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WELCOME to the inaugural issue of INsight_Americas, the publication we have designed to explore the most interesting and challenging issues facing our clients. In the following pages, we focus on looking ahead, while remaining mindful of today’s major topics. It is the knowledge and understanding of yesterday and today that will equip the insurance industry to fulfill its role in global and local markets, by being ready for the challenges of tomorrow.

The speed at which change occurs these days makes it increasingly hard to stay ahead of events, but with higher-than-ever stakes, it is vital for those of us in the risk business to continue to do so.

Our industry is changing and opportunities are growing. To ensure stability in the future, global organizations like the XL group remain vigilant of business prospects, in emerging markets, and markets closer to home. Our society is changing. From class action suits to business continuity management and pandemic preparedness we investigate how we can stay ahead of the game, to offer you, our clients, security as the landscape shifts around you.

Our environment — natural and man-made — is changing faster than ever. The INsight team looks at the growing role of the insurance industry in alternative energy options, and the environmental pitfalls inherent in property transactions. Our industry’s rules and regulations have evolved — and understanding the complexity of today’s global regulatory framework requires knowledge and experience, whether to enable customers to benefit from global programs or get the best coverage for directors and officers.

Arguably, preparation for the future has never been more complex. It has certainly never been so critical. As insurers, we want to work with our clients to make sure that “business as usual” can continue — in these most business-unusual times. Thank you for joining us to consider these important issues facing us and our industries today. I look forward to talking to you over the next few months.

Clive Tobin
Chief Executive, Insurance Operations
The ups and downs of the insurance market cycle
A conversation with Clive Tobin

THE CYCLICAL NATURE OF THE INSURANCE INDUSTRY is a constant topic of debate. How can insurers, brokers, and their clients prepare themselves for the hard and soft market periods? Clive Tobin, Chief Executive of Insurance Operations for the XL group, answers questions about managing the risks of insurance market cycle.

Clive: In very general terms, the industry views a hard market as a period of capacity shortage, increased pricing, and more restrictive terms and conditions. A soft market, on the other hand, is characterized by excess capacity, increased competition, and declining premiums.

In the mid-1980s, the industry experienced the most severe hard market that it had ever seen. The speed and severity of reserve deterioration from asbestos and environmental liabilities resulted in a significant loss of capital and a number of insolvencies. This caused an acute capacity shortage, especially for liability coverage. This situation resulted in the emergence of new capital and companies like XL Capital to address the needs that could not be met.

In the early 1990s, the market experienced Hurricane Andrew and the Northridge Earthquake which were, until 9/11 and Hurricane Katrina, the most costly disasters for the insurance industry. This resulted in the creation of a new generation of Bermuda cat companies providing capital to meet demand for higher limits and lost capacity. It was the start of the capital markets moving quickly to replace capital and limit the severity of hard markets. The speed of raising new capital has been an important development to stabilize the market and bring greater security to insureds. So from the mid-eighties to the mid-nineties we had a hard and stable market. In the late nineties, however, we saw the industry spiral into a long, very soft market. There were several factors causing this. We had no major natural catastrophes and excess capital started to build resulting in increased capacity. At the same time we had a hot investment market so companies chased cash flow on casualty business and pretty much ignored technical underwriting.
Then what happened?

Clive: This all came to a grinding halt in 2001. 9/11 brought the largest catastrophe loss to the industry at the time, the investment market crashed with companies carrying large unrealized losses on their equities and the severe under-pricing on casualty business was emerging with large prior year loss reserve developments. According to Dowling & Partners, the difference between the initial and ultimate loss estimates on their composite portfolio of (re)insurers was $59 billion for 1998-2001. What was different about the end of this soft cycle was that poor results were prevalent across just about every line of business unlike the asbestos situation in the mid-eighties and natural catastrophes that occurred in the early nineties. Enter the next hard market and another wave of new companies.

What factors drive the insurance market cycle?

Clive: The two major factors driving the insurance market cycle are capital and investment returns. In today’s low interest rate environment we see companies much more focused on technical underwriting rather than cash-flow underwriting. This drives a more stable market which I believe is good for both insureds and insurers. A liquid capital market is also important in maintaining this stability. After Katrina, insurers were able to raise significant additional capital which lessened the impact of reduced capacity on our clients. The ability of our industry today to withstand events such as 9/11 and Katrina without the market falling apart, as it essentially did in the mid-eighties, is a major step forward.

How have the rating agencies, regulators and Sarbanes-Oxley contributed to today’s market dynamics?

Clive: Rating agencies are more extensive in their review of insurance companies, as are regulators. There is much greater analysis of performance metrics, volatility and risk management control. Failure to perform within expected parameters could have an impact on a company’s ratings and capital requirements. This deters companies from taking outsize market positions in relation to their capital.

Sarbanes-Oxley has placed greater responsibility on management for oversight of controls and financial reporting. This means the financials reflect performance more clearly and show where we are in the cycle in a much more transparent way. Results cannot be influenced to the extent they were previously by things like the widely publicized use of finite reinsurance.

How has this changed the market cycle?

Clive: Overall, I believe these factors will create a more stable environment and cycles will be shorter and less severe. In general, there are more controls in place and greater access to capital to manage market dynamics. In addition, we see increasing consolidation amongst insurers and with their bigger balance sheets they are less dependent on reinsurance to manage the cycle.
Where are we now in the cycle?

Clive: There is no question that rates have peaked and are softening somewhat but I still see a very responsible market. With the two largest catastrophes in history having occurred in the past six years and the ongoing threat of terrorism there is a sense of caution from sellers and buyers. There is often a greater concern for capacity over price. However, it’s amazing what a difference a year makes. 2005 saw record losses and capital raising while 2006 saw record profits and insurers looking at how they will deal with excess capital. It will be interesting to see what impact this has on the market in 2007.

What does this mean for insurance clients?

Clive: The good news is that there should be more capacity in the market in 2007 than there was in 2006 but in a broader sense it means that clients are dealing with companies that are better capitalized, more stable and responsible. Insurance companies are not going to be rewarded for some of the market share growth activities that we may have seen in the past. Industry analysts, clients, investors and other stakeholders are looking for responsibility in the market.

What can brokers do to help clients manage the cycle?

Clive: Clearly the broker has to listen and understand what a client’s needs are. Do they want long-term partnerships to manage through the cycle or are they price driven and content to take their chances on available capacity? Providing clients with a clear perspective on different strategies is important and then, of course, the brokers must be able to find the markets to execute. For those clients more concerned with certainty of capacity and the quality of their insurance partner, we’ve seen a strong interest in multi-year policies with highly-rated carriers, which I think bodes well for both sides.

What can clients do to manage the risks of the market cycle — even those that are shorter and less severe?

Clive: Certainly a client who demonstrates strong commitment to good risk management practices will be viewed favorably. Risk quality will always be more important than price for any responsible insurer. In addition, a risk manager who is proactive in building close and long-term relationships with insurers to improve the underwriters’ understanding of their risk will fare better throughout the cycle.
THE UNITED STATES has often been called the “Land of Opportunity”. Over the centuries, immigrants have flocked to its shores seeking opportunities to own land, practice religion freely, move up the socioeconomic ladder and, to this day, conduct business.

While emerging economies in Asia, Latin America, Eastern Europe and other parts of the world are indeed offering growth opportunities for the global insurance industry, the US is still the largest and fastest growing commercial insurance market and very much a place of opportunity for well qualified and financially secure insurers.

In general, and throughout its history, growth in the insurance industry has been fueled by increasing levels of income and wealth within the markets it serves. Areas which show high growth in gross domestic product (GDP) are those areas which generally purchase the most insurance. While premium volumes continue to grow in emerging markets such as China, premiums per capita are still quite low compared to those in developed countries. With a per capita GDP of $43,500 in 2006, the US is the largest economy in the world (CIA World Fact Book), and therefore, remains well positioned to continue attracting the largest portion of global insurance dollars.

Aside from the advantages of this wealth, US businesses operate in a significantly more litigious society than many other parts of the world. In a wealthy economy, minor incidents tend to result in more costly claims.

