriation of assets. No, I found myself imagining the market for some kind of product that could insure politicians against catastrophic hits to the political bottom line.

If you could figure out a way to write it, I bet you could find a market right now selling politicians reputational risk coverage—or maybe some sort of sophisticated structured policy aimed at propping up political stock in decline.

Trent Lott would probably pay a fortune right now for some kind of retrospective finite program that would allow him to move some of the political losses off his books.

Maybe this kind of coverage could involve a dual-trigger structure, kicking in if you've suffered a reputational catastrophe at a time when you lack the political capital to weather it. With his high approval ratings, for example, if George W. Bush were to commit a verbal gaffe or two, or even engage in some wildly inflammatory rhetoric, he could probably absorb

the impact. But should the economy stay rough and those poll numbers fall, he might be a buyer of such coverage down the road, if it were to exist.

Here in Chicago, our current mayor's father, the legendary Richard J. Daley, survived the catastrophe that was the 1968 Democratic convention, brushing himself off and managing to hold office until his death eight years later. Someone like that would probably have little use for this kind of political risk product. Even if such insurance did exist, a politician with that much capital can obviously afford to retain a lot of risk.

Underwriting this kind of coverage might be challenging, but the history of the risk is usually pretty obvious to anyone who really wants to look for it. Politicians generally live their lives in the public fishbowl, and close observation should provide a pretty clear picture of the nature of the risk.

In going on about all this, I should make it clear that I'm not belittling the issues at the heart of the Mississippi senator's troubles. Whether his much-reported comments at Strom Thurmond's birthday party were meant, as he has said, simply as a light-hearted attempt to make an old man feel good or were something more sinister, Sen. Lott's remarks conveyed the same message.

Perhaps, as I heard some politicians suggest on various radio programs last week, once the smoke clears, this entire episode may yield some benefit by prompting serious attention in Washington to issues of race relations.

Or not. Whatever the outcome, though, this isn't a matter to be taken lightly. And all I mean to suggest is that, in this age of sophisticated media strategies and scientific polling, I'll bet if there were a way for politicians to insure against catastrophic losses caused by "mistakes of the head" (or elsewhere), it would likely be a hot product.

But, in fact, despite all the efforts of political heavy hitters to "inoculate" themselves from the adverse impact of unpopular policies or to spin the facts on the Sunday morning news talks, there's just no way for politicians to transfer certain risks. And perhaps that's how it should be.

Senior Editor Rodd Zolkos' commentary appears periodically and on www.businessinsurance.com.



Rodd Zolkos

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Court ruling expands online publishers' libel liability

Australian can sue U.S. publisher

By JUDY GREENWALD

CANBERRA, Australia—In a landmark decision that increases the potential liability of online publishers and could lead to higher libel insurance rates worldwide, Australia's highest court has ruled that publishers can be sued there for defamation regardless of their geographical location.

The Dec. 10 decision in *Dow Jones & Co. Inc. vs. Gutnick* by the High Court of Australia is the first ruling on this issue by any country's highest court, and it is expected to be influential in both British Commonwealth and other nations' courts.

"I think that Gutnick raises a very real threat that any Internet publisher can now be sued anywhere in the world," said Jim Borelli, vp-claims at Kansas City, Mo.-based Media/Professional Insurance.

Meanwhile, in a comparable case with a different outcome, a U.S. appellate court earlier this month dis-

missed a libel suit filed by a Virginia prison warden against two Connecticut newspapers because its online articles concerning him were not directed at a Virginia audience (see story, next page).

The Australian case involves Victorian businessman Joseph Gutnick, who sued Dow Jones & Co. Inc. for statements made about him that were published in October 2000 in Barron's Online, which has about 1,700 Australian subscribers. The article described Mr. Gutnick as a money launderer, according to the decision. All seven judges agreed to dismiss Dow Jones' appeal of a lower court decision permitting the suit to proceed.

The decision says that because the alleged damage to Mr. Gutnick's reputation occurred in the Australian state of Victoria, where he lives, it is appropriate that it has jurisdiction, even though the article had been distributed from servers in New Jersey. "It is his reputation in

that state, and only that state which he seeks to vindicate," says the opinion.

The decision says, "The specter which Dow Jones sought to conjure up in the present appeal, of a publisher forced to consider every article it publishes on the World Wide Web against the defamation laws of every country from Afghanistan to Zimbabwe is seen to be unreal when it is recalled that in all except the most unusual of cases, identifying the person about whom material is to be published will readily identify the defamation law to which that person may resort."

The decision means Mr. Gutnick can now proceed with his lawsuit against Dow Jones in Victoria.

Mr. Borelli, whose firm joined in an amicus brief filed on Dow Jones' behalf in the case, said, "I think the decision may well further the trend of higher premiums, larger deductibles, more restrictive policy terms" in the libel insurance mar-

ket.

"A key factor that is analyzed in underwriting every risk is the location where each operation of the applicant is located," said Mr. Borelli. "The Gutnick decision takes that key underwriting factor away, because now, apparently, anyone that publishes on the Internet can be subject to jurisdiction anywhere in the world. This creates uncertainty and is never favored by insurers, especially in an inopportune time with the current hard market and lack of capacity."

Eric E. Jorstad, a media attorney with Faegre & Benson in Minneapolis, said, "I believe there's a potential here to broaden the potential exposure for publishers who use the Internet for distribution, which, of course, is a matter of concern, especially where it's hard to predict where materials end up on the Internet."

The decision may influence pub-

See LIBEL/next page

U.K. proposals for pension reform get chilly reception

By SARAH VEYSEY

LONDON—Government-backed pension reform proposals designed to ensure that workers have sufficient retirement income do not take the right tack, pension experts say.

The proposed reforms were set out in a Dec. 17 consultative document, and the government is seeking public comment on the proposals.

The government review of the U.K. pension system stems largely from growing public concern about the adequacy of many workers' retirement savings. Fueling those concerns are such factors as the growing trend of employers shifting to defined contribution from defined benefit plans, and the aging of the British workforce.

According to the consultative document—known as a green paper—the government's Department of Work and Pensions will consider whether employers offering pension plans should be allowed to make membership in pension plans a condition of employment. In addition, it will examine whether employee contributions to pension plans should be made mandatory, and whether employers should be required to consult employees before making structural changes to pension plans.

Other proposals include a simplification of the tax regime for occupational pension plans, and the replacement of the controversial minimum funding requirement for

pension plans with a plan-specific statement of funding principles to be agreed between employers and plan trustees. The minimum funding requirement provision specifies that pension funds hold sufficient funds to ensure that they are able to pay future liabilities. Some employers claim that the current system of regulating the minimum funding requirement increases the costs associated with running a pension plan.

Work and Pensions Secretary Andrew Smith said he would set up a task force to assess whether changes are needed to the current system of voluntary membership in pension plans.

"I want to see this process open to independent scrutiny, so I am establishing an independent commission to monitor the progress of the U.K. voluntary approach and assess whether we need to consider the options for additional compulsion," Mr. Smith said in a statement.

The government's proposals have drawn mixed responses.

The Chartered Institute of Personnel Development, a London-based group for personnel managers, said it believes any proposals to "force employers to provide occupational pension schemes, and employees to join them, would be inflexible and not suit the needs of many staff and organizations."

Paul Greenwood, head of retirement research at Mercer Human Resource Consulting in London, said that if minimum contributions

See PENSIONS/next page



PHOTO: AFP

After colliding with another ship on Dec. 14, the Norwegian cargo ship Tricolor sank, resulting in a loss for its cargo of up to \$50 million in luxury automobiles.

\$80 million in claims from Channel collision

LONDON—Marine insurers could face hull and liability losses of more than \$80 million after a Dec. 14 collision in the English Channel that resulted in the loss of one of the vessels' cargo of luxury cars.

The Norwegian-registered car transporter Tricolor sank hours after colliding in fog with a Bahamas-registered cargo ship, Kariba.

The Kariba, which was holed above the water line, was able to make it into port. The 20-year-old vessel suffered only minor damage, and none of her cargo was lost. But the Tricolor, which was carrying 2,862 luxury cars, as well as tractor cranes and crane parts, capsized. None of the 24 crew members of the Tricolor was injured.

