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THE INSURANCE NEWSLETTER

Summer 2005

What About the D & O Market?

The above was the title of the lead article in our last issue. It prompted a call from one of our very nice clients who correctly pointed out that “D & O” was not explained to be shorthand for “Directors and Officers’ Liability Insurance”. Sometimes we get trapped up in our own lingo and don’t realize that our readers don’t speak insurance lingo. *Mea Culpa*.

We think this is a good opportunity for a brief explanation of what D&O is all about.

Contrary to common beliefs, D&O insurance is not only for directors and officers of publicly owned corporations. Privately held corporation also need D&O, primarily because many suits against directors and officers come from sources other than from stockholders. Other aggrieved parties may be employees, competitors, contractors, customers, creditors, suppliers and any of dozens of governmental regulatory agencies.

Don’t overlook fellow officers or directors, even of family owned corporations. Those are often bred by divorce, sibling rivalry, and other outcomes following death or retirement of the founder or other chief honcho.

Another large area wherein D&O is a must is the area of non-profits, including quasi-governmental

boards, such as school boards. The doctrine of governmental immunity (“The king can do no wrong”) has gone the way of the buggy whip, as has the charitable immunity. So hospitals, churches and all kinds of non-profits, such as condos, food co-ops and unions have legal exposures for their directors and officers.

There are individuals --- lawyers, corporate executives, academics and others --- who serve on several or many boards, and who may not feel comfortable relying on the D&O coverage of these various boards. They may choose to buy coverage for themselves. In particular, law firms may have several parties engaging in such outside activities.

Back to corporations. Most corporate by-laws provide that the corporation entity will indemnify their directors and officers who are held liable for certain actions, excluding criminal acts. In this way, the corporation buys the insurance, but the ultimate recipients of coverage are the directors and officers, not the corporate entity. While D&O policies are non-standard, some policies provide that the individuals would be protected in case the corporation goes bankrupt. In the absence of specific wording to that effect, the outcome could be murky, as is the law.

If your company or favorite non-profit does not have D&O, call us ASAP.

A Historical Clue to Market Conditions

It was recently revealed that in 2004 Property/Casualty insurers as a class showed it’s first underwriting profit --- of 1.2% of premiums written --- since 1978. In the intervening 25 years, and for most of the years between WWII and 1978, P/C insurers lost money on their underwriting, but lived on their investment gain.

Another recent bit of news was the April report from MarketScout that average P/C rates dropped 2%. A recent survey of answers from 38 risk managers shows an estimated average drop of 4% for commercial insurance in 2005: 6% for property and 2% for casualty. These were representatives of very large companies.

The first reaction of some of the younger buyers of insurance --- those who aren’t around through the normal pre-1987 cycles of insurance markets --- was “Whoopee! Now we’re in another period of soft markets with plenty of rate-cutting and loose underwriting”.

Not so fast. As the old saying goes, “One swallow doesn’t make a summer”. True, the profit was a meager 1.2%, but that was in spite of the 4 hurricanes, without which the profit would have been 1.7%. And the average rate drop of 2% in April was just that --- an average, with various lines of insurance departing in either direction, up or down.

A look at market cycle history may give us a clue to the future. From WWII to about 1986, the P/C industry went through fairly regular cycles of approximately every eight years. On average, four years of hardening to hard markets, followed by four years of softening to soft markets. Then came a first time 13-year soft market, with insurers cutting rates recklessly in their drive to get premiums to invest. This started in 1987 and ended abruptly in 2000, when the investments turned sour. We've all lived through a very tough market from 2000 to 2004.

There's no doubt that the insurance underwriting market is now in a softening phase. It's fairly level --- flat on the whole. Will we see a return to the old eight-year cycle with real rate competition coming up? We may. Anything is possible. But, we'd be very cautious about any such prediction, particularly with the uncertainty in the investment climate.

A condition of current relatively stable rating would be most welcome for buyers, as well as insurers. And that may be the case for the next year or two.

Should the market go swiftly to another round of drastic rate cutting, you can be sure it will end suddenly with a sharp reversal to tight underwriting as it did in 2000 and following. Business planning and budgeting is very difficult with unstable market conditions.

