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fsi@fsiinsurance.com • www.forrestsherer.com

COMMERCIAL INSURANCE CENTER
24 North 6th St. • P.O. Box 900
Terre Haute, IN 47808
Telephone: (812) 232-0441
Toll Free: (877) 232-0441
Fax: (812) 232-0926

PERSONAL INSURANCE CENTER
1219 Ohio St. • P.O. Box 506
Terre Haute, IN 47808
Telephone: (812) 232-6011
Fax: (812) 232-0926



THE INSURANCE NEWSLETTER

Fall 2006

The State of the Insurance Market

Overall commercial coverage rates for June — the latest available — dropped by 7% from a year earlier, according to the MarketScout barometer. Thus we can say that the market is “soft” and has been softening since early in 2005.

But beware of averages. There are many components to the wide field of Property/Casualty (P-C) insurance. Property insurance led the pre-Katrina charge to lower rates, but no more. Property insurance, business income insurance and crime insurance are all up by an average of 1 percent. But some areas — the most vulnerable — have property rates increasing by 40%, 50% and more — when it is available.

The old reason — “the tail wags the dog” — is largely responsible for this anomaly. The catastrophe reinsurance market is very tight, with some carriers having left the field; others have upped Florida rates by 125%. As reinsurance rates go up, the primary carriers have to raise their rates. If a few more exit the field, property rates will increase farther.

Our crystal ball is a bit cloudy, but habitational risks, which are up an average of 6 percent are the most vulnerable for increases. The

three main factors are “location, location and location”.

Shedding Light on Wind v. Water

The flood exclusion on all property insurance policies has existed for many years. The wording is quite clear to attorneys and to most people of at least average intelligence who take the trouble to read their policies. That leaves a lot of people who might be said to have a “reasonable expectation” that they have flood coverage.

Because of the fact that individual insurers do not write flood insurance — except in special cases — in 1968 the National Flood Insurance Program (NFIP) became available to property owners in eligible flood prone communities. The NFIP has been well publicized over the years.

Nevertheless a nasty gal named Katrina caused billions of damage by flood. As property owners put in damage claims to their insurers, they got paid for their wind damage — some \$18 billion so far — and no payment for their flood damage, which in most cases far exceeded the wind damage.

Enter the trial lawyers, notably Richard Scruggs of Mississippi, who socked the tobacco companies for a few gazillion a few years ago. But this time, his

clients got zilch in a suit against their insurer for flood damage, as decided in a Federal court. Presumably, this may make it unfeasible for trial lawyers to bring such cases in the future. However, each case would and should be judged on its individual merits.

Most of the hundreds or perhaps thousands of pending cases are probably in state courts, which may or may not have to follow the decision in the Federal court, but would certainly be influenced by it. Although an appeal is always possible, but the case referred to would seem to cut the legs out from under Jim Hood, the attorney general of Mississippi. He’s trying to put together a class action suit.

Had the case referred to gone the other way, the insurance industry would have lost so many billions that rates would have to be raised astronomically for all property owners wherever located.

Another Possible Solution

Catastrophes of one sort or another are not isolated events. All sections of the country are subject to something.

A leading regulator, John Garamendi of California, met recently with top regulators from

other large states: New York, Florida, Illinois. The subject of catastrophe potential was topmost on the agenda. It was noted that if the San Francisco earthquake of exactly 100 years ago were to hit today, the economic loss would exceed \$400 billion —approximately the combined policy holders' surplus (PHS) of all the insurance companies in the country. And, of course, we may be facing years of record-shattering catastrophes, given recent weather patterns.

The essence of the regulators' discussion was that there should be a national financial backup — along the lines of TRIA, the Terrorism Risk Insurance Act — to help repair, rebuild and recover from an otherwise overwhelming catastrophe. \$400 billion would essentially wipe out the entire property/casualty (PC) insurance companies, and with it our entire economy would be absolutely ruined. A nice thought, eh?

Another Fallout from Natural Disasters

Insurance policies routinely exclude losses attributable to pollution. But pollution coverage to cover the physical damage to one's property, cost of cleanup and liability to others has been around for about 25 years. Today, the majority of commercial and industrial operations need some sort of environmental protection. The simple act of selling a building or even vacant land may incur substantial liabilities of an environmental nature. And of course, the prevalence of mold where dampness and warmth do their dirty work has become a bugaboo of late.

We learn from events. The disaster we all learned to hate was named Katrina. She let loose a lot of pollution, e.g., ruptured

tanks of one kind or another, oil spills etc., floating vehicles acting as missiles aimed at commercial properties storing chemicals of one kind or another. Flood waters released all kinds contaminants from households and from the soil.

No one expected damage of this sort, but it happened. And if it happens once it could happen again. The boy scouts have two words for it : "Be Prepared".