Wallenius Wilhelmsen Lines AS of Norway, operator of the Tricolor, said the 15-year-old vessel was insured for about \$40 million by the Norwegian Hull Club of Oslo, Norway. The shipping line's liability coverage is placed with Assurance Foreningen Gard, a Norwegian protection and indemnity mutual.

The cargo of luxury automobiles was worth between \$40 million and \$50 million, according to a Wallenius Wilhelmsen spokesman.

The spokesman would not comment on the likely cause of the collision.

—By Edwin Unsworth

World Updates

HLS to get coverage from U.K. government

The U.K. Department of Trade and Industry will provide insurance to Huntingdon Life Sciences Group, which has been the target of a sustained and often violent campaign by activists who oppose the company's animal-testing practices. Trade and Industry Secretary Patricia Hewitt told Parliament that the DTI would provide HLS with a range of coverages, including fire, theft and employers liability protection. She said the DTI would not use commercial insurance or brokers and would instead provide the coverage "from its own resources."

Catastrophe losses below norm in 2002

Catastrophes cost insurers around \$12 billion in 2002, down from the \$21.5 billion annual average during the 1990s, reports Swiss Reinsurance Co. This year has seen more than 300 major catastrophe events, the study notes. Swiss Re estimates the total economic loss from those events at \$40 billion, down from the annual average of \$68 billion since 1990. Of this year's insured losses, an estimated \$10 billion was from natural catastrophes.

Royal & SunAlliance names CEO, chairman

Royal & SunAlliance Insurance Group P.L.C. has named a new chief executive and a chairman-designate. Andy Haste, currently chief executive of London-based AXA Sun Life and an executive director of AXA U.K., will become chief executive of RSA in April 2003. He will replace Bob Mendelsohn, who resigned earlier this year. John Napier has been named as the group's chairman-designate. Mr. Napier, chairman of Kelda Group P.L.C., will join the RSA board in January and succeed outgoing chairman Sir Patrick Gillam in March.

Allianz names Diekmann as next chairman

Henning Schulte-Noelle will resign as chairman of Allianz A.G. Holding after its April 29, 2003, annual meeting. He will be succeeded by Michael Diekmann, who is currently in charge of Allianz's North and South American insurance activities and head of human resources.

Briefly noted

Marsh Inc. named **Sunshine Insurance Ltd.** in Nassau its correspondent in the Bahamas. ...French insurer AXA S.A. plans to sell its Austrian unit, **AXA Konzern A.G.** (Austria), to a group of shareholders of Vienna-based UNIQA Versicherungen A.G.

Libel: Court allows lawsuit

Continued from previous page

lishers, say observers. Stephanie S. Abrutyn, New York-based counsel/East Coast media for The Tribune Co., said, "The Gutnick decision obviously could have a potential chilling effect on what's out there on the Internet." U.S. publications "may have to think twice (if they) are subject to suits all over the world and subject to the laws of Australia or anyplace else with a more-restrictive view of free speech simply by having a Web site to service their Web-based customers," said Ms. Abrutyn.

Megan Gray, an attorney with Gray Matters in Washington D. C., said the decision "certainly is going to increase (publishers') anxiety level. I don't think a large enterprise like the New York Times will necessarily change the content of their reporting subjects, but I do think it

will cause their legal departments to pay greater attention to subjects in those stories that are located internationally."

Observers note that U.S. libel laws are more defendant-friendly than are those elsewhere. Lee Tien, senior staff attorney with the San Francisco-based Electronic Frontier Foundation, said that in the United States, for instance, public figures generally fail to win defamation suits and can be freely criticized. "That's not the rule in the rest of the world," he said.

Ian Ballon, a media attorney with Manatt, Phelps & Phillips in Palo Alto, Calif., said differences between laws in the United States, because of the First Amendment, and those elsewhere, particularly in the United Kingdom and Australia, could lead to forum shopping. "There are strong incentives for liti-

gants to bring suit on speech-based claims outside of the U.S. if they're able to do so, because the outcome is likely to be different," said Mr. Ballon.

Observers say an international forum or treaty may be necessary. Kevin W. Goering, an attorney with the Coudert Bros. law firm in New York, said, "There's no uniform approach to these issues from country to country and no treaty or other rule of international law to give any guidance to courts on how to approach the issue. I think you're going to see an increasing demand for discussion at an international level for some sort of treaty solution to the problem."

Dow Jones & Co. Inc. vs. Gutnick; High Court of Australia; (2002) HCA 56.

Court rejects libel from another state

By JUDY GREENWALD

RICHMOND, Va.—A federal appellate court in Richmond, Va., has dismissed a libel case filed by a Virginia prison warden in connection with online articles published by two Connecticut newspapers, finding that the articles were not directed at a Virginia audience.

The unanimous Dec. 13 opinion by a three-judge panel of the 4th U.S. Circuit Court of Appeals in *Stanley K. Young vs. New Haven Advocate et al.* reverses a lower court's ruling on the issue. It stands in contrast to a recent decision by Australia's High Court, in which the court ruled a Victoria businessman could sue Dow Jones & Co. locally for an Internet article it had disseminated about him (see story, page 21).

According to the decision, two Connecticut newspapers, the New Haven Advocate and the Hartford Courant, reported on Connecticut's policy of transferring prisoners to Virginia correctional facilities. Mr. Young claimed the articles implied he was a racist.

In March 2000, the Advocate published a news article that appeared online that mentioned a class-action suit brought against Stanley K. Young, the warden at Wallens Ridge State Prison in Big Stone Gap, Va. It quoted a Connecticut state senator as stating that Mr. Young had Confederate Civil War memorabilia in his office, according to the decision.

At about the same time, three Courant columns on the subject were published, including one in which the writer referred to Wallens Ridge as a "cut-rate gulag," the decision shows. Mr. Young then sued the newspapers, their editors and two reporters for libel.

In dismissing the case, the panel ruled that a Virginia court "cannot constitutionally exercise jurisdiction over the Connecticut-based newspaper defendants because they did not manifest an intent to aim their Web sites or the posted articles at a Virginia audience."

The decision said, "The articles reported on and encouraged a public debate in Connecticut about whether the transfer policy was sound or practical for that state and its citizens. Connecticut, not Virginia, was the focal point of the articles."

"I think it was a good decision," said Jim Borelli, vp-claims at Kansas City, Mo.-based Media/Professional Insurance. "It's a type of decision that can give underwriters more certainty in underwriting" this type of risk, he said. "Just as importantly, it can give risk managers and in-house counsels the type of certainty they need" in advising publishers, Mr. Borelli said.

Charles H. Kennedy, a media attorney with Morrison & Foerster in McLean, Va., said the decision "is just the latest in a long line of Internet jurisdiction cases in this country" that are inconsistent with one another.

"We don't have clear guidance as to how purposeful your activity directed at another jurisdiction has to be, how interactive your Web site has to be...exactly where we want to draw those lines," Mr. Kennedy said. "I think everybody in this field would be fascinated if the Supreme Court looked at this issue one of these days."

Stanley K. Young vs. New Haven Advocate et al.; 4th U.S. Circuit Court of Appeals; Decided Dec. 13, 2002.

Pension: Government proposal

Continued from previous page

were set, the risk of those plans providing inadequate income for retirees would not necessarily be eliminated. "The problem is, if you set a contribution rate as a minimum, it becomes a norm," he said. A prescribed minimum amount may not be sufficient to ensure adequate retirement savings for many pension plan members, he said.

Raj Mody, a consultant with Hewitt Bacon & Woodrow in Leeds, England, said that providing incentives for people to contribute to pension plans, rather than requiring them to do so, would be a more effective way of encouraging workers to save for retirement.

"It is a more difficult issue than just, 'Should pension savings be compulsory?'" he said. "For exam-

ple, if you are going to make pensions savings to an occupational scheme compulsory, then the security of that scheme has to be rock solid. You can't make members contribute to an occupational scheme that's flaky."

London-based labor federation the Trades Union Congress welcomed the green paper, but said that it still believes that compulsory pension contributions are needed in order to avoid "condemning growing numbers of people at work to poverty in retirement."

Mercer's Mr. Greenwood said that although the green paper does propose removing some of the "excessive complexity" of pension regulation, it is "an opportunity lost."