Expanding Risks and Expanding Coverages

Back in the real old, old days, like mid-19th century, the only land-based insurance was fire insurance. (Ocean marine insurance was already centuries old.) When an insurance executive suggested that insurers should offer windstorm insurance along with fire insurance, he was literally laughed at by his

colleagues and competitors.

The world has changed a bit since. Last issue we noted that Employment Practices Liability Insurance (EPLI), hardly heard of barely a dozen years ago, has become a standard practice among businesses of all sizes larger than a mom-and-pop store.

Since time immemorial both property policies and liability policies have excluded coverage for loss due to pollution. About 20 or 25 years ago, various regulations required pollution cleanup and liability in a very limited area, where substantial pollution dangers could be apparent, such as for owners of gas tanks or "hazmat" transporters. Thus, the small amount of pollution insurance was basically regulatory driven.

Today, pollution insurance purchase is driven by practical business and legal decisions. For example, a firm wants to bid on a construction project. To be eligible just to bid, it often must show evidence of pollution coverage, more formally known as Environmental Impairment Liability insurance (EIL).

Want to sell some real estate or sell a business? Furnish proof of EIL. Want to get financing for expansion? Get up the EIL. And so it goes.

Basically, EIL falls into several categories:

- Protect your own property from financial loss due to pollution;
- Cost of clean-up, whether ordered or voluntary;
- Liability to others for bodily injury and/or property damages due to pollution chargeable to your negligence or the negligence of parties hired by you.

The above is, of course, a simplification. The fact of the matter is that EIL insurance is becoming standard practice for a host of business enterprises far removed from the obvious

chemical or petroleum exposures.

Give us a buzz if you don't have it or don't know whether or not you do. We'll come over and talk about it.

The Need for Loss Prevention

A hypothetical policy holder buys just about all the insurance that is available. Yet some reasonable judgments have to be made to keep premiums costs under control. For example, it would make sense to have a premium deduction in return for a deductible. As we noted in an article last issue, an area-wide disaster, e.g., a hurricane, with resulting shortages of labor and materials to rebuild, may substantially increase reconstruction costs.

Turning to Business Interruption insurance and related coverages, the policyholder may buy a good policy embellishment that reimburses for business lost not only until the damages premises are restored, but also for some additional months until the business gains momentum to recapture the customers who were obliged to deal elsewhere while the business was down. But the shutdown may have caused the permanent loss of some customers.

Two more examples of what may be termed collateral uninsured losses. An accident on the assembly line, which then stops temporarily. A co-worker takes the injured person to the hospital while the rest of the crew slows down while talking about it.

A product liability claim by numerous people alleging injury gets widespread coverage by the media. The company's reputation is badly tarnished, with a permanent loss of business.

And so it goes, with many more examples of collateral costs of one kind of another when an insured loss of almost any type occurs. The moral of this story is: DON'T LET

THE LOSS HAPPEN, because all the insurance it is reasonable to buy won't make you whole.

e-Commerce and Insurance

Traditional property and liability policies for the most part exclude such risks as loss of electronic data as well as network liabilities. A policy that covers theft or damage to tangible property --- you can touch tangible property --- generally does not cover electronic data. It may be property, and quite valuable at that, but electronic data is not tangible. Look up "tangible" in your dictionary. Ours says, in part, "that which can be touched and felt." There's also a lot to lose in intellectual property on hard drives.

Special policies to cover cyber risks are available. First party coverages protect policyholders against damages and losses to their own computer networks and digital data. Included are such events as stolen or destroyed proprietary information, deletion or alteration of vital financial records, business interruption due to a shutdown of a web site. About 400 viruses appear every month!

Third-party liability covers one's liability to others as a result of one's business activity. If a customer's computer catches a virus from one's Web site, that is just one of the many types of incidents that can lead to liability.

As we noted in a previous mini-article on the subject there are no standard "off the shelf" policy forms. A lot of customization is often needed as the technology and data bases of each company may vary.