Recent events have also prompted US businesses to seek appropriate coverage to protect their assets from some very specific, sometimes new, risks. Natural and man-made catastrophes, for instance, have highlighted the advantages of having business interruption coverage, as well as contingent business interruption coverages, to keep a business financially secure even when operations or supplies have been halted. Similarly, corporate scandals and the subsequent passage of Sarbanes-Oxley legislation have increased the demand for insurance for corporate directors and officers in both public and private companies. This requirement for increased transparency has resulted in businesses’ desire to address their potential liabilities more aggressively on many levels. To allay shareholders’ concerns and help protect the balance sheet from environmental liabilities, for example, environmental insurance is being used more frequently as a risk management strategy.
From protecting intellectual property to minimizing exposure to cyber risks or environmental liability, the global insurance market continues to face a demand for protection against emerging business risks. Growth in a strong, mature market like the US requires its own set of strategies. For XL Insurance, as an example, continued success and growth in the US insurance market will depend on investing the right resources to support the changing needs of US risk managers and brokers by expanding product capability, enhancing customer service and establishing an even greater presence in key business markets.

While the US is certainly not the sole target for XL Insurance’s growth, it is a strong starting point to fuel its regional growth throughout the Americas. With close proximity to client support in key business hubs and industry expertise, Canada and Latin America are also emerging as important growth areas for XL Insurance.

To enhance customer service, continued focus on industry specific risks will also drive success in the Americas. Any given industry — construction, manufacturing, aviation, energy, and real estate, to name a few — has its own specific risks and trends. Maintaining or increasing market share throughout the Americas will require insurers to deliver industry-focused risk management solutions supported by extensive industry expertise and knowledge, not only in the underwriting of policies but also in the prevention of risks up front and the claims administration.

Meeting market needs

While the US is by no means an emerging market, there is plenty of room for XL Insurance to grow in the region, according to Dennis Kane, COO for the Americas. In the mature, but expanding US commercial insurance market and neighboring Canadian market, growth opportunity will be driven by demands for:

QUALITY PROPERTY CAPACITY: While the 2005 hurricane season may have shaken the property market momentarily, insurers have worked hard to prepare themselves to meet the demand for property coverage — even in areas prone to natural catastrophes. “Disciplined underwriting, client loss prevention, education and improved catastrophe modeling leaves XL Insurance well equipped to handle the issues that the industry has previously faced,” says Dennis.

DIRECTORS & OFFICERS LIABILITY: Concerned with Sarbanes-Oxley, securities litigation, poor financial performance and practices such as stock option back dating, executives need personal liability protection. “Executives carry a heavy fiduciary and legal responsibility to shareholders,” explains Dennis. “To entice the most qualified executives to sit on their boards, companies see value in offering strong personal asset protection such as broad A-side coverage.” US companies are not alone, according to Cindy Guyatt, XL Insurance’s Country Manager for Canada, who notes: “The personal demands and potential financial risks to company executives in Canada make top quality D&O coverage very desirable.”

SPECIALTY ERRORS & OMISSIONS COVERAGE: The US economy is a service-based economy and those providing services — lawyers, real estate agents, consultants, communications professionals — need tailored professional liability protection and risk management assistance.

ENVIRONMENTAL INSURANCE: Environmental cleanups can carry a hefty price tag. Standard Commercial General Liability (CGL) policies offer very limited or no pollution coverage. Many businesses have found themselves facing the high cost of environmental exposures uninsured. “Over the last two decades, businesses have grown more aware of potential environmental exposures and added pollution coverage to their insurance portfolio,” says Dennis, adding that contract or lender requirements in property transactions are also resulting in more demand for environmental insurance.

INDUSTRY-SPECIFIC RISK MANAGEMENT EXPERTISE: “From the construction industry to the upstream and downstream energy specific industries, customers have a wide range of risk management concerns,” says Dennis. “XL Insurance has a significant global presence in both construction and energy and we see new opportunities emerging in the US and Canadian markets as both countries prepare to face the increased future demand for energy and the technology and infrastructure necessary to meet these demands.”
Not all risk is attractive to all insurers. They may not be equipped to handle it and at various times in the past, have shown that they are not afraid to walk away from difficult risks. Industry knowledge and expertise is what also qualifies insurers, like XL Insurance, to take on business’s large, more complex risks. In a business world that is unquestionably more challenging to navigate, the demand for the highest levels of risk management expertise is not likely to diminish.

Rather than face these risks unprotected, businesses in the US, Canada and Latin America may come to rely more heavily on insurers who continue to commit time and resources to understanding and addressing complex, industry-specific risks.

For XL Insurance, the Americas are, in fact, the lands of opportunity. 🇺🇸

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Peter Needra
Regional Leader
Design Professional
A long and winding road

The drive toward enduring success in emerging markets

The great thing in the world is not so much where we stand, as in what direction we are moving. — Oliver Wendell Holmes

IN COMMON WITH GLOBAL companies of all sizes, the XL group remains constantly vigilant for new opportunities. Without growth, we die, as the saying goes. But this is not about growth for growth’s sake — it is about making provision for the future. Jacqueline Jones, XL's Head of Segment Strategy and Development, explains: “Our job is to ensure that in the long term there are sources of continuing profits. We have to be confident that we are not only doing what we are good at now, in the countries that are important to us now, but that we will have an income stream in the future.”

Today, planning for the future inevitably leads to talk of emerging markets — the big four BRIC countries, Brazil, Russia, India and China, as well as the rest of Latin America, and the Eastern European nations. The attentive company looks to these regions as untapped markets for existing products.

Somewhere between 80% and 90% of XL’s business is generated from the developed economies of the world. On the assumption that the balance of global economic power has a propensity to periodic readjustment, it makes sense to explore additional territories, although it does not always make sense to locate in these jurisdictions. Newly established or relatively untested financial, regulatory, legal and tax frameworks are fraught with risk for new foreign entrants, and the potential for political instability with all its economic consequences is also a major deterrent.

But a company like XL does not need to have a physical presence everywhere. “Since we don’t do personal lines and retail life — which are the biggest growth areas — we are not going to be operating directly in many of these countries,” says Jacqueline. “Neither do we need to be physically located in parts of the world where the

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major risks, such as energy and shipping, come to us anyway, through our wholesale Lloyd’s and Bermuda operations, or through XL Re.

“But having said that, development in emerging markets is a very important part of our long-term strategy.”

This strategy is clearly evident in recent moves by the XL group in China, India and Brazil. A representative office was opened in China in early 2006. This was followed by a unique initiative in conjunction with the Chinese Insurance Regulatory Commission, involving a leadership education program for the China insurance industry, developed with The Wharton School of the University of Pennsylvania. “This is the country we know we will have to be in, in the long term. If you look at China’s development in the last decade and the economic growth forecasts, there is no doubt that it will be a major economy. There will be significant opportunities and a company like ours should be there.” In India, an XL office of highly skilled employees is providing support to the company and their work is an important component of many key functions in our global company. Aside from this, India is also a vibrant and growing economy and offers long-term opportunity. “In both China and India, we are well placed to consider our next moves because we are there, on the ground,” says Jacqueline.

The latest big move for XL, however, is in Brazil where a joint venture was launched in 2006. This was not a new market entry, as XL was already operating in Brazil, the world’s 14th largest economy. “The formation of a joint venture company with Banco Itaú Holding Financeira S.A., the leading Brazilian bank and number three commercial lines insurer, has given us a very strong partner,” notes Jacqueline. “Doing business in a different environment, we do face some broader regulatory risks, but this partnership ensures that we don’t trip up. They bring their deep understanding of the Brazilian market; we bring the skills, experience and relationships developed in the open market. It really does offer the best opportunity for return on investment for shareholders. We also hope that this will provide a platform from which we can develop other business in Latin America.”

As a New York Stock Exchange listed company, XL needs to consider the terms of engagement in any of the new territories it enters. “It’s important that we evaluate whether the broader regulatory, legal and institutional framework, and business practices in a region match both SEC requirements and our own company values — and whether we can function successfully, i.e. profitably, within that environment,” says Jacqueline. “We are always looking for that new ‘something’ to assure our future — and it needs to be where we will have the best chance of success, and in a business environment in which we can comfortably operate.”

For XL in Brazil, there is no doubt that the pieces all came together very neatly in 2006. The joint venture company is now writing $200 million in business, compared with the $11 million XL was previously writing. And there is a potential benefit for XL’s reinsurance business in Brazil. The XL brand is now seen as bigger and more serious due to the Itaú relationship, and this means XL Re will be taken more seriously too.

