

Forrest Sherer Inc.

The Sherer Edge

The Sherer Edge Insurance and Risk Management
Employee Benefits • Financial Services • Loss Control
Surety • Personal Insurance *Since 1920*

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THE INSURANCE NEWSLETTER

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Market Update

Not much change: the Property/Casualty (P/C) market is still a tough one for commercial properties and entities. And the personal lines market — auto, homeowners, etc. — heretofore more moderate than for commercial lines is toughening up more than before.

With all the uncertainties in the world, particularly the absolutely anemic returns on short term bonds, most expert observers feel the hard market will last past the end of 2003 and quite possibly through 2004. These, of course, are guesses, which are in the same class as predicting the weather five days ahead.

Returns on equity (ROE) for insurers are still woefully weak, despite sharp rate hikes during the past two years. The stock market malaise is not a major contributor. Most insurers invest approximately only 15% to 20% of their assets in stocks, although some of the very large and very strong companies go somewhat higher. While life insurers' holdings are heavy in long term bonds, the P/C companies tend more to intermediate and short term. And you know what you are getting on your T-bills, CD's and money market funds.

However, the chief culprit is the underwriting picture: the end result of 13 years of reckless under pricing

and under-reserving. Industry leader AIG's reserve increase of \$1.8 billion is a sure sign of a continuing hard market. Even today's rate levels are still less than that of 1987's, adjusted for inflation and for the growth of the economy.

We can't repeat too often the effect of a jury system gone haywire on the cost to buyers of liability insurance and eventually paid for by consumers. While only a very small percentage of cases — be they malpractice, product liability, auto accident or whatever — go to juries, the extraordinary high settlements are based on the fear of "what if this goes to an out-of-control jury?"

There you have it in a nutshell.

Terrorism Insurance

Congress must have been reading this newsletter for the past year, because, as you know, it finally passed, and the President signed, the Terrorism Risk Insurance Act (TRIA) in November.

The details are not all that important to the public. Just for information, you do know that there's a federal backup at certain levels through 2005. Should there be any more major terrorist attacks, the insurance industry will be better able to survive and serve the public's total insurance needs with

this backup.

Let's go back to before 9/11. Insurance policies have always excluded loss due to war, whether declared or not. (However, special war risk insurance, mostly for ships and their cargoes, has been around for centuries). Thus the 9/11 losses were covered, as they were not acts of war. Although the President subsequently announced that we're at war, that wouldn't necessarily mean that acts of terrorism would constitute acts of war and thus not be covered.

However, after 9/11, insurers specifically excluded acts of terrorism from coverage, which heretofore were not excluded. The Act says nothing about domestic terrorism — e.g. Oklahoma City — so that may create legal problems under some circumstances.

As it now stands, insurers must offer coverage for terrorism and must inform applicants of the rate to be charged and the fact that there is a government backup. Just as we went to press, the Insurance Services Offices issued advisory rate guidelines. For 95% of the country it's \$1.00 per \$100,000; for many large cities it's \$18.00 and for downtown Washington and Manhattan below 59th street it's \$30 — all quite reasonable.

Policyholders may decline to

accept the terrorism coverage offered, with such declination being in writing. But before anyone decides not to buy terrorism coverage, they should be aware that virtually all lenders will require the coverage, as respects both domestic and international acts of terrorism.

One detail in the way the level at which the government comes in over the insurer's "deductible" is perplexing and may backfire. An insurance company's assumption of terrorism losses before the feds are involved is determined by the amount of gross premiums written during the previous year with no credit given for the premiums it pays out for insurance. Example: For 2004, the company's deductible threshold is 10% of gross premiums written in 2003. Assume that its written premiums for 2003 are \$100 million gross, less \$80 million for reinsurance ceded leaving \$20 million net. It is stuck for \$10 million in terrorism losses before Uncle Sam steps in — 10% of gross premiums. However, if the threshold were the net premiums that actually go on the Company's books the feds would step in at \$2 million — 10% of the \$20 million net.

You may say, "So what? That's not my problem." But it may be your problem, our problem, and the problem of American business in general. How come? It will surely lead to a very substantial reduction in the amount of reinsurance written.

Here's a scenario. You have a plant or property needing, say \$2,000,000 coverage. Normally, we might give you one policy for the entire amount, with the carrier getting a number of reinsurance policies totalling, say, \$1,700,000, with your insurer retaining \$300,000. You're unaware of the reinsurance, and in most cases we're unaware of the details of it, although

we know it's the way the company operates.

With this new setup for terrorism, the companies will substantially reduce their reinsurance in order not to retain as much terrorism exposure. So, instead of getting you a policy for \$2,000,000, we'll get you half a dozen policies, more or less, totalling \$2,000,000. More bookkeeping for you, a lot more work for us, and sometimes other complications totally unrelated to terrorism coverage.

Maybe this will be corrected in time, but as the Act was written, this is a major flaw. It will have to be corrected by Congress, so it won't happen next week. And don't bet on it at all.

