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**2003-2004 IIAI Agency of the Year**

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## THE INSURANCE NEWSLETTER

Spring 2005

### What About the D & O Market?

You read about it in the daily papers earlier this year. First, 10 directors of World Com were ordered by the court to pay a total of \$18million to partially recompense shareholders and employees for their losses when the company went bankrupt as a result of hanky-panky by management. Then a week later, 10 directors of Enron were ordered by a court to cough up \$13million in the same fashion.

In a later development, a court threw out the WorldCom case on a technicality, which left the door open for a much harsher penalty as a possibility.

The interesting part of these two independent decisions is that both courts stipulated that payments must come from the personal assets of the named directors and that insurance is not allowed to cover their losses, nor can they be reimbursed by the companies of which they were directors. The point is that the directors were held to be derelict in their duties, which include being watchdogs of management. As we know, too many corporate directors serve as rubber stamps for the managements that appoint them – usually the CEO'S who are their buddies.

These two high profile cases may well be the forerunners of many more to follow. Time will tell. In any event, these cases will certainly act as a deterrent to many capable people who

might otherwise be willing to serve as independent directors. The end result may be difficulties in cooperative governance.

Well, then, what about the D & O market? We don't see a negative effect, although it's too early to get a clear picture. If anything, it probably bodes well for D&O insurers, which in turn means a more open and competitive market. But it may kill the small market that independent outside directors buy for their own protection. Again, time will tell.

All the above primarily concerns only publicly owned companies. We don't see this type of situation having a material effect on privately owned close corporations or on non-profits.

Incidentally, the "buddy system" of corporate directors, so common in this country, does not operate to nearly the same extent in other leading industrial countries.

For example, in Germany the major corporations all have representatives of labor serving on the boards. We understand that in Japan, too, directors include major suppliers and customers. In both countries, the boards are truly watchdogs. Maybe we can learn something from them.

### An Epidemic in an Unlikely Place

Companies dealing in electronics, clothing, jewelry and other items of high concentration of values are very

much aware of their susceptibility to theft losses, from both outsiders and employees.

Surprisingly, there has been a big increase - over 30% in two years – in theft of contractor's equipment of all kinds. Not just hand tools, but big items like road graders, cranes, tractors and the like. Typically, they are brought to a job on Friday so as to get an early start on Monday, but they disappear over the weekends!

Insurance rates are naturally climbing. Owners of all kinds of equipment – small and large – must take the appropriate steps in loss prevention. Of course, this applies to all kinds of businesses as well.

### Weather Related Losses

In our last issue we made a premature guess that the four Florida hurricanes would cost insurers some \$25 billion to \$27B. Thank God we were wrong. The final tally appears to be \$20.5B – still a hefty amount.

But recent times have highlighted weather related losses: floods in desert-like Arizona and other places, a killer mudslide of a mountain in California, and the Asian tsunami of Dec.26.

As horrible as the tsunami was, those poor populations had very little insurance. The loss to American insurers may be "only" one or two billion dollars. But the flood losses were

typically out of season; spring time is flood time. So while we overlooked reminding you in our Winter edition, we'll remind you now in this Spring edition.

Your business property insurance policy normally does not cover losses by flood, even though it may cover water damage of an internal nature, e.g., burst pipes, etc. Same with your homeowner's policy.

By abbreviated definition, "flood" means surface waters, overflows from lakes and rivers, tidal waves and mudslides.

Some large companies with multiple locations in different areas may get flood coverage on their property policies. But for the most part, "small" commercial properties and dwelling owners must get it at a federal agency, the National Flood Insurance Program, serviced by an insurance company and sold by a broker or agent – like us. In order to qualify, your community must be eligible.

If you don't have flood coverage, call us. If your community is eligible, we'll get it from the N.F.I.P. at a rate subsidized by us taxpayers.

## **The Current Underwriting Market**

For the first time in a couple of years, this subject is relegated to our inside page. The brief summary is that as a whole, the market has almost leveled off, with some variation by type of coverage: some modest increases and a few modest decreases on renewal.

Of course, as always, the loss experience and loss prevention activities of individual policy holders is a key determination of pricing.

One black cloud on the horizon. As of this time, Congress has failed to act on TRIA – The Terrorism Risk Insurance Act. There's no way that insurance companies, on their own without a federal backup, will be supplying anything like a significant

amount of the coverage, while the risk may be increasing in possibility, geographical diversity and severity.

TRIA is to insurance companies what FDIC is to banks: prevent widespread failures.

TRIA expires 12/31/05. Policies written now for a year to expire sometime in 2006 typically carry a restriction that terminates the terrorism coverage on 12/31/05. That restriction can be removed only if Congress votes---and the President signs---to extend TRIA. As things now stand Congress has to be convinced as to the importance of continuing TRIA.

Major real estate and other business interests are not in the mood to take on new projects without terrorism coverage. Our whole economy can stall.