“Overall, I believe we are in a very good position right now,” says Jacqueline.
The great escape

Potential rewards of loss prevention measures

“THERE ARE NO SECRETS to success. It is the result of preparation, hard work, and learning from failure,” according to former US Secretary of State, General Colin Powell.

Similar to General Powell’s observations, property insurance carriers today are aware that there are no secrets to the successful management of risk. Preparation and hard work are key but rather than see their clients learn from failure, insurance carriers prefer to help them prevent failing. Successful risk management, therefore, relies on identifying the areas that could fail or pose a risk, in order to eliminate or minimize the potential for failure, which could result in financial losses, employee injury or insurance claims.

Fortunately, today’s insurance clients depend on their insurance carriers for more than just their claims paying ability. With global carriers having handled the “lessons learned” of numerous customers, they can provide their clients with the benefit of their expertise and skill to help mitigate risk, or more specifically, to help actually prevent losses. With their insurers’ broad view of loss trends and proven solutions to
address risk, along with their own in-depth business and industry knowledge and the details of their operations, insurance buyers have found partnering with their insurers beneficial beyond just the provision of a financial safety net when a loss occurs.

Among the services an insurer’s in-house loss prevention specialists may provide are:

- Improving fire prevention strategies and adhering to building fire codes;
- Analyzing fire protection systems;
- Examining plant layout, fire divisions, combustible loading, and storage arrangements;
- Reviewing plant interdependencies and contingent exposures;
- Advising on a business’s susceptibility to flood, earthquake and high winds and finding ways to improve the integrity of a business’s structures/buildings, such as reinforcing roofs, windows, etc.;
- Developing the best possible pre-emergency and business continuity plan for natural catastrophes;
- Reviewing and advising on client risk management programs dealing with loss prevention self-inspections, hot work management, contractor controls, and management of change;
- Reviewing and assessing maintenance programs, particularly to help minimize the risk of failure of key machinery and equipment.

**HOLISTIC SCRUTINY**

Rather than pinpointing a few problem areas to make improvements, effective loss prevention requires a careful investigation of a business’s whole operation. This provides the opportunity to address risk potential that could impact the whole business, causing the operation to slow down or even come to a halt.

Working together, a business and its insurer need not only to ensure full identification and a common understanding of the risks, but also to communicate the risks and impart a philosophy of loss prevention and risk mitigation practices. Besides physical hazards affecting property, these risks may involve business interruption exposures, including interdependencies, contingent business interruption, or service interruption exposures. For instance, if a major supplier cannot service the company, does it have an alternative supplier that it can quickly rely on to keep its business operational?

For various energy operations, an insurer’s loss prevention team will help identify boiler and machinery risks, looking at the business’s key objects, unique equipment, redundancies, contingency plans, spares policy and maintenance practices.

Loss prevention professionals will also view a business’s claims history and issues surrounding its previous claims so that trends can be identified and acted upon. Aside from the technical aspects of an operation, loss prevention specialists do not overlook the human factor. Both a business’s management and its workforce are involved in its risk management success or failure. Management’s responsibility is to ensure that a holistic risk management philosophy is not only communicated throughout the company, but is also fully implemented, measured and ultimately “lived” by all levels of the workforce.

**A PLAN OF ACTION**

There is not a one-size-fits-all risk assessment process; the best loss prevention approaches are tailored for the business and regularly reviewed, with an insurance carrier lending assistance in key areas.

The 2005 hurricane season certainly showed the harsh reality that business operations lacking adequate continuity and risk management practices are vulnerable to disruptions, shutdowns, and significant financial losses. In Louisiana alone, state officials estimated that 81,000 businesses were closed as a result of Hurricane Katrina and one year later, only 62,000 of them had
reopened. The hurricane season’s lingering lesson remains — businesses need to plan especially hard and well in advance to avoid failures in the face of such catastrophic events. The success of a business, and even its survival, requires preparedness. Therefore, for businesses in hurricane prone areas, annual preparedness plans to mitigate potential hurricane losses and to minimize or even prevent disruption, have become more widespread. Before the hint of a hurricane, simple procedures, attention to operational details and maintenance and back-up plans can save time and money and contribute to a quicker recovery from a disaster.

As a result of significant hurricane losses, insurers are examining a variety of factors, including a company’s catastrophic risk exposure and its commitment to implementing loss control strategies, business continuity management, and emergency response planning. Businesses, too, would be wise to look at how their insurer’s loss prevention expertise can be used to help them make the most of their advance planning and avoid the lessons of failure altogether.

When numbers count against you

THERE IS POWER IN NUMBERS. Winners receive the most votes in an election. The prize goes to the highest bidder. Therefore, when outnumbered, the odds may seem daunting and there is easy justification to “call it quits” or find the quickest way out of a situation. This is the power behind class action lawsuits.

continued on next page
In a class action lawsuit, a group of persons or entities having common characteristics or attributes band together to bring a single lawsuit and exhibit strength in numbers. There are many benefits. The cost of litigation is shared among the class members, rather than each individual having to bear the full cost. The court overseeing the litigation does not need to adjudicate numerous individual suits, and it avoids the possibility of conflicting rulings on the same cause of action. The defendant may also benefit as it is only litigating one case in one court versus numerous individual cases potentially in different court houses. For instance, there is currently a group of class action attorneys seeking individuals who purchased fabrics used for bed sheets and other linens which may have overstated thread counts. Consumers are being invited to join the action and seek appropriate compensation. They may also join a class action suit against their health and fitness center or dating service about their membership cancellation policies, or a suit involving trans fat in their fast food lunches.

Because class action suits involve numerous parties claiming the same injury, large corporations are often saddled with significant litigation and settlement costs — not to mention unwanted media attention. While the cases are very often settled out of court to avoid excessive defensive costs, they can still divert corporate time and attention and pose significant concerns about risks to revenue and reputation among employees, clients and shareholders.

**CORPORATE CONUNDRUM**

There are declines in some types of class action activity. A recent study, the Stanford Law School’s Securities Class Action Clearinghouse, showed that securities fraud class action lawsuits slid to an all-time low in 2006, decreasing by 38% from the previous year. According to the report, in 2006 the total Disclosure Dollar Loss (DDL) decreased from $93 billion in 2005 to $52 billion in 2006. The study attributes lower losses related to securities fraud class action filings to three main factors: a strong stock market, a strengthened federal enforcement environment created by legislation like Sarbanes-Oxley, and the fact that a majority of securities class action suits filed in the late 1990s and early 2000 are now settled.

For directors and officers of publicly traded corporations, class action suits related to options backdating appear to be on the rise, however. The Stanford Law School study reported that, as of January 2, 2007, there were 22 securities class actions filed to date. There are currently an estimated 80 ongoing backdating investigations involving high-profile companies that may result in future litigation. Many companies have launched stock option investigations and are looking at their risks associated with stock options, contemplating both defense and insurance strategies.
SUCCESS BREEDS MORE
Declines in securities suits may, in part, be attributable to a healthy economy, a well-performing stock market and attention to greater internal controls. A decline in the stock market or other market conditions that affect a company’s performance may lead to greater exposure to shareholder lawsuits. Likewise, a successful outcome by the plaintiff in one class action suit can lead to other similar cases. The outcome of high-profile cases may result in class action attorneys seeking additional opportunities to start class actions against similar companies or circumstances.

Recent regulatory changes have altered the picture somewhat. In 2005, Congress passed the Class Action Fairness Act. Signed by President Bush in February 2005, the legislation, according to a White House press release, marked “a critical step toward ending the lawsuit culture in our country”. It contains a number of provisions aimed at protecting the interests of the individual class members in any proposed settlement and curbing the enormous legal fees often charged by class action attorneys.

Additionally, attempts to curb legal abuses have also come from the judicial bench. In a class action suit involving silicosis, Judge Janis Graham Jack issued a weighty 249-page decision that put a halt to a class action suit against 250 companies. The plaintiffs claimed they were diagnosed with silicosis as a result of being exposed to silica dust, fine pieces of sand which are released into the air during certain activities, such as sandblasting. She observed in the suit that 9,000 plaintiffs were diagnosed by the same nine doctors retained by the law firms. When deposed, the doctors admitted that they took their orders from the plaintiffs’ attorneys. Another issue that the judge uncovered was that 65% of the plaintiffs in the case had previously been involved in an asbestos class action suit. Judge Jack’s diligence uncovered the myriad abuses and possibilities of fraud that can occur in class actions, and she opened the door to further scrutiny of these cases.