This is a Sleeper

Most of our clients have a form of Business Income insurance; either Business Interruption (B.I.) or Extra Expense (E.E.) insurance, according to their needs. But some may also have a need for Contingent B.I. Or Contingent E.E. and we don't even know about it.

Here's how it works. A manufacturing or assembly operation gets its raw materials as component parts from one or several sources. If that major or sole source suffers a disaster and has to shut down for a while and can't ship to our subject, the latter's operation suffers. It may have to temporarily shut down or curtail operations or incur substantial additional expense to keep going. Contingent B.I. And/or Contingent E.E. to the rescue. You buy coverage on the supplier, who may have a lousy unsprinklered plant without good fire protection. Or you buy it on several suppliers if needed.

The sleeper may be that a chief supplier's location calls for the need for terrorism insurance even though the principle firm does not carry it.

P.S. Another form of Contingent coverage known as Recipient Contingent — may be purchased where one's sales are very heavy to one customer.

Obviously, this is not as common as the usual supplier-dependent kind, but it does exist where a major distributor is in the picture.

Uninsurable Collateral Losses

We can't repeat it too often: Every loss you may incur that is covered by insurance is very apt to have a collateral loss for which there is no insurance available. Hence, it is of prime importance to devote your operation to risk management which involves the avoidance of losses where practicable, the prevention of losses where possible, and the mitigation of losses that nevertheless do occur despite your best efforts.

Here's one type of loss that creates collateral damage that we haven't illustrated. It came to mind because of an item we read about. (No names, please). A company manufactures or just sells a product — any kind of a product. The product turns out to be defective and a number of people suffer injury. They sue and collect, as the maker or distributor has ample product liability limits.

However, it turns out to be a good item for the media — local newspaper or widespread Wall St. Journal, local TV or CNN or network, or Internet. Whatever the case, the company's reputation is damaged. In a worst case scenario, the company goes out of business. Short of that, the bottom line suffers.

What we're saying is not confined to product liability and its attendant hazards. Virtually all insurable losses of any consequence bring with them the very real likelihood of uninsurable collateral damage to one's bottom line.. Insurance is just one aspect of risk management. What

you do about loss prevention is the key to your bottom line.

Keeping Up with the Times

Lest you forgot, there was a pretty hard market from early 2000 to early 2005. During that time, many policyholders were squeezed. Some dropped certain policies, many reduced the limits on policies. We're not preaching how foolish such actions were; lots of coverages were simply unaffordable to many policyholders. We felt your pain.

As we've noted, the market has softened considerably in most commercial lines. But the soft market won't last forever. Now is an appropriate time to take a good look at what you may have dropped or reduced, and restore those coverages and/or limits to what is needed in today's environment.

Building costs are up. Commodity prices are up. Litigiousness continues to influence the number and size of suits any business may face. Many types of crime — so-called "white collar" crime — are up substantially, thanks to the computer. And of course, health care costs — affecting liability and workers' comp as well as employee benefits — continue to skyrocket.

Don't just read this. Do something!

E-mail Risks

It's estimated that the daily worldwide volume of business e-mails sent is currently at least 80 billion and growing. That outweighs "snail mail" by about 75 to 1. However, it is estimated that about a quarter of that is personal in nature. Thus there's ample room for unauthorized

use of company facilities: spying and other malicious activities; infecting company facilities with viruses can also occur unwittingly. There's seemingly no limit to the abuses and harm done to a computer system.

All this can expose a company to legal liability to others if the company can be shown to be negligent in not preventing many forms of abuse by their employees. The legal implications are manifold. Monitoring usage, educating employees and enforcing policies regarding usage are appropriate risk management tools. Employees should know they are subject to dismissal for violating company e-mail policy.

To fill the gaps despite all the vigilance, something called network risk insurance can address the potential liability remaining. It's not exactly an "off the shelf" insurance product, but it could be worked out in many situations.

If You Wait, it Could be too Late

The economy is still fairly strong, but there definitely are clouds on the horizon. Unemployment is not too high by historical standards, but has risen lately. Job creation is below estimates and below the rate of population increase. The housing market has definitely cooled off. GDP growth is anemic compared with what it was earlier this year.

And so it goes. Very few economists have flatly predicted a recession coming soon — yet. But virtually all agree that the economy is softening, and many have not ruled out the possibility of a recession.

Why do we bring this up? Simply because a vital form of insurance fluctuates with the economy. When the economy is hot, the

insurers are eager to write it, but many businesses feel — wrongly — that they don't need it. Conversely, when the economy is in a slump, everybody wants to buy it, but the companies are very wary about writing it and find excuses to pump up the rates.

OK, wanna know what we're referring to? We're referring to credit insurance. If you have credit insurance and a customer defaults on its payments due you because it goes out of business, you get paid by your insurer. Insolvency is necessary for the loss payment.

