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FOR STRATEGIC DECISION MAKERS IN COMMERCIAL INSURANCE

ALTERNATIVE RISK MARKETS

DIFFERENT DIRECTIONS

INDUSTRY FOCUS ISSUE 2, FEBRUARY 2008
FOR STRATEGIC DECISION MAKERS IN COMMERCIAL INSURANCE

COVER FOCUS

ALTERNATIVE RISK MARKETS

FEATURES

THREE QUESTIONS

DEPARTMENTS

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FIRST WORD

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Wrestling with the R word

Probably because I spend so much time working with them, wrestling them and generally trying to coax them to do my journalistic bidding, I have a certain interest in words.

I enjoy discussion of word choice or nuance, or analysis of the language of public discourse.

My wife, Kathy, has made her career in various words-related tasks as well, and among our friends are others whose careers or passions are wrapped up in language.

Ah, the lively dinner table banter we share.

As 2007 ended and 2008 gets under way, I've found myself interested in a very high-profile demonstration of linguistic wrangling: the debate over what to call what's happening to our economy.

You know, the debate over "the R word."

Is the U.S. economy in recession? Not, apparently, by the textbook definition, which holds that a recession is a "period of general economic decline; specifically, a decline in GDP for two or more consecutive quarters."

The Commerce Department last month reporter that U.S. economic growth slowed to 0.6% in the fourth quarter of 2007, down from 4.9% in the third quarter. The fourth-quarter growth figure is anemic, sure, but not textbook recession.

In his State of the Union address last month, President Bush called what our economy is experiencing a "period of uncertainty."

Polls have shown increasing percentages of average Americans saying the economy is in recession for months, and academic debates in the future over when or if a recession actually began probably have little bearing on their experience.

Numerous factors are shaping that experience. Higher gas prices, the housing market mess and rising—and, according to many reports, longer term—unemployment are among the metrics on which many Americans base their economic assessment. Some, too, have experienced the subprime mortgage crisis firsthand.

As serious as the implications are, I doubt if bond insurers' woes and their potential to trigger major investment write-downs by Wall Street banks and higher borrowing costs for state and local governments have hit home yet on Main Street.

On the plus side, while a weak dollar does not do much for vacations in Europe, it does hold potential for increased U.S. exports.

In the debate over word choice, accuracy is always a key consideration. But I wonder in this case which is more accurate, the economists' textbook definition of recession, or the reality of people's everyday experience.

In an Associated Press piece late last month, Frank Lichtenberg, the Courtney C. Brown professor of business at Columbia Business School in New York, noted that whether the current economy ever meets economists' definition of recession is "not going to make a great deal of difference to people's economic well-being or their pocketbooks."

"The idea that if you're on one side of the line you're in a recession and if you're on the other side you're fine—that's not really the case," he said. "Clearly, we are in a very difficult period."

CHALLENGING TIMES present opportunities for creative problem solvers.

Challenging times, though, present opportunities for creative problem solvers.

In this issue of *Industry Focus*, our Cover Focus is Alternative Risk Markets, an area of great interest to me. A few weeks after joining *Business Insurance* a number of years ago, I was lucky enough to be introduced to the world of captive insurance and alternative risk transfer, an area teeming with creativity.

In fact, my experience at *BI* has introduced me to a number of creative individuals crafting risk transfer solutions and new business opportunities across the insurance industry, both in the alternative market and on the traditional side. There are a lot of smart people in this business.

By any name, these are challenging times. But experience suggests that there are creative individuals in this business, ready to solve problems and find opportunities.

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**Editorial highlights are subject to change.*

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INDUSTRY NEWS

AIR finds pattern in hurricanes' genesis, landfall

BOSTON—New research by risk modeling firm AIR Worldwide Corp. shows that where a hurricane begins can significantly affect the likelihood of it making landfall in North America.

According to Boston-based AIR, the study shows that using only Atlantic basin hurricane activity as a predictor of landfall activity can produce flawed estimates of both the landfall risk and the potential insured losses.

In a statement announcing the findings, Peter Dailey, director of research in atmospheric science at AIR, said every hurricane season is unique, with actual landfall activity being a function of "complex interactions between a range of environmental factors such as genesis location, sea surface temperatures and the depth of warm ocean waters, wind shear and atmospheric steering."

"A higher number of tropical storms in the Atlantic basin does not translate to an equivalent increase in hurricanes or landfalling hurricanes," Mr. Dailey said.

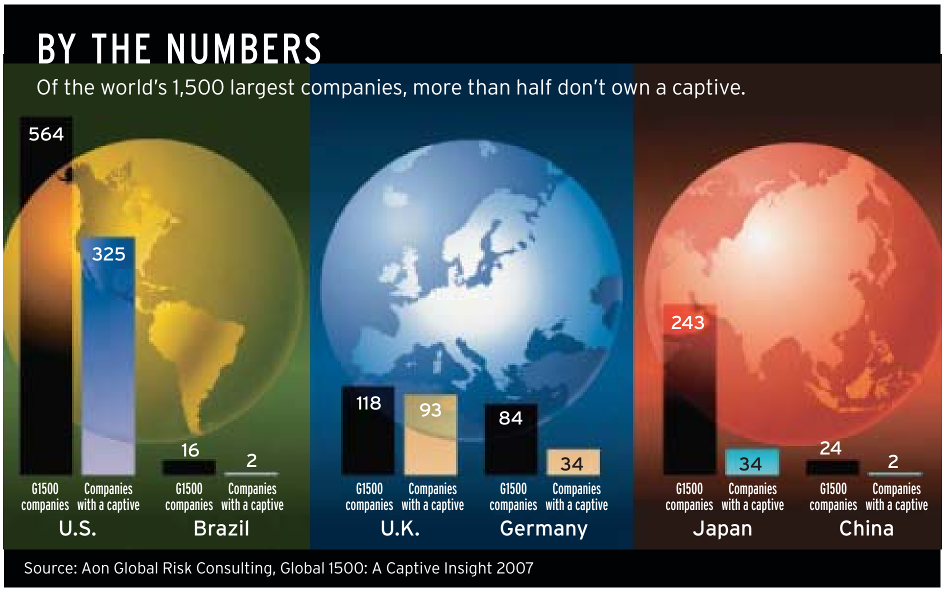
AIR's study found that the pattern of where hurricanes begin changes from year to year, and that comparing the pattern for a particular season to long-term hurricane activity can provide a better understanding of differences in the proportion of storms making landfall from year to year.


REUTERS

AIR's study found that the pattern of where hurricanes begin changes from year to year.

Mr. Dailey noted that while forecasters correctly projected a higher-than-average number of tropical storms forming in the Atlantic basin in 2007, "it's much more difficult to predict not only how many of these storms will become hurricanes, but more importantly how many will make landfall as hurricanes."

Similar to many previous hurricane seasons, 2007 demonstrated that "an elevated number of tropical storms does not always translate to more hurricanes or more landfalling hurricanes," Mr. Dailey said. IF



IRISK applies ERM for mid-market, small companies

WEST CHESTER, Pa.—A new independent risk management consulting firm, IRISK Solutions, plans to apply an enterprise risk management approach to serving small to middle-market companies with gross annual premiums of $50,000 to $1 million.

West Chester, Pa.-based IRISK will provide a full suite of standard and custom services, including claims consulting, loss control consulting, trending analysis, managed care review and information systems.

The firm aims to work with insurance companies, program administrators, alternative risk transfer consultants, insurance agents and brokers and insurance buyers.

IRISK Solutions uses a customized version of RiskConsole, a Web-based risk management information system provided in partnership between IRISK Solutions and RiskLabs, which was acquired by Aon Corp. in 2004.

In its ERM approach, IRISK utilizes tools to help clients align risk appetites and strategies, enhance risk response decisions, reduce operational surprises and losses, identify and manage multiple and cross-enterprise risks, take advantage of business opportunities, improve the deployment of capital and manage risk.

IRISK is a subsidiary of insurance services group Inventure Inc., which provides products and services in business segments including specialty program administration, wholesale workers compensation and risk management services. IF

THREE QUESTIONS

Leonard Crouse, Vermont's top captive insurance regulator for the past 18 years, announced last month that he'll be retiring from his position as Vermont's deputy commissioner of captive insurance June 1. During Mr. Crouse's tenure in Vermont, the state licensed more than 600 captives, and Mr. Crouse has been known not just for promoting Vermont but the captive industry in general. Recently, he talked about changes he's seen in the captive industry, and what he sees ahead for the industry and himself.

Obviously the alternative risk transfer market has grown considerably during your time in Vermont. What do you think are some of the key changes you've seen in the captive business?

The captive industry's changed dramatically in 10 years. Just the types of captives we've had, there's been employee benefits, there's been securitization captives, there's been reciprocal captives.

There are all sorts of different things going on. And the lines of business captives write, that's changed a little as well. Ten, 15 years ago, it was mostly GL, auto, workers comp. Now we see health benefits, TRIA, property, all sorts of lines of business. The alternative market is a perfect place for this business to go and it's going to continue to grow.

It's changed. It's bigger, more people involved. It was a relatively unknown entity when I started 17, 18 years ago. Just the people who were in it knew about it.

The growth that we've had in this business has been phenomenal, too. I think one of my greatest accomplishments is the growth here in the department. When I started here we had four people…and now we have 30 people in the department. The department, building the department, is one of the things I take the most pride in.

How about looking ahead? What are some of the things you see in the captive industry's future?

Continued growth. The securitization activity should continue, at least for a few years, at least until the NAIC and the actuarial committees get some of the reserving issues the life companies are facing straightened out.

The alternative market depends a lot on the fluctuations in the traditional market, the cyclical swings, hard to soft. That affects our market, there's no doubt about it. The reinsurance market affects our market a lot, there's no doubt about that.

You look around. When we started, we were the only (domestic) game in town with Hawaii. Now, there are 30 states with captive legislation. Some of them will be here in 10 years, some won't and that's fine. There should still be plenty of business for everybody. Hopefully, most of it will still come to Vermont.

And for yourself? What's ahead for Len Crouse?

I'll take it a little bit easier. Play a little bit of golf, spend a little more time with the grandkids down in Massachusetts.