GOOD JUDGMENT
Well-established practices for both internal and external communications, strong financial controls and good business judgment are among a company’s best strategies to at least minimize risks associated with a class action lawsuit. In the case of securities lawsuits, internal controls designed to quickly identify issues within the company coupled with effective corporate communications should result in timely and accurate reporting of good news and bad news. Many times, securities allegations assert that a company knew of an internal problem but failed to advise the public of the potentially bad news in a timely manner. As a result, the company’s stock was artificially inflated because the company did not notify the investing public that the company had encountered some difficult times.

The failure of directors and officers of a corporation to act in good faith and use good business judgment may be grounds for a suit to be brought against the company. The company needs to ensure that when an officer or director of the company is speaking publicly the information that is conveyed accurately reflects the current status of the company. Overly positive or overly negative news can be problematic.

For many, especially large companies, avoiding class action suits altogether may seem impossible, but they would be wise to stay alert to situations that can pose class action risks.
Preparing for the unknown

What will we face from pandemics?

THE AIRPLAY MAY HAVE DIMINISHED, but the influenza pandemic discussion is more significant now than it was two years ago when public debate on the subject was at its height. In 2005 the avian flu virus H5N1 had been identified in 12 countries. A year later it was confirmed in 55 countries. In 2005, there were approximately 32 identified strains of H5N1; currently, there are more than 1,600 identified. Scientific studies of H5N1 have shown it to be remarkably similar to the Spanish influenza virus of 1918. Accurate data from past pandemics are few, as epidemiology is a relatively new science. What we do know is:

- Records of influenza pandemics only go back about 300 years, during which time there appears to have been 10 influenza pandemics, with a few additional events which may have been influenza pandemics.
- More detailed statistical records are only available for the three pandemics which occurred in the 20th century (1918, 1957 and 1968).
- High morbidity and low mortality, with most deaths among infants and the elderly, were characteristics of the pandemics, with the exception of 1918.
- The 1918 pandemic was a singular event in terms of the high death rates among young adults.

It is the similarity between the H5N1 virus and the 1918 Spanish influenza virus that drives insurers’ concerns, both in terms of the severity and the concentration of deaths over age ranges with the highest numbers of insured lives. Given that an influenza pandemic has been experienced approximately every 30 years, we are overdue. The last one was almost 40 years ago — the Hong Kong flu in 1968. This, coupled with the potential lethality and persistence of H5N1, suggest that it is prudent and responsible to prepare for the possibility of a serious influenza pandemic.

While H5N1 has shown the potential to have the virulence of the 1918 virus, it does not follow that the impact would be similar. Improvements in the overall level of mortality in insured populations indicate generally better health and ability to withstand diseases. Population mortality in 2006 was 20% of the level it was in 1918. International organizations, such as the World Health Organization, exist today to coordinate monitoring of emerging diseases to ensure that steps are taken to minimize the chances of their emergence, and strategic plans and resources are positioned for effective response.

The key is preparation and monitoring — as governments, businesses and individuals. The XL Group is monitoring the risk through a variety of specialized third party vendors and reputable government agencies. XL is coordinating responses to both the business risk and the operational risk through an integrated global team with senior representation from actuarial and risk management, travel, IT, communications, legal, and HR departments. The team meets weekly to discuss current risk, ongoing preparations, and policy. For business risk, an integrated approach is essential given that a pandemic is global and systemic for any life contingent risks. Risks are assessed across all lines of business to ensure that XL’s appetite for pandemic risk is not exceeded and to ultimately protect the company’s financial position.

For operational risk, a business continuity plan is essential, and it needs to be both robust and flexible. Above all it needs to be tested, so that key individuals are appropriately trained and the plan itself is put to the test. As a leader in the industry, XL was invited last year by Lloyd’s of London and the UK regulatory body the Financial Services Authority to take part in an exercise scenario over a six-week period. We learned a great deal, and have incorporated those lessons into our plan. The UK market is probably one of the strictest in respect of business continuity and what we have learned in that market is of benefit to our global plan.

Companies around the world are seeking to ensure that their ability to conduct business in the event of a pandemic or other crisis is not compromised. The serious social and economic impact of an influenza pandemic cannot be forecast with any certainty, but being prepared for the eventuality will enable us to minimize the damage.
When business unusual strikes

How one company is responding to the threat of disaster

XL is among a growing number of companies investing thousands of dollars, hours, and human resources in plans and activities to guard against disasters. According to a recent Deloitte & Touche survey, the number of US companies that have developed formal business continuity management (BCM) programs within the last six years has nearly tripled. This has been attributed to the increase in terrorism, other man-made and natural disasters, and the current regulatory environment. Additionally, the survey showed that management’s intolerance for operational downtime continues to be a leading driver of BCM programs.

Historically, BCM was not an integrated program within the XL group. Given the high level of acquisition activity between 1998 and 2001, disaster recovery planning (DRP) was defined in isolation, and there was no centralized coordination of BCM activities throughout the group, although business continuity planning (BCP) existed for some functions in most large locations. It was also focused on business needs, with no actual geographic location oversight, and without a formal link to DRP.

However, XL has changed considerably since its beginnings as a mutual insurance company in one location. Now a global insurance, reinsurance, and financial services group with more than $58 billion in consolidated assets and operating out of almost 70 locations in 27 countries, it is implementing a robust and consistent global approach to business continuity and disaster recovery.

The purpose of XL’s global BCM program is to ensure that all operations critical to business continue in the event of disruption. The plan itself also provides a framework for facilitating emergency response, crisis communications, and operational recovery before, during, and after an incident.

“The program has been set up to ensure that XL fully meets, or exceeds, all applicable local, national and international regulatory requirements with regard to business continuity and disaster recovery,” says Spike Lobdell, Chief Executive of XL Global Business Services and Chairman of the group’s Enterprise Risk Committee.

“The objectives include protecting XL’s employees, buildings, business information, financial performance, and reputation.”

The BCM Steering Committee comprises Business Continuity Manager Thomas Mezger, Tom Dunbar, Head of the Disaster Recovery Program, and Hank Kalt, Disaster Recovery Manager. The committee oversees the global program, while each location and function is responsible for defining, testing, maintaining and updating their own business continuity and disaster recovery plans. In fact, some of XL’s larger offices, such as London (600 staff) and Zurich (250), have already conducted business continuity tests.

A special working group has also been established within the BCM governance model to consider specific risks, including a flu pandemic, from a global perspective.

By the end of 2006, more than 90% of all XL employees were part of business continuity processes; all offices with more than 100 employees had a full business continuity plan in place; and about one-third of all locations had fully-tested BCP in place. By 2010, the goal is to have fully tested and regularly maintained plans throughout the XL group.
WITH THE ADVENT OF THE INTERNET and other affordable communication technology, the world quickly became a more connected global market. It is a development that has offered tremendous opportunity for businesses to enter emerging markets and provide their products and services around the globe. Businesses in the United States have enthusiastically seized the opportunity to expand their reach and, as reported in the Washington Times, “spend more money establishing and expanding overseas operations than those of any other nation.”

With the expansion of business operations, risk management strategies originally developed for operations in a specific marketplace, need to be flexible and adaptable to respond to the challenges of the global marketplace. Businesses see the advantages of working with a global insurance carrier whose “global footprint” matches their own — doing business in similar locations.
As a company grows, risk managers may initially entrust the purchase of insurance coverage to local employees, or secure coverage through their broker’s local network. As global growth continues, however, it becomes more and more difficult to manage this decentralized approach and risk managers often partner with global brokers and insurers to implement a global program to manage their worldwide exposures. Consider a risk manager’s dilemma in purchasing casualty coverage for a company with operations in 25 different countries. Risk managers may find themselves in a situation where it is nearly impossible to keep track of what coverages they have in any given country, and more importantly, the potential gaps in coverage. A global carrier with a network of offices and fronting partners can provide a risk manager with the benefits of local underwriting, regulatory and claims handling expertise, as well as the tools for centralized management.