"We do not believe the government has brought in sufficient in-

centives to stem the tide of employers reducing their commitment to occupational pension provision," he said. "Much more will be needed to address the immediate issues faced by company pension funds," he added. The cost to employers of administering an occupational pension plan needs to be lowered, he said, to encourage employers to maintain adequate company pension plans.

Those wishing to comment on the proposals have until March 2003 to register responses.

Copies of the green paper, "Simplicity, Security and Choice: Working and Saving for Retirement," are available at: www.dwp.gov.uk/consultations/consult/2002/pensions/index.htm

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Muni bonds: Business booming

Continued from page 1

ues to attract new entrants, including two recently formed companies. Interest in creating more remains strong, though the financial barriers to entry remain high.

Little competition

Financial guarantee insurers say they encounter relatively little significant competition from multiline insurers in the United States. Multiline insurers cannot issue financial guarantee policies in this country unless they segregate their capital and form monoline insurers.

Financial guarantee insurers guarantee to pay the interest and principal on the obligations their policyholders issue. The four major financial guarantee AAA-rated primary insurers are: MBIA Inc. in Armonk, N.Y.; and Financial Guaranty Insurance Co., AMBAC Assurance Corp. and Financial Security Assurance Inc., all based in New York. Relatively new AAA-rated entrants include New York-based XL Capital Assurance; and CIFG Group, a New York-based unit of Paris-based CDC IXIS, a financial services firm.

Other monoline insurers include AA-rated Radian Asset Assurance Inc. and A-rated American Capital Access Corp., both in New York. Both multiline and financial guarantee monoline reinsurers reinsure the primary companies' business.

The AAA-rated insurers confer their rating agency-granted AAA on the bonds they insure, which lets municipalities that buy the insurance to pay the holders of those bonds lower interest rates. This savings more than makes up for whatever the municipal bond insurers charge, say observers.

Robert P. Ryan, an analyst with Banc of America Securities in New York, said, "The general unease in the credit markets has widened spreads and, therefore, made the bond insurance that much more valuable, because, essentially, the issuers are borrowing a AAA rating from the insurers instead of issuing something BBB or AA."

It is very different for the property/casualty insurance industry, which has a "whole different mechanism of supply and demand," said Mr. Ryan.

"I would say business has been pretty good for them over the last couple of years," said Richard P. Smith, managing director at Standard & Poor's Insurance Rating Services in New York, speaking of the financial guarantee insurers. "They've been growing in all segments of their business—the domestic, municipal, the asset-backed and international."

Mr. Smith said rates "have been improving steadily in most of the market over the last several years."

"I think we're in a very healthy pricing environment," said David C. Stevens, president of XL Capital Assurance. "Five years ago, the industry was underpricing risk, and I think that has changed. And I believe we're in a healthy period for the financial guarantee industry."

Martin A. Karmack, president of Radian Asset Assurance and Radian

Reinsurance Inc. in New York, a monoline reinsurer, said, though, "The municipalities that are issuing insured deals today are paying such absolutely low rates of interest on those bonds with the insurance that, I think, they're delighted with the outcome, and it's not really meaningful to say whether they're paying more for the insurance."

The volume of insured bonds is up, at least partly because of a flight to quality by investors.

Richard A. Ciccarone
McDonnell Investment Management

Steve Klein, managing director and head of public finance at CIFG, said that although CIFG is a new company, "to date, we really haven't found it necessary to engage in aggressive price cutting in order to be accepted. We're trying to be opportunistic about the transactions we pursue and haven't needed to engage in wholesale price-cutting in order to be competitive."

High demand for bonds

A booming municipal bond market has helped financial guarantee insurers. According to the New York-based Bond Market Insurance Assn., municipal long-term bond issuance totaled \$165 billion for the first half of this year, which puts it on pace to exceed last year's \$286.5 billion. Insured bonds accounted for \$86.6 billion, or 52.5%, of the total for this year's first half, compared with 46.4% for all of last year.

Interest rates are low and the weak economy has put municipalities "in a position where they need a bit more money, because it's not coming in through taxes," said Mr. Smith, explaining the increase in issuance.

MBIA Insurance Corp. President Gary C. Dunton said the low interest rates are stimulating demand. "If anyone were to borrow, they would certainly want to borrow now," he said, because there is not much room for interest rates to move further down. Furthermore, said Mr. Dunton, "the states no longer are generating surpluses, and so perhaps what they could have refinanced themselves before they now have to go back into the capital markets and borrow funds."

The lowest interest rates in 30 years have also led to an increase in the size of individual municipal bond issues, which have grown, on average, to about \$25 million this year, compared to \$19 million in 2001, said Richard A. Ciccarone, chief research officer and managing director at Oak Brook, Ill.-based McDonnell Investment Management.

The low interest rates have also encouraged many municipalities to refund their bonds and reissue them at lower rates. According to the Bond Marketing Assn., refunding accounted for \$55.3 billion of issues the first half of this year, compared to \$88.2 billion for all of 2001 and just \$35.4 billion in 2000.

"That's really made a huge difference in the bond volume," said Mr. Ciccarone.

The refunding is unlikely to continue at the same pace, though, said MBIA's Mr. Dunton. "There's only so many times you can do that," he said, "I think we've seen the big wave this year and last year."

At the same time, the volume of insured bonds is up, at least partly because of a flight to quality by investors who have observed the performance of the stock market and corporate bonds under stress this year, said Mr. Ciccarone.

Mr. Dunton said, "To the extent people want to buy protection, we are seeing more demand across all of our business sectors than at least I have seen over the last five years."

Mr. Karmack said that when volume is as high as it is now, "there's more value to the insurance, because it allows for greater liquidity for the bonds, a wider market for the bonds and, obviously, higher ratings on the bonds in a market where the higher earnings are important. So I think it's been a good value proposition all around for bond insurance this year."

Tapping growth areas

At the same time, though, municipal bonds are considered a mature business, and asset-backed and international business, which generate higher returns, are considered to be financial guarantee insurers' major growth areas.

Stanislas Rouyer, senior vp with rating agency Moody's Investors Service in New York, said that because the U.S. municipal market is fairly mature, "the growth there is really going to be probably linked to the growth of the U.S. economy," although he noted that there will be some volatility of volume year over year in response to interest rate fluctuation.

But while the default rate for investment-grade municipal bonds is extremely low, losses are higher in the corporate area. Financial guarantee insurers' loss ratio used to be zero, and now they are reporting at least some losses, said Mr. Ciccarone. But loss ratios remain "very, very low by insurance industry standards," he said.

Last year, for instance, members of the New York-based Assn. of Financial Guaranty Insurers, a trade association that represents nine insurers and reinsurers, posted a 5.9% loss ratio. None of the insurers experienced any losses as a result of the World Trade Center attacks.

Some concern has focused on the CDO and airline EETC markets. Insurers, say, though, that there is little to worry about. MBIA's CDO business is an "incredibly rock-solid book of business," with at least 80% of it rated at the AAA level. That means "incredibly bad things have to happen for an incredibly long period of time for us to have any losses, things never experienced before in the U.S. economy," said Mr. Dunton.

MBIA has strongly denied a report by a hedge fund, Gotham Partners Management Co. L.L.C. in



PHOTO: GETTY IMAGES

Bond issues such as O'Hare International Airport's general airport revenue bonds and asset-backed issues by airlines make up a sizable part of AMBAC Assurance's financial guarantee exposure.

New York, that its CDO business, among other factors, threatens its AAA rating.

The EETCs are well protected as well, said Mr. Dunton. "Like all of our deals, we structure them with sort of the worst-case scenario in mind," he said.

Frank J. Bivona, AMBAC's vice chairman and chief financial officer, said, "Our role in the CDO market has been in the most senior tranches of securitization of CDOs and, typically, what we insure is the AA or AAA end of the securitization, which is the least risky."

'The international part of the business represents the greatest growth opportunity.'

Sean McCarthy
Financial Security Assurance Inc.

"Ninety percent of our book is rated AA or better before our insurance," Mr. Bivona said. "It has held up very well for us," although the lower end of the market has experienced more problems.

"The corporate credit market is still in a fairly bad shape, with a large volume of downgrades and defaults," said Mr. Rouyer. "That has had two distinct impacts on the financial guarantors," he said. "On the one hand, it has created some stress in their portfolios, and that translates mostly into rating downgrades in their CDO portfolios and, in a few cases, in actual or anticipated credit losses. But these losses are relatively small, because the deals are structured so that others would assume losses before the guarantors had any exposure."