Again, keep your system as secure as possible, but be sure to recognize there is no such thing as being 100% fail-safe. That's where a program of e-Commerce insurance

comes in. Call us. p.s. Most computer crimes come from within! It may be wise to hire a professional internal security firm.

Hidden Exposure for Certain Firms

Some of our clients --- probably more than those we know about --- hire temporary workers from time to time from companies specializing in leasing out temps. Responsibilities of the respective companies are usually spelled out quite clearly, e.g. who pays them, who provides Workers Comp, etc.

But one area is a murky one, and that is the interaction of the hiring firm's regular employees and managers with the temps. We're referring to such matters as discrimination, harassment --- sexual and otherwise --- and occasional physical abuse. Usually the temps are on the receiving end, but the reverse could be true in some instances.

The important thing to do is to treat the temps in the same way one treats the regular staff. And of course be sure to carry EPLI --- Employment Practices Liability insurance --- written to cover the use of temps.

Limitations in Insurance Policies

Except for giant companies that are big enough to self insure, just about every business carries CGL --- Commercial General liability policy. It covers the buyer's liability for bodily injury and property damage to others due to negligence. Of necessity, all insurance policies have certain exclusions and limitations, notwithstanding words such as "comprehensive" and "all risks".

The important thing about the ubiquitous CGL is that it's use is essentially to provide liability for bodily injury and property damage. It does not --- by itself --- cover li-

ability for loss to others due to errors of omission or commission by people acting in a professional or consulting capacity. It is generally known that lawyers, accountants, architects, engineers and other professionals carry E&O insurance --- Errors and Omissions.

What we also have today are consultants operating in two or more closely related fields and with somewhat different exposures to loss. For example, a real estate agent may also manage properties. There are any number of similar situations of "blended professionals" in many fields, particularly where information technology (IT) is involved.

As this is a fairly new development, E&O insurance for these guys and gals with fingers in several pies is not always easy to get, but in today's litigious environment they need it. The average amount for defending a claim with just legal expenses in the period 1990-1999 was \$22,649.* It's likely to be \$40,000 or so today. And during that same period the average loss amount paid was \$119,170.* Probably \$150,00 or more today. As these are averages, it would appear that limits of \$1,000,000, are in order, with some types of professionals needing several times that.

*figures from Jury Verdict Research Inc. Horsham, PA

Outsourcing

Years ago, outsourcing meant using contractors to do work for one's business instead of using one's own plant and labor. Typically, it involved manufacturing firms in the Northeast using contractors with cheaper labor in the Southeast.

You don't have to read Tom Friedman's new book "The World is Flat" to know that today most outsourcing is to third world countries climbing their way to first world status. Press a button on your phone and

you're talking to Bangalore, India. Go for an MRI and the radiologist reading it may be in Thailand reporting to your doctor. And so it goes.

It isn't only firms that outsource work to a foreign country that need political risk insurance. Any company with property or personnel overseas or sales to overseas markets needs it.

What is political risk insurance? It provides coverage against such risks as war, expropriation of property, confiscation, inconvertibility of foreign currency, cancellation, suspension or restriction of export or import licenses and, where available, terrorism.

Another feature of it is foreign credit insurance. Just like home-

grown domestic credit insurance, it covers the vendor who can't collect its receivables because its foreign customer went belly-up.

If you have any foreign commercial trade, political risk insurance is needed. The more it's needed, based on the countries involved, obviously the more it costs. We hardly think political risk insurance is needed if your foreign exposure is limited to Canada.

But credit insurance --- foreign and domestic --- is needed unless all your business is retail, on a cash basis. You know where to reach us.

Inflation?

Think health care is the chief ingredient of inflation? It's bad enough

---typically kicking up about 11% to 13% a year.

A worse inflation ingredient -- - somewhat affected by health care costs --- is the rise in jury verdicts in personal injury cases. They've been going up on an average of 20% a year in recent years.* And the worst part of that are verdicts in product liability cases.

All this emphasizes the need for very high umbrella liability limits in our very litigious society.

*An injury today may not reach a jury for five years in many jurisdictions. At 20% a year that will compound to an increase of 150% in five years!

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.