**GLOBAL PROGRAM ADVANTAGES**

Since local management has controlled the local buying decision and relationship, the major obstacle the risk manager often faces is securing the buy-in of its local management to a centralized approach, on the basis that it is in fact more efficient and effective. For risk managers, the goal is to work with a qualified carrier that can provide:

- Seamless, consistent worldwide limits and coverage, while maintaining specific standard local coverage requirements;
- Compliance with local tax and regulatory authorities;
- Flexibility and administrative efficiency;
- Centralized premium and claims reporting.

This centralized risk management approach has many additional advantages. For one, with a single global carrier providing admitted coverage, a risk manager retains centralized control over the program with access to local underwriting, regulatory, claims and loss control expertise. Working with one carrier and a global program, many companies also feel more secure with their spread of risk and uniformity of limits and coverage, reducing the possibility of duplication and coverage gaps. Likewise, working with one global insurer, they enjoy greater flexibility of program design, coverage and premium allocations. Centralized loss reporting also allows risk managers to access loss data about any location and adapt their risk management strategies accordingly.

In order to execute a global program, the selected global insurance carrier: issues a master policy that serves as an “umbrella” over the local placements providing excess and difference-in-conditions coverage; coordinates the issuance of local underlying policies by their insurance network of owned companies and fronting partners where the insured has local operations; and coordinates invoicing, premium payment, loss control and local claims servicing with the local broker representative and local insured.

**FUNDAMENTALS OF SUCCESS**

Risk management plays an integral role in assuring that expansion opportunities can be profitable opportunities. Implementing a successful program and achieving the risk management goals requires coordination and communication between all parties. Communication between a risk manager, the broker and the insurance carrier is likely to lead to a good understanding of the specifics of the business’s local insurance coverage and requirements. Local policies have to comply with local regulations. Therefore, for the risk manager, reliance on a competent global insurance network provides a resource of insurance professionals who are also knowledgeable about local coverage requirements.

Just as technology created the opportunities for global expansion, technology plays a significant role in servicing the insurance needs of global businesses. Sophisticated information technology to address policy issuance, tax payments, premium flows, currency conversions, claims filing and administration is a key component of the successful implementation of a global program. Ultimately, such a system enables the efficient monitoring of an
Global programs, continued

insurer’s risk distribution, premium allocation and claims activity. It enables the parties to continuously evaluate the program’s effectiveness and tailor its design as needed. For example, clients can evaluate: claims activity to determine the adequacy of local premium allocations; the need for specific loss control programs; and the effectiveness of local management, among other issues.

Demand for global programs is stronger than ever. Companies operating in a global business environment require a global approach to managing their risks. As developing and servicing global programs requires a significant commitment of resources, an insurer’s ability to deliver service excellence is a critical differentiator. Success with global programs is achieved with effective communication, flexibility and adaptability. The end result is worthwhile, with a global insurer establishing itself as more than just insurance provider, but rather a strategic partner in today’s global marketplace.

Global Programs Defined

**A CONTROLLED MASTER PROGRAM**
A Controlled Master Program extends coverage for the worldwide exposures of a multinational company. A master policy that governs the program is issued to the parent company in the multinational’s country of domicile. Local underlying policies are issued to the subsidiaries of the parent company in the countries where the insured has operations.

**A GLOBAL PROGRAM FOR US MULTINATIONALS**
A Global Program for US Multinationals comprises a master policy and local underlying policies that include the United States exposures and the foreign exposures of a US multinational. The limits of the local underlying policies (including the United States) reduce the limits of insurance under the master policy.

**AN INTERNATIONAL PROGRAM FOR US MULTINATIONALS**
An International Program for US Multinationals is made up of a master policy and local underlying policies that include the foreign exposures of a US multinational. The US exposures may be written by the same carrier but not as part of the global program. The limits of insurance of the US policies do not reduce the limits of insurance of the master policy.

Uwe Schoberth  
Regional Executive, Central US

Olivia Macia  
Chief Underwriting Officer  
International Casualty, Americas
Environmental insurance: a vital tool for property transactions

THE TRUE VALUE OF INSURANCE is — in most cases — only realized following a loss. With any business involved in the redevelopment or transfer of property, however, the importance of insurance, especially environmental insurance, is recognized before any loss is suffered or any financial pay-out is made. For businesses and lending institutions involved in property ownership or management, the role of insurance is to transfer some of the environmental risk associated with properties.

IN THE BEGINNING
The perception and uses of environmental insurance have substantially changed over the years. The environmental insurance market grew out of the need for businesses to meet regulatory requirements, but today the majority of the environmental insurance market’s growth is driven by its recognition as an important business tool for covering operational risks or managing potential environmental liabilities of a transaction, such as the closure of a facility or property sale.

As anyone in redevelopment knows, a property buyer should seek assurances about a property's condition. But even though strict due diligence is undertaken, there is always the possibility that an environmental condition could be discovered later. This could leave a redevelopment project at a standstill or stall a property transfer for an extended period of time while remediation takes place.

Often an environmental insurance policy provides for the possibility of unforeseen cleanup expenses associated with the redevelopment or transfer of property. Lending institutions are increasingly using insurance to cover possible remediation expense and pollution legal liability on properties they may own, operate or hold in trust.
THE ROLE OF ENVIRONMENTAL INSURANCE

The annual premium for environmental insurance is certainly more attractive than a seven-figure cleanup expense. Environmental coverages are now available to insure the various parties and aspects of property transfers, sales transactions and real estate redevelopment projects, including contractors, developers, subcontractors, financial institutions, and future buyers. Coverages are also available to protect the owner from changes in government regulations that could require additional unexpected cleanup costs after the development is completed and the site is occupied by tenants. Without some kind of protection, these groups were often understandably hesitant to undertake a project or transaction that involved known environmental contamination and, more importantly, the risk of unknown pollutants. Common environmental insurance programs used in these situations include:

- **Pollution and Remediation Legal Liability (PARLL)** policy provides coverage for on-site and off-site sudden and gradual pollution conditions at or from covered locations that result in third party property damage and bodily injury, remediation expense, and legal defense expense under one policy.

- **Real Estate Lenders Policy (RELP)** provides coverage for the interest of a secured creditor in a real estate loan such as a bank, insurance company or other financial institution holding commercial real estate collateral. Coverage includes pollution legal liability and the lesser of remediation expense or outstanding loan balance.

- **Remediation Stop Loss (RSL)** programs provide protection against cost overruns resulting from scheduled remedial activities.

Environmental insurance providers are recognized for their flexibility in writing coverages. Pollution insurance policies are underwritten specifically to accommodate the environmental concerns of the individual transaction. Enhancements or endorsements can be attached to the standard PARLL policy to address specific issues such as indoor air quality or underground storage tanks, among others.

LOOK FOR STRENGTH AND EXPERTISE

It is important to understand that environmental insurance is an engineered product — a substantial amount of upfront, hands-on work and evaluation go into assessing a potential buyer’s environmental exposure before a policy is actually underwritten. Fortunately, there are a handful of financially strong insurance companies that have remained long-time participants in the environmental insurance market. Predetermining a provider’s level of expertise in underwriting environmental risk, providing loss control services and managing claims should be a guiding principle when deciding upon the right provider and appropriate coverages.

Since the majority of environmental liability policies for property transactions are written for a period of several years, it is important to place insurance with a carrier that has demonstrated its long-term commitment to the environmental insurance marketplace and has the financial strength to back it up. With underwriters who are technical specialists with a background in environmental sciences and engineering, you can be assured you will receive intelligent solutions from someone who can structure a program that suits your unique needs and be there throughout the life of the policy to assist with necessary changes.
INSURANCE IN ACTION
What is happening today on former military bases nationwide is clearly showing how environmental insurance can keep big redevelopment dreams alive, with minimal delays and doubt, and help return these closed military sites to productive community use. (See the following article, “A risky, but worthwhile, mission”.)

A VALUABLE TOOL FOR TAKING CARE OF BUSINESS
Traditionally, pollution liability caused disputes and stood in the way of real estate transactions and other property issues. Today, there are specialty coverages available to address this unique liability and protect the many parties involved in redeveloping, transferring and financing property. Environmental insurance is proving to be a valuable business tool for making the most of lucrative property deals that would have been passed up in the past.

