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Could D&O Coverage Have Fueled Credit Crisis?

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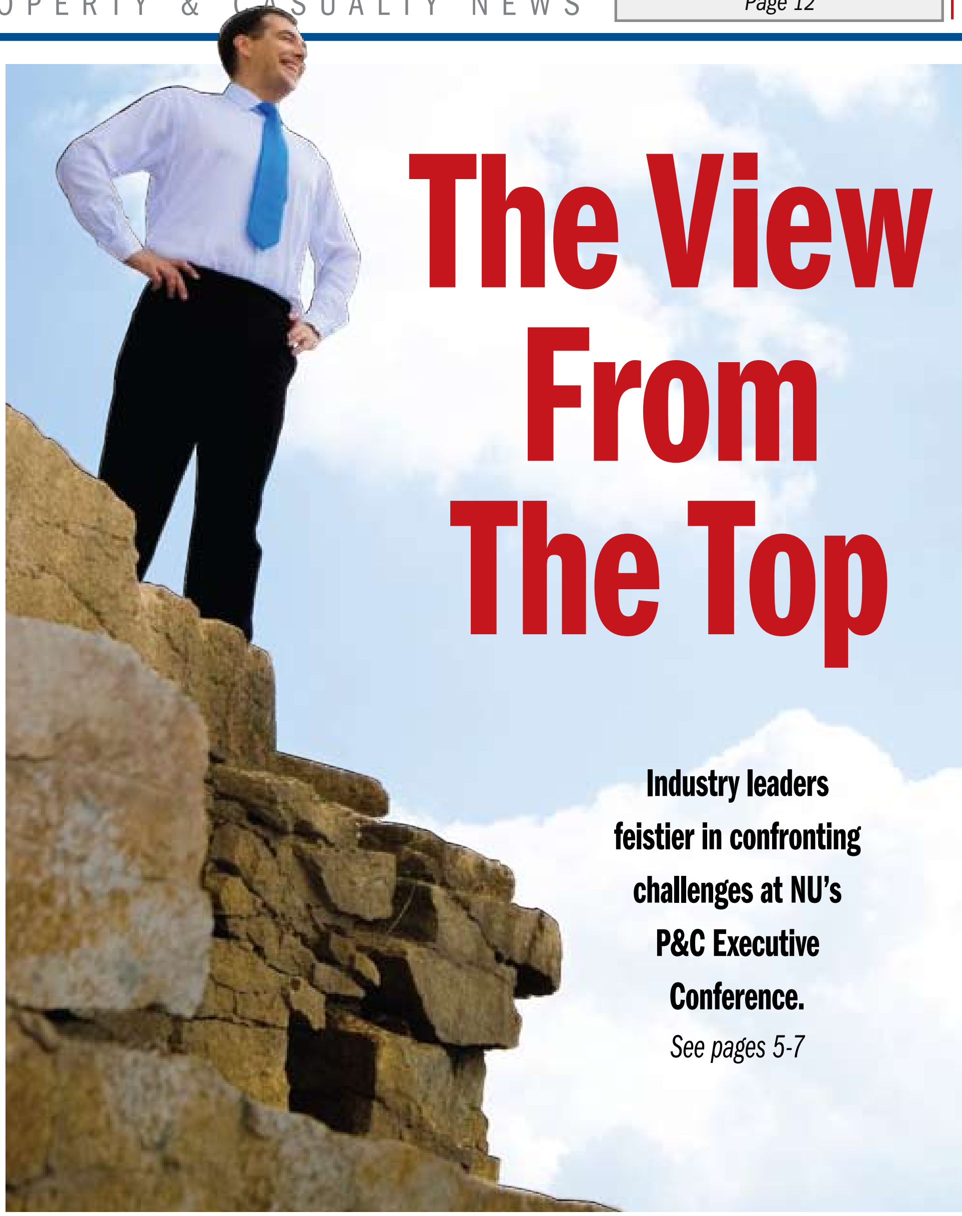

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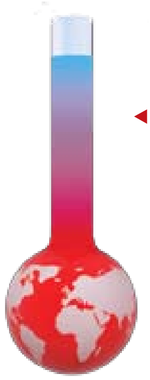

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A VIEW FROM THE PRESS BOX

Ready To Fight Back?

I CAME AWAY FROM OUR ANNUAL P&C Executive Conference impressed by the feistiness of many of the top players speaking, compared to last year's far more introspective and downbeat lot.

Part of that has to do with the times. Last fall's conference took place when the economy was collapsing, and the poster child for reckless investment decisions was American International Group.

Even though AIG's p&c carriers were walled off from the financial guarantee woes forcing their corporate parent to accept massive bailout funds from Uncle Sam, civilians—those in the general public outside the insurance industry—heard those three magic letters, and thanks to very effective branding, thought immediately of insurance.

That lingering misconception haunts the industry to this day, as Congress keeps treating all financial entities alike, even though it was banks and investment firms, not p&c insurers, that got us into this mess.

But last fall, with everyone licking their wounds and running scared, the industry's leading figures did not put up too much of a fight. As usual during a crisis, p&c insurers retreated into their shells, waiting for the furious public and their panicked political representatives to stop pounding them so they could crawl away once the coast was clear.

But Mike McGavick, CEO of XL Capital, wasn't having any of that humble pie as he led off this year's P&C Executive Conference—put together by The National Underwriter Company, working with sponsors Ernst & Young and Genpact.

Mr. McGavick said not only were p&c carriers not to blame for the financial crisis, but that the sound way this industry was regulated by the states should provide lessons to the federal government as Congress struggles to get a grip on so-called systemic risks.

You may comment on this column on Sam's Nov. 16 blog entry at **www.NUSamSoapbox.com.** You may also follow Sam on Twitter at **http://twitter.com/NUSam.**

Mr. McGavick urged his fellow p&c insurer executives not to "hide behind your trade associations," and step up to testify before Congress to tout the industry's soundness and the fine example it set, while all other financial sectors were going you-know-where in a hand basket!

Robert Hartwig, the Insurance Information Institute's president and top-notch economist, warned carriers that if they were complacent about activities in Washington, not only might they be "swept in" to any new federal regulatory schemes designed to police much different breeds of cat in the financial sector, but that long-established tort reforms could be eroded as well.

Last but not least, near the end of a one-on-one interview I did on stage, Chartis CFO Robert Schimek was also taking no guff when I asked for his reaction to gripes from competitors that AIG's rebranded commercial insurers had underpriced them to try to make up for reputational challenges following credit default swap woes at AIG's Financial Products unit.

He pretty much told these critics to stuff it, insisting that such charges were not only baseless, but were sour grapes by those who had hoped and expected AIG's carriers to just fade into the sunset.

All in all, I felt a far more positive attitude at this conference than last year's. Even a stubborn soft market, tanking economy and lousy investment environment do not seem to have dampened optimism about the future of this business. It was quite a refreshing change of pace!

The p&c industry has the facts—and history—on its side. They have run the gauntlet in this economic meltdown and lived to tell the tale. They should refuse to take any abuse from anybody who dares to suggest otherwise.

Sam Friedman
Editor In Chief

THE NEWS

THE VIEW FROM THE TOP

McGavick Urges Fellow P&C Leaders To Speak Up In D.C. To Defend Industry

Congress can learn lessons from insurers in how to improve regulation, says XL CEO

BY PHIL GUSMAN
New York City

INSURERS WHO BELIEVE IN American-style capitalism have to rally behind the free market to head off a government overreaction in regulating the economy in general, and property and casualty insurance in particular, warned Michael McGavick, chief executive officer of XL Capital.

"Give voice to the benefits of the free enterprise system that allows us to succeed, before it is too late," he said.

Mr. McGavick urged industry leaders to "stop hiding behind your trade associations" and step up to take part in the "profound debate" about the federal government's role in protecting against reckless economic activities, especially because p&c insurers did not engage in any such behavior.

"The simple truth is we're the ones who managed well through this crisis," he said. "Why not apply our lessons to banks?"

He told a meeting of executives here that industry representatives need to recommend their own corporate governance proposals, based in part on the successful p&c model, and should start with guarantees of real transparency and clarity.

Mr. McGavick's remarks came here at The National Underwriter Company's 21st Annual Executive Conference for the Property and Casualty Industry, sponsored by Ernst & Young and Genpact.

Mr. McGavick said the free enterprise system dominated in America until this global economic crisis hit. Now, he warned, there is "deep doubt" about whether the country's style of capitalism can endure.

Mr. McGavick cited five principles that he said CEOs should use to guide their companies in general, and through the economic crisis specifically:

- A narrow focus on an organization's strengths.
- Direct accountability and public action for mistakes made.

"The simple truth is we're the ones who managed well through this crisis. Why not apply our lessons to banks?"

Michael McGavick, CEO, XL Capital

- Acting every day "like you only get one bite at the apple."
- Investing in the future.
- Communicating effectively.

Mr. McGavick said those lawmakers now proposing big-government solutions have been planning them for 29 years, and they are not wasting any time moving forward with their agenda now that the free enterprise system is in disarray.

The p&c insurance industry, by contrast, is pushing no plan and is lacking focus in the debate, Mr. McGavick charged.

On accountability, he said the government has effectively forced the free enterprise system to take "an enormous amount of medicine." The insurance industry in particular, he added, is being threatened by proposals in Washington, but is not acting like its future is at risk.

Instead, he said, the p&c industry is trying to act like this is not their fight because they did not cause the financial problems that crippled the economy.

