CPCU SOCIETY
INSURING YOUR SUCCESS

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Being a Risk Management Professional

Serving Society through Risk Management

George Head, Ph.D., CPCU, ARM, stepped down from the American Institute for CPCU at the beginning of 2000 because of decreasing stamina, eyesight, and pain tolerance, related to his life-long cerebral palsy. Since then, he has continued his work in risk management education through some freelancing in the risk management trade press and, since August 2002, as a telecommuting special advisor to the Nonprofit Risk Management Center in Washington, DC. Dr. Head maintains an office and an emeritus title at the American Institute for CPCU in Malvern, PA. He can be reached via e-mail at george@nonprofitrisk.org or head@cpcuiia.org.

What's in this Issue?

Editor's Note: This is the first of what we hope to be many columns contributed by George Head, Ph.D., CPCU, ARM, a very learned professional who has contributed so much to the field of risk management and risk management education.

CPCU Society records show that CPCUs within very diverse insurance-centered occupations—producers, adjusters, underwriters, actuaries, financial managers, researchers, and teachers, and naturally risk managers for private, public, and nonprofit organizations—are members of the Risk Management Section. This section's newsletter has one of the broadest readerships among the Society's "specialized" publications.

This has been true over the years since the Society's interest sections began. It is true even though the occupational groups within the readers of *RMQ* seem to do daily battle with one another as part of their professional pledge to serve their employers and clients "as if their interests were my own." Producers traditionally joust with underwriters about whether a particular risk is insurable or about which rating class is most appropriate for the risk. An insurer's financial managers, actuaries, and claims managers often disagree on the amounts for which individual major claims should be reserved. Adjusters often want to settle a claim for less than the risk manager for the insured believes the claim merits. Yet many professionals from all these occupations—thoughtful people who view the insurance from a full circle of perspectives—all belong to the Society's Risk Management Section!

Why?

I believe it is because that section presents what I support as the correct, especially inclusive, view of what it means to be a property and liability insurance professional. All such professionals dedicate their careers to helping others achieve their objectives despite the adverse effects, actual or threatened accidental losses—that is, they are dedicated to helping others manage risk. Virtually every professional within the property and liability insurance community also helps others manage risk. Property and liability insurance producers certainly assist others in coping with risk, just as surely as do underwriters, adjusters, actuaries, researchers, financial managers, safety experts, consultants, and many other property and liability insurance groups.

Beyond these, the life and health insurance community encompasses an equally broad set of specific occupations whose professionals are committed to helping others manage life and health risks. Risk management is the nexus at which all their varied fields of expertise converge. Indeed, risk management—when viewed correctly as assisting others in meeting their goals despite accidental losses that do or could occur—is a core function of many professions beyond insurance. Each in their own ways, those who practice law and medicine as well as the clergy help others reach goals despite threats of unforeseen financial and other personal and organizational losses. Risk management is a very inclusive societal function, a responsibility that many share.

Within this broad setting, what should all the diverse readers of the *RMQ* be doing

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Serving Society through Risk Management

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as risk management professionals to "serve others as if their interests were my own"? Given this global perspective on risk management, who are the "others" whose interests CPCUs should professionally serve? I suggest three answers.

> *But, in doing your best for those whom you serve through risk management, play fair—have respect for your fellow risk management professionals and for the risk management processes through which our society enables everyone to cope with the adverse effects of accidental losses.*

The first, most immediate, answer is to keep on doing, as best you can, exactly what you are doing now. Regardless of whether you come to risk management with a producer's, adjuster's, underwriter's, risk manager's, or other financial interest to protect day in and day out, continue to play your role in an essentially adversarial process, realize that others are advocates for their respective positions, and have faith that the overall process will generate the best overall result as long as everyone joins you in doing their best. At this first step, those whose interests you serve are, as always, those who pay you—your employers and clients.

But, in doing your best for those whom you serve through risk management, play fair—have respect for your fellow risk management professionals and for the risk management processes through which our society enables everyone to cope with the adverse effects of accidental losses. My second answer to the question of whom risk management professionals should serve is that we serve our fellow practitioners and the risk-coping process in which we are all engaged. Thus, even though they may daily be "squaring off" over specific insureds' issues, producers and underwriters, adjusters and corporate risk managers, or actuaries and financial managers, should not fight these battles so heatedly or myopically that they permanently injure the advocates for the opposing side or damage the process for resolving these issues.

