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THE INSURANCE NEWSLETTER

Winter 2006 - 2007

The State of the Insurance Market

As storms failed to materialize as predicted, property/casualty (P.C.) rates continued their softening, going into the third year of the process. The average P.C. rate decrease was -8% for September v. September a year ago.

First, a word about averages, which can be misleading, because very few entities mirror the average directly. Perhaps you've heard this one.

Ten guys with an average wealth of \$100,000. are sitting at a bar. In walks Bill Gates who joins them. Now the average wealth jumps to \$6 Billion! Nothing changed among the original ten, except maybe their median wealth may have moved up a couple of thousand at most.

Back to our illustration. The 8% decrease was surely disproportionately influenced by the large accounts, such as the premiums paid by the Fortune 500 companies and the like. We can't judge the precise amount of influence they had. Then, each line of business, e.g. general liability, property, etc., has it's own rate of comparison, as do various sections of the country. And of course, loss experience of individual commercial policyholders has a bearing on what they pay.

So there's nothing magical about

-8%: nevertheless, with the appropriate caveats, we still feel that it's worthwhile to give you these quarterly reports as a feel for the overall trends in the market place. 'Nuff said about averages.

Insurance: A Cog in the Wheel

Businesses — and individuals — are constantly confronted with risks of all kinds. How they deal with the risks determine in large measure how successfully they operate. If a business owner or manager is content to buy insurance against any foreseeable loss — an impossibility — and let it go at that, it can't operate successfully. As we've often noted, every insurable loss develops other uninsurable or collateral loss or damage for which no insurance can cover.

The tool is risk management. There may be some loss exposures that it may be appropriate to eliminate entirely. More likely, other exposures may be reduced by various loss prevention activities. And, not to be overlooked are the various steps to take to mitigate losses that nevertheless happen. These basic stepping stones have to get management's constant attention. We'll be glad to sit down with you at any time — not Sundays at 5:00a.m.! — to discuss them with you.

Note that the above paragraph did not mention the word "insurance." It's the last station on the risk management line, but is a key element of the risk management process.

"Time Element": What Is It?

One area of insurance whose importance has been emphasized by catastrophes of the past few years has been what is known as "Time Element" exposure, wherein the measure of loss is the loss of profits, rentals, extra expenses, etc., over a period of time after disaster strikes. Here are a few examples.

1. A simple case of business interruption. Fire damages the building in which your business operates, and you can't function until repairs are completed, and both stock and machinery are in place. All that takes — or should take — six months, for example. But now it's 10 months after the fire and business hasn't yet caught up to par. Without an EPI endorsement — Extended Period of Indemnity — to your Business Interruption policy, you wouldn't collect for the time beyond six months that you suffer a loss.

2. Rent Insurance does for a building owner who rents space for tenants what Business Interruption does for businesses.

3. Some businesses — notably service businesses that have proliferated in our economy — don't need B.I.I. but need Extra Expense (E.E.) insurance. If they suffer damage to their premises, they can't just sit back until repairs are done. They have to continue immediately, "Full speed ahead; damn the cost!" Rent space, machinery, computers, phones, trucks, whatever — but stay in business while premises, etc. are rebuilt.

4. And then there's contingent B.I. And Contingent E.E., wherein your operations are contingent upon the continuing operations of others, e.g., suppliers of raw materials or parts or finished goods, etc. They suffer a shutdown due to — you name it — and you can't operate either at all or only at partial speed. They may be in this country or overseas. All kinds of dependencies.

In short, a complete review of your time element exposures is like a periodic medical check up. Call us. We're the risk management doctors!

Employee Theft

Losses caused by dishonesty of employees is far more prevalent — and costly — than losses caused by outsiders. With very few exceptions. It always was so, but the existence of the computer has made it far more convenient for the embezzler to operate. A nasty side effect of this has been the frequency of embezzlement in non-profit institutions: school districts, local governments, hospitals, churches, you name it.

Another feature of the current embezzlement situation is that the perpetrators don't fit the old-fashioned mold of a tough street gang type of criminal. They could

be anybody, especially long-time employees who've long been trusted employees. Watch out for grandma!