On the other hand, Mr. Rouyer said, "this more nervous credit environment is beneficial to the guarantors in the sense that the market values credit enhancement...and that translates, in some cases, into higher prices and, in other cases, into higher volume for the financial guarantors. So, net, probably the guarantors are likely to benefit more from the environment than they are likely to suffer from it. However, we don't know yet how things are going to develop in the future."

AMBAC has insured \$600 million worth of asset-backed securities is-

sued by Carmel, Ind.-based Consec, Inc., which filed for bankruptcy last week, while FSA has \$456 million worth of Consec asset-backed bonds in its portfolio. Both companies, however, said the securities are performing well, and they do not anticipate any losses.

International business remains promising as well. "The international part of the business represents the greatest growth opportunity," said Sean McCarthy, FSA's president and chief operating officer. Although this business continues to be largely European, "there's been a number of different transactions" in Australia, Japan and Korea. "It's really driven by the creditworthiness of the country and the strength of their legal system and the quality of the information" provided, Mr. McCarthy said.

Mr. Bivona said, "It's a slower-developing business than perhaps the asset-backed business in the U.S.... But for us, it still represents our largest growth segment. It's a business that is slowly evolving to the use of capital markets for infrastructure finance and asset-backed securities."

Few newcomers

Of the two new financial guarantee insurers, CIFG began writing business earlier this year, while XL Capital began writing business in December 2000.

Observers say that, with the financial guarantee business flourishing, there has been interest in more startups, although this demands considerable capital.

S&P has an "unprecedented number of names" of parties interested in starting a financial guarantee insurer, although "it just remains to be seen how many people actually manage to put it all together," said Mr. Smith. Most of those interested are focusing on the asset-backed markets. "I guess people still look at the asset-backed markets and see a lot of opportunity over time," said Mr. Smith.

Mr. Bivona said, "I think we welcome competition and it may help broaden the market even more, but I don't see anyone directly on the horizon. It takes very strong commitment of capital and resources for a long period of time, and we just haven't seen that other than a few instances."

States: Laws clash with terrorism insurance act

Continued from page 2

choice," because "I think that is what the (federal) bill envisioned."

Companies that meet the multiple criteria that define "large policyholder" in both Georgia and Texas, however, may be among the least affected by these regulatory changes because their negotiations with insurers may already be exempted from regulatory oversight.

In addition, California's position is uncertain because a bulletin on the subject is now being drafted, department representatives say.

While California previously announced it was generally banning terrorism exclusions, its authority over forms is limited only to their rating component. Consequently, the California department has allowed about 400 exclusionary filings by insurers, according to department representatives. It has not approved another 200 filings, primarily because regulators indicated that they probably would have resulted in excessive rates.

Other hurdles that the insurance industry faces stem from the federal law's incomplete or unclear statements concerning the lines of

insurance and entities it seeks to protect, industry representatives say.

For example, the bill does not list fidelity insurance among the coverages included under the act, said Michael Koziol, senior director and counsel of the Des Plaines, Ill.-based National Assn. of Independent Insurers. In addition, the federal law's exclusion of medical malpractice coverage may create problems for nursing home operators in those states where their primary liability exposure falls under that line of coverage, he said.

The NAIC's effort to encourage

uniformity among states is only one way that it has demonstrated its understanding of the issue's significance.

For example, it also recently established an Executive Committee subgroup, which is headed by Terri Vaughan, the NAIC's immediate past president, to continue discussing terrorism act issues with the U.S. Treasury Department. Those issues will include legal questions that the NAIC decided at its meeting to solicit from industry representatives. The deadline for submitting questions is Dec. 27.

How the NAIC and states handle

the issue of implementing the federal law may have repercussions on state regulation, industry observers say.

"The key question, however, is whether states' activity on the terrorism issue will make the case for continued state regulation," said Lenore Marema, vp-legal and regulatory affairs for the Downers Grove, Ill.-based Alliance of American Insurers. "Will the states demonstrate on a highly visible issue that they can act in a consistent and efficient manner or will state activity fan the flames for federal intervention?" she asked.

Governance: Lawsuits less likely

Continued from page 3

Indeed, Mr. Useem noted that corporations with good governance "build confidence with investors," reducing the number of shareholder suits.

Insurers writing directors and officers liability coverage also welcome the growing interest in corporate governance rules, said Donald Bailey, senior vp in the specialty products group at Allianz Insurance Co. in Chicago.

During the 1990s, many insurers increased their capacity for D&O risks while rates were dropping. Now, claims are rolling in, and D&O underwriters are taking severe hits.

"It has been the perfect storm for these companies," said Mr. Bailey, who moderated the discussion. "D&O insurers have gotten pummeled," and those insurers that have stayed in the line have pushed up rates and retentions, he said.

One significant problem for D&O insurers stems from their inclusion of entity coverage in policies, noted

John McCarrick, partner with the law firm of Duane Morris in Briarcliff Manor, N.Y.

Entity coverage, which indemnifies a corporation as opposed to its directors and officers, was added to

'E-mail has become one of the most destructive and widely used tools of the plaintiffs bar.'

*John McCarrick
Duane Morris*

D&O liability policies in the 1990s to resolve problems in allocating D&O limits between executives and companies.

The use of such coverage "has separated the interests of the D&O clients and the D&O insurers," Mr. McCarrick said.

If a company has entity coverage, directors and officers may be more willing to settle suits within the limits of that coverage, as they have no personal financial liability.

"Entity coverage continues to be a significant problem," he said. Policyholders need to have a financial stake in the settlement or they will have less incentive to prevent suits, he said.

Contrary to expectations, enactment of the Private Litigation Securities Reform Act of 1995 has not reduced the severity and frequency of shareholder suits, Mr. McCarrick said.

He attributes the growth in such suits to an increasing number of corporate financial restatements; greater conflicts of interest by outside vendors, such as auditors or investment bankers that want to sell additional services; and the rise of e-mail.

The discovery process in securities litigation often uncovers internal e-mails that privately contradict what a company has publicly disclosed, Mr. McCarrick said.

"E-mail has become one of the most destructive and widely used tools of the plaintiffs bar," Mr. McCarrick said.

Health: Medicare drugs top agenda

Continued from page 3

rank among the legislative initiatives cited by the Democratic staffers on the panel.

Bridgett Taylor, an aide to Rep. John Dingell, D-Mich., said that Democrats are particularly concerned about how to deal with the impact of state budget shortfalls on Medicaid programs.

'Our view is that, instead of consumer driven, (these plans are) sort of consultant driven, as employers seek to cut costs.'

*Adam Miller
United Auto Workers International*

Debbie Curtis, chief of staff for Rep. Pete Stark, D-Calif., expressed concern that the addition of a Medicare prescription drug benefit might be done in such a way that would damage Medicare as an entitlement program. That would be too high a price to pay, Ms. Curtis said.

The discussion was the second health care policy forum held by the Alliance for Health Reform in four days. In a Dec. 16 Capitol Hill forum on the challenges facing employer-based coverage, a U.S. Chamber of Commerce official called for a series of reforms to encourage small businesses to offer health coverage to their employees and thus reduce the number of the

uninsured.

One of the major reforms would be to allow health insurers to offer coverage free of state mandates, said Kate Sullivan, director of health care policy for the Chamber.

Ms. Sullivan also said that small employers should be allowed to form health coverage pools that cross state lines. In addition, she advocated using tax credits and deductions to encourage uninsured people to purchase coverage.

Another speaker, though, stressed his belief that turning to so-called consumer-driven health plans, where employees assume greater responsibility for designing their own benefit packages, could make a bad situation even worse.

Such plans don't cut costs, they simply shift them from employer to employee, said Adam Miller, a benefit consultant for the United Auto Workers International in Detroit.

"Our view is that, instead of consumer driven, it's sort of consultant driven," as employers seek to cut costs, Mr. Miller said.

Market: Risks keeping rates up

Continued from page 3

seeing their investment income fall as interest rates drop and equity markets continue to produce poor returns, he said.

"So, up until today, it's been a profitless recovery," Mr. Greenberg said.