For example, from time to time producers should stop to imagine themselves to be underwriters, adjusters imagine being risk managers, or actuaries imagine being financial managers (and vice versa). In these reversed roles within the risk management process, they should each then ask themselves how they would have liked a recent specific issue to have been resolved if they "had been in the other person's shoes." In dealing with this recent issue, how would they have liked the advocates for the opposition to have acted? Pondering these questions leads every truly thoughtful risk management professional to an important truth: Those whom you should serve "as though their interests were your own" include your fellow professionals—even those with whom you were contending over a claim, a premium rate, or a claim reserve only just yesterday. Those whom you serve include your fellow risk management professionals—indeed the risk management profession itself. Protect it as it protects you.

My third answer is that all risk management professionals should ultimately bear in mind that the process in which we all are engaged should serve society. This process—regardless of our part in it or whose partisan financial interests we happen to be championing today—should function in ways that reduce the overall cost of risk for our community's and the world's economy as a whole. Thus, as professionals, we should seek solutions to specific insurance disputes that, if universalized for everyone in the same circumstances, would make the world a better place. Conversely, we should shun risk management actions that, again if universalized by having everyone do them, would harm the world.

Consistently taking these three actions are the heart of what I believe it means to be a risk management professional. I hope in future *RMQ* columns to explore how taking these three actions—serving the seemingly conflicting interests of employers and clients, of one's fellow risk management professionals, and of society as a whole—can benefit us all. ■

New Look for Newsletter

This issue premieres a new look for your section newsletter. This modern, dynamic design maximizes the space on each page while preserving an easy-to-read format. And keeping in line with our concern for the environment, the newsletter is printed on recycled paper.

Terrorism Insurance Coverage

by George Y. Andrea, CPCU

George Y. Andrea, CPCU, is a finance professor at the University of Baltimore Merrick School of Business. Andrea is also the research chairman of the CPCU Society's Maryland Chapter.

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September 11, 2001, represents the largest single insured event in history with estimated losses between $40 billion to $70 billion.

The inability to spread the risk of terrorist attacks through their reinsurance network, along with a stock market decline that has decimated investment returns, forced domestic insurers to ask for governmental action to fill the void left by the reinsurers.

President Bush signed into law the Terrorism Risk Insurance Act of 2002 on November 26, 2002. The new law creates a short-term federal backstop program for the insurance industry with a transparent system of shared public and private compensation for insured losses resulting from acts of international terrorism.

This act expires in 2005 and does not address the issue of terrorism coverage for personal line policies such as auto and homeowners.

The intent of this act, according to the United States Department of Treasury, is to protect consumers by addressing market disruptions and to ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk.

In addition, it should allow for a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses, while preserving state insurance regulation and consumer protections.

The Terrorism Risk Insurance Act of 2002 is a good start towards building a long-term financing risk transfer for terrorism losses. This is necessary for providing affordable terrorism risk insurance.

In the past, insurers hedged against catastrophic risk through the purchase of reinsurance contracts and the use of securitization—the repackaging of insurance risks for capital market investors.

The use of risk-linked securities, such as catastrophe bonds, was introduced in the 1990s to complement reinsurance as an alternative way of transferring the risks posed by hurricanes, earthquakes, and other natural perils.

The use of securitization generated a new source of capital for catastrophe losses provided by capital market investors willing to assume risk for a return. This process enabled catastrophe risks to be available and affordable, thereby reducing the burden on the federal and state governments to provide emergency disaster relief.

After consulting with the Homeland Security Council and top advisors last week, the President decided to raise the national threat level to orange, representing a high risk for terrorist attacks.

A long-term solution to terrorism exposure utilizing the securitization process for additional source of capital is vital for the survival of the insurance industry.

Terrorism risk exposure from a severity loss exposure is similar to catastrophe exposures due to earthquakes and other national disasters.

By using similar hedging mechanisms and pricing models as used for catastrophe losses, the insurance and reinsurance companies should be able to provide affordable long-term terrorism insurance coverage to both personal and commercial insurers. ■

Message from the Chairman

by George J. Kolczun Jr., CPCU

George J. Kolczun Jr., CPCU, is vice president, Rooney Insurance Agency, Inc. in Tulsa, Oklahoma.

If you didn't attend the CPCU Society's Annual Meeting and Seminars in Orlando, FL, you probably have at least received positive feedback. I would like to give you some feedback about your section committee's meeting. It really was a positive, productive meeting.