I'd like to dabble a little bit in the business. I'd like to do something. We'll see what happens in three or four months. I'm definitely not going to disappear into an easy chair. I want to stay involved, but in a way that gives me a little more time.

I just woke up one morning and decided it was time. That's exactly how it happened. It's been fantastic. Most of it's been the people I've met. You think about it, 600 captives licensed here in Vermont and that means 600 meetings. It's always been a people business and that's the way it should be. IF

BIMA endorses ICCIE educational designation

HAMILTON, Bermuda—The Bermuda Insurance Management Assn. has endorsed the Associate in Captive Insurance designation offered by the International Center for Captive Insurance Education.

The ACI program is the only professional designation for the captive insurance industry. Consisting of seven courses and three teleconferences, the program can be completed online.

At the same time it endorsed the ACI program, the Hamilton-based BIMA, along with the Bermuda Captive Conference, created a scholarship fund for Bermudians. The fund, with an initial amount of $10,000, will cover the complete tuition expenses for two ACI students selected by the Bermuda Insurance Institute Scholarship Committee.

Remaining funds will be used to provide two Bermuda Insurance Diploma scholarships to Bermudian students interested in starting careers in the captive insurance industry. More than 500 people have graduated from the BID program since it was introduced in 1970.

Since its launch in 2004, the Burlington, Vt.-based ICCIE has attracted almost 400 students, with more than half of those pursuing the complete series of courses needed for the ACI designation. IF

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INDUSTRY NEWS

Confie Seguros aimed at Hispanic buyers

SAN FRANCISCO—A private equity firm and a California broker have partnered to form a platform to consolidate insurance brokerages focusing primarily on Hispanic buyers.

San Francisco-based investment firm Genstar Capital L.L.C. has partnered with Cypress, Calif.-based Westline Corp. to create Confie Seguros. Over the next three years, Genstar and Confie Seguros, led by John Addeo, chief executive officer, hope to build a national distribution company with more than $300 million in revenue, focusing on markets including California, Arizona, Florida, Texas, Georgia and Nevada.

Based in Cypress, Calif., Westline will serve as the operating platform on which to build Confie Seguros' California business.

Funding for future acquisitions will be provided by a commitment of $75 million from Genstar and a bank facility with an expected capacity of more than $200 million.

> Over the next three years, Genstar and Confie Seguros, hope to build a national distribution company with more than $300 million in revenue.

Mr. Addeo previously served as president and CEO of Alliant Resources Group, and before that as president and chief operating officer of USI Insurance Services. In both positions, he guided efforts to build the firms through acquisitions.

Also involved in Confie Seguros' leadership team are Mordy Rothberg, president, who will lead business development and strategy; Stephan Provenzano, executive vp and chief financial officer; and Andre Urena, senior vp of business development, who also is CEO and founder of the Latin American Agents Assn. IF

THE QUOTE

'I DON'T THINK that the threat of a recession will decrease the need for captives.'

NANCY GRAY
EXECUTIVE DIRECTOR-NORTH AMERICA
AON INSURANCE MANAGERS

Edwards Angell, Kendall Freeman team to work both sides of Atlantic

NEW YORK—U.S. law firm Edwards Angell Palmer & Dodge has merged with the Kendall Freeman firm of London.

The firm will operate as Edwards Angell Palmer & Dodge L.L.P. in the U.S. and Edwards Angell Palmer & Dodge U.K. L.L.P. in London.

Edwards Angell said the merger enhances the capabilities of the firm's insurance and reinsurance practices by providing an international platform to serve clients on both sides of the Atlantic. The firm now has more than 600 attorneys and solicitors practicing in 11 offices.

In addition to its offices in New York and London, the firm has offices in Boston; Fort Lauderdale, Fla.; Hartford, Conn.; Madison, N.J.; Providence, R.I.; Stamford, Conn.; Washington; Wilmington, Del.; and West Palm Beach, Fla.

Partners Alan J. Levin and David Kendall chair the firm's 100-lawyer insurance and reinsurance department. Terrence M. Finn and Charles E. DeWitt will continue to serve as co-managing partners of Edwards Angell Palmer & Dodge.

Laurence Harris will serve as partner-in-charge of the London office, and, along with Mr. Kendall, will join the firm's executive committee. IF

USA Risk Group taps into Barbados with majority stake in MIMS International

MONTPELIER, Vt.—Independent alternative risk market service provider USA Risk Group has expanded into Barbados, purchasing a majority ownership in MIMS International (Barbados) Ltd.

Martin Hole, principal officer of MIMS, will remain as head of the Barbados office, which will be renamed USA Risk Group (Barbados) Ltd.

MIMS has been involved in captive management since 1986 and services 22 captives under management with a staff of five. It was the first captive manager licensed in Barbados.

In addition to its new presence in Barbados and its offices in Montpelier, Vt., USA Risk Group provides captive management, program administration, reinsurance and other related services in all major North American domiciles, Bermuda, the Cayman Islands and the British Virgin Islands. IF

AI Risk launches LexExpress cover for small fleets

NEW YORK—AI Risk Specialists Insurance Inc., a brokerage subsidiary of New York-based American International Group Inc., has introduced LexExpress, excess auto liability insurance coverage developed to address the needs of small to midsize trucking fleets.

LexExpress provides limits of $1 million in excess of $1 million in primary coverage. In addition to the standard excess auto liability coverage, the policy provides such additional coverages as pollution and accident and health coverage.

Through the program, AI Risk can address the exposures of long- and short-haul truckers, flat-bed haulers, dry bulk garbage, mix-in-transit, and moving and storage.

LexExpress is underwritten on a non-admitted basis by Lexington Insurance Co. as part of the AIG Transportation Solutions practice, and is available throughout the United States, except in Alabama, Delaware, Louisiana, New York City and New Jersey.

LexExpress was developed to cover small to midsize trucking fleets.

The LexExpress product can be quoted quickly and bound online through AI Risk ProgramConnect at *www.programconnect.com*.

AI Risk provides specialty property/casualty and personal lines insurance underwritten by Lexington Insurance Co. and other AIG companies. IF

Beazley aims to connect specialty lines to brand

LONDON—Beazley Group P.L.C. is embarking on a rebranding effort that the London-based company said it hopes will emphasize the creativity of its various business areas while linking those teams to the broader Beazley brand.

The current Beazley logo is being replaced with a line drawing of the Beazley name. Logos and images representing individual teams, such as scales of justice for Beazley's lawyers professional liability team or an underwriter's pen for the company's specialty lines division, will likewise be depicted in line drawings, with the continuous line connecting to the Beazley logo.

On Beazley's new Web site, the line will be animated to "draw" the team-specific illustrations.

The line drawings symbolize Beazley's creativity and help create a more prominent sub-brand identity for the company's underwriting and claims teams, while making it clear they're all part of Beazley, said William Pitt, the company's chief marketing officer, specialty lines.

"A lot of companies, not just in insurance, have struggled with sub-branding and we think this represents an elegant solution," Mr. Pitt said.

The current Beazley logo (left) is being replaced with a line drawing.

The specialty insurer will retain the "Beazley pink" shade featured in its prior branding to accent text and for other promotional purposes, and will continue to use the advertising tagline "Straight Answers." IF

MEMIC exec named chair of ACORD board

PEARL RIVER, N.Y.—John Leonard, president and chief executive officer of the MEMIC Group, has been named the 2008 chairman of the ACORD board.

It is the second time Mr. Leonard has chaired the board of the Pearl River, N.Y.-based Assn. for Cooperative Operations Research and Development, having previously held the position in 2001.

Mr. Leonard joined the Portland-based Maine Employers' Mutual Insurance Co. in 1993 after a 27-year career with Travelers Cos. Inc. where he led the commercial lines agency marketing and underwriting division.

Mr. Leonard

He is a former president of the American Assn. of State Compensation Insurance Funds and chairman of its executive committee, and also serves on the board of the National Council on Compensation Insurance and on the board of the National Workers Compensation Reinsurance Pool.

ACORD also announced three new members elected to its board for 2008: Lawrence E. Blakeman, senior vp and chief information officer, individual business at Metropolitan Life Insurance Co.; Robert Slocum, president of the Slocum Agency Inc. in Warwick, R.I., representing the Independent Insurance Agents & Brokers of America; and Andreas Beerli, chief operating officer and member of the executive committee of Swiss Reinsurance Co.

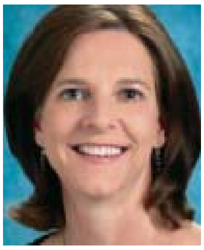
ACORD is a global nonprofit association working to facilitate the development and use of standards for the insurance, reinsurance and related financial services industries. IF

ON THE MOVE

New York-based Marsh Inc. has made several appointments as part of a global reorganization. **Joseph M. McSweeny**, former chairman of Willis Risk Solutions, was named president of Marsh's U.S./Canada division. Mr. McSweeny had been on the faculty of St. Thomas Aquinas College since 2005. **Alexander Moczarski**, who had been chief executive officer of Marsh's Europe, Middle East and Africa region, has been named president of the company's new international division. **David Batchelor**, who had been head of Asia Pacific for Marsh, was named to succeed Mr. Moczarski as CEO of Marsh's EMEA operations. **Alexander W. Vietor**, who joined Marsh in December from Aon Corp., where he was an executive vp, will serve as president of Marsh's global specialties unit.

Aon Ltd., the London-based unit of Chicago-based Aon Corp., has appointed **Robert Brown** to head its U.K. corporate insurance business. As CEO of Aon Corporate, Mr. Brown, who previously headed Aon Global U.K.'s risk transfer unit, will be responsible for the company's large commercial insurance, professional services and trade credit operations.

Chicago-based CNA Financial Corp. has named **John A. Beckman** senior vp and chief risk officer. Mr. Beckman recently served as president of ReAdvisory, a unit of specialty reinsurance broker Carvill that provides consulting services on areas including enterprise risk management.


Ms. Doyle

Wausau Insurance Cos. has appointed **Susan Doyle** president and chief operating officer. Ms. Doyle, who most recently was executive vp of field operations at the Wausau, Wis.-based insurer, replaces Mark Fiebrink who retired.