Marcel Ricciardelli
Senior Vice President
Facilities Underwriting Manager
Environmental

SINCE THE BASE REALIGNMENT AND CLOSURE (BRAC) ACT OF 1988, 97 military bases in the US have been closed. Now, under the 2005 BRAC recommendations, a further 22 bases will be shutting their gates to military operations as well.

By statute, the Department of Defense (DoD) now has until September 15, 2007 to begin closing and realigning the installations. The process must be completed by September 15, 2011.

As the closed military recommendations become law, many communities are asking the question: What do we do now?

GOOD EXAMPLES
Fortunately, there are some good examples to follow, such as developments at these former military properties:

– Bergstrom Air Force Base, near Austin, Texas, was transformed into an international, commercial airport that generates $1.8 billion annually into the community and created 37,500 jobs.

– The former Philadelphia Navy Yard currently houses docks for ship building, a cruise terminal, a corporate park and a historic district.

– In Lubbock, Texas, the former Reese Air Force Base is now Reese Technology Center, home to several biotechnology firms.

– The Village of Glenview, Illinois, once the location for Glenview Naval Air Station, established The Glen, a 1,121-acre mixed-use district, with new homes, offices, two golf courses and retail space.

Many of the closed military bases have reinvented themselves as revitalized properties for housing, industrial, training, educational and recreational facilities and hubs of commercial business activity. This is positive news, according to the General Accounting Office (GAO) and others: the base closings have resulted in an estimated $16.7 billion savings to the military, and are expected to continue to save more than $6 billion a year. Additionally, according to the

A risky, but worthwhile, mission: redeveloping former military bases

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National Association of Installation Developers, 50,000 civilian jobs have been created at bases closed since 1988, more than 1,300 private and public sector employers now operate at closed bases, and 15 communities have created more jobs at former bases than were lost because of the closures.

**JUMPING THE HURDLES**

One of the biggest proven obstacles faced on former military bases is the existing environmental condition of the property. Military bases — often self-contained communities — have all the environmental issues of a city. There is housing, motor vehicle maintenance facilities, fueling islands for a variety of military vehicles, laundry and dry cleaning, mechanical and electrical equipment maintenance and waste dumps.

Under Section 120 of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the DoD is responsible for all remedial action necessary to protect human health and the environment resulting from its activities in the past. The intent of the CERCLA section was to ensure that military installations would remediate to acceptable levels for human and ecological health before the property was transferred to the private sector.

Once the closure of a base is announced, a Local Redevelopment Authority (LRA) is formed and work begins on the environmental cleanup of the site and a master plan for the base’s future. Once the cleanup is complete, the land is transferred to the local authority at no charge. Developers then work with the LRA to help make the master plan a reality.

Despite the DoD’s best efforts to clean up the property before transferring the land, there is often concern about ongoing liability. Uncertainty surrounding the ability of the DoD to remediate a site prior to its transfer to the private sector, and the extent of the DoD’s liability thereafter sometimes makes LRAs and other private sector entities unwilling to accept ownership of former military property. Examples include:

- Additional contamination may be discovered, requiring a business to halt operations on a former base for an extended period of time while remediation takes place;
- Lack of assistance in indemnifying and defending subsequent property owners if they are named as co-defendants in lawsuits brought by third parties because of an environmental incident;
The discovery of new contamination.

Regardless of these risks, the attractiveness of these development opportunities can be enhanced and improved through the reduction of uncertainty and the addition of risk management controls.

TOOLS AND STRATEGIES
A variety of government programs and risk management strategies, such as the purchase of environmental insurance programs, have helped both local redevelopment authorities and private developers to protect themselves against environmental liability. Environmental insurance products available today may help to eliminate or reduce the uncertainty that exists for all parties involved in a property transaction, such as the subsequent sale of DoD military base property, get BRAC facilities back on the municipal tax rolls, and aid in local job creation.

SHOWCASE REDEVELOPMENT
The redevelopment of the former Lowry Air Force Base, outside of Denver, Colorado, is considered a military base success story. The Lowry Redevelopment Authority, an independent agency, was established to manage the site’s redevelopment activities which included plans for new housing, a golf course, commercial businesses, a town center and an educational campus. Lowry Air Force Base closed in 1994 and the redevelopment is now 70% complete.

According to new research conducted by Development Research Partners, a local real estate analysis and economic development research company, redeveloping Lowry created a $4 billion gross economic impact between 1994 and 2003. The majority of Lowry (89%) is in the City and County of Denver, and 11% is in Aurora. The economic impact report focused on Denver’s economic benefits because very little new development has occurred to date on the Aurora portion of Lowry. Approximately $2.3 billion directly benefited the City and County of Denver, including $39 million in taxes and fees. The remaining $1.7 billion benefited the City of Aurora, the State of Colorado and other states.

LOWRY’S LESSONS
Lowry’s achievements have been widely recognized for their success. Among the challenges to the project were contamination issues: a plume of groundwater pollution involving spilled jet fuel and de-icing materials extended over several hundred acres; numerous buildings contained asbestos; a contaminated landfill and various hazardous and non-hazardous substances existed on the premises.

While the Air Force had provided thorough environmental remediation at Lowry, LRA used innovative risk management strategies in the base’s redevelopment process. The use of environmental insurance offered additional reassurance to Lowry’s potential buyers by eliminating or reducing the uncertainty that existed for all parties involved in such property transfers. In the event that an environmental incident occurred, Lowry had purchased an environmental insurance policy in 1997 to address ongoing liability issues.
Insuring an alternative energy future

IN HIS FIRST STATE OF THE UNION address for 2007, President George W. Bush announced his "Twenty In Ten" plan aimed at increasing the US's energy security by reducing its dependence on oil. The plan aims to reduce US gasoline consumption by 20% in the next 10 years through increasing the supply of alternative fuels, such as ethanol and other biofuels, and supporting alternative energy resources, including solar, geothermal and wind power.

While the Bush Administration’s energy plan focuses on alternative energy resources, many energy businesses have already directed their attention toward developing new alternative energy technologies and products while improving reliability and efficiency.

Given the extreme weather of late, including colder winters, hotter summers, and of course, the active hurricane seasons that affect energy production, the interest in alternative energy use is likely to continue to grow. This interest will be further fueled by oil and gas prices that are expected to remain high, and a recent United Nations’ report on global warming, which is adding credence to calls to cut dependence on fossil fuel and look for new alternatives to meet energy demands.

As the energy industry continues to explore new resources, the insurance industry has increased its efforts to manage the risks associated with alternative energy. For some of the technologies, such as hydropower and ethanol production, the risk management issues are very much the same issues faced by more traditional energy companies, such as exposures related to general operational issues, construction of energy projects, and reliability of power sources and facility equipment such as turbines. Other alternative energy technologies expose different risks.

POWERFUL ALTERNATIVES

Wind farm operators, for example, have had to overcome significant challenges and the insurance industry has learned some lessons about insuring risks associated with wind power. The first wind turbines used in the US were designed by European firms. The equipment proved to be better equipped at handling the more constant, but gentler, winds common to that continent, than the stronger US breezes. Then the US aerospace industry began to apply some of its technological know-how, entering the market with small, light turbines. Similar to the European models, these lighter and smaller designs did not stand up well. Many early wind farm power developments were situated in California where winds may average 35 mph or more and peak at over 80 mph during the windy season, May-October. The technology was simply not able to handle these high-wind conditions.

After the failure of these early ventures, wind farm operations sought financial relief by turning to the turbine manufacturer’s warranty or their insurance policies. This resulted in insurance carriers paying out millions of dollars in claims and many of them stopped providing wind farm coverage altogether.

While the wind power market was largely eroded in the United States by the 1950s, the use of wind power remained strong throughout Europe and in parts of Africa and Australia. Despite the early setbacks and with lessons learned elsewhere, wind farm operators in North America worked on improving technology and reliability while the insurance market continued to monitor its progress and develop a greater understanding of the risks faced by wind farms.

Reluctance to provide insurance coverage has lessened with a greater understanding and confidence level in the wind power industry’s ability to manage its exposures. Improved turbine designs backed by stronger manufacturer warranties, maintenance programs, and greater attention to risk
management, have led to wind farms’ significantly higher reliability, productivity and cost effectiveness and subsequently, their insurability.