The primary theme of the meeting was to determine how we can best serve you. Our primary tool is this newsletter. We have all committed to deliver to you quality, informative articles. Sometimes, this is difficult. In fact, I would like to ask all of you to consider writing or finding an article that we could reproduce for the entire section. If you would e-mail the article to John Kelly, CPCU, at the CPCU Society he will forward it on to our editor, Kathleen A. Murphy, CPCU, who would be glad to include it in the newsletter. This newsletter is your way of communicating with your fellow section members. Utilize the newsletter to share your thoughts.

The committee also discussed ways of developing our web site. One suggestion is to use hotlinks that will take you to other sites of equal interest or help. We are working on this and hopefully it will be up and running soon.

We are in the first stages of planning the New Orleans meeting. There is discussion about developing an all-day seminar that would address each of the sections specific interests. The concept is terrific and your section committee hopes to be a part of this for you.

Your committee wants to be your connection to your fellow section members. Help us do that. Let me know what you want to see in the newsletters or on the web site. My e-mail address is gkolczun@rooneyinsurance.com. I will share your requests with your committee and we will do everything possible to make sure that it is done. I look forward to working with and for you.

Meet a Member of the Risk Management Section Committee

Walter G. York, CPCU, AIC, CCLA

Vice President
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As an account executive with RCM&D, Walter is responsible for a wide range of accounts including non-profits, publishing, and professional and manufacturing.

Walter began his insurance career as a claims adjuster for The Hartford. Walter worked as a claims supervisor, and as an insurance analyst before joining RCM&D. His duties included purchasing insurance, negotiating with brokers and underwriters, adjusting proper claims, exposure analysis, reviewing contracts and leases, and assisting Baltimore Gas & Electric's Legal Department in the administration of liability claims. He obtained additional risk management experience at the Insurance Buyer's Council and at the Mass Transit Administration.

Walter is a graduate of the University of Maryland with a bachelor of science degree in business administration. He holds a master of administrative science degree from the Johns Hopkins University. Walter holds the Chartered Property Casualty Underwriter (CPCU), Associate in Claims (AIC), and Casualty Claims Law Associate (CCLA) designations.

Credibility GAAP: In Fact It's a GAAS. But It's Not, "All Right"

by Donald W. Bendure, CPCU, RPLU, ARM

Donald W. Bendure, CPCU, RPLU, ARM, is an associate of Robert Hughes Associates, Inc., based in Richardson, Texas, and principal consultant for Quantum Leap Solutions based in Colleyville, TX. Bendure holds an M.B.A. in corporate finance, and the Chartered Property Casualty Underwriter (CPCU), Registered Professional Liability Underwriter (RPLU), and Associate in Risk Management (ARM) professional designations.

Along with the opening of the Rolling Stones' World Tour, last year was filled with a multitude of momentous insurance and economic events that set the stage for 2003. Lloyd's of London got a new lease on life, and Citigroup decided the insurance business wasn't so swell after all and sent Travelers packing. The insurance industry was itself terrorized by the federal backstop reinsurance that the insurance industry cried out for and got. (Be careful what you ask for. . . . could this be the beginning of federal regulation? It has been shown that events can conspire.) The stalwarts of medical malpractice insurance vaporized in front of us with no apologies. Phantom asbestos claims somehow surfaced again with a vengeance. Premiums increased substantially (again) across the board, and property underwriters were once again restored to respectable status after too long being ignored. It's hard to believe that the era of the "two cent rate" is over. (Remember when everything was "two cents"?) Even Warren Buffet had to admit he made a mistake (but he claims it won't happen again). 2002 was in many respects a difficult year. If you don't think so, just ask Martha. She'll straighten your tie.

But few events from the past year have had an impact greater than what resulted from the absence of sound corporate governance. Remember 10 years ago when the heads of corporations like Apple, Kodak, IBM, and General Motors, among others, rolled at the behest of a mob of angry boards and stockholders? It was dubbed the "Year of Sharp Knives" and was intended to reshape expectations for management and usher in a new day of reason and rewards for performance. Somewhere between Apple and Enron, we forgot to tell the boards of directors that *they* had to do their homework as well. Not that they weren't paid well to know that already. The long answer is too involved to recite, but the short answer is that CEOs and CFOs were incentivized by boards to create a house of cards. Then the high-flying opiate of the "new economy" numbed everyone's senses and we were drunk on the spirits of paper profits and "creative accounting." Boards asked questions, but the questions didn't penetrate the veil of creativity. Enron bled into Worldcom. Tyco and Adelphia confirmed the epidemic. Arthur Andersen bled to death as a result and its insurers went into chronic shock syndrome, taking double hits from huge directors and officers, and errors and omissions insurance losses.