Farmers Group Inc. has named **Scott Lindquist** executive vp and chief financial officer. Mr. Lindquist had been controller of Genworth Financial Inc. Mr. Lindquist takes a position previously held by Pierre Wauthier, who left Los Angeles-based Farmers last year to become group treasurer and head of finance operations at Zurich Financial Services Group, Farmers parent company.

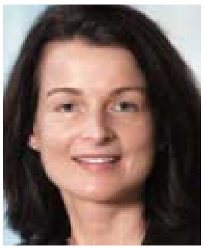
The New York Insurance Assn. Inc. has named **Ellen D. Melchionni** president. She succeeds Bernard N. Bourdeau who retired. Ms. Melchionni previously was a vp at NYIA.

Frederic Goldstein has been named president, director and COO of U.S. Preventive Medicine Inc., a Dallas-based company focused on building a prevention-based health network. Mr. Goldstein has been president and CEO of U.S. Care Management Inc., USPM's disease management subsidiary.

Overland Park, Kan.-based third-party administrator FMH Benefit Services Inc., has named **Ben Frisch** president. Mr. Frisch had previously been the company's vp of sales and marketing. FMH is a unit of Lake Forest, Ill.-based CoreSource Inc.

Marvin H. Feldman has been named president and CEO of the Arlington, Va.-based Life and Health Insurance Foundation for Education. Mr. Feldman, who succeeds David F. Woods, who is retiring, previously had been chairman of the foundation's board and is principal of the Clearwater, Fla.-based Feldman Agency and Feldman Financial Group.

New York-based AXA Equitable Life Insurance Co. has hired **Suzanne van Staveren** as vp and COO of Corporate Markets, a newly created distribution channel providing retirement plan solutions to Fortune 1000 companies and their employees. Before joining AXA, Ms. van Staveren spent 13 years with Fidelity Investments, most recently as vp, scale and profitability for large corporate market retirement services at Fidelity Employer Services Co.


Ms. van Staveren

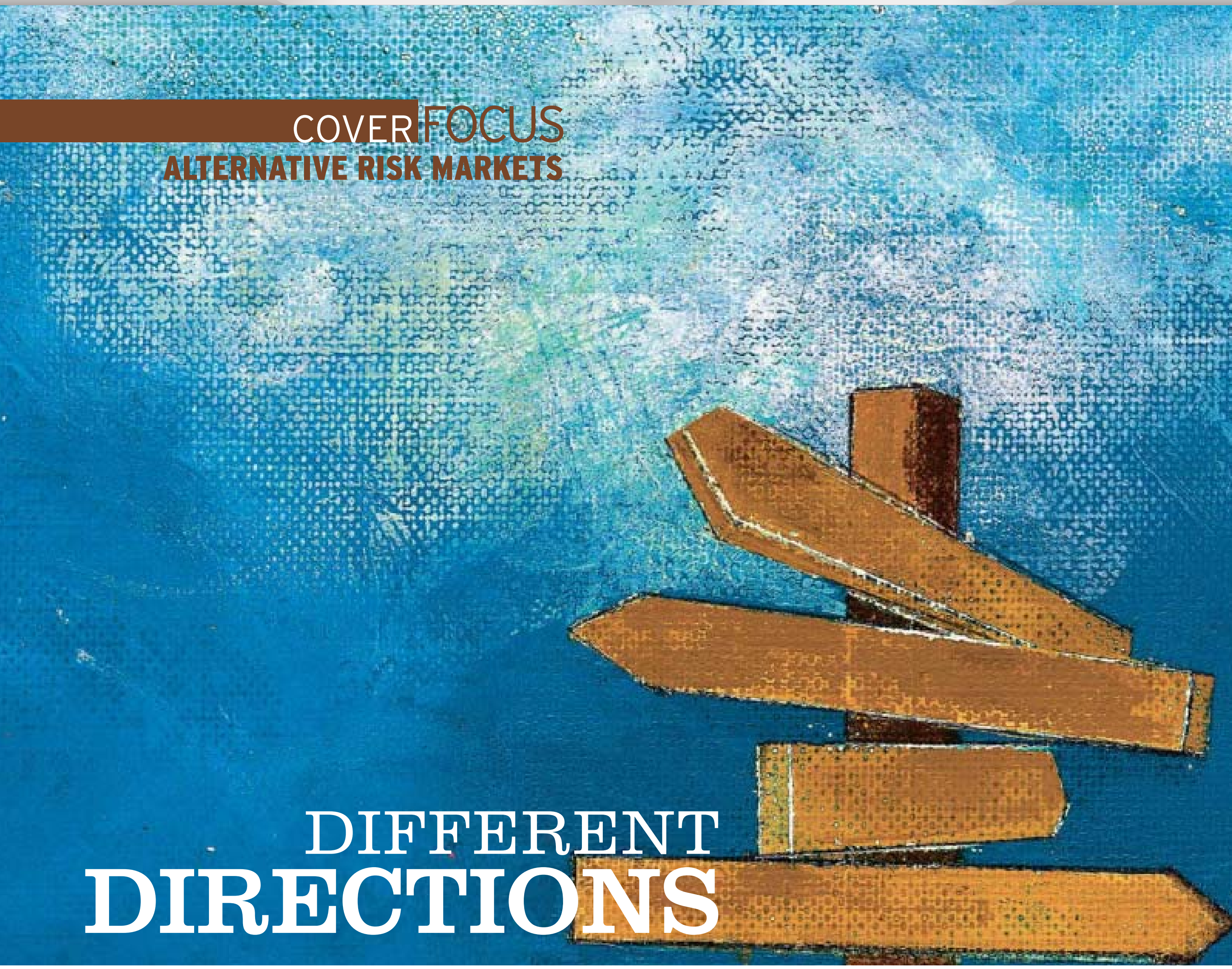
Denver-based health care service provider Bridge-Health International Inc. has named **Dr. Andrew Dombro** chief medical officer. Dr. Dombro has practiced medicine in various settings for more than 20 years, and is a professor at the University of Colorado Health Sciences Center.

Hamilton, Bermuda-based Platinum Underwriters Holding Ltd. has named **Kevin S. Marine** COO of its U.S. reinsurance subsidiary, Platinum Underwriters Reinsurance Inc. Mr. Marine will continue to serve in his role as chief underwriting officer-property and marine of the U.S. operation. The company also named **Thomas P. Kelly** chief underwriting officer-casualty of Platinum Underwriters Reinsurance. Mr. Kelly has been with Platinum Underwriters since the company's inception in 2002, most recently as senior vp of the commercial liability department.

London-based Willis Group Holdings Ltd. has appointed **Eugenio Paschoal** CEO for Latin America. For the past 10 years, Mr. Paschoal has been CEO of Willis Brazil and will be based in São Paolo. Mr. Paschoal replaces Jose Ribeiro who left Willis to take a position at Lloyd's of London. Separately, Willis named **Flavio Piccolomini** CEO of its Continental Europe operations, including the Nordic region. Mr. Piccolomini most recently was CEO of the broker's Italian operations. Guido De Spirt will succeed Mr. Piccolomini at Willis Italia S.p.A. IF

COVER FOCUS

ALTERNATIVE RISK MARKETS



DIFFERENT DIRECTIONS

Lloyd's-like insurance exchange gets fresh scrutiny in N.Y.

By Meg Fletcher

NEW YORK—New York Insurance Superintendent Eric Dinallo says the time is right to consider reviving the New York Insurance Exchange, a reinsurance marketplace that had early success but later shut down and took 18 years to pay its secured claims.

Conditions have changed since the NYIE, a Lloyd's of London-type exchange in Manhattan that opened in 1980 and shut down in 1987, ceased operations. Now, there is "tremendous potential to reopen it successfully," Mr. Dinallo said recently.

Reinsurance markets today are more global than the soft market that dimmed the NYIE's prospects. Also, today's technology could allow such a facility to operate very efficiently, he said.

Most importantly, "I think there are tremendously higher amounts of capital investment that didn't exist 20 years ago," Mr. Dinallo said. Hedge funds and other financial services companies seek opportunities to invest capital in risks, such as natural catastrophes and terrorism, that are uncorrelated to risks of their other financial investments.

For example, New York-based Goldman Sachs Group Inc. recently invested $200 million to establish a syndicate at Lloyd's of London. Arrow Syndicate 1910 will write reinsurance, the company said.

Shortly after New York Gov. Eliot Spitzer appointed him superintendent in December 2006, Mr. Dinallo said he began reading insurance law, became intrigued with the exchange concept and started discussing the idea with industry representatives. He's ready to appoint an advisory group to review the concept and determine its workability by the middle of this year.

Many industry representatives say the idea is worth exploring.

Some, though, are wary and fear that a regulator-driven proposal might fail to attract enough insurance industry support. They say there already is sufficient capacity for average risks and that offshore and alternative U.S. markets offer attractive options in the form of sidecars and protected cell companies.

Among cynics may be former exchange participants and their customers, who had to wait until 2005—18 years—for the exchange's security fund

Learn from past mistakes to find success in the future

By Meg Fletcher

Exploring why the New York Insurance Exchange failed to meet its potential during the 1980s may provide some insight into how such an exchange should operate in a proposed revival, sources say.

Mr. Bickford

The NYIE opened in March 1980 "to great fanfare and expectations…to help stem the flow of capital and premiums out of the United States," said Peter H. Bickford, a New York-based attorney who is an independent insurance consultant and a certified reinsurance arbitrator. He was the NYIE's vp, general counsel and secretary from 1980 to 1985 and subsequently represented some syndicates. He wrote a book on the exchange and related papers.

Initially, the NYIE was a success and by the end of 1984 ranked as the eighth-largest U.S. reinsurer with $345.6 million in premium volume and as the fifth-largest based on its $182.6 million policyholder surplus, Mr. Bickford said.

However, it then had rapid growth in premium volume as well as loss ratios, Mr. Bickford wrote. While NYIE officials asked certain syndicates to stop underwriting renewals and new business, "these actions proved to be too little and too late."

In 1985, the exchange recorded its first drop in volume and additional syndicates stopped writing business or sought to withdraw. *Business Insurance* reported that year that about 25 of the exchange's 44 syndicates wrote $309.5 million in gross premiums backed by $194.1 million in capital and surplus. Net premiums were $201.1 million and the exchange's net loss was $42.1 million. At the time, the NYIE had 108 broker members.