But the industry should be getting

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Chartis CFO Says Competitors Griping About Price Guilty Of Sour Grapes

BY PHIL GUSMAN
New York City

A TOP EXECUTIVE OF CHARTIS, the rebranded property and casualty carrier of American International Group, says any lingering accusations by competitors about alleged underpricing to counteract AIG's damaged reputation are bogus and simply sour grapes.

The comments from Robert Schimek, chief financial officer of Chartis, came near the end of an appearance here at The National Underwriter Company's 21st Annual Executive Conference for the Property and Casualty Industry, sponsored by Ernst & Young and Genpact.

Mr. Schimek said Chartis—formerly AIU Holdings, encompassing the domestic and foreign p&c business units of AIG—puts a strong focus on underwriting and affirmed that the carrier is walking away from business that it believes is underpriced, particularly in workers' compensation.

"They expected us to just disappear, and we have certainly not done anything of the kind."

Robert Schimek, CFO, Chartis

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SHOPPING SPREE?

Marsh Begins Buying Independent Agencies

CEO Duperreault says more acquisitions might be concluded by end of the year

BY PHIL GUSMAN
NEW YORK CITY

A DAY AFTER ANNOUNCING THE acquisition of Texas independent agency Insurance Alliance, the head of Marsh & McLennan Companies said the firm could announce the purchase of several additional agencies by year's end, with more coming in 2010 as part of the firm's strategy to target more middle-market business.

MMC announced the establishment of its Marsh & McLennan Agency subsidiary in October 2008, saying it planned to make it one of the premiere insurance agency networks in the United States--offering commercial property and casualty, personal lines and employee benefits to client across the country.

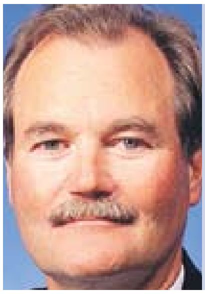
MMC President and Chief Executive Officer Brian Duperreault said he has been encouraged by the quality of agencies his company has approached about a possible acquisition, but he noted that courting the targeted agencies has taken some time.

Mr. Duperreault spoke about the MMC agency initiative and the state of the market in a live interview with *NU* Editor Sam Friedman during The National Underwriter Company's 21st Annual Executive Conference for the Property and Casualty Industry, sponsored by Ernst & Young and Genpact.

Explaining MMC's agency initiative, Mr. Duperreault said it was determined that global broker Marsh was not as effective as it could be in the smaller-account space. The brokerage had tried to penetrate that client base, he said, but using the same approach it applied to large, national and international accounts was not working.

The brokerage decided to establish a culture and approach separate from Marsh to be successful in this space, and came up with a plan to acquire high-quality regional agencies, Mr. Duperreault said.

When Mr. Friedman asked why it has taken so long between announcing MMC's new strategy and acquiring its first agency, Mr. Duperreault explained the due diligence



MMC President Brian Duperreault has been encouraged by the quality of agencies approached about a possible acquisition, but said courting the targeted agencies has taken some time.

process is extensive, and while the inclination is to move more quickly, some agencies are not necessarily inclined to sell right away, and so courting them takes time.

This year's economic struggles have actually helped, rather than hurt Marsh's efforts in acquiring agencies, according to Mr. Duperreault, who said that while the mergers and acquisition market is still competitive, some who would normally be interested in acquiring agencies—such as banks and private equity firms—have disappeared or retrenched amidst the recession. On the other hand, he added, times of crisis could push agency owners to consider a sale.

The first agency acquired--Insurance Alliance—was described by MMC as one of the largest independent insurance agencies in Texas. Terms of the deal were not disclosed.

Houston-based Insurance Alliance has annual revenue of $15 million and serves over 1,500 commercial clients located primarily in Texas and throughout the South-

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Hartwig Says Health Care Bill May Be 'Trial Lawyer's Dream'

BY PHIL GUSMAN
NEW YORK CITY

THE HOUSE HEALTH CARE REFORM bill is a "trial lawyer's dream" that could have some degree of a "spill-over effect" on the property and casualty industry, according to Insurance Information Institute President Robert P. Hartwig.

"**What happens this year** and next in Congress will affect you throughout your insurance careers, and perhaps those of your children and grandchildren as well."

Robert P. Hartwig, President
Insurance Information Institute

Indeed, he said the industry is locked in an "era of no tort reform" that began in 2006, warning that a tort crisis could be on the horizon by 2012-2014.

He also said regulatory reform in financial services could dramatically change how insurers are overseen by the federal government, even though p&c carriers came out of the financial crisis in excellent shape.

"What happens this year and next in Congress will affect you throughout your insurance careers and perhaps those of your children and grandchildren as well," he said.

Mr. Hartwig delivered his take on the challenges ahead for the industry during a

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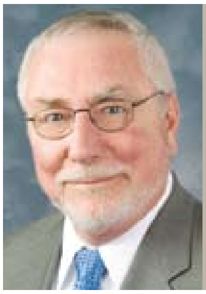
WASHINGTON UPDATE

NAIC Gets Fed Insurance Office Revised

House bill gives state regulators more say, while limiting Washington's authority

BY ARTHUR D. POSTAL
WASHINGTON

THE NATIONAL ASSOCIATION OF Insurance Commissioners has won significant changes to legislation creating a Federal Insurance Office, giving state regulators more say in its operations.



> **"While the NAIC continues to oppose** a federal functional regulator for insurance or misguided attempts to further empower the FIO, the bill as currently drafted is an appropriately narrow and targeted improvement to our system of supervision."
>
> *NAIC President Roger Sevigny*

The new language is contained in a manager's amendment to the bill agreed to last week. It would require the new agency to closely coordinate with state regulators, and would give Congress and the courts the authority to further limit the agency's authority in insurance matters.

The changes in the Federal Insurance Office Act of 2009 were agreed to by the leadership of the House Financial Services Committee.

The bill was scheduled to be marked up late last week by the committee, but insurance industry sources said that after some parties objected, committee officials agreed to delay drafting activity until after the Thanksgiving holiday.

The proposed NAIC alterations to the legislation apparently upset supporters of a stronger federal role in regulation of insurance. These include the American Insurance Association, the Reinsurance Association of America, the American Council of Life Insurers and the Financial Services Roundtable.

The changes the NAIC negotiated in the bill would:

- Mandate closer cooperation between the states and the FIO on narrow international agreements.
- Ensure that international agreements don't preempt state prudential regulation of U.S. insurers.
- Limit the scope of agreements to recognizing a level of supervision consistent with state protections.
- Add congressional involvement and consultation.
- Add judicial review on preemptive determinations made by the proposed agency.
- Reassert state authority to regulate the "business of insurance."

"The recent amendments strike an appropriate balance among the needs of consumers, state regulators and federal negotiators, by preserving important state and market regulation while allowing for agreements with equivalent regulatory systems," said NAIC President Roger Sevigny.

"While the NAIC continues to oppose a federal functional regulator for insurance or misguided attempts to further empower the FIO, the bill as currently drafted is an appropriately narrow and targeted improvement to our system of supervision," added Mr. Sevigny, who is New Hampshire's insurance commissioner.

SYSTEMIC RISK

In other federal regulatory news, property and casualty as well as life insurers have written lawmakers objecting to lan-

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PUBLIC OPTION SURVIVES

Senate Health Care Reform Bill May Yet Revoke Antitrust Shield

BY ARTHUR D. POSTAL
WASHINGTON

HEALTH CARE REFORM legislation unveiled by the Senate Democratic leadership last week includes a "public plan" that states could reject, but raises some concerns about preserving the ability of insurance agents to sell all types of coverage offered under the new system.

At the same time, however, it does not contain any language giving the Federal Trade Commission authority to oversee or even write reports about the insurance industry, either limited to the health care industry or to all insurers. There is also no language limiting the antitrust exemption now accorded to health and medical malpractice carriers under the McCarran-Ferguson Act.

Legislation passed earlier this month by the House contains both provisions.

However, an amendment that would repeal the antitrust exemption for health and medical malpractice insurers is expected to be introduced during debate on the Senate floor. The amendment will be the language contained in S. 1681, which was reported out last month by the Senate Judiciary Committee. The bill has 16 cosponsors.

Of key interest to agents is that the legislation would require the Department of Health and Human Services to establish an advisory board that would have to include "individuals and entities with experience in facilitating enrollment in qualified health plans" to assist the agency in clarifying the requirements for the state exchanges set up for consumers to shop for coverage.

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PLUS CONFERENCE REPORT

Did D&O Coverage Fuel The Credit Crisis?

Legal experts point to executive pay, absence of regulation as the main culprits

BY SUSANNE SCLAFANE
CHICAGO

DID THE AVAILABILITY OF directors and officers liability insurance products contribute to the credit crisis fueled by investment firms that securitized subprime mortgages and other debt obligations?

Richard Bortnick, a coverage attorney for Cozen O'Connor in West Conshohocken, Pa., posed the question to an insurance company executive during the annual meeting of an association of professional liability underwriters and litigators last week.

During a session of the international conference of the Minneapolis-based Professional Liability Underwriting Society--which covered hot-button D&O issues ranging from executive compensation to global warming--Mr. Bortnick specifically asked whether the availability of insurance provides "an incentive for executives to maybe not entirely play by the rules."

Addressing his question to a fellow panelist--Steven White, vice president of executive assurance claims for Arch Insurance Company in New York--Mr. Bortnick reasoned that "the perception of insurance is moving more towards a financial guaranty product."

"It's not, but directors and officers are looking at it that way [as a guaranty]," Mr. Bortnick suggested, basing his assessment on conversations he said he has had with insurance brokers and policyholder advocates.