Headhunters can't find enough "qualified" candidates for director positions, and everyone is decrying the lack of talent among the management ranks.

Congress attempted to legislate accountability. It is not the best of times to be either a CEO or a CFO of a public firm. According to Citigate Global Intelligence & Security (www.citigategis.com) 80 percent of financial statement fraud involves either the company's CFO or CEO, or both. The Sarbanes-Oxley Act of 2002 will cause a few sleepless nights for many CEOs who will now want greater assurances that what they see is what they get. Directors and officers liability insurance has never been in more demand while at the same time never

more expensive or scarce. Errors and omissions coverage is suffering from the same economics. Now we have a shortage of everything and everyone touching corporate finance and governance. Headhunters can't find enough "qualified" candidates for director positions, and everyone is decrying the lack of talent among the management ranks. "Competence and capability" are the watchwords for boards and management.

Lo and behold, we are also awakening to this fact within the insurance industry ranks. At a recent international conference held by the Professional Liability Underwriting Society, it was boldly confessed that the property and casualty industry suffers from a lack of "professionalism" at its highest levels. Aside from this comment being understated, it is one problem that has not gone unnoticed by many for years. One panelist even maintained that, "The fault always lies at the top." However, the truth even here was missed in part because the "top" is not the "highest levels of management." It is the Board of Directors. One major European insurer,

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Credibility GAAP: In Fact It's a GAAS. But It's Not, "All Right"

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when speaking about their scrutiny of board selection, stated that now, "We are not just kicking the tires. We are putting them on the operating table, opening them up and seeing what we can find."

> *Talent is scarce, premiums are way up, policy limits offered are a fraction of the previous year, and retentions in some cases are reported as high as 50 percent.*

Many boards have become in large part, a sham. This sad fact evolved by management design through "stacking" the board with a large percentage of "insiders." This is now starting to change, but not fast enough, and especially not fast enough in the insurance industry. One case in point is one large property and casualty insurer based in Texas that simply ceased operations in 2002. That's right. Ceased operations; as in, "Can't find anyone to buy this 'stuff.'" It can be argued that this is also one reason why Best's downgraded 380 insurance companies in 2001, then downgraded 648 in 2002. The insurance marketplace is so jittery now that a downgrade to a Best's rating of A- can seriously impact ongoing operations. This was so even to the extent that for one well-known national insurer, a cut-through agreement had to be obtained in order to quiet the storm. There was a day when an A- was a respectable grade. See what poor corporate governance does to the curve? Rather than graduating "cum laude" it's now considered "laude laude."

But this is not all bad. It is our job to make sure that good will rise out of these ashes. Patton once said that he never wanted to pay for the same real estate twice. Since we've already paid for these mistakes twice, how do we now make these lessons stick this time and put the word "govern" back in the word "governance?" We obviously learned little from the "Year of Sharp Knives" 10 years ago. How do we prevent history from repeating itself?

What has evolved as a result of all this carnage is a multi-front attack. Institutional investors are now beginning to insist on a passing grade for boards in order to invest in a company. Tools have been developed in the marketplace to rate boards of directors. Some such tools are the resources of the "Corporate Library" (www.thecorporatelibrary.com), which is a research group that will soon rate all boards just like we rate bonds—anywhere from AAA to "junk." This tool and others will prove invaluable for the directors and officers liability insurance carriers. The Public Company Accounting Oversight Board will no doubt have a few words to say about audit committees and how the errors and omissions exposure for audit firms may be mitigated. Citigate Global Intelligence & Security has developed what it calls the "board of directors tool kit" that helps companies comply with the Sarbanes-Oxley Act. Nyquil included for an additional fee.

One thing is certain: the ante has been increased considerably. Board members are understandably worried about their personal exposure. D&O and E&O carriers have pulled on the choke chain very hard over the last year. Talent is scarce, premiums are way up, policy limits offered are a fraction of the previous year, and retentions in some cases are reported as high as 50 percent. But new D&O and E&O insurance capacity is actually entering the market now, and this crisis of availability too will pass. With a healthy dose of history and homework, we can equip ourselves to prevent paying for our mistakes yet again. Only then will "paper profits" actually translate into real "value." ■

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For more information or to register, go to **www.cpcusociety.org**. If you have questions, contact the Member Resource Center at (800) 932-CPCU, option 4, or at membercenter@cpcusociety.org.

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