The reason for such action is usually precipitated by a financial strain. Massive credit card debt is one aspect, wherein the root causes may be anything: compulsive shopping, gambling, marital infidelity, drugs, you name it. But lately, with 47 million uninsured, sudden massive medical and hospital costs have been overwhelming, and lie at the root of embezzlement.

Unlike a burglary that can be discovered the next morning, inside embezzlement often remains undiscovered for a long time. We remember a case years ago, when the embezzlement was hidden for 24 years! That, of course, was unique. But discovery of a year or two after the fact isn't all that unknown.

Now here's the rub. The typical Employee Dishonesty policy — usually written in the form of a fidelity bond — is written on what is known as a "loss sustained" basis. That means that if there was no prior insurance the loss must be sustained during the policy period and discovered — and reported to the insurer — within the policy period or within 60 days after expiration. That sounds a bit harsh.

Most insurers will extend the discovery (and reporting) period beyond the 60 day period for an additional premium. Here conditions and premiums vary by the company for what is known as loss discovery coverage. A 24-year discovery period would be very costly!

Keep us Informed

Every once in a while one of our clients develops a new exposure.

It may be a new location, another truck, an additional salesman — oops, salesperson — or whatever, and never tells us. We learn of it when something happens: an accident, a fire, a burglary, etc. Sometimes coverage applies on an automatic basis, but frequently, there is none. There are such a variety of situations that we can't generalize. Play it safe, let us know. And better to tell us in advance of the event so there's no gap in coverage.

There's an opposite situation that can play tricks with one's coverage. You shut down a corporation that may have been for a discontinued product or other operation that was discontinued. Then a product claim comes out of the blue. A person injured by a product you stopped making but was still in circulation.

If you take it upon yourself to tell us to delete coverage for Corp. X because it no longer functions you may still have an exposure, as noted above. We would want to know why, and we may suggest that you keep the old entity on your General Liability policy for a couple of years. Or we may suggest that you purchase discontinued product liability.

These situations are akin to a doctor or other professional dropping malpractice insurance on the day he or she retires from practice. Then, whoops, a year later the claim comes in. One reason why obstetricians have such a tough time with their malpractice is that a botched delivery may create a claim when the baby — deformed or otherwise — reaches maturity, 18 or so years later. This is what's known as a "long tail" in insurance lingo. A very long tail indeed.

An Important Source of Identity Theft

It wasn't long ago that an employee of the Veteran's Administration took home a computer of the VA with data on millions of vets: names, addresses, S.S. numbers and the like. This could have caused thousands of dollars of losses to millions of people. Luckily, nothing came of what turned out to be an innocent mistake, but it caused millions of cases of the jitters.

But it taught everyone a lesson. It was determined that laptops — which are often stolen from travelers and others — provide more opportunities for identity theft and other data theft. The laptop — or disk or other media storage device — is stolen from an employee's home, office, car or in an airport waiting room. While the thief may just have been after the hardware, he now has an unbelievable amount of personal data that could conceivably cause millions of dollars of personal losses.

The lesson is that all portable storage devices have to be guarded with utmost care, "I just left it for a minute to get a cup of coffee" is a pretty lame excuse for a significant loss. A company must have an adequate response plan in the event such a "misplacement" occurs, and once it occurs, the response plan must be put into effect immediately. Every minute of delay could be costly.

An Ugly Side to Employer - Employee Relationship

Employment Practices Liability insurance (EPLI) sprang from nowhere to become a basic

form of liability insurance for all but the tiniest companies, e.g. a Mom'n'Pop store. EPLI coverage is only about a dozen years old — maybe 15. Claims come from a variety of sources: unfair firing, discrimination in promotion, etc. And the leading cause has been sexual harassment.

Now a fairly new type of claim is in it's ascendancy: "Whistle-blower Retaliation." Ever since a gutsy gal, Sherron Watkins, blew the whistle on Ken Lay, late of Enron, other whistleblowers, many of them women, have popped up all over the corporate scene to assert corporate shenanigans under the Sarbanes Oxley Act — SOX for short.

Corporate retaliation against whistleblowers is a growing development. Of course, the whistleblower has to establish that retaliation was at least one factor in the employer making an adverse personal decision against the blower. Of course, that's true in all liability cases.

To management: be on your guard. Listen to complaints and don't punish complainers. Sometimes you learn from them.