Mr. White responded that "there are moral hazards with any insurance product and D&O [insurance] is no different."

Mr. White said he believes, however, that the capacity to completely cover both settlement (or judgment) dollars and defense bills for lawsuits arising from "what is alleged to have happened in some of these incredible financial meltdowns" actually isn't available from the insurance marketplace.

"You're not thinking about your insurance when you start to go down that path" of reckless behavior, Mr. White asserted. "At best, with the way defense costs are, your insurance tower probably is going to get you a defense, but it's not going to protect you to the extent that you're going to want to take those kinds of risks."

The exchange followed a discussion by legal and corporate governance experts about the roles that executive-pay practices, shareholder pressures, and board and regulatory lapses have played in fueling the credit crisis.

After one governance expert--Gary Brown, a lawyer for Baker, Donelson, Bearman, Caldwell & Berkowitz in Washington--gave advice on how directors can stay out of trouble with some common-sense practices, Mr. White jumped in to give what he himself described as a "shameless plug" for two specialized D&O products—Side A policies and independent director liability policies.

These products cover non-indemnifiable D&O losses, providing separate towers of limits for separately identified groups of in-

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PLUS CONFERENCE REPORT

Global Warming Regulations Likely To Spark D&O Claims

BY SUSANNE SCLAFANE
CHICAGO

A LACK OF REGULATION IS contributing to a crisis that will ultimately spill over into the directors and officer liability world—global warming, predicts a leading plaintiff attorney.

Mark Lebovitch, a plaintiffs' lawyer for Bernstein Litowitz Berger & Grossmann LLP in New York, made that connection during a panel discussion here during the international conference of the Professional Liability Underwriting Society.

Kicking off that discussion was Richard Bortnick, a coverage attorney for Cozen O'Connor in West Conshohocken, Pa., who was introduced as an expert in climate legal issues. Last year, he said, 76 percent of companies made no climate change disclosures at all in their annual 10-K filings with the SEC, because there have not been laws on the books requiring them to.

He presented a list of proposed bills and regulations that will impose such disclosure requirements in the future. Once disclosures start, lawsuits will follow alleging bad or incomplete disclosures, he warned.

Ric Marshall, chief analyst for The Corporate Library, a Portland, Me., firm that analyzes corporate governance practices, predicted that as soon as standards are put in place, "a bit of a Black Swan" will emerge.

"One day it's not an issue, the next day it [will be] an issue for everyone," he said, noting that disclosures won't just impact corporations involved in transportation, utilities, and oil and gas industries, but will affect companies that invest in greenhouse-gas-producing firms.

Mr. Lebovitch agreed that environmental disclosure cases "will come to the forefront" in the future, adding that "it wouldn't be a bad thing if there was enough liability to create incentives for companies to do...things that are environmentally friendly." He suggested that lawsuits can "provide a service" if threats of liability put an end to what he called "efficient breaches" of polluters' environmental responsibilities.

"They know exactly what it would take to cure their problems in their factories," but because there are caps on their liabilities, they won't spend millions to do so, he said. "They're able to make more money by sticking with completely outdated technologies... because they're not going to be punished for ignoring their responsibilities."

He added that "part of that problem is the insurers continue to pay the defendants' legal fees," adding that "I think...there are ways [for insurers] to keep the litigation under control and do a good thing for the world." NU


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Pollution Risk At Elder Care Facilities Pose

Frail population creates 'hot zone' of potential injury and liability exposures

BY JOHN BUTLER

ONE OF THE FEW GROWTH AREAS of the economy is the elder care industry. Driven by the rapidly expanding senior population in the United States, profit and nonprofit elder care organizations are racing to keep up with the demand for new or expanded nursing homes, assisted and independent living facilities, adult daycare and dementia centers, and rehabilitation centers.

Among the thousands of insurance professionals across the country providing insurance programs covering the unique risks of these organizations and their operations, few have recognized the potential financial impact to their elder care facility clients of failing to insure pollution risk and exposures.

Although there are several reasons for this oversight, the most common is simply failing to recognize pollution as a risk management issue to elder care facilities.

Pollution risk is traditionally perceived as a problem faced by industrial companies that use or generate hazardous materials that could contaminate soil and water resources and potentially injure surrounding populations.

But elder care facilities can present an even greater risk and loss exposure to their owners than a manufacturing plant, refinery or waste disposal site that is closely monitored through a loss control program.

Elder care facilities face some of the most dangerous pollution risks of any industry. Their environmental risk profile is much higher because of their full-time occupancy of a fragile population, which completely changes all the rules that apply to other commercial facilities.

The compromised health conditions of the residents that live in these facilities create a "hot zone" where a pollution condition could result in serious injury or death.

To most of the population, pollution conditions such as mold, bacterial outbreaks and viral contamination are little more than an annoyance, whereas they are potentially devastating to elderly residents.

If these conditions result from facility-based causes, such as Legionnaires disease outbreaks from HVAC systems, mold conditions or improper handling of medical waste, the organization in question could potentially face catastrophic exposure to substantial bodily injury claims, including the much-feared class action lawsuit.

In a less dramatic but equally expensive fashion, the fragile resident population could also be physically impacted by conditions not often thought of as pollution: fumes from freshly applied paint, petroleum-based materials in carpeting and furnishings, and properly applied pesticides and herbicides.

Outside air pollution sources, such as industrial and vehicle emissions from loading docks, dumpsters, unsanitary debris or building exhausts near air intakes all present serious everyday risks to these residents.

An intangible but important factor that should be considered when assessing the elder care pollution risk is the greater awareness of environmental issues by newer generations.

Baby boomers and their families have experienced the evolution of environmental issues from Superfund, the Exxon Valdez oil spill, asbestos litigation, toxic mold and even anthrax attacks. Because of these events, they understand there is legal recourse if they are affected by pollution incidents.

RAISING AWARENESS

The understanding of environmental risk and insurance has continued to evolve among a growing variety of industry sec-

Real, But Underappreciated Threat

▶ **EVEN CONDITIONS NOT OFTEN** considered as pollution, such as fumes from freshly applied paint, can put fragile resident populations at risk.

tors as risk managers and administrators become more aware of the risk factors that could affect their organizations.

Over the past couple of years, a significant part of this awareness includes the fact that the absolute pollution exclusion contained throughout their standard insurance program took away any chance of recovering financial losses caused by environmental incidents.

One industry that really understands the benefits of specialty environmental insurance as a risk management tool is real estate. Owners of every type of commercial and large residential property have recognized that their exposures to environmental loss, with particular emphasis on indoor air pollution incidents, has produced large judgments and legal expense arising from alleged or real injury and even death to individuals working, visiting and living in their facilities.

From an insurance perspective, the critical lesson this industry learned is that claims resulting from the indoor environment are as much a pollution incident as a leaking oil tank or chemical spill.

Agents are challenged to place an environmental insurance policy for any type of client, but making certain an elder care organization has proper coverage proves much more difficult. Environmental insurers will consider insuring pollution risks involving most industry sectors, but when faced with providing coverage for elder care facilities, they generally take a very conservative underwriting approach.

In view of the magnified risk factors, these policy proposals can be severely limited as to the types of pollution conditions that are covered, with bacterial, mold and viral contamination often, if not always, excluded.

High deductibles and premium cost can also occur with endorsements limiting or eliminating critical coverage such as first party clean-up of pollution conditions and business interruption.

The agent with an elder care facility client should rely on a specialty broker who is not only knowledgeable in environmental risk, but also able to specifically accommodate the unique challenges of this industry.

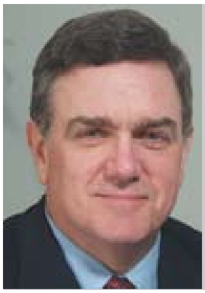
The conversation an insurance agent never wants to have with a client is one that informs them that there is no coverage available to cover the claim they have just filed or for the damage to their facility.

Pollution-based incidents are one of the most common topics of those conversations, and being unprepared—not having the appropriate environmental coverage solution—could be both the client's and agent's worst nightmare.

A common example is when the discovery of a serious mold condition causes the insured to face a big clean-up and some bodily injury allegations.

The coverage questions will confront the agent in rapid-fire style: Is there a mold exclusion? Does the property policy pay for cleaning up mold? Is there coverage for repairing building damage caused by the mold cleanup? Is mold actually pollution?

The answers will vary from policy to policy, adjuster to adjuster and perhaps lawyer to lawyer, but one thing remains constant—clients want their insurance professionals to make certain their claims are paid.



"**To most people, pollution conditions** such as mold, bacterial outbreaks and viral contamination are little more than an annoyance, but they are potentially devastating to residents of elder care facilities."

John Butler

Introducing environmental risk and insurance to a client is difficult for most agents simply because they don't know that much about it. The easiest way for the agent to assess the pollution risk of their elder care account is to explore with the client the types of incidents

▶ *continued on page 21*

UNSOLVED MYSTERY

Chinese Drywall Study Finds No Solid Link To Health Damage, Fed Agency Says

Waiting game for concerned insurers, homeowners, as exposure studies continue

BY PHIL GUSMAN

A FEDERAL REPORT ON Chinese drywall found the building material contains higher concentrations of bothersome chemicals, but said these would not cause the health issues or physical degradation of property that have been seen.

Lori Saltzman, director, Division of Health Sciences, Office of Hazard Identification and Reduction at the U.S. Consumer Product Safety Commission (CPSC), said elevated levels of strontium that were found do not pose a radiation safety risk to individuals and homes.