Solar energy technology is following a similar path. As solar technology has evolved and demand for it has grown, the insurance market is investigating ways to meet the demand to insure solar power systems. Some solar energy supporters are even quick to say just how the insurance industry can benefit from greater use of solar electricity — outside of providing insurance. According to proponents of solar power, photovoltaic cells which convert energy from the sun into electricity, can be used to restore power to businesses and residences more quickly, reducing business interruption losses and living expenses claims. Likewise, supporters say that solar power could improve the insurance industry’s response to catastrophes by powering mobile offices at disaster sites.

SHINING ADVANCEMENTS

From a risk perspective, many businesses involved in alternative energy projects can benefit from specialized insurance coverage, whether they are wind farms or solar energy installations on a single building or a whole housing development. Insurance is a risk management strategy for all involved in the process of supporting alternative energy production, including:

- **The Manufacturer**, who must deal with equipment warranty issues related to the equipment provided for the project, but is concerned about carrying the liability of warranties on his own books;
- **The Lender**, who may be concerned with manufacturers’ warranties, and is interested in protecting the financing of a specific project;
- **The Installer**, who manages their exposures during the construction of an alternative energy facility;
- **The Operator**, who has responsibility for day-to-day operational exposures and business interruption concerns;
- **The End User**, who is concerned with the contingent business interruption risks if the facility cannot provide adequate energy at any given time.

Wind and solar power involve harnessing natural resources that are not always available in the quantity needed to produce power. As the wind does not always blow at steady levels and the sun certainly does not always shine on all corners of the earth, weather insurance is also valued for protection against variances in weather affecting the facility’s ability to produce energy.

INCREASED CONFIDENCE

For alternative energy ventures, insurers pay close attention to the planning, operation and maintenance of the project. Just as the energy industry has depended on technical expertise to develop alternative energy, the insurance industry has relied on its technical expertise to write the risks. Many of today’s energy insurance underwriters are engineers, trained in risk management issues facing energy companies.

The end result of the insurance industry’s growing level of confidence is that insurance coverage is currently available. During all project phases, financial losses, such as income, profit, loss of tax credits and other incentives, may now be covered. Insurance policies offer protection against damage of equipment during transit and construction, as well as any physical loss or damage including a natural catastrophe. Additional coverage offers protection against business interruption.

With more competitive rates and terms, insurers are also showing increased flexibility with their programs offering combined construction and operation policies as well as the ability for a developer or operator to combine multiple sites under one policy.

Venturing into the alternative energy market appears to be growing more enticing for many companies. As energy users have adapted to alternative energy sources, so has the insurance industry to underwriting the risks associated with alternative energy. Today’s insurers have more of a risk appetite and capacity for providing insurance coverage during various stages of development, construction and operation of alternative energy projects. Such coverage has become even more important giving financial protection from delays and damage that may affect the overall financial viability of a project.

Ron Berler
Senior Vice President
Global Energy Coordinator
CANADA’S MULTICULTURISM — a combination of British, French, and Aboriginal cultures and traditions — is preserved and displayed within the walls of the country’s impressive system of some 2500 museums and cultural institutions. According to the Canadian Museums Association (CMA), these institutions contribute over $650 million in salaries and wages to the national economy and an estimated $17 billion annually to Canada’s GDP.

Perhaps more important than its economic contribution is how millions of art works, objects, artifacts, and documents in trust in Canada’s museums play a significant role, according to the CMA, in preserving Canada’s collective memory, shaping the country’s identity and promoting tolerance and greater understanding in such a diverse country. How does one place a value on that role? Or more specifically, how does one protect the value of any individual one-of-a-kind piece displayed on these museum walls?

“Time extracts various values from a painter’s work,” Impressionist Painter Henri Matisse wrote. “When these values are exhausted the pictures are forgotten, and the more a picture has to give, the greater it is.” Through its museum funding and various organizations, Canada’s museum system assures its national treasures can be enjoyed by its more than 59 million visitors each year. To ensure that these national treasures are further protected, enjoyed for future generations and their value preserved, a growing number of Canadian museums, galleries, colleges and universities with collections use fine art insurance.

PROTECTING VALUES

Although fine art coverage may appear to be very expensive, it is considered one of the most comprehensive insurance coverages available on the market today, especially in the context of rising art values. Documenting value is one of the initial steps in underwriting fine art protection. As the value of art goes up, insurance premiums will increase accordingly. To make certain their insurance cov-
erage effectively protects the value of a collection, collectors and museums will find themselves reevaluating their works on a regular basis, usually every three to five years.

Unlike a building, that if damaged or destroyed can be rebuilt at a specified cost, damaged, stolen or lost artwork can rarely be replaced. Its uniqueness is, in part, what creates its value. Insuring fine art requires distinctive underwriting treatment because of the distinct characteristic of what is being insured.

With priceless treasures and art work entrusted to them, most museums and collectors, in the eyes of insurance companies, are deemed “good risks” as they tend to be meticulous about displaying, lending, and handling art work. Canada is a particularly attractive fine art insurance market because clients pay attention to risk management practices, benefit from a low crime rate and are less susceptible to natural disasters and other exposures that pose risk to art collections.

Many museums and collectors choose to insure their art works under All-Risk policies which offer broad coverage with few exceptions to exclude coverage. Under these specialized fine art All-Risk art work is protected against flood, earthquake, vermin, mold, fire and other potential exposures. Fine art premiums are typically calculated on probable maximum losses. Two paintings displayed in one place, such as an individual’s private collection stored at home, could be entirely destroyed in a fire. It is less likely that an entire $150 million museum collection housed in several locations would be destroyed at once. Therefore, large collections, such as those of museums, may only purchase a certain percentage of the value of their entire collection, while a private collector may purchase insurance to cover an entire collection.

**COLLECTIVE APPROACH**

Many Canadian institutions have found benefits in taking a collective approach to address their insurance needs. The Canadian Universities Reciprocal Insurance Exchange (CURIE) for example, is an insurance pool of 42 Canadian universities. CURIE collectively purchases its property, liability, errors & omissions and more recently, fine arts insurance to offer expanded coverage for university collections, including art, books and other valuable documents or artifacts. Similarly, the CMA offers members special insurance programs designed specifically for their museum members.

While art theft is of concern to any collector, especially in light of the increasing value of art, common reasons for the loss of art work are fire, smoke damage, water damage and, the most common, breakage or damage during transit. Works of art are particularly vulnerable when they are moved, but care also needs to be taken as to where and how they are displayed. If they are small, they are more vulnerable to theft; if heavy, they might need to be additionally secured; and if fragile, serious thought should be given as to how to protect them. Many insurance firms will work with clients to ensure that the art works are covered appropriately or “nail-to-nail” — from one location to the next. The value of art involves more than its price at auction: preserving works of art is important as they celebrate our cultural differences, our heritage and our national identity.
MARINE INSURANCE IS ONE OF the oldest types of insurance, dating back thousands of years to the Babylonian traders who assumed the risks of the caravan trade through loans that were repaid with interest once the goods arrived safely. The Phoenicians and the Greeks applied a similar system to their sea trading, and by the early part of the 14th century, marine insurance was widespread among Europe's maritime nations.

In London, merchants, ship owners, and underwriters met to transact business at Edward Lloyd’s Coffee House, which opened in 1688 and became known not only for its coffee, but also as a source of marine insurance. By the end of the 18th century, Lloyd's was no longer a coffee house, and had become one of the first modern insurance companies.

While the maritime industry is one of the oldest known to man, the industry and the business environment in which it operates have changed. Today’s marine insurance policies therefore should not read like ancient history, and their language needs to clearly detail the term of the insurance contract to be effective. Significantly, in keeping with this principle, the United Kingdom Financial Services Authority last year required the implementation of “contract certainty” on all insurance contracts.

OLD-FASHIONED LANGUAGE
Unfortunately, many marine policy forms have not adapted to changing times, leading to lengthy (and costly) debate when it comes to settling insurance claims.