* * * *

As an adjunct to the above article we might note the percentage of lawsuits filed in 2005 with the Equal Employment Opportunity commission. This is a federal agency, and the study does not include the many cases that surely are filed in state courts as well as claims of a minor nature that might not have developed into litigation. Note that the percentages total more than 100%, as some suits involve more than one type of claim.

Type of Claim	% of Lawsuits
Sexual Discrimination	46.9%
Retaliation	35.8%
Race	21.1%
Disability	12.8%
Age	11.2%
National Origin	7.8%
Religion	3.9%
Equal Pay	3.4%

Note that retaliation has moved right up to a fairly close second place. We suspect it hardly existed a few years back.

Age discrimination used to be a big source of claims, with employers rarely being held not liable. We can see it's a relatively minor factor now. And religion is rarely a source of claims.

It Usually Includes Flood and Earthquake

By now, everyone who hasn't been holed up for over a year in the Brazilian rain forest knows that Homeowner Policies do not cover damage by flood. (That is, everyone except Sen. Trent Lott of Mississippi.) The reason that insurers don't cover flood insurance is that it is very subject to adverse selection, meaning that those who know that their location almost guarantees that they'll have a loss are the only ones who will buy it. It's as though only those people who have terminal cancer will buy life and/or health insurance.

How do we know this? Because several insurers offered flood insurance back in the 50's and early 60's and promptly went broke, learning it the hard way. Hence the Federal Gov't came up with NFIP— the National Flood Insurance Program.

Earthquake insurance is somewhat akin to that, but not quite as pronounced. Insurers do write

it as separate add-ons, but do not automatically include it. The rates in recognized 'quake zones are obviously many times the rates elsewhere.

None of the above apply for the most part to insurance on movable properties, the theory being that by their very nature they can be moved out of areas when a flood is imminent. In other cases, the property is always on the move.

Your auto policy is a good example. It does not exclude damage by flood or earthquake. The same would be true of various types of mobile equipment, from huge earth moving equipment down to wheelbarrows and bicycles.

Going a step further are various types of policies covering the transportation of goods and material, be it by truck, rail, ship or plane.

Back to mobile equipment. Most owners of such equipment — and of plant machinery as well — arrive at their insurable values the simple way: by applying a set amount of depreciation for tax purposes. Simple? Yes. Accurate for insurance purposes? No. In the great majority of cases, such values result in underinsurance. The answer is to get a full appraisal based upon inspection by an expert every few years. Of course, that costs money, but in the event of a serious loss — by fire, storm, flood or whatever — it would result in a recovery more in line with what it would cost to replace.

Déjà vu All Over Again

Last year at this time, the insurance industry in particular, as well as the banking and construction

industries and others, were quaking in their boots as the expiration of TRIA — Terrorism Risk Insurance Act — was due at year end. Congress and the Administration were fiddling while anxiety grew, with President Bush finally signing a watered down version on Dec.22, with the new Act set to expire 12/31/07.

Well, we have over a year to go, so “what me worry?” Not quite. Policies written in 2007 to expire after 12/31/07 will generally be worded so that the risk of terrorism will terminate on 12/31/07 even though the other perils will remain in force until policy expiration.

It's too soon after the election to get the feel of how congress may respond to the prompt need for action to continue TRIA in a reasonable form subsequent to 2007.

Stay tuned.

EQUIPMENT LEASING

Business owners are, with increasing frequency, leasing equipment for a myriad of reasons. Leased equipment requires no capital expenditure, can meet short-term use needs, typically has no maintenance costs, fits a specific need, and avoids the risk of obsolescence. If you lease equipment, you will most likely accept the risks of physical damage to that equipment or be presented with an option or options to purchase the lessor's “Rental Protection Plan”, “Lease Insurance”, “Loss Damage Waiver” or similar. If you accept the risks of physical loss to that equipment, consult with us as to your options. If you, as lessee, are considering the lessor's aforementioned options, then beware; the offerings may not meet your expectations and most likely will fall short of what your own insurance will offer. The fine print in rental agreements offering “Rental Protection” or “Lease Insurance” often contains exclusions of coverage for which you would not normally be exposed.

*Call us today or send your next proposed lease for our review.
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