James E. Woolford, director, Office of Superfund Remediation & Technology Innovation (OSRTI), Office of Solid Waste and Emergency Response, U.S. Environmental Protection Agency, said sampling data analyzed does not indicate substantive levels of sulfur or strontium that were both found would lead to health issues.

▶ **STUDIES ARE ONGOING** as the government tries to get to the bottom of a "very perplexing problem" that some say has caused dry cough, eye irritation, sore throat and asthma exacerbation.

Mr. Woolford added that an indoor air study found detectable concentrations of two known irritant compounds, acetaldehyde and formaldehyde. He noted, however, that these compounds were detected in homes both with and without Chinese drywall, and that the levels of formaldehyde were not unusual for new homes.

Studies are ongoing as the government tries to get to the bottom of a problem that has—according to Michael McGeehin, director, Division of Environmental Hazards & Health Effects, National Center for Environmental Health, Centers for Disease Control and Prevention—caused dry cough, eye irritation, sore throat and asthma exacerbation. He called the issue a "very perplexing problem."

While federal agency representatives said "all options are on the table" with respect to a response, they noted that actions such as a recall could require legal action, and the government wants to make sure it has proper scientific justification for such a measure.

Studies will continue and more results are expected next month.

From an insurance standpoint, a representative from Citizens Property Insurance Corporation, the state-created insurer of last resort in Florida, said 24 claims related to Chinese drywall have been individually inspected, and none have resulted in payment.

John Kuczwanski, public information manager for Citizens, said an exclusion for builder's defects and a pollution exclusion are standard for most homeowners policies. The report from the government stating nothing conclusive at this point further substantiates denials for Chinese drywall claims, he added.

Michael Barry, spokesperson for the Insurance Information Institute, confirmed that for homeowners, the policies generally exclude losses that would be associated with Chinese drywall. He said it is considered defective work or inadequate construction materials.

Homeowners could go back to the builder for recourse, and the builder would likely turn to the manufacturer, he said.

Lennar Corporation, a home building company headquartered in Miami, stated in its most recent 10-Q SEC filing, "As of Aug. 31, 2009, the Company identified approximately 500 homes delivered in Florida primarily during its 2006 and 2007 fiscal years that are confirmed to have defective Chinese drywall and resulting damage."

The company said it has accrued $54.5 million of warranty reserves, which include amounts related to homes identified as having defective Chinese drywall as well as an estimate for homes not yet inspected that may contain Chinese drywall.

Indicating that commercial insurers could see claims related to Chinese drywall, Lennar said in the filing, "The Company has a $33.6 million receivable for covered damages under its insurance coverage relative to the cost it expects to incur in remedying the homes confirmed and estimated to have defective Chinese drywall and resulting damage."

Lennar listed its insurers as one party from which it will seek reimbursement.

David Golden, director of commercial lines for the Property Casualty Insurers Association of America, speaking to the scope of this issue for insurers and answering the dreaded question of whether it could be the "next asbestos," said Chinese drywall is a "limited universe."

He explained, "You're talking primarily about three years of construction, heavily concentrated in fairly few states." He cited Florida, Louisiana and to a lesser extent Virginia as the areas that are seeing the highest concentration.

Mr. Golden also pointed to a "small reference" that CPSC made about identifying hundreds of thousands of sheets of drywall in storage. If many sheets are still in storage, he said, it could reduce the number of affected homes, as estimates are based on the number of sheets believed to have been imported and used.

"It's not the next asbestos," Mr. Golden said. "The next asbestos is always asbestos."

Looking to possible future exposures, while the federal agency representatives said during their press conference that there has not been a ban on the import of Chinese drywall, it is not being used in current construction projects.

Chinese drywall is "not the next asbestos," says PCI's David Golden.

Mr. Golden explained that the original motivation for using Chinese drywall was due to a shortage of domestic drywall because of a building boom and reconstruction efforts in the wake of active hurricane seasons in 2004 and 2005. "All of a sudden you had an actual shortage of drywall," he said.

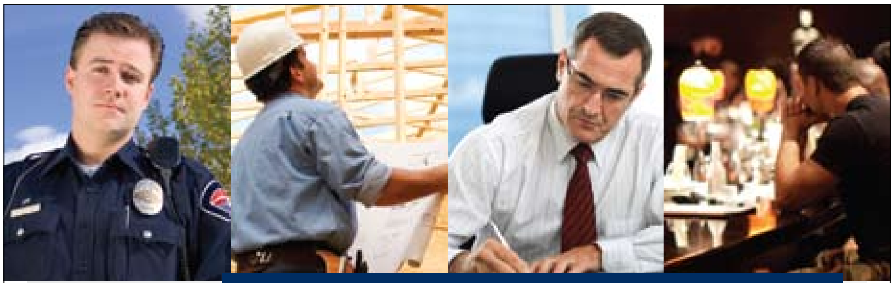
It then became economically feasible to import drywall all the way from China, he said. Today, he noted, "you have a building industry that is markedly reduced in terms of the number of buildings going up, and also we haven't had the storm damage the last year or so. There is no shortage of drywall."

Ultimately, for insurers, it will take time to get all of the facts and get answers, Mr. Golden said. "The commercial insurers, at least liability insurers, are going to have to deal with these claims as they come up," he said, noting that it is still very early in the litigation cycle for Chinese drywall issues. "It will be a number of years" before litigation around the issue sorts itself out, he said.

For homeowners, it is also a waiting game. "You're suddenly dealing with what amounts to a mystery," Mr. Golden said. There are reports of odors and adverse physical symptoms, he said, and there seems to be a correlation to Chinese drywall. But he noted there are no answers yet, and people should not jump to conclusions.

He said at some point during the summer, published reports came out that there were a couple of fires in homes with Chinese drywall, and news accounts made it seem as if the Chinese drywall caused the fires. But further investigation revealed the causes of the fires had nothing to do with the drywall.

The scientific research to determine if it is a problem with the drywall itself, or the drywall in combination with other factors, will take some time, Mr. Golden said. NU



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EMERGING RISKS

Are Drywall, Silt & Green Building The Next Environmental Liability Landmines?

Dozens of drywall suits have already been filed in jurisdictions around the country

BY ADRIEN T. ROBINSON

IF AN UNDERWRITER stoppeD by the office a few years ago and proposed that drywall leads to significant pollution liabilities, you probably would have laughed. Yet it turns out that drywall—pulverized limestone sandwiched between paper—isn't as innocuous as one would assume.

While all limestone contains sulphur, for reasons unknown, the sulphur levels in the now infamous Chinese drywall are significantly higher—so much so that, when moisture hits the sulfur-rich drywall, sulphuric gases are emitted.

The results are claims of failing electrical and plumbing systems, the foul odor of hydrogen sulphide, and emerging concerns over adverse health effects.

Dozens of lawsuits have been filed in various jurisdictions around the country against those who handled defective drywall, and the number is likely to grow.

In a July 8 report, the U.S. Consumer Product Safety Commission noted that defective Chinese drywall has so far been reported in 21 states and Washington, D.C., with most reports coming from Florida, Louisiana and Virginia. (For a recent report about the effects Chinese drywall from the CPSC, see related article, page 14.)

What many believe will follow is some of the most complicated and expensive litigation involving products pollution in the past decade. Factors complicating this litigation include the difficulty of suing foreign manufacturers and the reoccurring question of whether sulphuric gases are "pollutants" as defined in typical commercial general liability insurance policies. These gases are indeed likely to be treated as "pollutants" and, in many cases, subject to the pollution exclusion common in most CGL policies today.

▶ **GOVERNMENT REGULATION OF SILT** runoff from construction sites isn't new, but stepped up enforcement practices in recent years are putting the risk on the radar screen of those who watch out for emerging environmental liability landmines.

"...[T]he most prudent course of action is to include robust environmental decision-making in corporate risk management practices now, before the next environmental issue explodes."

Adrien T. Robinson

Environmental liability isn't new.

MTBE (methyl tertiary butyl ether), a gasoline additive, enables cleaner combustion and lower emissions. Widespread usage began in 1980. But by 2000, many concerns arose over adverse effects on the nation's water supplies.

Just as the use of MTBE was phasing out, toxic mold exploded onto the scene in 2003. A jury in the case of *Ballard v. Fire Insurance Exchange* (part of the Farmers Insurance Group) initially awarded the Ballard family $32 million, including punitive damages, mental anguish and lawyers' fees. Thousands of lawsuits alleging various damages and ailments from toxic mold have followed.

So what are the next potential environmental landmines?

While it's impossible to predict, several issues have been smoldering over the past few years, including silt runoff from construction sites, green construction and evolving environmental regulations.

SILT REGULATION

Environmental regulators recently have focused on silt runoff from construction sites. When rain washes exposed soil at construction sites downstream, sedimentation, or silt, may pollute the receiving waters.

Silt runoff has been regulated under the Clean Water Act since 1987, and subject to National Pollutant Discharge Elimination System (NPDES) permissions since 1991. Until recently, enforcement of these regulations was lacking. In 2008, however, U.S. EPA announced a $4.3 million settlement against four home builders for the discharge of silt at construction sites.

Many states have followed the EPA's lead. In Minnesota, nearly 100 enforcement actions and $700,000 in penalties related to stormwater controls at construction sites were levied between 2007 and 2009.

Regulatory scrutiny hasn't been limited to contractors. Home Depot was fined in excess of $1 million for silt runoff from sites where new stores were being constructed. And while these penalties are no small potatoes, defining sedimentation as a "pollutant" creates perhaps the most drastic ramifications from an insurance coverage standpoint. Claims concerning pollutants are likely to fit squarely in crosshairs of the pollution exclusion in most CGL policies.