To help avoid court battles, the Insurance Services Office (ISO) has frequently revised its standard general liability policy form to improve the clarity of policy language. Since 1986, the standard occurrence commercial general liability (CGL) policy has been revised seven times. In addition, ISO publishes a number of standard endorsements which are also frequently updated. ISO’s forms and endorsements are available to its participating insurance companies, as are forms from the American Institute of Marine Underwriters (AIMU).

Using the guidelines from ISO and AIMU, marine underwriters have introduced one combined policy form to provide comprehensive, seamless marine and general liability (GL) coverage. This is of great importance to the marine industry because the courts have occasionally struggled to separate the coverages on issues such as contractual liability and debris removal. A recent 2nd Circuit court case involving personal injury to a worker of a company hired to clean tank barges confirmed that a marine GL policy was indeed a marine contract and could not be separated into GL and marine components. The policy provided both CGL and Ship Repairers Legal Liability coverage and the court concluded: “The two sections of the policy operate seamlessly to provide coverage that is primarily marine in nature … (and) the policy is custom-built to fill the gaps that traditional marine insurance policies … leave in maritime-industry coverage.”

TIME FOR A CHANGE
An extensive examination of marine forms in the marketplace today reveals that very few companies have incorporated current ISO CGL language into their Marine GL forms and endorsements. As a result, in the event of a claim, marine insureds may be faced with the realization that their policies did not provide the seamless coverage expected.

A prime example is the additional insured endorsement, which is frequently used to provide blanket additional insured status to other entities wherever named insureds have agreed. Previous versions of the blanket additional insured endorsement have been
interpreted by the courts as providing coverage for the sole negligence of the additional insured, even where the named insured has no culpability. Newer editions limit such coverage. Since many marine insureds are using older versions of this language, their policies may be providing much broader coverage to additional insureds than the named insured realizes or was contractually obligated to provide. These named insureds will undoubtedly be surprised to find that the marine policies for which they paid significant premiums may now be less valuable to them because the limits of liability may have been eroded by claims against such additional insureds.

This is just one example of the many changes to the ISO CGL policy that companies have failed to incorporate into marine insurance policies in the marketplace today. Other significant changes not incorporated include the treatment of mobile equipment and electronic data, the definition of advertising and personal injury, and the addition of volunteer workers as insureds. Costly gaps in coverage or, at the very least, extensive litigation costs to determine the intent of the policy, are sure to result.

USEFUL GUIDELINES
Given the choice, it is unlikely that a company wants to have its business settled within the courtroom. Therefore, it is wise to adopt specific procedures to make sure insurance policies meet a marine business’s specific needs, policy language is up to date, and there is an understanding of how claims will be handled. Marine companies can reduce their risk by:

- Taking an active part in the insurance buying process;
- Looking for terms and conditions that meet their specific needs;
- Making sure information on an insurance application or policy is accurate;
- Obtaining a complete copy of the policy and paying particular attention to any exclusions;
- Exploring possible claims scenarios and how they will be handled.

Like many courtroom battles, insurance coverage disputes can be costly and time-consuming. Fortunately, the marine industry can purchase effective insurance and take advantage of it when a claim needs to be filed, as long as they have taken the time to consider their purchasing options and carefully understand the terms of their coverage.

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IT IS WISE TO ADOPT SPECIFIC PROCEDURES TO MAKE SURE INSURANCE POLICIES MEET A MARINE BUSINESS’S SPECIFIC NEEDS
A committed relationship

How to get the best out of your D&O coverage

A COUPLE OF YEARS AGO, it was difficult to pick up a business publication that did not contain some worthy treatise on the need for good corporate governance, accountability and ethical values. While these topics were certainly not new, the misbehavior of several large, high profile organizations brought them to the forefront of the business world. Along with this came the heightened awareness of the need for directors’ and officers’ insurance coverage. If these directors and officers (D&Os) were going to be held to a higher standard of accountability, then they were going to need a broader, stronger safety net.

D&O coverage has been around for decades in the US, which has led the rest of the world in insurance for directors and officers since the 1950s. What is newer is the dedicated A-side D&O product.

The term “A-side” refers to a fairly standard Insuring Agreement found in most D&O contracts. This agreement provides coverage to the insured persons (D&Os) where corporate indemnification is unavailable to them. Most standard D&O contracts also contain Insuring Agreements B and C, providing coverage to the Entity (or Corporation) for its indemnification obligation to the insured persons (Insuring Agreement B), and claims against the Entity itself (Insuring Agreement C), respectively.

A dedicated A-side product has many benefits, including:

- The contract is designed to protect the individual D&Os only. There is no coverage for the corporation embedded in the policy form. The benefits are: a) no sharing of limits with the company; b) in the event of bankruptcy, there is less risk of the court “freezing” the policy proceeds as an asset of the bankrupt estate.
- Difference-in-conditions coverage: Most A-side forms provide broader coverage to the insured persons than a standard ABC D&O form. For example, our main A-side form only contains four exclusions, whereas most standard ABC D&O forms contain at least double that number. Since A-side forms are often purchased to supplement a standard ABC D&O program, the...
potential exists for an A-side policy to provide coverage to the D&Os that simply does not exist within a standard ABC contract.

- Response feature: The A-side products are designed to take effect before an individual D&O has to dig into his/her own pocket. If a company refuses indemnification to an insured person, rightly or wrongly, and the traditional insurance program fails to pay for any reason (exclusions, rescission, bankruptcy of insurance carrier, poor claims response by primary carriers, etc.), our policy is designed to respond on behalf of the insured person who has been left uncovered. The XL Insurance companies would retain subrogation rights against those corporations or insurers who have wrongly denied indemnity or coverage. The point is: the insured person who buys our A-side contract knows they have a last line of defense in the event that “all else fails”.

This leads to the two main scenarios in which A-side policies are implicated.

1. Corporate insolvency. If a company can’t pay (or more technically, indemnify its D&Os) because of its insolvent status, Insuring Agreement A is triggered. If the policy is tied up in bankruptcy court, it may not be working for the individual D&Os. In addition, most D&O claims take years to resolve, making it important that your carrier is still in business in five years’ time when a claim is finalized. There is no security guarantee for any carrier, regardless of their rating, but statistics show that highly-rated companies are more likely to maintain claims-paying abilities over time when compared to lesser rated companies.

2. Derivative shareholder suit. Simply stated, this is a law suit initiated by a shareholder on behalf of the company, against the D&Os. These suits seek damages on behalf of the company, in contrast with direct securities class actions, in which plaintiff shareholders are suing for their own benefit. Derivatives have more meaning in an A-side world because of “circular indemnity”. Let me explain: in many states, it is against the law for the corporation to indemnify the D&Os for settlements and/or judgments arising from a derivative lawsuit. Why? Follow the money: the shareholder initiates the suit on behalf of the company, against the D&Os; if the shareholder wins the action, then the D&Os are required to pay money to the company; if the company indemnified those D&Os, the money would be taking a round trip, from D&Os to company back to D&Os. Note, however, that most states allow for D&Os’ defense expenses to be indemnified by the company. For these reasons, an A-side insurance product is a valuable asset for D&Os entangled in derivative lawsuits.

It is essential to ensure you have the “right” A-side carrier — and in this respect there are some key characteristics to look for:

- Financial strength: Clearly you want a highly rated provider. Again, apply the stress test lens; choosing an A-minus carrier to provide your A-side coverage doesn’t make a lot of sense, nor would you want to buy it from an insurance company’s managing general agent, whose stability is not assured.
- Commitment to the A-side product: Although the product has been around for some time, most carriers didn’t embrace it until 2004 or later. The XL Insurance companies have been committed to the A-side product since its very early days, but many large carriers have been inconsistent with their A-side product offerings, moving in and out of the market depending on whether the product is a “hot” item or not.
- Claims handling staff who are familiar with and experienced in dealing with the product.
- Forms that are structured in a simple, “all-risk” nature, are superior to those written to address the 2005 issue, or the 2006 issue, for example. At XL, A-side forms are designed to be simple, all-risk policies designed to address whatever the issue of the year ends up being.

In conclusion, it’s important to remember that not all A-side is the same. Many companies have entered this business recently, making the market more competitive on a pricing basis. That can be good for customers, but it is important to remember the core benefit of the product: to be there consistently when all else fails.

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not pictured: John DiBiasi President, Excess & Surplus Lines  Anthony Giacco Senior Vice President

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