According to other *BI* reporting, problems also included back-office accounting difficulties, significant fixed costs including the 1984 purchase of a headquarters building and the failure of many insurer-owned syndicates to maintain staff on the exchange floor.

New York's exchange law also offered "a tremendous opportunity" for self-regulation, but exchange officials did not utilize it, Mr. Bickford said.

The NYIE ceased operations in 1987.

Somewhat similar exchanges in Florida and Illinois also began operating during the 1980s. Florida's ended in several lawsuits. The renamed INEX, the Insurance Exchange in Chicago, experienced the insolvency of several syndicates but continues operating with one syndicate.

Given the problematic history of U.S. exchanges generally, and the NYIE specifically, New York Insurance Superintendent Eric Dinallo said he might consider a new name for the facility. IF

to pay out about $82 million, or about 74 cents for every $1 due in claims.

LAW STILL ON THE BOOKS

Mr. Dinallo envisions such an exchange offering reinsurance for local and international risks, direct coverage of major properties and other unspecified innovative coverages.

Reviving the concept also would mesh well with the spirit of a statewide regulatory modernization initiative that seeks to help New York enhance its status as the world's financial capital, he said. The proposal also demonstrates another aspect of Mr. Dinallo's continuing interest in reinsurance, as previously seen in his proposal to relax collateral requirements for non-U.S. reinsurers doing business in the state.

A key factor is that legislation authorizing the exchange is still on the books, Mr. Dinallo said.

The two-and-one-half page law, Article 62, broadly outlines the exchange facility consisting of member syndicates and member brokers, and gives the New York insurance superintendent "broad discretion," Mr. Dinallo said.

The law describes the exchange as a facility for underwriting reinsurance for all types of insurance, direct insurance of all types of risks located entirely outside the United States and direct insurance of U.S. risks on an excess and surplus lines basis.

It requires that the exchange have a constitution and bylaws covering the role of governors and members, their voting powers and establishing a security fund. It provides that exchange contracts are not covered by any New York security or guaranty funds.

SHAPING IDEAS

Two decades of advances in communication technology would allow an exchange to operate efficiently and without a lot of administrative overhead, compared with the former exchange's paper-based operations. "It would be a great clearing mechanism," Mr. Dinallo said.

In addition, oversight of the exchange could use a regulatory approach compatible with "deep pocket" backers expected to participate in the revived exchange, he said. Such an exchange, which would not handle policies for individuals, needs to be regulated from a business point of view and not a consumer point of view, Mr. Dinallo said.

The department

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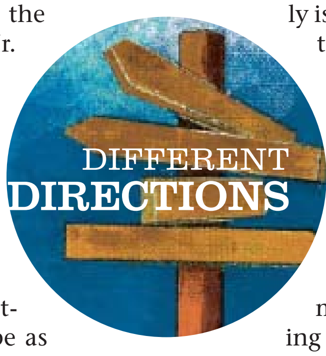
proposes to borrow from the United Kingdom's "principles-based" regulatory structure by considering an outcomes-focused "principles-guided approach."

In addition, a revived exchange could be part of a "passporting" mechanism that would help mostly non-U.S. companies write coverage in the United States, Mr. Dinallo said. While getting other states to treat exchange coverage as an admitted asset for ceding companies that buy it could be "a high hurdle," he said all states did accept exchange coverage in the 1980s.

Whether there is sufficient industry support to revive the exchange remains in question.

One reason the NYIE failed was a lack of real support by the insurance industry, Mr. Dinallo said. Currently, other financial services companies are the most enthusiastic supporters. Bankers, however, need to understand that they'd be investing in a liability rather than an asset, but the investment's duration could be as short as one year, he said.



The exchange should be industry-driven, not regulator-driven, said Peter H. Bickford, a New York-based attorney who is an independent insurance consultant and a certified reinsurance arbitrator. He was the NYIE's vp, general counsel and secretary from 1980 to 1985 and subsequently represented some syndicates. He wrote a book about the exchange and has made presentations on the topic.

"The regulators can provide the forum and support for the development of a plan, but the primary force needs to come from inside the insurance and financial services industries if there is to be any lasting success," Mr. Bickford said.

QUESTIONS REMAIN

Several insurance industry representatives thought such an idea merits further exploration.

"I think it's a very interesting idea," said Sean McGovern, general counsel of Lloyd's in London. He said any idea from Mr. Dinallo, whose approach to regulation he considers "very refreshing," is welcome.

Tracey Laws, senior vp and general counsel of the Washington-based Reinsurance Assn. of America, praised Mr. Dinallo for being "a thought leader" and said the RAA would like to participate in future discussions.

Debra J. Hall, senior vp-group legal for Swiss Re America Holding Corp. in Armonk, N.Y., said the New York superintendent's broad discretionary authority puts him in a unique position to consider such a proposal.

Other observers suggested key elements to include in any exchange proposal. Using technology efficiently is critical for any exchange to function successfully, nearly all observers said.

"A new exchange will need to take full advantage of the technical developments over the decades since the original exchange, including instant communications, virtual trading capabilities, and real-time access to and use of transactional and other data," Mr. Bickford said.

State-of-the-art technology should provide "a lower cost" operating environment, said Daniel F. Maher Jr., executive director of the Excess Line Assn. of New York.

Mr. Dinallo also should carefully consider what lines of business the exchange would allow as well as tax and regulatory considerations that force most new insurance capital offshore. Among policies that would help attract needed Wall Street capital would be favorable tax treatment by municipal or state authorities, Mr. Maher said.

Regulators also should allow the exchange to sell unusual products that will attract buyers, said Mr. Maher.

However, regulators need to be cautious about special treatment that would give such an exchange a competitive advantage that current market players might resent, sources said.

Another key component is "a strong commitment on the part of both the regulators and the industry to self-regulation and control of the market," Mr. Bickford said. The industry needs to have "the will to enforce its rules and its financial security requirements." Failure to do so "was a major failing" of the previous exchange, Mr. Bickford said.

And syndicates' capital requirements must be significantly higher than those of the failed exchange, he added.

A viable security fund is also essential, many agreed. The authorizing law requires a security fund, but gives the superintendent great discretion over how it's established or funded.

Many non-U.S. reinsurers have balked at the concept of paying into a U.S. security fund that would duplicate funds in their countries of domicile.

"The issue of security is an important one and must be addressed," Mr. Bickford said. "I don't see the security fund as a hurdle."

Patricia A. Borowski, senior vp government and regulatory affairs for the Alexandria, Va.-based National Assn. of Professional Insurance Agents, said "the security fund is a key issue," as is the proposed regulatory approach.

She said she appreciates New York's aspirations to be a leader in financial services regulation, but questioned what regulators could do to prevent problems that three separate insurance exchanges have experienced (see story, page 11). Principles-based regulation won't necessarily solve everything, she said. In fact, she said such an approach may ignore or try to trump several legal precedents regarding company rights.

"It's ironic that New York is talking about revitalizing the insurance exchange" at this time, said Terry L. Ryan, vp of administration and secretary of INEX, the Illinois Insurance Exchange in Chicago that is the lone surviving U.S. insurance exchange.

INEX has one syndicate operating and is trying to rekindle business after its security fund paid $32 million last July to 2,400 policyholders stemming from six syndicates' insolvencies.

People have stayed away from INEX because they feared having to share in prior losses, Ms. Ryan said. "Now we are hoping since that is behind us, we'll be able to attract new syndicates." IF

COVER FOCUS
ALTERNATIVE RISK MARKETS

Gaining traction

Sour economy is not hindering the slow, steady growth of benefits captives

By Meg Fletcher

The recent downturn in the U.S. economy is not expected to have a significant effect on the willingness of large employers to consider reinsuring employee benefits through their captives, industry experts say.

Interest in adding reinsurance of benefit risks to the property/casualty risks that are already covered in a captive program is expected to continue at the same measured pace that has characterized the market during the past seven years.

"I don't think that the threat of a recession will decrease the need for captives," said Nancy Gray, executive director-North America of Aon Insurance Managers in Burlington, Vt., which manages more than 1,300 captives worldwide. Employers set up captives because they are in the employer's long-run best interest, she said.

An economic downturn may shift a company's priorities, but employer interest in benefit captives is expected to grow over time, said Sofia Tesfazion, a New York-based consultant with Towers Perrin.

Among employers, the idea of putting benefits in captives "is still a new concept, but it is getting traction," Ms. Tesfazion said. "More insurance companies are getting eager to play in this field," primarily as fronting insurers for an employer's captive arrangement, she said.

Len Crouse, deputy commissioner of captive insurance in the Vermont Department of Banking, Insurance, Securities and Health Care Administration, said the market will grow because "all companies are trying to cut the costs of health benefits," and a good captive program can help do that.

However, market demand for benefit captives has been very slow in developing during the past several years. "It hasn't turned out to be the boom I thought it would be," said Mr. Crouse.

In 2000, benefit captive supporters cleared an important hurdle when the U.S. Department of Labor approved Columbia Energy Group Ltd.'s request to fund long-term disability benefits for its U.S. employees through the Vermont branch of Columbia's Bermuda-based insurance affiliate. Columbia, then of Herndon, Va., subsequently was acquired by NiSource Inc. of Merrillville, Ind.

Since then, nearly a dozen benefits captives have begun operating from U.S.-based domiciles after receiving Labor Department approval, Ms. Gray said.

Several more companies are in the process of studying or applying for permission to begin such arrangements, sources said.

Large U.S. companies regulated under the federal Employee Retirement Income Security Act must obtain Labor Department approval in the form of a prohibited transaction exemption before they can place benefits for U.S. workers into captives. Global programs that insure benefits for non-U.S. employees do not face such a review.

Currently, there are five U.S. jurisdictions that have the authority to license captives to include benefit risks. Vermont is the largest U.S. captive domicile, but benefit captives also are authorized in Hawaii, South Carolina, the U.S. Virgin Islands and Arizona.

Globally, there is greater use of captives by U.S. and non-U.S. employers to provide benefits to non-U.S. employees, experts agree. That's primarily because employers do not have to get Labor Department approval for non-U.S. employees.