As a result, "we'll see firming rates throughout 2003, but I can't speak beyond that," Mr. Greenberg said.

The hard market will likely last at least three or four years, as insurers continue to make increases to their reserves, predicted William R. Berkley, chairman and chief executive officer of W.R. Berkley Corp. in Greenwich, Conn.

"We will have a hard market that will last longer than most people believe, because people are afraid," Mr. Berkley said.

Insurers' liabilities from previous policy years, the general turmoil in financial markets and rising concern over corporate governance issues will combine to prolong the hard market, he said.

Rates are continuing to increase across nearly every line of business, said William D. Smith, president and chief operating officer of Kemper Insurance Cos. in Long Grove, Ill. "There's a lack of competition," he said.

With insurers' returns falling, 'up until today, it's been a profitless recovery....We'll see firming rates throughout 2003, but I can't speak beyond that.'

*Maurice R. Greenberg
American International Group Inc.*

The only exception is large risk casualty accounts that do not have catastrophe exposure, Mr. Smith said. For those risks, policyholders are paying the same rates as they were in 2000, he said.

Generally, though, insurance companies are continuing to press for increases as they continue to operate in what they perceive to be a difficult financial environment, Mr. Smith said.

That environment was changed little by the Terrorism Risk Insurance Act of 2002, which was signed into law last month, Mr. Smith said. "The act doesn't do us any good at all," he said.

The provision in the act mandating that insurance companies retain a deductible of 7% of their direct written premiums in the first year, 10% in the second and 15% in the third means that insurers would still face a huge liability in the event of another terrorist attack, Mr. Smith said.

He noted that, in accordance with the act, in the first year after it will have come into force, Kemper would be liable to pay out a maximum of about \$300 million. "That's not an event we can afford," Mr. Smith said.

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Patriot: All claimants must be screened

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organizations lobbied against including property/casualty insurers before the law was enacted last July.

"Property/casualty is not a good vehicle for money laundering," said Ms. Jensen. "To try and launder money using a property/casualty company, you'd really have to go through a lot of gyrations."

By contrast, it is easier to launder money with life insurance vehicles, such as annuities, she said.

As a result, life insurance companies are still required under the law to develop anti-money-laundering programs.

But all insurers—as well as third-party administrators and self-insured employers—are subject to the OFAC regulations, which were introduced in 1979 but recently were given new emphasis.

Although the OFAC list—which contains some 5,000 "Specially Designated Nationals and Blocked Persons," including numerous foreign agents and front organizations, terrorists and narcotics traffickers—has existed for 23 years, requiring its use was reinforced by a Sept. 14, 2001, executive order issued by President George W. Bush.

Under OFAC, before any financial transaction—including the payment of an insurance claim—can be

conducted, the name of the customer must first be checked against the list.

If an insurance claimant is on the list, the claims payer—be it an insurer, a third-party administrator or even a self-insured employer—must notify OFAC. If they don't, and it turns out they are making a prohibited transaction, they face fines up to \$1 million and up to 12 years in jail. OFAC also has authority to impose civil penalties.

For example, in the case of a company violating sanctions against transactions with Iraq, civil penalties of up to \$275,000 per count are authorized.

Among the examples of prohibited transactions listed in a Treasury Department bulletin on OFAC are:

- A health insurance policy issued by U.S. insurer to a citizen of Cuba.
- A life insurance policy naming a resident of Cuba as beneficiary.
- An aviation policy issued to a nonblocked foreign airline but which names the Arab Bank for Investment & Foreign Trade in Abu Dhabi—named by the U.S. government as a Specially Designated National of Libya—as an additional insured because the bank holds a mortgage on the aircraft.
- A liability insurance policy cov-

ering the pharmaceutical operations of Laboratorios Blanco Pharma S.A. of Bogota, Colombia, that has been named as a Specially Designated Narcotics Trafficker.

- A reinsurance contract for policies underwritten in whole or in

'Self-insured employers and those with high deductible programs also have to be cognizant of these requirements and be in compliance.'

Bill Wargo
Quality Dining Inc.

part by the Arab Commercial Insurance Co. of the Channel Islands, named as a Specially Designated National of Libya.

- The return of a premium overpayment to a Cuban.

In addition, any claims paid in connection with any insurance policy covering an OFAC-listed individual or entity is prohibited.

"All U.S. insurance companies and U.S. citizens and permanent resident aliens who are employees, officers or directors of U.S. or foreign insurance companies need to be aware that they may be held ac-

countable for sanctions violations," warns a bulletin issued by the U.S. Treasury Department pertaining to OFAC.

But the requirement is not exclusive to insurers, according to Bill Wargo, director of safety and security at Quality Dining Inc. in Mishawaka, Ind.

"Self-insured employers and those with high deductible programs also have to be cognizant of these requirements and be in compliance," he said.

While most of Quality Dining's workers compensation claims are minor, rarely resulting in lost time, "we are going to initiate that process for claims that are closed with a settlement," he said.

"We also are implementing the same process for adjusting general liability claims," he added.

Quality Dining, a restaurant franchise owner with 176 restaurants in 15 states and approximately 8,300 employees, has a large deductible workers compensation program in which it pays claims up to \$250,000. The company's general liability program has a \$150,000 self-insured retention. Both coverages are underwritten by Liberty Mutual Insurance Co. of Boston.

"OFAC affects everybody," said the NAII's Ms. Jensen. "And it's not

just an insurance issue. It's every company that should be checking to make sure they're not employing somebody" on the list, she said.

Unfortunately, "the word definitely has not gotten out," Ms. Jensen said.

But, "the next time there's any sort of terrorism, they're going to find out who was transacting business with them," she warned. "They're not going to randomly go into companies and check. It's going to be when it's a known fact that you have done business with someone who's on the list."

To assist insurers, TPAs and self-insured companies that subscribe to ISO ClaimSearch, the Insurance Services Office Inc. is preparing an enhancement that will enable a company to cross-check claimants against the OFAC list, according to Vincent Ciadella, vp in Jersey City, N.J.

The ISO product, which serves as a claims clearinghouse for the property/casualty insurance industry and houses more than 300 million claims, is used to detect and prevent insurance fraud, Mr. Ciadella explained.

The enhancement, which will be available for an additional fee, is expected to be released by the end of the first quarter of 2003, he said.

Settlements: Big deals struck on asbestos claims

Continued from page 1

that each claim include proof of actual injury and identification of the product that caused the injury, said Neal S. Manne, a partner with Susman Godfrey L.L.C. in Houston, representing London insurers.

"London is going to go to the wall on these issues in any bankruptcy in any venue," Mr. Manne said.

London underwriters, for example, are "highly likely" to challenge the Babcock settlement on these grounds, he said. "In these bankruptcy-related cases, a settlement is not the end. A settlement is kind of the beginning."

The recent asbestos agreements differ in size and in the way they would fund defendants' liabilities, but they have one feature in common: All make use of section 524(g) of the U.S. Bankruptcy Code, which provides for the formation of bankruptcy trusts to pay long-tail liabilities like asbestos claims.

The trusts theoretically allow the kind of global claims settlement that proved impossible in proposed class-action settlements outside of bankruptcy court. The U.S. Supreme Court struck down such settlements in 1997 and 1999 rulings involving Amchem Products Inc. and Fibreboard Corp., finding that claimants were too diverse to represent a single class.

A rising number of asbestos defendants have filed for Chapter 11 protection in the last two years, prompted by the surge of asbestos claims that began in the 1990s and by the prospect that claims could be resolved in mass settlements in

bankruptcy courts. Of more than 50 defendant companies that have filed for reorganization since 1982, 22 have been forced into bankruptcy since Jan. 1, 2000, Steven Kazan, an Oakland, Calif.-based asbestos plaintiffs' attorney with Kazan, McClain, Edises, Abrams, Fernandez, Lyons & Farris, told a U.S. Senate panel in September.

Defendant companies have realized that Chapter 11 filings can "put boundaries around their problems" with a class-action-like settlement mechanism that was not allowed outside of bankruptcy court, noted Thomas W. Brunner, a partner with Wiley, Rein & Fielding L.L.P. in Washington.

That realization, he said, has led to the series of recent agreements.

Push to form trusts

Babcock, a unit of New Orleans-based McDermott International Inc. that filed for Chapter 11 protection in 2000, announced a reorganization plan last week that includes a settlement with bankruptcy committees representing current and future asbestos claimants.