GOING GREEN

Like MTBE, green construction techniques were designed with environmental stewardship in mind. With promises of reducing impacts to the environment, creating healthier spaces for building occupants and lowering building energy costs, green construction is rapidly building steam around the county.

But while green construction may be admirable, it doesn't necessarily equate to lower liability for those engaged in the process. New construction techniques carry a higher risk of unforeseen liabilities. For example, the placement of gardens on rooftops may lead to water penetration into the building envelope, causing toxic mold.

Many industry observers also believe that some of the green building techniques begin to blur the line between traditional professional activities and purely contracting operations. Such was the case in *Shaw Development v. Southern Builders*, where an owner alleged hundreds of thousands of dollars in lost tax credits as damages against the contractors resulting from not achieving green certification on time.

Shaw since has been dubbed the "first green building litigation." However, neither professional services nor economic damages are typically covered under many contractors' CGL policies.

MORE TO COME

Other emerging issues deserving mention include potential new regulations surrounding "e-waste" (discarded electronic equipment), nanotechnology

▸ *continued on page 19*

▸ **Adrien T. Robinson**, J.D., P.E., is the environmental practice leader for The Navigators Group Inc., an international specialty insurance company headquartered in New York. Mr. Robinson has more than 14 years of experience in the environmental industry, is licensed in Illinois as a professional engineer and is admitted to the Illinois Bar. He may be reached at ARobinson@navg.com.

BIG VERDICT

Exxon Mobil Hit With $105M Damage Award For New York Pollution

BY DANIEL HAYS

A FEDERAL JURY IN MANHATTAN, after an 11-week trial, found Exxon Mobil liable for a $105 million in damages for contaminating part of the New York City well water supply.

The panel found the oil company had caused contamination with the gasoline additive methyl tertiary butyl ether, or MTBE, in six drinking water wells in the borough of Queens and awarded costs for removing MTBE from those locations.

An Exxon Mobil spokesperson, Kevin Allexon, said the company would not discuss details of its insurance coverage.

He e-mailed a statement saying the company is "disappointed with this decision and will be considering all our legal options. As we've maintained throughout, our service stations were not the source of the MTBE contamination at the Station 6 wells and the city's own principal expert identified three non-Exxon Mobil sources. We do not believe we should be required to compensate the City of New York for someone else's contamination.

New York City Law Department's Corporation Counsel's office said the jury found Exxon liable for product liability for failure to warn people about the dangerous nature of its product as well as trespass, public nuisance and negligence.

The law department in a statement noted that several of the nation's largest oil companies—including Shell, BP,

▸ *continued on page 19*

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Global Warming Coverage Required By Gassy Businesses, Legal Expert Warns

BY DANIEL HAYS

BUSINESSES EMITTING greenhouse gases that cause global warming face imminent liability problems, and they should secure insurance coverage to protect themselves, a legal expert is warning.

Insurance recovery attorney John G. Nevius gave that advice in a statement issued by his firm, which noted that three recent federal court decisions during a seven-day period last month have split two-to-one over the viability of suits seeking damages arising out of greenhouse gas emissions and global warming impacts.

"The proliferation of such suits will lead to further disputes over the duty to defend them," said Mr. Nevius, a shareholder in the New York office of Anderson Kill & Olick. "The different federal outcomes and the continuing uncertainty over the viability of GHG-related suits lend support to the argument that existing pollution exclusions cannot be said to definitively preclude all insurance coverage."

Mr. Nevius, who has no direct involvement in the litigation, cited a ruling Monday, Oct. 16 by the 5th U.S. Circuit Court of Appeals in New Orleans, allowing a class-action Hurricane Katrina damage lawsuit, filed by 14 Mississippi property owners, to proceed against coal, oil and chemical companies.

Their complaint argues that plant operations emitted greenhouse gasses that contributed to global warming and rising sea levels that heightened hurricane damage.

The 5th U.S. Circuit, in *Comer v. Murphy Oil*—citing a recent U.S. Supreme Court decision accepting the plausibility of a link between emissions and hurricane severity—held that the plaintiffs had standing and should be allowed to proceed to establish that their injuries are "fairly traceable" to defendants' activities.

The 5th Circuit's ruling agreed with the reasoning in a September ruling in *Connecticut v. AEP* by the 2nd U.S. Circuit Court of Appeals in New York, which allowed an action to go ahead that was brought by a coalition of state attorneys that declares carbon emissions by various power companies to be a public nuisance and seeks to have them capped and then reduce such emissions.

At the same time, in a ruling that is expected to be appealed, a U.S. District Court judge in San Francisco tossed out a case filed against oil and power companies by the Inupiat Eskimo fishing village of Kivalina, which argued the companies were causing global warming by raising sea levels that would put their town underwater.

Global warming actions in the Kivalina case, according to Mr. Nevius, have resulted in litigation over the scope of an insurer's duty to defend against such suits.

According to the attorney, on July 9, 2008, Steadfast Insurance Company filed a complaint in state court in Virginia seeking a declaration of no coverage for one of the underlying Kivalina defendants.

Steadfast, a subsidiary of Zurich Financial Services, alleged that it had no duty to defend its policyholder for three reasons: 1) lack of an "occurrence"; 2) a Loss In Progress Endorsement; and 3) application of a pollution exclusion.

Mr. Nevius said defending lawsuits such as the Kivalina case can be expensive, and while the underlying Kivalina case has now been dismissed, legal costs will continue to mount through the appeals process.

> **▶ WHILE TWO FEDERAL APPEALS** court rulings allowing greenhouse gas suits to go forward raise warning flags to emitters, the lack of federal court unanimity also bolsters the case for insurance coverage for any related liability, according to one legal expert.

While many companies may think of "nuisance" suits alleging harm from their greenhouse gas emissions as unlikely to survive, Mr. Nevius noted that two have crossed important early hurdles on appeal in the last two months, adding that the cost of defending such suits can dwarf the costs of any potential judgment.

An insurance company's duty to defend, he explained, is broader than its duty to indemnify, and companies facing such suits should move quickly to secure coverage for defense costs, or prepare for more high-stakes coverage battles such as the Steadfast case.

If Steadfast prevails, in Mr. Nevius' view, insurance companies will be that much less likely to defend initially, and rather may simply deny defense coverage at the outset of any greenhouse gas-related suit seeking damages.

He observed that filing in Virginia may be a smart tactic by the insurance industry, because the Virginia Supreme Court has held that chlorine added to water by municipalities as a disinfectant falls within the purview of a pollution exclusion.

While the two federal appeals court rulings allowing greenhouse gas suits to go forward raise a warning flag to emitters, the lack of federal court unanimity also bolsters the case for insurance coverage for any related liability, according to Mr. Nevius, who is an adjunct professor at Pace University School of Law, where he teaches a class on Climate and Insurance.

Given that the courts cannot agree on whether and how emissions of CO-2 and other greenhouse gasses give rise to actionable pollution, "it cannot be said with certainty that 'pollution exclusions' bar coverage. When uncertainty exists over coverage, the policyholder should receive the benefit of any doubt," he advised.

The attorney forecasted that continued uncertainty will be the rule as the gas-emission cases wind their way through the appeals process and the judiciary wrestles with who will bear the burdens of climate change. NU

LIABILITY LANDMINES

continued from page 17

and global warming.

(For a full discussion of nanotechnology risks, see *NU,* April 13, page 16.)

Environmental law and policy are likely to evolve rapidly in the near future in these areas. And while it's impossible to predict what the next potential environmental liability landmine will be, the most prudent course of action is to include robust environmental decision-making in corporate risk management practices now, before the next environmental issue explodes.

Just ask those who manufacture, distribute and install drywall. (This article was originally published on Oct. 2, 2009 by American Agent & Broker magazine, a member of Summit Business Media's P&C Magazine Group, which includes National Underwriter. The original publication was a Web exclusive on American Agent & Brokers' Web site, www.agentandbroker.com). NU

EXXON MOBIL

continued from page 17

Chevron, Citgo, Hess and Sunoco—previously settled claims against them for a total of $15 million.

The city presented evidence that Exxon Mobil added MTBE to gasoline knowing that it would contaminate groundwater when the gasoline leaked and knowing that underground storage tanks at gas stations—many of which are owned by Exxon Mobil—regularly leak.

New York also contended that Exxon Mobil ignored warnings from its own scientists and engineers not to use MTBE in areas of the country, like Queens, that use groundwater for drinking water.

Lawyers for the city argued that Exxon Mobil failed to inform government agencies, gasoline station owners, water suppliers and the public about the dangers from MTBE.

New York State banned MTBE as of 2004, after MTBE polluted groundwater drinking water supplies throughout the state.

Exxon Mobil is "disappointed with this decision and will be considering all our legal options," according to a company spokesman.

Approximately 20 other states have also banned MTBE.

"We are extremely gratified that the jury acted to protect the city's drinking water and awarded the city all the compensatory damages it sought," said Michael A. Cardozo, Corporation Counsel for New York City.

"The jury's verdict today represents a win for our ratepayers. DEP is committed to providing high-quality drinking water to all consumers. Now the financial burden of cleaning up contamination to the groundwater system caused by Exxon Mobil will rightly fall to the polluters," said Steven W. Lawitts, acting commissioner of the New York City Department of Environmental Protection.

The city's drinking water supply system includes 68 wells in southeast Queens.