European companies' use of captives for employee benefits "is increasing" due to "above-inflation increases for benefits costs, particularly medical, and resulting pressures to avoid medium-term reductions in corporate operating margins," said Markus Mende, managing director, Aon Global Risk Consulting-Continental Europe in Basel, Switzerland.

"By my estimate, there are approximately 40 to 50 captives writing this coverage," he said in an e-mail.

The types of benefit risks that captives reinsure often depend on where employees live, experts say.

In the United States, benefit captives may offer long-term disability, some group life and retiree health insurance. Another option is stop-loss coverage for active employees' medical coverage, Ms. Tesfazion said.

For example, financial services giant Wells Fargo & Co. in San Francisco recently received final Labor Department approval to use its Vermont captive, Superior Guaranty Insurance Co., to reinsure group life and long-term disability policies. The group life policies are being written by Minnesota Life Insurance Co. while the LTD policies are being written by Metropolitan Life Insurance Co. Each insurer is retaining 10% of the risk in the plan.

Outside the United States, benefits may include supplemental medical coverage, which is benefits beyond those offered by a national health insurance program, Ms. Tesfazion said.

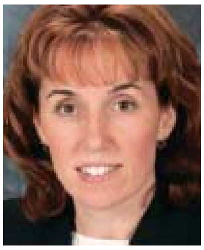
European companies are using captives for several employee benefits that include life, disability, medical and accident coverage, Mr. Mende said.

In addition, pensions are "a very new area" of coverage for non-U.S. benefit captives, Ms. Tesfazion said.

DEAL OR NO DEAL

In a typical transaction involving group life benefits, Aon said in a statement, an employer asks its life insurer to be a fronting insurer and to reinsure the coverage with the employer's captive. The employer then pays a premium to the fronting insurer, which in turn pays a reinsurance premium to the captive.

The reinsurance contract is an indemnity reinsurance arrangement, "which means that the fronting insurer will be liable for any claims that, for whatever reason, are not reimbursed by the employer's captive despite the reinsurance contract," according to its explanation. The fronting insurer charges various service fees and requires posting of collateral or a letter of credit to ensure that the captive will meet its obligations under the reinsurance contract.


Ms. Gray

An employer considering putting benefit risks in a captive usually begins by determining whether it will reduce costs by doing so, Vermont's Mr. Crouse said.

Cost savings is only one of several goals that employers hope to obtain from such a program, Ms. Gray said.

Employers often seek improved underwriting and investment income. They also want to diversify property/casualty risk exposures already in the captive with uncorrelated employee benefit risks, she said. A company may also improve its tax position because the Internal Revenue Service considers employee benefits business as being unrelated to that of the captive, Ms. Gray added.

Ms. Tesfazion said savings can result from many areas, including positive loss experience as well as improved cash flow and investment income. Savings also can result from lower costs for administration, underwriting, reinsurance and taxes.

Also, funding a company's benefit risks through a captive often reduces or eliminates a broker's commission, she said.

To calculate the potential savings of such a plan, Ms. Tesfazion recommends that employers consider the comparative costs of captive financing vs. other options to finance the risk exposure, such as a fully insured commercial plan or self-insurance. Comparisons should be based on the aftertax net present value of future cash flows and should consider the earnings impact on income statements of both the captive and parent company, she said.

For many employers that consider putting benefits in captives, "the key driver on all of this is control," Mr. Crouse said.

"It provides an opportunity for companies to unbundle the services they receive from insurers," Ms. Gray said. Better management of benefit claims by an active captive manager can help save costs, too, she said.

Before managers decide to explore insuring benefit risks through a company captive, it is essential that managers seek approval from the company's top financial official, Ms. Gray said. It is important that those executives understand the financial advantages of using a captive and support the idea, Ms. Gray said.

Additionally, a company's risk management and human resources departments need to collaborate on the project, she said. "I think that is key."

"One of the biggest hurdles is the silos" in which the departments often operate, Ms. Gray said.

In many companies, those two departments have historically operated independently, Mr. Crouse said. Their lack of cooperation has been a factor in limiting interest in benefit captives in the past, although it appears that is changing, he said.

One of six essential components for prompt Labor Department approval of captive benefits funding plans is "benefit enhancement," which requires that the employer improve the benefits in some way. That requirement prevents employers from reaping all the benefits of the change to a captive-funded plan through so-called "self-dealing," Ms. Tesfazion said. Examples of enhanced benefits may include higher coverage limits, accelerated death benefits and tuition reimbursement.

Benefit enhancement can be "one of the biggest issues" for companies, Ms. Gray said. "It is sometimes difficult to get agreement on what it should be."

Ms. Tesfazion said to get prompt Labor Department review of a captive benefit application, employers need to:

- Contract with an A-rated fronting insurance company to issue direct insurance for the benefits.
- Obtain a captive licensed by a U.S. jurisdiction that requires audited financial statements for the last fiscal year.
- Certify that market rates will be charged.
- Obtain an independent trustee's approval.
- Inform plan participants of the proposed change.

The Labor Department developed the components for fast-track treatment of benefit captive applications after taking years to review Columbia Energy's application for a benefits captive and that of a later applicant, Decatur, Ill.-based Archer Daniels Midland Co., which won Labor Department approval in 2002.

As a result, an application that contains those components is eligible for expedited review, which can take federal officials as little as 45 days, sources said. There also is a 30-day period during which plan participants are notified of the change, bringing the minimum total time to about 75 days, Ms. Gray said.

"Their turnaround has been timely," Ms. Tesfazion said.

"I think the Department of Labor has been very responsive," Ms. Gray said. Although the proposal to add retiree medical benefits to a captive program does not qualify for the expedited review, department officials said they will try to adhere to a similar timeline, she said.

Once they become operational, benefit captive programs have been very successful from a regulatory standpoint, Mr. Crouse said. "We've had no problem at all with them." IF

COVER FOCUS
ALTERNATIVE RISK MARKETS

Soft power

Reinsurance market conditions give captives strategic options

By Rodd Zolkos

While soft market conditions might prompt owners of some alternative risk transfer entities to turn back to the traditional market for coverage, for many, a long-term risk financing strategy remains the chief consideration.

And those same soft market conditions can hold benefits for captive programs in readily available reinsurance, according to several alternative risk market experts.

"Reinsurance pricing is down, too, and certainly captives and self-insurance pools can benefit from softening in the reinsurance market, as can commercial insurers," said Steve Langford, director at BMS Intermediaries Ltd. in London where he is leader of the specialty risk unit, which works with approximately 50 captives, self-insurance pools and mutual insurers.

"The good news is, right now it's a pretty competitive market across the spectrum in the reinsurance market and the general insurance market," said John Bowman, senior vp and principal in the consultative placement group at Towers Perrin in Boston.

"I think the market interest in supporting captives is broader and deeper than it has been, which I think is a reflection of the fact that there's a lot of capital out there looking for premium," said Brady Young, managing director and president of Strategic Risk Solutions Inc. in Waltham, Mass.

While conventional wisdom would seem to dictate that in a soft market a captive should decrease retentions and take advantage of the opportunity to purchase cheap reinsurance, Mr. Langford said there are some, though, who are choosing to increase retentions.

"Those organizations that can retain more are doing so," he said. But "a lot of these alternative risk mechanisms don't have the wherewithal to take significantly increased risk positions."

But many of those that can retain more risk recognize that in buying reinsurance, even in a soft market, "You're still paying somebody's margin," Mr. Langford said, an argument for retaining risk rather than transferring it.

Mr. Bowman noted that for many captive parents, a growing topic of strategic interest is to "optimize risk within a captive." More and more captives are willing to take larger amounts of risk as long as they're sure that their risk retention decisions are based on sound data, he said, while those concerned about the quality of their data will want to look to transfer risk at lower attachment points.

"Those with better data are acting more like a traditional insurance company," Mr. Bowman said, transferring risk at higher attachment points into traditional reinsurance programs.

In general, though, many captive parents recognize that their captive programs—to the extent possible—exist to smooth out the effects of capacity shortages and soft markets, Mr. Bowman said, and they're using their captives to smooth out those swings and achieve an appropriate balance between risk transfer and risk retention.

Having a captive in place, allows the parent to "transfer risk with greater facility" if they choose, he said, "so you can leverage the market, hedge the market but doing it with the backbone of your overall philosophy."

"I think the buyers' interest in using the captive to access reinsurance is also a function of the market," said Mr. Young of SRS. "I think there are some clients who have longer memories and know the market is cyclical."

Those captive owners realize that while they might be able to save a little money now by abandoning or reducing their captive program, there's value in a long-term risk financing strategy and the partnership they've established with a reinsurer.

In many cases in the current market, it's an issue of "Do you need to? Do you have to? Probably not," Mr. Young said. But, in many cases "People recognize that going to the source of the capital and having a relationship certainly helps you when the market turns and I think some people get that and some people don't."

Medical malpractice captives, for example, typically rely on reinsurance capacity in the London or Bermuda markets. While the traditional med mal market may be softening, offering options other than the captive, parents of some med mal captives may see value in continuing to use their captive to finance risk as a way to maintain their relationships with their reinsurers.

"For some accounts, certain types of risks, it's a good long-term strategy," Mr. Young said.

"Where you can obviously take advantage of the market is when the market's soft you can look at your attachment points," Mr. Young said. "They haven't abandoned the strategy, but they've adjusted the tactics to match the market conditions."

And, he noted, pricing is just one variable in the reinsurance equation, and in a soft market, captives may find themselves able to negotiate other favorable features in their reinsurance programs. "It's not just about price, it's about terms," Mr. Young said.

Mr. Langford of BMS said that the issue for alternative markets when faced with such soft commercial market competition "is that the cheapness of the product in the commercial market is very difficult to ignore."

While in many cases, the argument is still made that you create a captive program to provide stability to your insurance program and smooth out the impact of cycles, Mr. Langford said that BMS has seen cases in which captives and self-insurance pools have been shut down in the face of the cheap coverage available in the traditional market.

Still, "I think a lot of these alternative risk mechanisms are utilizing reinsurance as a means to protect themselves across the cycle," he said.

And for many captive parents, gaining direct access to the reinsurance markets is a key element of a captive's appeal.