The deal would create a bankruptcy trust to which McDermott would contribute all of its equity in Babcock itself and all of McDermott's and its subsidiaries' rights to insurance recoveries on asbestos claims.

McDermott would also contribute 4.75 million restricted common shares and \$92 million in unsecured promissory notes paying \$8.36 million a year for 11 years. The trust's ability to sell the McDer-

mott stock would be limited during the first three years after court confirmation of the reorganization plan, and McDermott would guarantee a minimum price of \$19 per share for stock sold by the trust after the three-year period, according to the company.

The agreement is still subject to several conditions, including final approval by claimants and the bankruptcy court, the company said.

'I can absolutely guarantee that London will have objections, and vigorous ones at that' to the Babcock plan.

Neal S. Manne
Susman Godfrey L.L.C.

Babcock's plan is not likely to have entirely smooth sailing, though.

"I can absolutely guarantee that London will have objections, and vigorous ones at that," Mr. Manne said.

For one thing, the plan does not yet spell out trust distribution procedures that would set standards for covering claims, leaving it unclear whether the trust would follow documentation requirements imposed last year by London insurers, he said.

Because plaintiffs' lawyers are likely to have a significant degree of control over trust payments, Mr. Manne argued, the odds of the distribution procedures meeting with London insurers' approval "could

best be described as a decimal point followed by a lot of zeros."

McDermott said it expects the process of finalizing the settlement to take up to nine months, depending on the extent of objections and appeals in the bankruptcy court.

Lloyd's underwriters sued Babcock and McDermott last year to void a coverage-in-place agreement under which insurers had paid more than \$650 million in asbestos claims prior to Babcock's bankruptcy filing. A federal judge in New Orleans threw out the suit in January, though, finding that the insurers had not shown that the expected reorganization plan breached the agreement's terms (BI, Jan. 14).

Last Wednesday, meanwhile, Halliburton reported that it has reached its own agreement in principle with asbestos plaintiffs under which it will pay about \$4 billion as part of a prepackaged bankruptcy filing by Halliburton subsidiaries DII Industries L.L.C.—formerly Dresser Industries Inc.—and Kellogg Brown & Root Inc.

Halliburton would contribute up to \$2.78 billion in cash, 59.5 million shares of Halliburton stock—now worth about \$1.21 billion—and notes with a net present value of less than \$100 million to settle current and future asbestos claims, the company said. DII and KBR would retain the rights to the first \$2.3 billion of any insurance proceeds the estate was able to collect, with up to \$700 million of any insurance recoveries in excess of \$2.3 billion going to a bankruptcy trust for claimants.

Halliburton itself and subsidiaries

Halliburton Energy Services Inc. and Landmark Graphics Corp. would not be included in the bankruptcy filing. Also excluded would be KBR's U.S. government operations business and KBR affiliates with no U.S. operations.

The agreement is still subject to negotiation of final terms, claimants' acceptance of a reorganization plan, financing of the settlement amount and bankruptcy court approval, the company noted.

Halliburton units are facing more than 300,000 pending asbestos claims, the company has reported in Securities and Exchange Commission filings. DII has about \$2.1 billion in aggregate insurance limits covering the years in question, of which more than half is with London insurers and Equitas Ltd., the runoff reinsurer for Lloyd's of London pre-1993 liabilities, the filing says.

Unlike the Babcock plan—which transfers insurance recovery rights to the trust—Halliburton is assuming the insurance recovery risk on its claims, agreeing to fund its trust itself and seek reimbursement from insurers later, Mr. Manne observed.

London insurers have not decided whether to challenge the Halliburton plan, and any objections will depend largely on whether the trust follows London documentation requirements in approving claims, he said.

Halliburton's coverage is already in litigation, though. Dresser and a former Dresser unit—Harbison-Walker Refractories Co., already in

See **SETTLEMENTS**/next page

December 23, 2002

For the Record

This roundup of news from the previous week is generated by BI's daily news reporting. To get breaking news as it occurs, log on to www.businessinsurance.com, or sign up online for free BI Daily News by e-mail.



United Airlines employees can no longer invest 401(k) funds in the company's stock.

UAL fiduciary blocks 401(k) stock purchases

The independent fiduciary that manages UAL Corp. stock held in the company's 401(k) plans is barring participants from buying company stock until the airline emerges from bankruptcy protection and new stock is issued. The stock fund is an investment option in the 401(k) plans of UAL, the parent of United Airlines. Instead, all new contributions to the fund will be deposited in UAL's blended income fund, a money market instrument, Aon Corp. unit Aon Fiduciary Counselors Inc. said in a letter to United employees. Meanwhile, State Street Bank & Trust, which manages UAL's employee stock ownership plan, has sold over one-third of the employees' 55% stake in the company.

12.3% premium growth forecast for U.S. insurers

U.S. insurers will see, on average, a 12.3% increase in written premiums in 2003, according to 12 stock analysts surveyed by the Insurance Information Institute. Individual predictions, though, ranged from 9.0% to 18.4%. The predicted growth would represent the second-highest growth rate since 1986. The analysts also predicted that the industry's combined ratio would improve to 103.3% in 2003 from an expected 106.3% this year. Individual predictions ranged from 99.9% to 105.2%.

NAIC aims to ease fears on flood cover program

The National Assn. of Insurance Commissioners is expected to formally adopt a resolution to help alleviate the anxiety of federal flood



insurance policyholders, insurers and agents who are concerned about the program's Dec. 31 sunset date. The NAIC's Property & Casualty Committee drafted a resolution calling for state regulators to waive actions against insurers related to technical compliance issues arising solely because of Congress' failure to reauthorize the National Flood Insurance Program before adjourning, an NAIC spokeswoman said.

P/C insurers post improved results

The U.S. property/casualty industry's net income surged to \$9.3 billion in the first nine months of 2002, compared with a \$2.6 billion net loss a year earlier, according to the Insurance Services Office Inc. and the National Assn. of Independent Insurers. Growth in premiums and lower catastrophe losses were the main factors in the industry's improved results. Net written premiums for the nine-month period increased 13.6% to \$279.8 billion. Property/casualty insurers' combined ratio, after dividends, for the period improved to 104.9% from 114.4% in the year-earlier period.

Backstop would bear minority of losses: Study

The majority of future terrorism losses would fall upon private insurers, despite creation of a federal terrorism insurance backstop, according to a Tillinghast-Towers Perrin report. Tillinghast estimated that if there were annual terrorism losses of \$4.50 billion, insurers would pay out \$2.66 billion—or about 59% of the total—in 2003, the federal insurance program's first year. Insurers' share of the losses would rise to 66% in 2004 and 74% in 2005.

College fund to honor the late Spencer Traver

Spencer J. Traver, a pioneer in the risk management profession, has died at age 73. Mr. Traver's career in insurance and risk management, which spanned 50 years, included top risk management positions at Brunswick Corp., Baxter Travenol Laboratories Inc. and BF Goodrich Co. His accomplishments at BF Goodrich, which included setting up the first captive insurer in Vermont,

were recognized by *Business Insurance* in 1982, when he was named Runner Up in the magazine's Risk Manager of the Year competition. A fund in honor of Mr. Traver has been established to support the risk management and insurance program at the Terry College of Business at the University of Georgia.

Buck raises projected health care cost hikes

Health care cost increases are projected to be greater in 2003 than was expected a few months ago, according to a survey by Buck Consultants Inc. Costs for preferred provider organizations are now projected to increase, on average, by 15.0% in 2003, compared with the 14.8% increase that was projected six months ago, according to the survey. Similarly, costs for point-of-service plans are projected to rise by 14.8% on average, up from 14.6% in the earlier forecast.