The case was tried before U.S. District Court Judge Shira Scheindlin in the Southern District of New York. NU

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CREDIT CRISIS
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dividuals. (Side A and IDL policies respond when a corporation cannot indemnify directors because of statutory prohibitions in a state, because the corporation is financially impaired, or for some other reason.)

"I'm not sure…discussions" about the need for these ancillary D&O products are conducted "as much as they should be," Mr. White said, adding that they are needed "in the event that everything Gary [Brown] is talking about somehow didn't happen right—something goes a little bit sideways and they get sued."

The panel moderator-Ivan Dolowich, a partner with Kaufman Dolowich Voluck and Gonzo LLP in New York--led off the session by asking about experts to weigh in on the causes of the credit crisis. "Are recent economic developments the result of poor business decisions or a systematic breakdown of business ethics?" Mr. Dolowich asked.

Ric Marshall, chief analyst for The Corporate Library in Portland, Me., a firm that analyzes corporate governance practices, said that "if you really step back, nearly everyone involved in the market system has some culpability here"-listing corporations themselves, boards of directors and management teams, shareholders who wanted more profits, and regulators for failing to exercise needed enforcement.

Mark Lebovitch, a plaintiffs' lawyer for Bernstein Litowitz Berger & Grossmann LLP in New York, said there was "a massive failure for regulators and the law to put limits on what happened." Rejecting the idea that shareholders should shoulder any blame, he also pointed to pay practices as a key driver of the meltdown.

"Shareholders have been clamoring for years for greater rights to act like owners of their companies," Mr. Lebovitch said, noting that they have been seeking a "say on pay" (which would allow them to vote on compensation packages annually, and proxy access ("the real right to remove the board").

"If by the time of the next crisis, they have greater rights, then it's fair to blame them," the lawyer said.

Pointing to guiltier parties and "the culture that got us to the credit crisis," he said, "Wall Street [professionals] created products…they knew they shouldn't."

"People had incentives to act in ways to put their companies at risk—and ultimately the entire economy," Mr. Lebovitch said, referring to remarks by former Citibank chief executive, Charles Prince, who reportedly said his firm would "dance until the music stopped" when asked about the risks of collateralized debt obligations.

Wall Street bankers no longer spend their entire careers at one firm, instead moving around to obtain ever-more-lucrative pay packages, he said, so they work "to create earnings today [and] don't really care about where the company is five or six years [in the future]."

Such an environment makes it difficult for one company at a time to improve pay practices, he said, underscoring the need for government intervention in the area of executive compensation. NU

REFORM BILL
continued from page 8

But what concerns industry lawyers the most, is the fact that the HHS secretary is required to "establish procedures under which a state may allow"--but is not required to permit--"agents and brokers to enroll individuals" in exchange plans, according to one analysis.

Another potential concern is the authority of the HHS secretary to issue "rate schedules for broker commissions paid by health benefits plans offered through an exchange," rather than permitting such commissions to be negotiated in the marketplace, the legal analysis said.

"This bill has a long ways to go before it becomes something that we can support," said Joel Kopperud, a director of government relations for the Council of Insurance Agents and Brokers. Specifically, he said, it allows brokers to sell products in the exchanges, "but still risks defining us as a conflict of interest."

Mr. Kopperud said that CIAB's "biggest concern is the authority it grants HHS to determine compensation rates on brokers working through state-based exchanges."

He said the proposed public option would do significant damage to employer-provided benefits, and that "the weak individual mandates make the market reforms difficult to support--when they will result in higher premiums.

Under the bill, most people would be required to carry insurance. A person without coverage could be required to pay a financial penalty, starting at $95 in 2014 and rising to $750 in 2016, with a maximum of $2,250 for a family.

The Senate bill would not explicitly require employers to offer health insurance. But if an employer with more than 50 workers does not offer coverage, and if any worker qualifies for a federal subsidy, the employer would have to pay a penalty--typically $750 for each employee.

It creates a government-run health insurance plan similar to that included in the House legislation. The proposal is called a "community health plan," and would be available only through state-based insurance exchanges that would be created under the legislation. It offers states the flexibility to opt-out, and would subject the plan to the same laws and requirements as those applicable to other health plans.

Other market reforms include guaranteed issue; no lifetime or "unreasonable" annual coverage limits; a ban on pre-existing conditions limitations and rescissions; guaranteed renewals; non-discrimination standards; network provider standards; and mandatory extension of family coverage to older dependents. These mandates mirror those in the House bill. NU

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POLLUTION RISK
continued from page 13

that could occur at the facility that would be defined as pollution.

A simple guideline to follow is that pollution takes place when the release of a manmade or organic material into a structure, soil, air or water causes harm to humans or the environment. Once everyone at the table concurs as to what pollution is or is not, then informed decisions can be made on whether to obtain insurance.

Without this process, the agent could someday be locked in an uncomfortable situation with his or her client.

When agents discuss this risk with their clients, it's typical for facility owners to maintain that nothing like that has ever happened, and to question why they should worry about it now.

The fact is that by now, most Americans should know that our ability to predict our economic future is extremely limited. When it comes to environmental matters, the future is not only unpredictable, but whatever rules have been established in the past can change at any moment.

The only way to prepare for an unforeseen crisis is by making certain the elder care client understands how pollution relates to their facilities, and that if they choose to not be covered, then they are bearing those risks on their own.

Communicating this fact should be considered at minimum the responsibility of every agent.

THE BOTTOM LINE

The good news is that environmental insurance is highly affordable and typically will only increase the total cost of the insurance program by a few percentage points.

Equally important as having the coverage to pay claims and expenses is the fact that the insurers provide the highly specialized legal and technical support needed when pollution events occur.

Even without regard to the financial element, an elder care facility is completely unsuited and ill-prepared to respond to pollution incidents that call for multiple sets of attorneys, scientists, mechanical and environmental consultants, and contractors.

The time and personnel required to manage what effectively becomes an environmental insurance claims department can be worse than the cost associated with the appropriate insurance add on. (This article was originally published by American Agent & Broker magazine, a member of Summit Business Media's P&C Magazine Group, which includes National Underwriter). NU

John Butler leads the environmental insurance practice of Program Brokerage Corp., a provider of specialist expertise to retail brokers throughout the United States and Canada. In addition to the elder care industry, he has developed environmental insurance solutions for energy, manufacturing, banking and real estate. He can be reached at JButler@programbrokerage.com.

P&C LEADERS
continued from page 6

out the truth that throughout the crisis, p&c carriers have performed well, with far less leverage and far more conservative investment portfolios than other financial services sectors.

He suggested that instead of finding a cure for what doesn't ail the p&c industry, the sector should be proposing solutions based on lessons learned from their own successful regulatory structure.

Discussing companies performing as though they have only one bite at the apple, Mr. McGavick said this is a chance for insurance executives to stand up for themselves, but instead too many are avoiding the spotlight.

He said p&c executives should be unafraid to defend the industry and make their case in Washington, instead of "just reacting" to efforts in Congress to include insurers in sweeping regulatory reform legislation now under debate.

He also strongly advised those who do testify on the industry's behalf in Washington to not be intimidated by those questioning them in Congress.

"When you play rope-a-dope with Congress and are a cowering witness, it invites a feeding frenzy," he warned. "Be properly humble, but make it clear you're not there to be a patsy. You've got a strong story to tell."

Overall, "we get an F" when it comes to communicating the industry's strength and financial soundness, he added. NU

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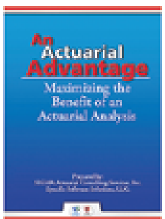

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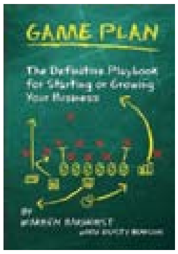

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INDEPENDENT AGENCIES

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west, according to MMC.

Insurance Alliance has specialist teams serving clients in construction, surety, energy and marine, professional services, general property and casualty, and employee benefits, noted MMC. Established in 1992, Insurance Alliance has 72 employees.

In a statement, David Eslick, chair and CEO of Marsh & McLennan Agency, called Insurance Alliance "a well-managed and growing enterprise with a highly qualified professional team and a reputation for service excellence [that] fits perfectly with the national organization we are working to build at Marsh & McLennan Agency."

In addition to announcing the acquisition, Marsh & McLennan Agency said Woody Woodard has been appointed CEO of its new Southwest operation. Mr. Woodard had been chair of Insurance Alliance. In addition, Insurance Alliance executives Jim Berger and Jim Tomforde will be chief operating officer and vice president of sales for the Southwest respectively.

Mr. Woodard said his organization looks forward "to helping build what we expect will be among the top national organizations in this industry."

MARKET UPDATE

Back at the P&C Executive Conference, Mr. Friedman asked Mr. Duperreault about a prediction he made early this year regarding an "invisible hard market" emerging in 2009—in which prices would generally be rising, but premium growth would be flat or down thanks to shrinking insurable exposures in the recession.

Mr. Friedman noted that while insurable exposures have indeed dropped, prices did not rise except for select accounts and lines, such a disaster-prone properties, or financial institution liability coverage.

Mr. Duperreault replied there was much talk about prices rising, and he noted there may have been a sincere desire to raise rates. But ultimately, he said, the market is competitive, and if a company wants to hold onto a good account, it will drop its rates to do so, if it must and can afford to.

He also said insurer balance sheets were not as damaged by the financial crisis as might have been expected. Companies still have adequate capital, he said, and that has helped keep prices down.