The opportunity to get direct access to the reinsurance market "definitely continues to be one of the key drivers" of many captive formation decisions, said Towers Perrin's Mr. Bowman.

And, as they look to transfer risk to reinsurers, many alternative risk financing entities are employing some of the same sophisticated analytical tools and approaches that traditional market insurers are beginning to use in making their reinsurance buying decisions.

"A lot of the work that goes on for our larger insurance company clients is being provided to the captive company clients," such as catastrophe modeling, risk retention analysis and capital analysis, Mr. Bowman said.

"Larger clients, more sophisticated clients, are being a little more thoughtful about what they're doing," Mr. Young said. And, at intermediaries focused on placing reinsurance for captives, today "the people are smarter, they're more serious, they have better analytical tools, they're more technically oriented," he said. "It's not all about golfing and drinking."

"Take cat modeling, for example. Some clients are asking their brokers to engage the modeling firms to model their portfolios," Mr. Young said. "For some clients, it makes sense to be able to go to the reinsurance market "and talk their language."

'A LOT OF THE WORK that goes on for our larger insurance company clients is being provided to the captive company clients.'

JOHN BOWMAN
TOWERS PERRIN

And in trying to get the best deals from reinsurers, data quality is key, according to Mr. Bowman.

"The captive loss data and the quality of the data is really the key driver and helps the captive differentiate itself and gives comfort to the reinsurance community," Mr. Bowman said. Reinsurers like to see five to 10 years' worth of solid data.

"So for newer captives, it's a little tougher, but a new captive can have very good data," Mr. Bowman said. "A more mature captive still has to focus on making sure their data is credible."

For many captive programs approaching the reinsurance market, there's actually "A little bit of a blurry line," Mr. Bowman said. "When people talk about reinsurance for a captive, it often doesn't end up in a quota share," he said. "It's excess and surplus."

Many of the underwriters for captives offer both traditional reinsurance and excess and surplus programs.

"It's blurry in that people, particularly when they're putting together their first reinsurance program, they might start off planning to go into the facultative reinsurance market or even the treaty reinsurance market for a larger captive," Mr. Bowman said. "The gray area is, will it wind up in the traditional reinsurance side of the house or the excess and surplus side."

Recently, he's seen more of the captives he's doing business with get their risk transfer programs accomplished in the excess market.

While reinsurance is "pretty readily available across the board" for captives, "probably an emerging issue is the D&O market," Mr. Bowman said. The subprime mortgage crisis is a concern, with it being heightened by the question of how the fallout from the subprime crisis might affect the ratings of insurers and reinsurers with whom captive owners might be considering partnering.

"There've been a couple of recent downgrades that have underwriters and captive owners alike in a watchful waiting phase," he said.

Though reinsurance is readily available for ART entities, reinsurers are maintaining market discipline, Mr. Langford said. They are looking not to repeat the mistakes of the 1990s, he said, when some offered coverage at less than the loss cost. In today's investment climate, "We don't have the ability for huge investment gains to be made."

Despite the current soft market, "Alternatives are still a viable option," said Mr. Langford. "It's not something that goes away."

And, he said, he would argue that the best time to create an ART vehicle is at the bottom of a soft market so it can be in place when the market turns.

"We will continue to see the creation of new entities. We will continue to see the growth over time of these existing markets," Mr. Langford said. IF

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FEATURE GATHERINGS

History repeating itself with soft market cycle

By Rodd Zolkos

NEW YORK—The current softening phase of the insurance pricing cycle will pressure insurers' financial performance this year, according to some industry executives, and, despite some suggestions to the contrary, is not markedly different from pricing cycles of the past.

Speaking as part of a chief executive officer panel last month at the annual Property/Casualty Joint Industry Forum in New York, Evan G. Greenberg, president, chairman and CEO of Hamilton, Bermuda-based ACE Ltd., said that if there are differences between the current cycle and those that preceded it, the differences are "on the margin."

PROPERTY/CASUALTY INSURANCE
JOINT INDUSTRY FORUM

Some differences that might help maintain pricing discipline in a softening market could include the current low interest rate environment, greater insurance company use of outside actuaries and governance pressures imposed by regulatory measures such as the federal Sarbanes-Oxley Act.

But, Mr. Greenberg said, insurance is a "lagging industry," with companies not knowing the actual cost of their products at the time they're sold.

"There is plenty of room to kid yourself," Mr. Greenberg said. "I don't think it's different from prior cycles."

Ramani Ayer, chairman and CEO of Hartford, Conn.-based Hartford Financial Services Group Inc., said he thinks reinsurers are being more disciplined than insurers in the current market.

Still, he said, there are "several circuit breakers in the system" that should prevent many insurers from cutting prices too deeply. Among them is a greater emphasis on financial transparency and greater shareholder awareness of insurers' core business performance than in the past.

And Gerald P. Schmidt, president and CEO of Mutual of Enumclaw Insurance Co. in Enumclaw, Wash., said he believes company boards are imposing a certain discipline today that didn't exist in previous cycles.

"I would not want to underestimate the revolution that has taken place in the boardroom since 1990," Mr. Schmidt said. "People's feet will be held to the fire in ways that they were not in the past."

But Anthony J. Kuczinski, CEO of Munich Reinsurance America Inc. in Princeton, N.J., wasn't sure much had changed, and questioned how great an impact the circuit breakers Mr. Ayer cited were likely to have.

"Memories are short in this business and we tend to rationalize. Even with these circuit breakers, there's a lot of cash in this market," Mr. Kuczinski said.

And the need to do something with that cash is likely to drive company behavior, according to some of the executives.

"I think balance sheets in the main are in good shape," Mr. Greenberg said. "I think the industry is pretty well-reserved." The question, though, is what does the industry do with extra capital?

"You can return it to shareholders or you can act like a giant mutual and return it to policyholders through lousy underwriting and that's generally what we tend to do," Mr. Greenberg said.

Mr. Ayer allowed that the industry's economics are such that companies with excess capital for an extended period can put it to work on Wall Street, on Main Street or "you can burn a hole in the balance sheet."

The softening market will make it difficult for the industry to match the financial performance it has enjoyed since 2006, according to some of the executives.

In 2008, "I think combined ratios are going to be markedly under pressure" vs. 2007, Mr. Greenberg said. "It's natural," he said, adding that competition is "fanning the flames."

Barring any serious catastrophe losses, Mr. Ayer said he expects 2008 to be a profitable year for the industry. He added, however, that he thinks the industry needs a greater period of sustained profitability. Mr. Greenberg said he expects 2008 to be "a marginal year," while Mr. Kuczinski said he thinks some lines of business are likely to perform better than others.

On the personal lines side, Thomas J. Wilson, president and CEO of Northbrook, Ill.-based Allstate Corp. and Allstate Insurance Co., said he thinks that while companies' margins will shrink a bit in 2008, "I don't think you'll see the kind of cycles where competition is based only on price."

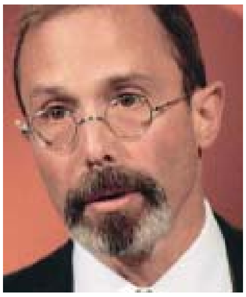
Competition in the personal lines business will be reflected in part by companies spending more on such areas as marketing, technology and claims handling, he said, with that spending having an inevitable impact on margins.

In the current environment, it will be difficult for commercial lines companies to generate top-line growth, Mr. Ayer said, given downward pressure on pricing. "My sense is that in personal lines, you'll see a more mixed story," he said.

"I think you see a little more discipline in personal lines than you have in

'YOU CAN RETURN (extra capital) to shareholders or you can act like a giant mutual and return it to policyholders through lousy underwriting and that's generally what we tend to do.'

EVAN G. GREENBERG
ACE LTD.



'MEMORIES ARE SHORT in this business and we tend to rationalize. Even with these circuit breakers, there's a lot of cash in this market.'

ANTHONY J. KUCZINSKI
MUNICH REINSURANCE AMERICA INC.

the past," Allstate's Mr. Wilson said. "If you think about meeting customers' needs and doing things differently… you can do that on the personal lines side" and generate growth.

Mr. Schmidt cited what he called "a collision of interests" in the homeowners business, though, between consumers' pricing expectations for homeowners insurance and insurers' desire to generate an adequate rate of return. "And currently we are losing that battle in the court of public opinion," he said.

Reinsurers don't appear to be immune from pressures of the cycle. Mr. Kuczinski said "reinsurers were trying to hold discipline, but the prices were somehow deteriorating more than they should have" during Jan. 1 renewals.

"The reinsurers are being disciplined by and large," he said. "I would also say they need to be very selective in who they do business with."

Mr. Greenberg noted that ACE is both a buyer and a seller of reinsurance. As a seller, "we had already contemplated a competitive environment for (Jan. 1) and across all lines it was more competitive than we planned for," he said. Not surprisingly, then, "as a buyer, it was a buyer's market," he said.

Despite the challenges of the current environment, Munich Re America's Mr. Kuczinski said he sees this sort of market as one in which companies can prepare themselves for the future. "I view a market where it's a challenge to make an underwriting profit as a time you position yourself for the next phase in the market," he said.

"One of the things you can do when the market's not working in your favor is start thinking about what does the market need, what is it demanding," Mr. Kuczinski said.

A U.S. recession could be another factor affecting industry performance.

"Unless it's a prolonged recession, I believe we'll recover quickly as an industry," Hartford's Mr. Ayer said. A prolonged recession, however, could confront the industry with both asset and credit issues, he said. The industry also could be hit in such areas as workers compensation with increased claims fraud.

On the subject of the U.S. regulatory system, Mr. Greenberg said, "It's a broken system and it's antiquated."

Mr. Schmidt said he'd like to see things such as portability of licensing from state to state, and cited what he described as onerous pricing restrictions in the current state-based regulatory environment.

The discussion prompted involvement by some regulators on the day's previous regulatory panel, including Sandy Praeger, Kansas commissioner of insurance and president of the National Assn. of Insurance Commissioners.

While defending the state-based regulatory system, Ms. Praeger agreed with the need for increased uniformity. "I think there are some areas where we're going to have to get assistance from Congress to get some uniformity," she said, such as in achieving principles-based reserving.