Briefly noted

The Pension Benefit Guaranty Corp. has taken over and terminated the pension plan sponsored by Columbia

Hospital for Women, a Washington-based facility that shut down earlier this year amid severe financial problems. The plan, which has just over 1,000 participants, is underfunded by \$8.6 million, according to the PBGC....Liberty Mutual Insurance Co. has received regulatory approval to form a rent-a-captive facility, **Arlington Insurance Co. Ltd.**, in Bermuda. Plans call for Arlington, a segregated-accounts company, to reinsure some Liberty Mutual risks....**Willis Group Holdings Ltd.** has purchased Special Risk Advisors International L.L.C., a Marietta, Ga.-based sports and entertainment brokerage. The purchase of the three-person firm helps expand Willis' presence in the field, the broker said. Terms were not disclosed....**Ohio's new insurance director** will be State Rep. Ann Womer Benjamin, R-Aurora, who also is an attorney with the firm of Arter & Hadden in Cleveland. Gov. Bob Taft announced that her appointment would be effective Jan. 6....**AXIS Specialty Ltd.** has completed its acquisition of New York-based Royal & SunAlliance Personal Insurance Co., renaming the company **AXIS Reinsurance Co.** and capitalizing it with \$375 million.

Online Poll [12/16 - 12/20]

Is your company prepared to comply with the privacy provisions of the Health Insurance Portability and Accountability Act, which take effect next April?

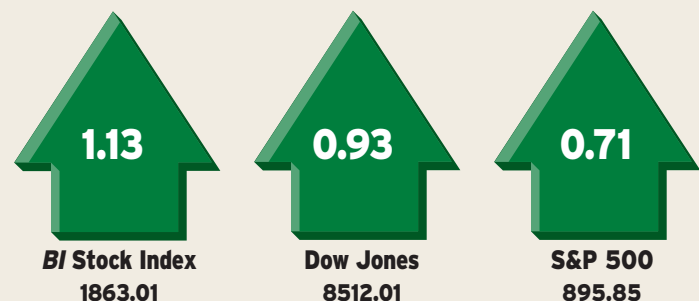


Take part in our weekly poll at www.businessinsurance.com

BI Stock Index [12/16 - 12/20]

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



Largest gains

CNA Surety
RLI Corp.
ProAssurance
Citigroup
PXRE Corp.

6.67%
6.33%
6.21%
5.94%
5.50%

Largest losses

Trenwick Group Ltd.
Navigators Group
Wellchoice Inc.
Philadelphia Cons. Holdings
Allmerica Financial Co.

-23.60%
-8.72%
-6.37%
-5.68%
-4.21%

Weekly change by market segment

Brokers	0.30%
Insurers/Reinsurers	-0.42%
Managed Care Organizations	-0.25%

Source: CNET Investor (investor.cnet.com)

Settlements: Big deals struck

Continued from previous page
bankruptcy in Pittsburgh—sued London market and U.S. insurers earlier this year for refusing to pay asbestos claims.

Mr. Kazan, the plaintiffs' lawyer, meanwhile expressed his own reservations about the Halliburton plan, saying that it substantially overvalues current asbestos claims and undervalues future claims.

Before the Babcock and Halliburton announcements, several other asbestos defendants had reached their own settlement agreements or reported deals in progress:

- Honeywell, which is negotiating a global settlement through the Chapter 11 reorganization of its former North American Refractories Co. unit. Honeywell will take a \$900 million aftertax charge in the fourth quarter to fund a planned asbestos claims trust in the NARCO bankruptcy. Honeywell said it is seeking to pay current claims over a four-year period and to impose an annual cap on its contributions to fund future claims.

Mr. Kazan said in an interview that he and some other plaintiffs' lawyers will fight the expected Hon-

eywell plan, to which he said Honeywell would be contributing too little to cover claims adequately.

- Sealed Air, which acquired a packaging products unit of bankrupt W.R. Grace & Co. and was sued by Grace asbestos claimants for participating in an allegedly

The Halliburton plan substantially overvalues current asbestos claims and undervalues future claims.

Steven Kazan
Kazan, McClain, Edises, Abrams,
Fernandez, Lyons & Farris

fraudulent transfer of Grace assets.

Sealed Air announced a deal last month in which it will contribute \$512.5 million in cash and 9 million shares of its stock—currently worth \$338 million—to a trust for asbestos claimants in the Grace bankruptcy. The deal, which would settle asbestos and fraudulent transfer claims, is still subject to a definitive agreement and bankruptcy court approval.

- The Combustion Engineering unit of Switzerland-based ABB. ABB announced last month that it was negotiating a settlement as part of an expected prepackaged bankruptcy filing by Combustion Engineering. An asbestos claims trust would be funded by Combustion Engineering's \$812 million in assets and roughly \$300 million to be contributed by ABB over several years, ABB reported.

ABB has reached an agreement in principle with lawyers representing current asbestos claimants and is working on an agreement with future claimants, confirmed David Austern, the future claimants' representative and general counsel of Fairfax, Va.-based Claims Resolution Management Corp.

- Shook & Fletcher Insulation Co., a Birmingham, Ala., company that filed for Chapter 11 protection in April with 80,000 pending asbestos claims against it. A court-approved reorganization plan took effect Dec. 11. Under the plan, current and future asbestos claimants will be paid from a \$250 million bankruptcy trust that is largely funded by the company's insurers.

Insurance exasperation leads to literary aspirations

By Myron M. Picoult and Jodi Picoult

'Twas the day before Christmas, a light snow was dropping,
And dozens of folks were out last-minute shopping—
For scarves and perfume, for stuffed teddy bears,
For remote control cars and for AIG shares.
As they canvassed department stores placing their orders,
An author sat doing a signing at Borders.
"Get a gift for your husband! Your grandson! Your ex!
It's better than Welch's book! Better than sex!"



Myron M. Picoult



Jodi Picoult

The author, of course, was blatantly lying.
In spite of his hawking, no one was buying.
And Almost Donothing, who'd written the tome,
Was desperately wishing he'd stayed at home.
The longtime CEO had been given a chance
To write out his memoirs...and snag an advance.
(A boon from a publisher took off the onus
Of missing another year's holiday bonus).

Plus, Donothing could nearly imagine the looks
Of his key employees, who'd get autographed books
Instead of a check. Some holiday reading
Beat handouts that might make the budget start bleeding.
But where were the crowds? Where were the fans?
Where were the devotees shaking his hands?
If Grisham could do it, and Clancy, and Turow,
Why couldn't a bestseller come from a CEO?

Well, it didn't matter. He glanced at the clock—
Within minutes he'd have a line stretched 'round the block.
For this morning he'd sent out a blanket e-mail
To every fellow and every female
Who sat on the board or who owed him a debt,
Suggesting that if they had presents to get,
They might try the Borders on 5th Avenue—
"In fact," wrote Donothing, "I'll see you at two."

Sure enough, as the minute hand rounded the hour,
One reluctant fan approached, looking quite sour:
Finn Agle, the new CFO straight from Sweden,
Joined by his assistant, a certain Miss Leading.
"Donothing," he said, his voice falling flat,
"Merry Christmas. *God Jul*. And, surely, congrats."
He picked up the book and started to crack it—
Donothing's face smiled up from the jacket.

"Finn! Great you could come!" boomed Donothing's voice.
The CFO snorted. "Oh. Was there a choice?"
Finn leafed through the pages, face riddled with doubt.
"So tell me," he said. "What's your story about?"
Donothing beamed. "The tough times we've been through...
And how things are starting to shine up brand new.
Pricing's far better than any of us expected—
Terms and conditions have been resurrected!"

Finn Agle smiles. "You must have a predilection
For taking the facts, then, and making them fiction.
Just kidding—this industry's truly improving.
Why, one only has to look at how prices are moving!"
"Ho! Ho! Ho!" a newcomer squeaked behind Finn,
As the chief actuary wormed his way in.
Ken B. Short gave Donothing a pat on the back.
"Almost, it's good to see you in the black."

(Old Reliable Casualty, Ken's former shop,
Had gone belly-up, after a big belly-flop.
Ken had jumped ship before the firm came to a halt,
Although people still thought it was partly his fault.)
Ken began a campaign of intense sucking up:
"This book's gonna be big, boy, I'm telling you. Yup!
This industry's finally on the right track,
Now that we've started to get reserves packed."

"Am I late?" cried a man as he ran through the store,
Juggling cell phone, Palm Pilot and gadgets galore.
Holden DeLine, the chief underwriter,
Arrived after pulling a crazy all-nighter.
(Lest you think that DeLine was toiling too late,
Let's just say that his job wasn't what's on his plate.
Beef tartare, caviar and crepes from Le Cirque,
Plus a hearty Bordeaux—this was Holden's best work.)