Joining Mr. Duperreault on stage was Peter Zaffino, president and CEO of Guy Carpenter & Company, where revenues were up 11 percent for the first nine months of the year and 13 percent for the third quarter--thanks in part to a more robust reinsurance market.

He noted that the property and casualty sector is still "awash in capital," and the question going forward is "what will they do with [the extra money]? Return it to shareholders, or use it to fuel more price cuts?"

Mr. Zaffino said that even if there is a major catastrophe, it is easier now to recapitalize than it would have been earlier in the year, further stabilizing the market.

SETTLEMENT ANNOUNCED

In other MMC news, the company announced it has reached a settlement in a securities class-action lawsuit filed in 2004 in the U.S. District Court for the Southern District of New York.

The settlement, which is subject to final court approval, resolves all of the claims in the litigation against MMC, Marsh and the named individuals. The suits claimed damages against investors and pension funds in Ohio and New Jersey after insurance bid-rigging allegations against Marsh.

Without admitting wrongdoing of any kind, MMC said it has agreed to pay $400 million--$205 million of which is expected to be covered by insurance. MMC said it will use cash on hand to fund the remainder of the settlement, which will be tax deductible and result in a cash refund.

Separately, the company also announced that an ERISA class-action lawsuit filed in 2004 in the U.S. District Court for the Southern District of New York has been settled for $35 million--$25 million of which will be covered by insurance.

In a statement, the company said that "after more than five years of litigation, MMC believes these settlements to be in the best interest of the company and its stockholders."

"While the company continues to deny all of the claims in these lawsuits, the resolution of these matters puts the litigation arising from the events of 2004 largely behind us and reduces the company's ongoing legal costs," the firm added. "MMC is focused on the future and further strengthening its world-class businesses." NU

CHARTIS CFO

continued from page 6

His remarks came in response to a question by interviewer Sam Friedman, group editor-in-chief of *National Underwriter*. During the live one-on-one interview, Mr. Friedman cited complaints over the past year by industry officials that AIG's p&c subsidiaries, now flying under the Chartis flag, were underpricing risks and prolonging the soft market, with the goal being to reassure clients concerned about financial problems at their parent firm.

Mr. Schimek said competitors' comments to the press represented a "degree of frustration" that they have been unable to unseat Chartis as a market leader. "They expected us to just disappear, and we have certainly not done anything of the kind," he said.

He noted that many who have complained have actually grown in premium volume, according to recent results. If the market is so competitive that pricing is irrational, Mr. Schimek asked, then why would his competitors choose to grow in that marketplace?

Chartis will remain as disciplined as possible where pricing is still too aggressive, and will also walk away from business if necessary, Mr. Schimek said. Indeed, net premiums written fell 13 percent in the third quarter at the company, although part of that was due to the effect of foreign exchange and the sale in 2008 of its Brazilian operations, Mr. Schimek explained.

He also addressed the issue of reports about talent leaving the company since the troubles experienced at its parent, AIG. Mr. Schimek said that while some players have left, it has allowed others in the company to step up into larger roles, and he said those people have done as well or better than those they replaced.

Using a sports team analogy concerning the company's available talent, Mr. Schimek said Chartis has a "really deep bench."

He also spoke about AIG's loans from the government. He said while headlines in the press citing an outstanding debt to Washington of $180 billion are technically correct with respect to the total amount of taxpayer money involved, the headlines are misleading because the company does not owe that much.

Some of the funds received involved AIG selling assets to the New York Fed, he noted, and because assets were sold, the company does not have to repay anything.

Additionally, the $180 billion also reflects unused lines of credit. The company does not have to repay unused funds, Mr. Schimek explained.

In its third-quarter results report, AIG said its total balance outstanding from a Federal Reserve Bank of New York facility is $41 billion. This includes $35.8 billion of net borrowings and $5.2 billion of accrued compounding interest and fees, with $24.2 billion still available in the fund.

With respect to AIG's efforts to sell business units to repay taxpayer loans, Mr. Schimek said there is no plan to sell any units associated with Chartis.

He said the company's foreign and domestic p&c units were brought together, not taken apart to be sold, and that it is Chartis' intention to keep the units together. NU

FED OFFICE REVISED

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guage in legislation giving Washington oversight of insurance holding companies they believe pose a systemic risk to the financial system. The letters were sent to all members of the House Financial Services Committee, which is currently marking up the bill--the Financial Stability Improvement Act of 2009.

Each member of the committee was written to by groups representing five p&c insurance trade groups, representing both underwriters and agents, as well as the American Council of Life Insurers.

P&C organizations that wrote are the American Insurance Association, the Independent Insurance Agents and Brokers of America, the National Association of zCasualty Insurers Association of America and the Reinsurance Association of America.

The industry groups asked that large insurers not be subject to any oversight by bank regulators unfamiliar with the insurance industry regulatory scheme.

They also requested that bank regulators not have the authority to determine whether insurers should be responsible for contributing into a fund that would be used to pay for resolving troubled financial institutions.

They voiced particular concern over an amendment to the proposed legislation that would require institutions that are designated systemically important to pay in advance into a fund that would be used to resolve insolvent financial institutions.

Such an amendment was expected from Rep. Luis Guitierrez, D-Ill., during the markup of the legislation by the committee.

"We strongly oppose the idea of prefunding because it runs counter to our own resolution system, amounts to a tax …," the five p&c insurance trade groups said in their letter. "We see no benefit to our industry and its customers that would flow from adopting an amendment to prefund the enhanced resolution authority."

The bill would give the Federal Reserve, the Federal Deposit Insurance Corp. and a council of federal regulators broad authority to deal with so-called "too big to fail" financial institutions, including insurers.

But it would not give the proposed Financial Services Oversight Council the authority to oversee the operating subsidiaries of insurance companies.

According to the ACLI letter, the bill would change the Bank Holding Company Act to effectively treat operating insurance companies as if they were national banks merely because they are in a holding company system that also owns an ancillary non-bank depository institution.

"Many insurance companies' insurance holding company systems contain small thrifts that are used to enhance the services provided to policyholders," the ACLI letter said. Many p&c insurance companies also include subsidiaries that operate thrifts.

"Although policy makers may see a need to restructure the regulation of thrifts, that should be done in a way that does not damage the other corporate entities within the holding company," the letter said.

In its letter, the p&c groups said its industry "did not pose systemic risk to the U.S. financial system or to the economy" during the economic crisis that is prompting the legislation. "We believe that any federal proposal to subject financial companies to heightened prudential supervision should start from the premise that property and casualty companies engaged in insurance activities should not be subject to such supervision." NU

'ON BOARD'

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portantly, these carriers are seeing the rate of completed applications increase. Carriers can achieve double-digit percentage increases in completed applications.

New real-time solutions for prefilling application data greatly decreases the time required to deliver a quote. The ability to search multiple data sources and intelligently cascade through them in just seconds is critical.

This capability improves the accuracy of data found and reduces data acquisition costs. It also reduces the number of quote requests that are abandoned before completion. Prefilled data from trusted sources will also produce quotes that are comparable to the policies consumers currently have, greatly reducing the risk of losing a policy opportunity because an applicant mistakenly believes their current policy offers better coverage.

Carriers can review and improve the process for quoting and binding new policies—the way they bring new customers "on-board."

Validation products that identify possible misrepresentations or simple mistakes reduce rate evasion, identify possibly fraudulent application data, and improve the ability to quote and provide accurate premiums. Validation is critical, even on prefilled data. Consumers who misrepresent application data on a quote are very likely to have done the same thing with their current policy.

Alerts and flags, delivered to point–of-quote by leveraging other third-party data, can be used to optimize the agent and consumer's time during the call.

Additionally, it's important to understand the likelihood that other relevant risk data exists. Through alerts, this data can be used to streamline the interview process and reduce the time required to quote.

Risk data can be moved up in the quote process, producing more accurate quotes in shorter time periods. Flags can be created from third-party data, identifying potential cross-sell and up-sell opportunities.

Agents can be focused on the relevant information that is unique to the applicant; reducing time spent on the quote, improving the accuracy of the premium, addressing additional insurance needs of the applicant, and providing better overall value to the applicant for the time they are spending with the carrier.

In today's economy, carriers need to focus on improving the efficiency of their business process. The ability to quickly and accurately quote premiums is one of the most critical elements.

Effective automated on-boarding, customized to a specific carrier's needs, can significantly improve agent relationships. It will greatly enhance the applicant's experience during the quote process, improve the efficacy of the rating plan and generate more business. NU

▶ **Michael Gaughan** is a vice president in TransUnion's insurance group. He may be reached at mgaughan@transunion.com.

TRIAL LAWYER'S DREAM

continued from page 7

speech at The National Underwriter Company's 21st Annual Executive Conference for the Property and Casualty Industry, sponsored by Ernst & Young and Genpact.

Regarding the health care bill, he said the Congressional Budget Office estimated that $54 billion can be saved by implementing medical malpractice tort reform, but the authors of the bill left out such reforms.

Additionally, Mr. Hartwig noted a provision in the bill that establishes an incentive program for states to adopt and implement alternatives to medical liability litigation. However, an addition asserts "a state is not eligible for the incentive payments if that state puts a law on the books that limits attorneys' fees or imposes caps on damages"—two reforms long sought by medical malpractice carriers.

The bill also grants the Federal Trade Commission authority to conduct studies "related to insurance," noted Mr. Hartwig, who stressed there is no language limiting that authority to just health insurers.

In fact, he called efforts to repeal the McCarran-Ferguson Act's limited federal antitrust exemption for health insurers a "slippery slope" that could find its way to p&c one day.