Franklin W. Nutter, president of the Reinsurance Assn. of America, moderated the CEO panel. IF

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FEATURE TRENDS

Risk laboratory

Florida's experiment with collateral waivers could pay rewards; or backfire

By Meg Fletcher

Florida may become the first U.S. state to effectively waive collateral requirements for the most financially secure non-U.S. reinsurers.

Backers of the idea say it would increase reinsurance capacity in the catastrophe-prone state and should help lower homeowners' rates, but opponents say the state already has plenty of reinsurance capacity and the plan could jeopardize the financial stability of ceding insurers.

Florida Insurance Commissioner Kevin McCarty is developing a rule that would allow him to decide which financially sound, mostly non-U.S. reinsurers can assume Florida risks from ceding insurers. Then, market forces would help determine the amount of collateral a reinsurer must post, with the most secure reinsurers posting none.

Florida insurance regulators are considering adopting such a measure in April as a way to bring new, private reinsurance capital to an area with $1.9 trillion in coastal risks that are threatened by inevitable hurricanes.

Development of the collateral reduction rule is the third major insurance initiative the Florida Legislature authorized last year in an effort to reduce consumers' insurance costs. Two others are already operational.

FLORIDA'S PLAN

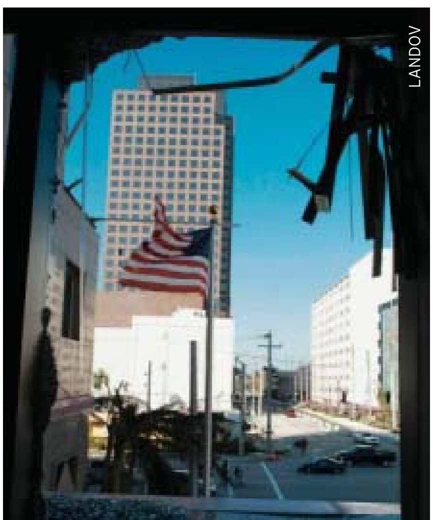
First, Florida added an extra $12 billion layer of inexpensively priced coverage through the Florida Hurricane Catastrophe Fund, which had "a significant impact on the market," said Sean Mooney, the New York-based chief economist with Guy Carpenter & Co. L.L.C., a unit of Marsh and McLennan Cos. Inc.

However, rating agency A.M. Best Co. Inc. expressed concern about the creditworthiness of FHCF should a loss occur and Florida had to post-fund it by issuing public debt, he said.

Second, the legislature significantly expanded Citizens Property Insurance Corp., which is pressuring insurers to lower rates due to its increased competitiveness.

Under the third initiative, Mr. McCarty would determine whether a reinsurer is financially stable enough to be considered an "eligible reinsurer" to assume Florida risks. The plan then focuses on ceding insurers by directly regulating the amount of credit they can take on their financial statements for reinsurance coverage they purchase from an eligible reinsurer.

A ceding insurer can claim credit in one of five levels—100%, 90%, 80%, 50% or zero—corresponding to the lowest financial stability rating the reinsurer has received from acceptable rating agencies. The market impact of the plan will be to effectively tie the amount of collateral that the cedent's reinsurer must post to those levels—or 0%, 10%, 20%, 50% or 100%—respectively.



Hurricane Wilma caused extensive damage to buildings in downtown Fort Lauderdale and elsewhere in Florida in 2005.

ONGOING DISCUSSION

Florida's plan makes it a laboratory for modernizing reinsurance regulation, said Walter Bell of Alabama, the immediate past president of the Kansas City, Mo.-based National Assn. of Insurance Commissioners. The NAIC has discussed the topic for more than a decade without resolution.

The focus of the NAIC's ongoing discussion is a requirement that non-U.S. reinsurers post collateral matching their exposures to U.S. risks. Many U.S. ceding insurers and reinsurers have opposed any relaxation, citing financial concerns. At the same time, overseas organizations, notably those in London, have pushed for such relaxation, arguing that many overseas reinsurers offer comparable, or better, security than many of their U.S. counterparts.

The Florida proposal brings new urgency to the discussions, according to comment letters written by both supporters and opponents.

According to Mr. McCarty, relaxing the requirements "will lead to increased capital and competition in our state" and help "stabilize and potentially reduce property insurance rates."

Florida regulators are currently reviewing comments and letters received at a November 2007 workshop designed to seek public input on the rule regulators say is designed to seek "the best interests of market stability and the solvency of ceding insurers."

A reinsurer that seeks the "eligible" designation also must have at least $100 million in surplus and be from a jurisdiction that Mr. McCarty approves as "eligible." Among the jurisdictional requirements he will look for are "a satisfactory structure and authority with regard to solvency regulation," as well as "prompt enforcement of valid U.S. judgments or arbitration awards."

In addition, a reinsurer must submit a certificate of good standing from its domiciliary regulator, audited financial statements, proof that it submits to U.S. legal jurisdiction and a list of all disputed or overdue recoverables.

Reinsurers deemed eligible must meet annual requirements to maintain that status, including filing financial statements, and agreeing to immediately advise Florida regulators of any ratings changes.

The commissioner would have the authority to withdraw a reinsurer's status as an eligible company or require it to post additional collateral.

Other provisions include:

- Deferring for one year collateral required for eight short-tail lines that are affected by a named hurricane loss.
- Reducing an eligible reinsurer's minimum collateral by 5% for depositing its required collateral in a depository financial institution in Florida.
- Spelling out specific contract requirements between the reinsurer and ceding insurer.

OTHER VIEWPOINTS

Industry response to the Florida's draft rule split along traditional lines.

Though they'd prefer widespread uniform change, non-U.S. reinsurers view the initiative as a sign of progress.

Swiss Re America Holding Corp. in Armonk, N.Y., "generally supports efforts to reduce collateral as part of comprehensive reinsurance regulatory reform," said Debra J. Hall, senior vp-group legal. Components should include collateral reduction, a single regulator and enhanced risk management, "but we understand that you can't do everything at once," she said.

Lloyd's of London welcomes Florida's plan as a step toward leveling the U.S. playing field that Lloyd's seeks, especially given the NAIC's lack of progress, said Sean McGovern, Lloyd's general counsel in London. If regulators "remove barriers and make the market more efficient, that should improve it," making it more attractive to the worldwide reinsurance market, he said.

In his comment letter, Joseph P. Gunset, general counsel of Lloyd's America Inc. in New York, recommended that Mr. McCarty be given discretion to determine a jurisdiction's eligibility and to waive some or all of the extensive supporting documentation that the draft law requires.

If Florida enacts the proposed rule, "this change will undoubtedly create further needed capacity for the state," David J. Matcham, chief executive of the London-based International Underwriting Assn., said in an e-mail.

Many IUA reinsurers already write substantial amounts of Florida business in spite of current "onerous" collateral requirements, Mr. Matcham wrote. Regulations effectively reducing collateral, "would find favor with these reinsurers and at least encourage them to consider further opportunities to write business in Florida," he wrote.

Bradley L. Kading, president and executive director of the Assn. of Bermuda Insurers and Reinsurers, said in a letter that the association supports Florida's proposed changes.

He made several recommendations, including extending the deferral period for short-tail business to two years instead of one. That would better match the typical catastrophe loss payment period, which is nine quarters, and prevent companies from having to post collateral even though a claim had been paid, he wrote.

The RAA also is concerned about the Office of Insurance Regulation's authority to identify non-U.S. eligible jurisdictions, suggesting that "OIR take the necessary steps to confirm its lawful authority in this area."

UNIFORMITY CONCERNS

Another major problem with Florida's approach is that "it creates a patchwork system," Ms. Laws said.

A potential lack of uniformity was one of several concerns of trade associations representing ceding companies.

Florida's draft rule approach is "inherently flawed," said Michael Koziol, assistant vp and counsel of the Des Plaines, Ill.-based Property Casualty Insurers Assn. of America. He cited numerous ways reducing collateral could impair ceding companies' credit for reinsurance, including "slow-pay" or "no-pay" reinsurers or one that's financially impaired and can't or won't post additional required collateral.

> If regulators **'REMOVE BARRIERS** and make the market more efficient, that should improve it,' making it more attractive to the worldwide reinsurance market.
>
> **SEAN MCGOVERN**
> LLOYD'S OF LONDON

Steven A. Bennett, assistant general counsel of the Washington-based American Insurance Assn., questioned the "drastic and unnecessarily dangerous" size of the collateral reductions and their potential impact on the solvency of Florida insurers.

And he challenged the reliance on commercial rating organizations. "They notoriously are too late with their rating downgrades," he wrote. Mr. Bennett urged that a security fund be established to protect ceding insurers.

William Boyd, financial regulation manager for the Indianapolis-based National Assn. of Mutual Insurance Cos., said the proposed rule doesn't deal with potential changes in reinsurers' financial status. "The state is walking out on a plank" when it comes to regulating the solvency risk of ceding insurers, he said.

Patricia A. Borowski, senior vp of government and regulatory affairs for the National Assn. of Professional Insurance Agents in Alexandria, Va., also generally supports the state's draft rule. The organization's Florida affiliate is still reviewing the topic before taking a formal position, she said.

A key factor in PIA National's support is the legislature's grant of legal immunity to producers who help provide coverage in transactions covered by the proposed rule, Ms. Borowski said.

Taking a dim view of the proposal's impact, however, are members of the Washington-based Reinsurance Assn. of America and representatives of ceding insurers.

The RAA supports comprehensive reinsurance regulatory reform but opposes the Florida plan. "There isn't any reinsurance capacity shortage in Florida at this time," said Tracey Laws, the RAA's senior vp and general counsel.

Florida regulators say April is the earliest the rule could be adopted. IF

Change, while painful, brightens road to future

By Alex Letts

New Year, New Hope. In October 2006, it was suggested that 15% of that season's London treaty reinsurance would be traded electronically at renewals. My prediction was proved hopelessly optimistic as fewer than 1,000 placements were traded in 2006 renewals via RI3K or peer-to-peer. Right vision, wrong time.