Another disturbing situation. Being that Workers Comp. policies are legal requirements, they have no terrorism exclusion. Consequently, W.C. underwriters are carefully limiting their writings in areas that they perceive as having a terrorism exposure. The underwriting market for W.C. is tight; this will make it tighter.

P.S. It is worth noting that MarketScout's year end survey of property-casualty rate levels showed composite rates for December 2004 up 2% over December 2003. January 2004 rates were up 11% over January 2003, which were up 27% from January 2002.

A by-product is reflected in the January survey of insurance company ratings by A.M.Best & Co. 11 upgrades vs 5 downgrades.

## **A Worsening Trend**

It didn't exist a dozen years or so ago, but today it's standard coverage for all businesses, except those living in the past and completely unaware of what the real business environment is like in 2005. We are referring

to EPLI – Employment Practices Liability Insurance.

There is a significant national trend of employee generated lawsuits. The accusations against employers run the gamut: sexual harassment, wrongful termination, discrimination based on color, race, sex, religion, national origin, disability and age. Age discrimination suits are the most numerous.

One factor in the increase, aside from the growing litigiousness of society, is the increasing numbers of women, older people, immigrants and other minorities in the workplace. Even obese people are getting into the act of suing.

It isn't just "big business" that's on the receiving end of the lawsuits, although they're the ones that make the daily papers. The only number tabulation is the one filed with the EEOC---Equal Employment Opportunity Commission. That's up over 100,000 a year, but that's only a small fraction of the suits filed directly in state and federal courts.

According to Jury Verdict Research, the median award in 2003 was \$250,000. That's the median, which is not affected by a few blockbuster multi-million dollar awards. The median award for 2003 reflects a rise of 18% from the previous year, so it's likely that today it's \$300,000 or so.

A survey by Chubb, a leading insurer, reveals that one in four privately held companies has been sued by an employee or former employee.

Most of our clients carry this coverage. If you are one of the few not so covered, please call us. Do it now!

P.S. Wealthy people have been targeted by household help for discrimination, etc. A few insurers offer the coverage as riders to homeowners and/or Personal umbrella policies.

## **Sounds Mysterious to Some**

It's known by various names, perhaps the most widely referred to the general public is the "Non-Admitted Market". Others are "Surplus Lines Companies" or the "E&S Market"-meaning Excess and Surplus Lines companies. Who are they and what is their function?

Undoubtedly, by far the largest and best known provider of "Non-Admitted" insurance is Lloyd's of London. There also are a number of U.S. based non admitted insurers, mostly large soundly financed companies operating under the aegis of some of the largest in the country.

What do we mean by "Non-Admitted" and why do they exist? It means simply that they are not admitted to do business in a given state or states and are not under the jurisdiction of the insurance departments of the states in which they do business on a non-admitted basis.

If someone is insured by a company on a non-admitted basis and has a complaint against the insurer, the aggrieved party can't go to the state department for protection. The state department just has no jurisdiction. And state guaranty funds do not enter the picture when a non-admitted company goes under – not a common occurrence.

That doesn't necessarily mean that the aggrieved party has no recourse. All the large non-admitted carriers---Lloyd's and others---have designated law firms to "accept service" of law suits that the courts will recognize. In addition, the various insurers in this category are in a competitive market and have their reputations to protect, so they are no more apt to be rough on their policyholders than are the many admitted carriers.

The reason for their existence is manifold, mostly having to do with

the fact that their freedom of regulation as to rate and form gives them more latitude to underwrite unusual or difficult risks that none of the standard companies would touch with a ten-foot pole.

During periods of a hard market or otherwise it may be the only resource to get coverage---at a price of course---for some businesses with a very difficult exposure or a very poor loss record.

And then there may be a need for multi-million dollar capacity in excess of what the standard market is able to provide. Hence, "surplus line" insurance, or "excess and surplus" lines.

There are certain requirements for dealing with this off-beat market. Without going into detail in this paper, we as brokers have to file affidavits with the state insurance departments that the required coverage was not available---or not sufficiently available---in the admitted market. That gives us the legality to place business with a non-admitted carrier.

Yes, we have to be careful whom we place business with, whether admitted or not, and especially careful with the non-admitted market. But as we noted above, many of the non-admitted carriers are very strong financially.

The non-admitted market has been around for a long time and fulfills a need.

## **Identity Theft**

Between use of the Internet and our love affair with credit cards and simple carelessness, identity theft has become the fastest growing crime. We know it's not wise to carry our Social Security cards with us, but it is often inevitable, e.g. people on Medicare should have their Medicare cards with them just in case they need medical attention.

The mess caused when someone steals your identity--and it happens 10 million times a year and growing rapidly--- is simply horrible. While

average out-of-pocket cost of clearing up identity theft is only about \$1,500, some cases could be many times that. But that's the least of it.

Reversing bad credit can take months or even years of correspondence and phone calls with credit agencies. Frequently, lawyers have to be hired.

Time taken from work--often with lost income--- is needed to deal with the likes of credit card companies, credit agencies, merchants, postal inspectors, police, motor vehicle departments, the Federal Trade Commission and the F.B.I! (Did we forget any?)