In general, with the mood of the nation trending toward populism and government expansion, Mr. Hartwig said the industry should be prepared to defend current personal lines underwriting criteria such as the use of credit information and education/occupation.

He said the feeling among some is that government can do a better job insuring risk than private insurers, pointing to suggestions to include wind coverage in the National Flood Insurance Program and the increased amount of risk taken on by state residual market plans.

In 1990, Mr. Hartwig said, around $54 billion of risk was in these plans. Now that number has grown to close to $700 billion.

Regarding the state of the industry, Mr. Hartwig said the economy is in the early stages of recovery, adding that it will take longer to get out of the recession than it took to get in. Still, he said, the economy is no longer shrinking, the pace of jobless claims is slowing, housing seems to be bottoming out, and there is some stabilization in retail.

He noted, however, that improvement in the economy alone won't pull the insurance industry out of the current soft market cycle. He said the insurance cycle is not tied to the economy and never has been, explaining that soft and hard markets have occurred previously during both recessions and recoveries.

Mr. Hartwig also said private business starts are still at depressed levels, which impacts the number of insurable risks for lines such as workers' compensation. Although credit has loosened up, he said, it has not yet reached "Main Street."

For the next 10 years, Mr. Hartwig said insurers should be thinking about entering growing sectors such as government, education, traditional energy, alternative energy, agriculture, natural resources, environmental protection, technology and light manufacturing.

He added that health care will be an important line for insurers over the next 10 years, and will make up one-fifth of the U.S. economy by that time. NU

ANOTHER PERSPECTIVE

Insurers Must Get Buyers 'On Board' In Soft Market

BY MICHAEL GAUGHAN

THE ECONOMY IS EXPERIENCING one of its worst recessions since The Great Depression. The real gross domestic product decreased at an annual rate of 5.5 percent in the first quarter of 2009 after contracting by 6.3 percent in the fourth quarter of 2008. The unemployment rate has risen from 7.2 percent to 10.2 percent over the past six months, and mortgage and auto loan delinquencies are hitting record levels.

Consumers have responded by tightening their belts, examining every purchase and every expense, determined to get the most value for their money.

Despite the negative economic implications, there is some good news. U.S. industrial production declines may be close to bottoming out, while business and consumer confidence recently has improved. The economy appears to be stabilizing in the second half of 2009, and a gradual recovery will begin in 2010.

Since this recession has been called unprecedented in nature, consumers will likely respond cautiously, facilitating a slow recovery. It also is expected during this recovery period that they will continue to be conservative with their spending, focusing on finding the best prices.

As the economy recovers, the property and casualty insurance industry will remain in a soft market.

The economic slowdown has resulted in a reduction in the number of new homes and new cars purchased. Consumers are becoming increasingly price sensitive, shopping insurance and reconsidering coverages. Many carriers are reporting an increase in the number of consumers shopping their auto insurance.

Captive agents are seeing a double-digit percentage increase in quoting volume. In the independent agent market, the quote volume has risen even more significantly as corresponding close rates have fallen. The increased volume of quotes is taxing personnel, pressuring systems and data resources, and increasing carriers' operating costs.

In addition, with the economic downturn and the fluctuation in gas prices, consumers are driving less. Miles-driven decreased 3.6 percent in 2008. The trend, however, is not resulting in significantly fewer accidents.

"**With downward pressure on** premiums, rising quoting and claim costs, risks to retention of policyholders, and falling investment returns, carriers need to focus on controlling and lowering operating costs."

Michael Gaughan

Personal passenger auto has seen a rise in claim costs due to increasing medical costs. In an effort to save money, more people are turning to motorcycles and scooters, which tend to carry more risk for accidents and serious injuries than traditional passenger cars. In addition, regulators have begun pressing for lower rates to coincide with the decrease in miles driven.

All of these factors point to expectations for stagnant or falling top-line growth for insurers.

As consumers increase their shopping activity, carriers are facing increased threats to retention. Carriers must do everything they can to retain their current policyholders. To do so, they need to identify their best customers and use proactive tools to ensure they take action to retain them.

A decline in their retention rates will only exacerbate the problems carriers are having in absorbing the costs of additional quote volume and medical costs.

In the 1980s, when interest rates were high, insurers could use investment income to offset an underwriting loss. In the 2000s, interest rates have been low, increasing the importance of underwriting profits.

With downward pressure on premiums, rising quoting and claim costs, risks to retention of policyholders and falling investment returns, carriers need to focus on controlling and lowering operating costs.

They need to improve their efficiency in the quoting process. And they must ensure the data they use to make a quote is accurate and valid. Finally, they need to improve the point-of-sale experience for the agents and consumers.

How can they accomplish this? For one, carriers can review and improve the process for quoting and binding new policies—the way they bring new customers "on-board."

Using external data, flexible decision platforms and advanced analytics, the on-boarding process can be completed in less than three minutes. In that period of time, carriers can issue accurate quotes on verified application data.

The process starts with the first interaction between the applicant and the agent. Consumers are increasingly concerned with privacy and are more and more reluctant to provide personal information over the phone. They are especially concerned when that information has to be provided through a Web site.

Social Security numbers, which are critical for ensuring complete and exhaustive data searches, continue to be a concern with consumers and agents. The ability to offer a consumer the option of providing a partial SSN—just the last four digits—and having a data provider who is able to accurately convert that to a full number for inclusion in the search process is the first step in improving the consumer's experience.

Carriers that have implemented this approach have seen hit rates improve as accurate four-digit numbers are provided by consumers who may otherwise have refused to provide a number or who would have given an incorrect number. Most im-

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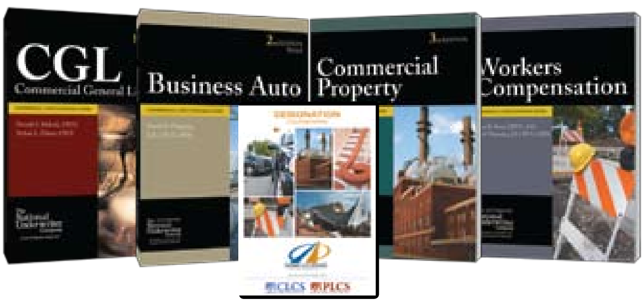

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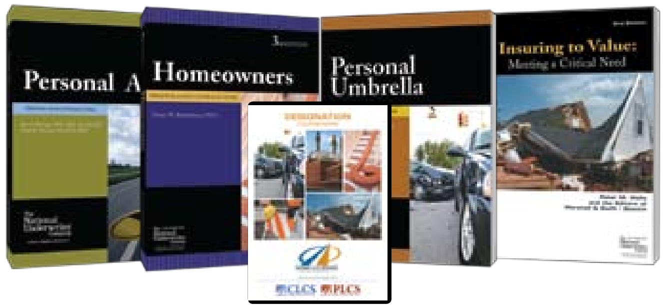

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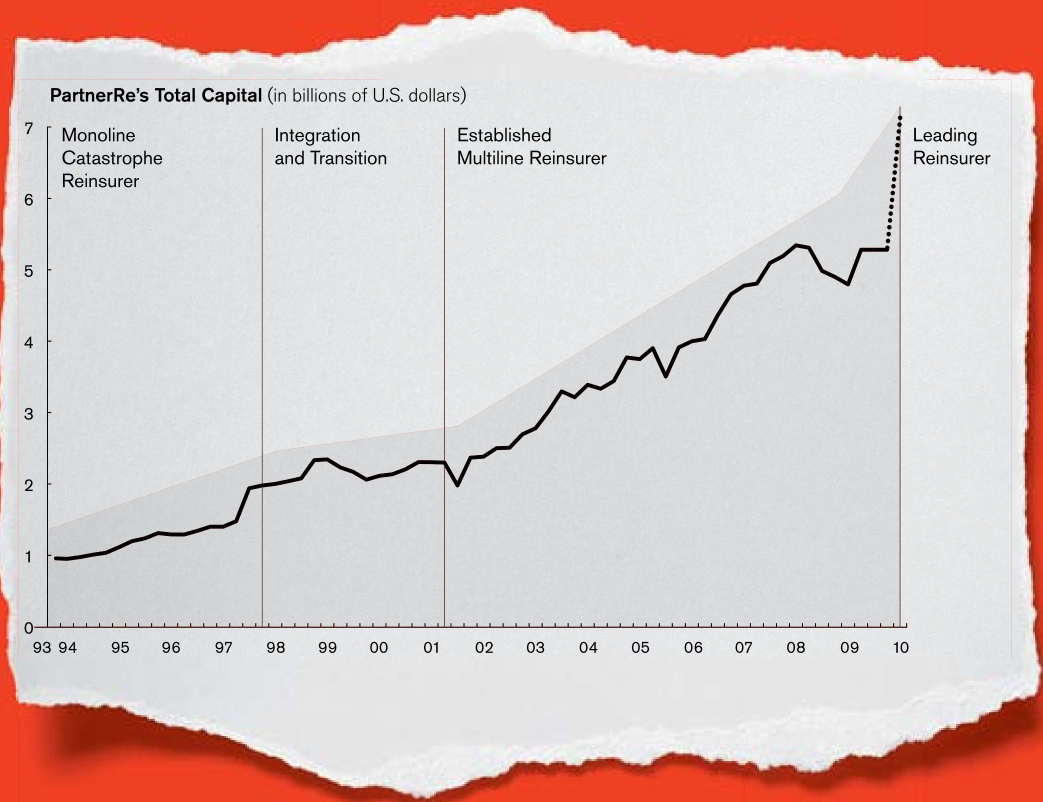

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