By the end of 2007, so much had changed. Lloyd's Chief Executive Richard Ward had emerged as a true champion of electronic trading. Aon Ltd. had committed itself fully to an e-placement rollout. Data messaging gateways were springing up in London insurance companies to enable e-traded risks to come into carrier systems without rekeying. And now Aon has just published an estimate that about 80% of its 2007 renewals were distributed and signed electronically. Aon is also ramping up its specialty and nonreinsurance business, which will multiply trading volumes tenfold.

The price, as in any great battle, has not been inconsiderable. Missteps over the past 15 years have cost the markets hundreds of millions of dollars directly in failed initiatives. And billions of dollars have been squandered in opportunity cost.

LIKE PULLING A TOOTH

Morale in the change arena has been tested to extremes; skepticism and resistance have had to be forcibly extracted, no less painfully than infected teeth. Technologies have, as ever, not lived up to their billing, and processes and implementation have been excruciatingly experimental. The market has been the guinea pig and has justifiably raised its eyes to the heavens and cried in anguish, "Why me, oh Lord, why me?"

But at the end of it all, 2007 was the watershed. Thousands upon thousands of complex, multilayered, multisectioned subscription risks were placed electronically. It wasn't pretty, it wasn't fun, but it got done.

RI3K's trading service alone probably handled placements in excess of $5 billion of premium. Now if you can handle this stuff in high volumes, then direct classes of business are less of a challenge.

Already, the acceleration in nonreinsurance trades is threatening to overshadow the reinsurance trading. At one point in December, RI3K was seeing three trades a minute—trivial by other financial services sectors' trading norms, but unimaginable in the insurance arena until just recently. Over 10,000 individual trading sessions in four weeks tells its own story.

But, more importantly, the market knows there is no going back from here. In years to come, those veterans of the 2007 bedlam will proudly boast to their apprentices that "they were there" in the first electronic trading season in London. Medals all round, and wear them proudly, for legends are made of this stuff.

In time of course, $5 billion of premium will be the monthly run rate for a market that has been expanded by the release from paper processing, but in the meantime, there are still battles to be fought, mistakes to be made, wounds to be healed. But above all else, there's a realization that the tiresome debate of "how" or "if" has been replaced with "how soon" and "how better." The ramp up by the brokers will dictate the answers.

INTO THE LIGHT

2008 is a new year, but it marks the end of an old epoch. Three hundred years of paper-based trading does not disappear overnight, but it will erode over the next 24 months. Increasingly, paper will become the exception, not the norm.

The journey through the darkness is now ending. The market has just stepped out blinking into the light that was glimpsed at the end of the tunnel all those years ago. It will take a moment or two to adjust its eyes, but as soon as it does, it will be released from the shackles that have restrained it. Goodness knows how far and how fast it can now move.

Intriguingly too, London will become an electronic trading zone during the soft part of the insurance cycle, which adds spice in terms of the promise for the future growth and prosperity as the cycle ends. As Western economies stumble grimly through the next five years of uncertainty, the prospects for insurance traders in London have never looked brighter. New Year? New Hope! IF

Alex Letts is chief executive of London-based insurance and reinsurance electronic trading exchange RI3K.

IN FOCUS

For many captive insurance and other alternative risk transfer arrangements, fronting insurance is an essential ingredient to make the program work. Sometimes, however, ART program parent companies find it difficult to find the necessary fronting coverage. Here's a look at some of the key players in the fronting insurance market, and a brief overview of the type of business they do and some of their requirements.

Discover Re

Discover Re is the unbundled alternative risk transfer unit of Travelers Cos. Inc. for individual risk and captive program customers. The company's captive business focuses on Discover Re as the issuing insurer and the captive as a risk-assuming partner.

LOCATION: FARMINGTON, CONN.

PHONE: 860-284-2762

FAX: 860-674-2671

WEB SITE: www.discover-re.com

COVERAGE LINES SERVED: ALL COMMERCIAL LINES: WORKERS COMPENSATION, AUTO LIABILITY, AUTO PHYSICAL DAMAGE, GENERAL LIABILITY, PROPERTY

JURISDICTIONS SERVED: ALL 50 U.S. STATES

COLLATERALIZATION REQUIREMENTS: COLLATERAL IS REQUIRED UP TO THE CAPTIVE LAYER "LOSS PICK" PLUS A BUFFER FOR UNEXPECTED LOSS DEVELOPMENT. THE BUFFER OR "GAP" IS CALCULATED FOR EACH CAPTIVE BASED ON AN ANALYSIS OF SEVERAL FACTORS, WITH THE TYPICAL BUFFER RANGING FROM 50% TO 75% ABOVE THE EXPECTED CAPTIVE LOSSES.

FRONTING COMPENSATION: BOTH FEE-BASED AND PREMIUM-BASED DEPENDING ON LIMITS

PRINCIPAL CONTACT: BLAINE BONTEMPO

Great American Insurance Cos.

The Alternative Markets Division of Great American Insurance Cos. specializes in risk-sharing arrangements for agents, groups and large accounts. There are several structure and service options available.

LOCATION: CINCINNATI

PHONE: 513-412-4331

FAX: 513-369-7559

WEB SITE: www.greatamericaninsurance.com

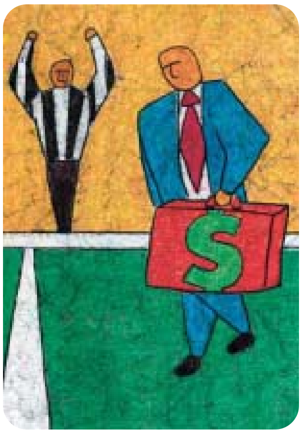
COVERAGE LINES SERVED: AUTO LIABILITY, GENERAL LIABILITY, PROPERTY, WORKERS COMPENSATION

JURISDICTIONS SERVED: ENTIRE U.S. EXCEPT FLORIDA AND OTHER COASTAL AREAS

COLLATERALIZATION REQUIREMENTS: FULL COLLATERALIZATION TO THE "GAP"

FRONTING COMPENSATION: N/A

PRINCIPAL CONTACT: SARAH COMERFORD



Old Republic Risk Management Inc.

Old Republic Risk Management specializes in providing alternative risk insurance products and services that help corporate and group clients manage their insurance programs and stabilize their insurance costs.

LOCATION: BROOKFIELD, WIS.

PHONE: 262-797-3440

FAX: 262-797-0486

WEB SITE: www.orrm.com

COVERAGE LINES SERVED: PRIMARY CASUALTY

JURISDICTIONS SERVED: ENTIRE UNITED STATES

COLLATERALIZATION REQUIREMENTS: COLLATERAL REQUIRED

FRONTING COMPENSATION: FEE-BASED

PRINCIPAL CONTACT: MICHAEL WEBER

Prudential Financial Co.

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LOCATION: SILVER SPRING, MD.

PHONE: 301-562-7821

WEB SITE: www.prudential.com

COVERAGE LINES SERVED: GROUP LIFE AND DISABILITY

JURISDICTIONS SERVED: ENTIRE UNITED STATES

COLLATERALIZATION REQUIREMENTS: CASE-SPECIFIC

FRONTING COMPENSATION: PREMIUM BASED ON LIMITS

PRINCIPAL CONTACT: DAVID BROOKER

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LAST WORD

PETER BREITSTONE is managing principal and chief executive officer of Aon Environmental Services Group. in Cedarhurst, N.Y.

Sustaining success and job security

"I say the Earth belongs to each generation. No generation can contract debts greater than may be paid during the course of its own existence"
THOMAS JEFFERSON–SEPT. 6, 1789

Sustainability is a global concept requiring that economic development and growth meet the needs of the present without compromising the future. An obscure ecological concept until a decade ago, sustainability is now embraced by many in the business world to connote enhancing shareholder value through social, environmental and ethical responsibility.

Risk managers must recognize that to survive, they must answer the call to address emerging risks that threaten the ability of an enterprise to perpetuate its operations.

Until recently, survival meant a focus on tangible factors deemed essential to corporate value. Likewise, risk management focused on purchasing traditional insurance products to protect those tangible factors.

But today's news is all about emerging risks like global warming, resource depletion, developing economies, water shortages, credit crises and pollution. How should risk managers respond to these emerging concerns, and how should sustainability be viewed against traditional responsibilities?

In the book "The Sustainable Advantage," Bob Willard describes the Company Value Iceberg, which incorporates both tangible and intangible factors affecting an organization's value. He emphasizes that the tangible factors, those typically addressed by traditional insurance programs, are no longer the primary determinants of corporate value. He estimates that intangible factors now comprise up to 80% of an organization's value.

For businesses, this shift can translate into success or failure depending upon the ability to anticipate future events and trends and recognize the associated risks and opportunities. For risk managers, understanding the concepts of sustainability will be essential to their success and critical to their job security.

Some areas to consider when looking at corporate value contributing factors include: brand value and reputation, employee productivity, efficiencies in manufacturing processes, efficient use of energy (beyond reductions in demand), conservation of consumable resources, and innovation and investment in research and development.

Other areas are reduced physical facility costs, customer satisfaction, supply-side security and diversity, risk mastery—buying less insurance and providing better protection for catastrophic risks—and thought leadership and enlightened management.

For risk managers, the news will be mixed. Those driving the identification of emerging risks and promoting the accompanying opportunities will be valued as part of the solution. Those who don't will see the role move to someone else—perhaps the newly hired vp of corporate sustainability.

More than 400 companies now report having an officer of sustainability, and the number is growing rapidly. Viewed as helping the company make money by identifying "green opportunities," sustainability officers have been welcomed into the top executive ranks.

FOR RISK MANAGERS, understanding the concepts of sustainability will be essential to the success of their function and critical to their job security in the future.

Risk management, on the other hand, continues to be perceived as a cost center. It's no wonder that risk managers who aren't conversant with the emerging sustainability issues find their functions being subsumed by the larger category of sustainability.

In this new milieu, risk managers' first task is to understand the issues critical to corporate sustainability. Then they should look for opportunities in the emerging risk areas that can be new business niches or bolster sales of existing products and services.

Risk managers must recognize that if they don't take action, others will, becoming their organizations' thought leaders. Sustainability is a 21st century risk management challenge, but also an opportunity to enhance responsibilities, create reputation and upgrade compensation. For risk managers becoming part of the solution, job sustainability will only be the beginning of future opportunities.

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Jun 16	**Emerging Markets & Globalization**	May 19
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