"This book's timely," said Holden, "but that's not surprising—
Underwriting standards clearly are rising.
The crazies have largely been forced out of the business...
I can't think of a better present for Christmas!"
Another arrival approached the small cluster
With all the humility that he could muster.
(Which, had there been something to measure it in,
Would pretty much fit on the head of a pin.)

Hailing from Wall Street, and now CIO,
Rich Sly oozed slickness wherever he'd go.
He presented himself as a know-it-all feller,
Though investment performance had been less than stellar.
"Great party! Great signing!" he said with a squeal
(While secretly wishing HE had a book deal).
"If you ask me, investment income is going to grow—
There's a very bright outlook for next year's cash flow.

"Yields have bottomed; the stock market's about to rebound.
The P&C industry's going to gain ground.
Bond investments have been tidied; stock portfolio rearranged...
Analysts looking at this industry will find it changed."
All of a sudden there arose such a clatter,
Everyone looked up to see what was the matter.
On the busy street, traffic had disbanded
In the wake of a helicopter, recently landed.

Hurrying in was Sir Simon Overlord,
The harried and hassled chairman of the board.
"Cheerio," he called out, "now, I've got just a minute—
There's a charity fundraiser that needs me in it.
But Donothing, I had to come by to give you a salute—
On the book, naturally, and on being astute.
We looked death in the face, and by God, we came through it!
I knew all along that this enterprise could do it!"

Donothing gave each of his comrades a look.
It was great that they'd come, but how 'bout the book?
It was one thing to have his co-workers' loyalties...
But, to be frank, what about getting royalties?
"Don't be shy!" he invited. "Who'll be first in line?
Just pick out your copy...I'm happy to sign!"
When the others just glanced around in consternation,
Donothing lifted a book, for illustration.

"I'd like one," said someone, his voice rich and loud.
He stepped forward surely, parting the crowd.
His eyes, how they twinkled; his dimples, how merry!
His cheeks were like roses, his nose like a cherry!
His droll little mouth was drawn up like a bow,
As if there was something Donothing didn't know.
He stepped toward the table so lively and quick,
They all knew, in a moment, it must be St. Nick.

"Your book," Santa said, "why that's truly a feat!
I love a good a tale of intrigue and deceit."
Donothing grew nervous—he couldn't afford
For some fat elf to prove he was really a fraud.
"Why, that's crazy," said Donothing, glancing askew,
"Everything in there's 100% true!"
He glanced at the faces of each acolyte.
"Guys, back me up here! Tell him I'm right!"

They looked at each other. They shuffled their feet.
They tentatively let their eyes meet.
Rich Sly's confidence was the first to flag—
"If I side with him, Santa, will I still get that Jag?"
Santa turned to the bunch. "What a pitiful group.
And Donothing, don't think you're left out of that loop.
You live in a fantasy world," Santa hissed.
"The North Pole's not the only place that doesn't exist.

"Tell me where I might find this fictional firm,"
He said as the others all started to squirm.
"You make it sound like you've come back from the dead,
When, in truth, there's a lot of hard work still ahead."
"The underwriting downturn isn't a mystery—

It was more prolonged and severe than in recent history.
Industry credibility is in retreat,
Due to misstatements on the balance sheet."

Santa turned to the actuary. "You might give some thought
To a name change from *Ken B.* to *Always Short*.
Your loss picks were too low; your reserves remain deficient,
And your financial reinsurance was overproficient."
To Rich Sly he said, "As the CIO, part of your field
Is knowing how hard it is to offset the decline in yields.
You have so much exposure to stocks that you might
Find yourself with a bad case of market frostbite."

Santa wheeled about face and smiled a bit brighter,
At the prospect of chastising the chief underwriter.
"You're one sorry sod. You think you did fine,
But you did a poor job of holdin' the line.
On weak reinsurers, you've made too many bets
That you're bound to wind up with nothing but regrets.
Your talent pool's light, and it's going to take years
To rebuild. Underwriters don't just magically appear."

Santa turned to Finn Agle. "You're not exempt.
Were those fourth-quarter writeoffs something you dreamt?
Your ROE expectations are too high,
And you're capital-constrained...that you can't deny."
Then he rounded on Simon. "You're partly to blame.
You're a board of directors only in name!
You rubber-stamped proposals at each of your sessions
When really you ought to have been asking questions!"

By now Almost Donothing had sunk 'neath the table,
Becoming invisible as best as he was able.
He crept away on hands and knees, only slowing
When he bumped into Santa. "Um, I'll just be going..."
Santa stared at the CEO where he was sprawled.
"And you," he sighed heavily. "You're worst of all.
Growing your way out of this...what were you thinking?
You've got disabled capital. You need to be shrinking.

"Transparency and legitimacy of reporting is fine,
But will increase volatility over time.
The ART market share will continue rising
Especially if you push too hard on pricing.
"And I've heard all of that balderdash
About rating agencies being viewed as being rash,
When, in fact, in time it will be revealed
That they were catching up with what's real."

"Underwriting is just a science—
You can't be all things to all clients.
Sculpting the book of business to your strengths
In the long run makes better sense."
"This year, it seems you have been loath
To balance pricing and strategic growth.
Again, I need to stipulate:
Balance unit growth and rate."

Then, offering a look that was quite eloquent,
And giving a nod, down the aisle he went.
"Donothing, I know you think you and your men
Will somehow be magically bailed out again.
But the tide, well, it's rising, faster than you think.
The water's neck high and you're starting to sink.
And rather than counting on fortune and luck, it
Might be more wise to start grabbing a bucket."

Then his gaze swept the crowd and with one final look
He reached down and picked up one of Donothing's books.
He slapped down some cash in a festive display.
"I've been looking for something to anchor my sleigh."
He carried the book to a bright, polished sled,
Where eight tiny reindeer each lifted a head.
And said the jolly old elf with no equal,
"Let's all just hope that there won't be a sequel."

Myron M. Picoult is an adviser to Lazard Freres & Co. in New York. He is a past president of the Assn. of Insurance & Financial Analysts and a member of the New York Society of Security Analysts. An archive of Mr. Picoult's columns is at www.businessinsurance.com.

Jodi Picoult, his daughter, is the best-selling author of nine novels, including her latest, "Perfect Match." Excerpts from her completed books, as well as her 10th novel in progress, can be viewed at www.jodipicoult.com.

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EMPLOYEE BENEFITS YEAR IN REVIEW

The collage features several overlapping covers of Business Insurance magazine. Key headlines include:

- July 29, 2002:** "As insurers go, so goes CEO compensation / 2", "New rules on blackout warnings Congress passes 401(k) reforms", "Pension funding levels decline", "Corporate governance: From Wall Street to Washington Risk manager oversight is...", "IRS issues guidance on HRAs Ruling expected to boost defined contribution approach", "Mid-sized employers hit hardest by cost hikes / 3", "HMO ruling may lead to ERISA clarification / 3", "Two ratings raise... for job bias claims / 3", "High court... of asbestos... / 2", "Service gaps pose formidable problems... to get on track", "Late News: Ann scraps sale of underwriting unit", "CIGNA", "Wellstone sentiment may spur parity bill vote", "Lloyd's of London reports increase in capital / 19", "You're got no coverage, U.S. court tells AOL / 2", "Business to feel bite of COBRA subsidy", "Congress forges plan to aid workers displaced by trade competition", "Late News: Senate, White House... / 2", "U.S. employers face uncertain liability Asbestos ruling raises questions", "Tobacco firms facing string of legal defeats", "Pa. court addresses nuclear liability issue / 3", "Illinois suing insurer in racketeering case / 3", "IRS, Treasury cash balance But rules threaten othe", "Class action bill backed by regulator", "RIMS seeks broader use of quality measures", "Spotlight: PROPERTY LOSS CONTROL", "TOP PROPERTY LOSS CONTROL SPECIALISTS", "Political risk... may shrink, but...", "Survey predicts more big costs Health care rising unabated", "Backstop details leave questions Buyers face cover decisions", "Late News: Government approves cash balance pay...", "J.S. lawsuits challenge Equitas status, handling", "Patient protection... but...", "Graying of America challenges employers", "THE AGING WORKFORCE PART ONE OF... HEALTH CARE", "Technology offers help on mass torts", "Tornadoes cost insurers \$460 million; PCS