Use of Corporate Cars

Many people, whether principals of a business or employees — usually salespeople — have exclusive use of a company owned car. In some cases, the company owned car is the sole car used by the individual and his family. **Warning!**

In such a case, it is vital to attach DOC — Driver Other Car coverage, a/k/a Use of Other Auto Liability Coverage. Without this special endorsement, there is no coverage for the use of another vehicle, whether rented or borrowed. The DOC coverage extends to the named individual and to his or her spouse, but not to children or other relatives living in the same household. Some insurers may add the latter for an additional premium on top of the modest premium for basic DOC.

However, in many cases in which a company car is used, an additional car owned by the individual or spouse is available. In such a case, the DOC is automatically available. People living alone are not apt to have their own car in addition to the company car.

Mold

It all started a few years ago when a Texas resident won a \$32 million verdict against an insurer that attempted to deny her coverage for damage to her residence by mold. The amount was subsequently knocked down by a court to a "paltry" \$4 million.

The engendered publicity focused attention on mold damage to dwellings in Texas and then initially to other southern states. Now there is a "mold alert" to dwellings all over — except perhaps Alaska — and also to virtually all manner of buildings. The result? Most insurers now exclude "fungus, bacteria and wet or dry rot." (Mold is a form of fungus).

Whether covered or not, building owners have to take whatever precautions are available to prevent mold damage, and to discover and deal with it should it occur: Dampness, warmth and humidity are mold's allies; they are therefore the enemies of building owners. "Eternal vigilance" is the watchword.

Contractors Attention!

A situation that has always existed has become more acute. Firms that engage contractors for various types of work have been conditioned to insert into contracts all kinds of hold harmless agreements and wordings that shift their own liability onto the contractors they hire.

Contractors, please have your attorneys look over every contract offered you and don't sign anything until your attorney sees it. Your attorney should be told by you to feel free to call us to check if any wording that appears unusual poses a problem insurance-wise. Contractors of almost all kind have been hurt especially hard in today's tough

insurance market. "If you give away the store" there may not be any insurance available to cover certain situations.

We never counted, but we probably have more clients who act as principals than we have clients who are contractors. To our clients who utilize contractors, we ask you to be realistic in the obligations you place on contractors. If they can't get coverage for a particular toughly worded obligation to you and as a result can't meet the financial obligation required, what good to you is their signature on a contract?

There has to be room for both parties to negotiate within the parameters imposed by today's very difficult insurance market that is most difficult for many types of contractors.

To All Our Clients

In all our experience we don't recall a time in which there were so many instances of rating downgrades of insurers by the rating agencies: A.M Best, S&P, Moody's, Fitch. The latest issue of Best's Rating Monitor shows 7 upgrades, 43 downgrades and 25 "under reviews" of insurers doing business in the U.S.

We try as best we can to adhere to a policy of not placing insurance with a rating less than B+ (A.M. Best) or BBB (S&P). In fact, in "normal" times we rarely dip below A.

With all the downgrading going on it's getting all the more difficult to always stick to this standard. There may be times — not often we hope — when we might be forced to compromise a bit.

A word of vigilance on your part. If another agent or broker offers you what appears to you to be a better deal, get the name of the

insurer involved. Let us know the name, we'll look up the ratings and advise you accordingly.

A "good deal" in a C or D rated company isn't worth the risk you'd be taking. "Insurance that is unable to pay is the most expensive insurance."

The question to ask yourself is: "Will the insurers writing our risks today be around to pay our claims tomorrow?" And "tomorrow" can be quite some years hence when third party liability or workers' comp is involved.

The Cost Of Waiting

Of late, there has been a lot of media attention given to the increased longevity projections for our population. Collateral to that has been more articles in business and investment publications to the growing need for long term insurance (LTC).

One item of interest was a comparison of rates for an average of the three leading LTC writers at several different ages. The sample policy chosen for the study was a very appropriate one with these features:

- \$200 a day, with benefits available for home care, nursing home and assisted living-facility
- Three years of benefits
- 100-day elimination period
- Compound inflation of benefits

While rates may vary by state of location and be reduced by certain discount factors, the following age at policy inception rates tell the story.

We'll use a hypothetical premium of \$1,000 at age 40 for simplicity of illustration. (This is a bit lower than the actual premium).

At age 50 the premium would be \$1241 for an increase of 24%.

If the buyer waits until age 60

before taking the policy, the annual premium becomes \$1880, an increase of 51.5% from age 50 and an increase of 88% from age 40.

At age 70, the going-in premium is a whopping \$3798! That's up 102% (double) from age 60, 206% (triple) from age 50 and 280% from age 40. Forget age 80 with the exponential almost vertical rise.

Let's make two things clear. One is that the hypothetical rates shown for each age is the rate in effect on initiating the policy and remains constant for the duration of the policy. Possible exception: if the company raises rates for all policies in the state. The three companies in the example have never done so. A number of smaller companies — whose assets are under a billion — have raised rates statewide on occasion.

The other point to remember is that the longer one waits the greater the possibility of deterioration in health that may preclude the possibility of obtaining any policy of LTC.