According to the Identity Theft Resource Center, the average case causes a loss of work of 607 hours. That's close to a third of a year. And we know how misleading averages can be; some cases can be two or three times that.

This has become a financial nightmare. 10 million cases a year equals about one in 11 or 12 families. Frightening.

Insurance is only a very slight answer. Many companies provide about \$15,000 of coverage on their homeowner's policy for about \$25.00. But that covers only the expense needed to clean up the mess, not the loss or loss of income. But one still has the trauma of dealing with it, insurance or not. Caution is the by-word, and a shredder may help.

It would seem that this article pertains only to the reader as an individual. But that's not the whole story. You as an employer have a great deal at stake, because your records include the Social Security numbers of all your employees.

The most vulnerable source of identity theft is the leakage of S.S. numbers to the wrong people. Your company would be in a terrible fix if those valuable S.S. numbers were tampered with by crooks. "A word to the wise...."

## **Power Outages**

The real spate of bad weather in various parts of the country noted in another article herein has caused numerous power outages of a local nature, worst of them resulting in uninsured losses of various magnitudes to local businesses.

Here's the scenario. We all depend on electricity---overwhelmingly so. Manufacturers need it to run machines. All businesses need it for lighting, heating and/or air-conditioning, computers and communication devices. Without it we're back in the 18th century.

So, you're up to date---we hope-- and have a Business Interruption Insurance policy. Unadorned, the policy does not cover loss caused by an off-premises power outage. But it would cover---subject to the usual 24 hour deductible-- if your B.I.I. policy is endorsed to cover Off-Premises Power, Water Supply and Communication Services, including the extension to cover transmission lines. So if a hurricane or tornado knocks down trees, which in turn knocks down the transmission lines leading from the public utility generating power

plant and you're out of business for a period of time, you're covered.

Having your own generator can mitigate some losses, and may be worthwhile, but only an engineer can tell you if it could possibly help you avoid all financial loss in the event of a substantial disaster.

Let's talk about : 1. your need for Business Interruption insurance in the first place, if by chance you don't have it; and 2. making sure your B.I.I. policy is properly "dressed up" to protect you against these contingencies.

## **Another Outcome**

Let's say you have enough insurance on your building, whether it be your home or a commercial or industrial building. A bad loss occurs--- fire, explosion or whatever. When the haggling with contractors is over you come out OK--- enough insurance.

But what if the loss is caused by a major area-wide disaster, such as a hurricane, earthquake, flood or whatever. There's a shortage of contractors as well as an acute shortage of building materials. A rebuilding job that normally would cost X dollars, now costs 2X dollars.

Maybe you should rethink the amount of insurance you should carry.

## **e-Commerce Risks**

Many businesses take due protection measures, such as anti-virus software and computer firewalls to prevent losses from e-commerce risks. These security breaches are a major concern and generally get attention from business managers.

However, liability risks associated with the Internet and a firm's web site are often overlooked. They're harder to quantify, but perhaps more costly and dangerous than the security risks. This can encompass a wide range of torts such as defamation, false advertising, misappropriation of intellectual property and various kinds of professional liability incurred by misuse of computer technology.

Various forms of cyber-insurance are available from leading insurers. Obviously, there are no standard "off the shelf" policy forms. Tell us your problems and concerns and we'll try to find a suit that fits.

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## **Forrest Sherer Expands Personal Planning Capabilities**

*Jeff Hallam* and *Mark Lammers* have joined Forrest Sherer Insurance to provide experienced financial and retirement planning services to our clients. Whether you are a business owner or personal client, their unique, specialist-based approach may be of interest to you. A topic of particular interest to many today is Long Term Care and the options for addressing this real concern. If this is something you've put off or if you would like to review your current situation, please call Jeff or Mark for a free initial consultation.

## **Employer Cost Reductions = Forrest Sherer's Safety First**

The Loss Prevention and Safety Department of Forrest Sherer Insurance would like to celebrate the following successes for continued loss prevention and safety improvement.

- Large electrical contractor surpasses two years without a lost time injury and reduces experience modification factor by 68 points. This equals a 68% reduction to workers compensation costs utilizing monthly loss prevention and safety services from Forrest Sherer Insurance.
- Southern Indiana general contractor surpasses two years without a lost time injury and reduces experience modification factor 40 points. This 40% decrease in premium occurred as a result of monthly guidance of Forrest Sherer's Loss Prevention and Safety Department.
- Large Indianapolis employer uses Forrest Sherer Insurance Loss Prevention and Safety Department to provide OSHA 10-hour training to over 300 employees.

Forrest Sherer Insurance is one of the few agencies that has an in-house Loss Prevention and Safety Department. The goal of this department is to assist companies with OSHA compliance, develop loss prevention strategies, provide risk management solutions and provide employee training on various safety and loss prevention programs. Many of our clients utilize this service to reduce employee injuries, improve safety documents and programs, provide employee training and reduce insurance costs. To start your company on a similar road to success, contact *Jon Stinson*, Loss Prevention and Safety Manager.

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