Credit insurance may be bought on a blanket basis, applying to all your customers. Or it could be bought to cover just one or several of your largest accounts, who are named in the policy. Naturally, your insurer will look very carefully into the financial structure of named customers.

The blanket form is the most commonly bought — and for good reason. If you instead name customers A,B,C & D and customer E goes belly-up then you feel like a fool. That kind of event makes the blanket form more popular. We're not pushing the blanket form, but we know how disappointments sometimes occur as stated above.

If you don't have credit insurance, or don't know whether or not you do, call us pronto. If the economy continues to soften, you could be left unable to get it at a reasonable price, if at all. Just don't say we never told you.

More Global Exposure

Last issue we noted some insurance requirements for firms having some global exposures. In today's "flat world" — to quote Tom Friedman's best seller — a business need not be the size of Exxon-Mobil to have workers, contractors, customers, or suppliers located overseas. This article

the transportation of goods or materials to or from overseas locations — usually from them to the U.S.

Let's say a supplier in — you name the country— ships products to your plant. You may or may not work on them further, or you may merely transship them to various customers in the U.S.

It travels in one of several ways

1. It starts out by rail and/or truck to a port, then goes by ship to a U.S. port, then by truck and/or rail to your plant. Then by truck and/or rail to your various customers.

2. It leaves your foreign supplier by truck to an airport. The next leg is by air to O'Hare, Kennedy or wherever, then by truck to

your place. Then to your various customers as above.

Now all this transportation except from your place to your customers — may have been arranged at the other end, be it China, Germany, Brazil or wherever. You get billed C.I.F. — that's cost, insurance and freight. You have no control over routes, carriers or insurance, either by method or cost. They do it and you pay.

It makes more sense for you to buy the stuff from them and arrange for transit and/or insurance by a somewhat misleading name. It's called Ocean Marine insurance with a "Warehouse to Warehouse" clause. It's very broad "all risks" coverage, usually including war risks. "Usually" means not

through a war zone. No problem using our examples China, Germany or Brazil.

The policy written here — by our office, not the Asian, the German or the Brazilian — can be tailored to any special requirements you may need. The insurance will be with an insurer we deal with. And you'll know exactly how your total costs are broken down.

Don't be misled by the title "Ocean Marine". It includes transportation by air, rail, truck, bicycle, rickshaw, hand cart or coolie back. Of course, the last four will cost more! By the way, ocean marine insurance was used by Phoenician merchants 2000 or so years ago, but they didn't cover air shipments.

The following is a reprint of our Summer, 2005 newsletter footnote, as it covers a topic we feel is very important.

What is Long-Term Care?

When people consider the subject of long-term care, they often think about nursing homes. In fact, long-term care has little to do with nursing homes. Understanding the difference can help you protect your family and finances.

Long-term care is a continuum of care services and housing you will need when you live a long life. Think you won't live a long life? Think back 25 years ago. If you had a stroke, cancer or a heart attack, you simply died. Few ever heard of Alzheimer's. Today, it is the leading cause for long-term care services. The longer you live, the more likely you are to need care. The question is not who will take care of you, because your family will most often, but rather what providing that care will do to your family and finances.

Who Covers the Cost?

Medicare, the primary health care program for retirees, pays only for skilled or rehabilitative care, not custodial care in any venue. Medicaid, a federal and state program for financially needy individuals, will pay for custodial care, but primarily in nursing homes. Funding for home care and assisted living is very limited and based on availability of funds.

The result is that consumers are forced to pay privately for their care. Unfortunately, the best thought-out retirement plan rarely takes into consideration living a long life. Put another way, those assets and income have been allocated to pay for retirement, not for the consequences of living a long life. This results in the need to invade principal and divert income. As a result, one of seniors' greatest fears - that of outliving their assets - literally may come true.

The use of long-term care insurance, thus, becomes an important part of planning for disability caused by living a long life. The product has two roles: helping keep families together and allowing your retirement portfolio to execute for the purpose for which it was intended, namely retirement.

From a family perspective, think about who will be providing your care. Like it or not, children will play a key role. Long-term care insurance (LTCI) doesn't replace the need for family involvement in providing care, but rather builds on it. It pays professionals to assist the person with the toughest tasks such as toileting, bathing, feeding and continence. This, in turn, allows the family to provide care better and longer at home. That leads to a critical question: have YOU planned for the consequences of living a long life?

From a financial point of view, LTCI allows your retirement plan to stay in tact. That is particularly important given the recent steep decline in portfolio value. The product, in effect, protects the balance of your account value. LTCI also protects income. Although you may qualify for Medicaid to pay for nursing home costs by transferring assets, your income (pension, social security, IRA and/or 401k payout) cannot be protected.

*Call today to discuss this valuable protection with one of our financial services professionals. Mark Lammers and Jeff Hallam are ready to work for you.
(812) 232-0441*

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