Here's another thought, assuming you're anywhere from about 30 to about 55 and you have elderly parents or in-laws in their 60's or up and who don't have LTC. Buy it for them — or with them — and relieve yourself and your spouse of a possible heavy financial obligation in the future. There are many ramifications to this, depending on their and your financial resources.

And don't overlook buying it for yourself and your spouse now, and avoid premiums that may be double or triple 10 or 20 years down the road.

Call or fax us and we'll talk about it.

Note: The original example appeared in Best's Review, November 2002, with statistics supplied by LTC Coach of Littleton, CO.

Is Your Worker's Comp Experience Good

It doesn't take much premium to get an experience modification — credit or debit — in Workers' Comp. However, our larger clients have other options that offer advantages to the overall costs of their WC, providing that their experience is better than average for their type of operation.

If their premiums for WC are in the low six figures, a retrospective rating plan ("retro") may serve them well. (Technically, firms with much lower premium levels are eligible for retro, but eligibility and practicality are two different things).

Under a retro plan, the size of the standard premium paid in advance determines a minimum premium and a maximum premium that may apply based on future experience. If the annual policy dates from, say, July 1, 2003, the incurred losses from 7/1/03 to 6/30/04 determine the additional or return premiums accruing to the policyholder retroactively after the policy expires. Note that

"incurred losses" means losses paid during the period plus reserves outstanding 6/30/04 minus outstanding reserves on the books as of 6/30/03.

For much larger insureds, with premiums on WC running well into six figures or more, a policyholder may wish to self-insure run-of-the-mill claims and buy a large deductible, say about \$200 — \$250,000, to protect against any single very large claim spoiling its experience and causing increased premiums.

The insured pays an initial greatly reduced premium calculated for the insurance above the deductible and has the use of what would otherwise be premium money to take care of the losses under the deductible as they occur.

Very large firms may wish to self-insure everything, but they would have to get an OK from the state to qualify, based on approval by the WC Commission of their financial wherewithal as sufficient to meet their financial obligations. Mom 'n' pop stores need not apply.

E-Commerce Insurance Needs

Typical property insurance policies cover loss of tangible property by various perils, e.g., fire, theft, etc. A leading case in Federal court recently decided that computer data is not tangible property as it cannot be "touched, seen and smelled" as defined in Black's Law Dictionary.

The case, Avery Dennison Corp. v. Allendale Mutual Ins. Co. involved the theft of trade secrets. It might just as well have pertained to any kind of computer data — customer lists or whatever — that appeared on a monitor by a click of the mouse. It was a value but is not tangible.

E-commerce policies are needed for situations such as this as well as for liability protection for many exposures not covered by traditional liability policies due to the nature of computer usage. "We got this virus from your computer and it cost us a million bucks. We're suing for it."

Call or fax us to discuss e-commerce insurance, unless you already have it.

What is "The Sherer Edge" ?

The process of placing your Commercial Risk Management Program is very complex. Yet, there are fundamentals that are essential in the process. Forrest Sherer, Inc. is dedicated to professionally addressing each issue in this process to make your ultimate decision easier. "The Sherer Edge" is:

Dependability and Experience - Since 1920, we have been providing clients with the finest insurance and financial services available. We have in excess of 60 associates with combined experience of over 800 years in the insurance industry. We currently serve the insurance needs of clients with locations in more than 28 states.

Cost and Loss Control Services - An essential ingredient in controlling your cost is the ability to control losses. At Forrest Sherer, Inc., our Loss Control Specialist can work with you and the companies we represent to assess and control loss-related risks. This is a value added service unique to Forrest Sherer in our market area.

Client Claims Service - Forrest Sherer, Inc. is dedicated to serving our client's claims needs. We help you process your claims quickly so that your settlement is both timely and proper. Another value added benefit of doing business with Forrest Sherer, Inc.

Market Penetration and Product Selection - We represent over 40 of the finest and most financially reputable carriers in the industry. This wide selection and knowledge base permits us to expertly assist you in judging the cost and value effectiveness of the available markets, as they apply to the needs of your particular business.

Employee Benefits - We also specialize in assisting our clients in the selection of Group Health and Life Programs. Our full-time professional benefits staff is dedicated to the same client-based goals, objectives and standards of service as our property and casualty insurance professionals.

A Commitment to Continuing Education - In order to be your expert in the ever-changing insurance industry, our producers and staff maintain a commitment to continuing education throughout the year.

Client Service Communication - Our custom-designed website at www.forrestsherer.com was constructed with our client communication needs in mind. Most policy maintenance and claims related reporting tasks can be quickly and easily performed via this website. Additionally, email communications are easily handled directly to members of your client service team or to our general email address - fsi@fsiinsurance.com.

These are a few of the ways we take the work out of your decision making process. Forrest Sherer, Inc. utilizes a team approach to anticipate and meet the needs of our clients. It is this focus and commitment to exceptional service that continues to differentiate us from our competitors. And, it is "The Sherer Edge" we bring to your company.

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