

# Risk and Insurance in a Postmodern World

by Russell Tyldesley, CPCU

If one cannot recognize irony and see humor in the contrivances of man, one is most certainly already mad or on the way to madness. As a self-appointed and long-time critic of the direction of government policy, it can sometimes happen that a teachable moment will arise from very mundane subject matter.

A recent insurance industry convention held in Bermuda included a panel discussion entitled, "Responding to Terrorism, the P/C Landscape in the Wake of 9/11." For those unfamiliar with insurance terminology, P/C stands for "property and casualty" and the group represented was the Alliance of American Insurers.

The consensus of several presenters was that terrorism is uninsurable. Among the reasons given for this determination were as follows:

1. There is no industry experience in assessing for predictability.
2. There is not enough historical or scientific data.
3. There is difficulty in zoning the risk geographically.

My favorite comment, though, was that, "the purpose of terrorism is to provoke fear, and to do this in a predictable manner, does not provoke fear." Humm. In other words, terrorists might suspend terrorizing and throw all the actuaries into a quandary. I don't think this lack of predictability (so far, at least) is the real reason for uninsurability. I think it is because there is not much room for the insurance industry to "engineer" (lessen) the risk.

A couple examples may help. The peril of embezzlement and stealing of all sorts (broadly, the dishonesty risk) is fairly predictable. People do not seem to be getting either more honest or more dishonest on the whole (eliminating the small subset of politicians and corporate executives). Although it is impossible (let's assume) to know exactly where "lightning will strike," embezzlement, robbery, burglary, and thefts of all stripes occur with enough frequency that they are predictable in the aggregate with a certain mathematical accuracy. As a risk

group, they also lack much of a catastrophe potential such as, for instance, a nuclear incident would entail. Of course, the nuclear risk has always been a standard exclusion in virtually all policies. In the ever more connected electronic world we live in, it may eventually happen that there is a catastrophe potential when someone is able to hack into the database of multiple banks, and transfer billions to a secret account. A rogue trader at All First Bank in Baltimore was able, a few months ago, to lose about \$650 billion of the bank's money in reckless unhedged currency trades. The "jury is still out" as to whether his acts will fit the policy definition of dishonesty. Still, the typical exposure right now is the occasional armored truck robbery or art theft that does the most damage. Another factor maintaining dishonesty as an insurable risk is that most policies have relatively low limits and are not designed to protect against the maximum possible risk, merely the maximum probable, determined by formula. How much insurance to buy is mostly discretionary, albeit there are some enforced minimum amounts required by bank regulations and ERISA legislation designed to protect employee retirement funds. It could also be argued that normal prudence should be exercised by risk managers of publicly traded companies in deciding on limits. There is also a very major difference between a thief and a terrorist. The thief values property, perhaps too much, and wants to live to enjoy it.

The problems associated with unobtainable, or very expensive, low limits of terrorism coverage is that it impedes normal commercial transactions such as the sale of large buildings and loan covenants that require full coverage on highly valued properties. There was some concern on the part of the owners of the largest mall in America that they would be in violation and their bank could, theoretically, at least, put them in default of their loan and take the property—perhaps an unlikely scenario in that the bank would not be any

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better able to obtain the coverage.

Getting back to dishonesty coverage, the underwriters feel they can “engineer” the risk by such methods as requiring frequent audits, mandating internal controls, investigating backgrounds, and experience so that it is unlikely the employee or even the employer can defeat the system. In the case of terrorism, where does one start in attempting to engineer the risk?

From a physical standpoint it may be possible to build shorter, stronger buildings and place security guards in the lobbies; with airplanes, the solution may be better airport security, and armed marshals and pilots on planes. A version of this type of security could be used at all sites with a high concentration of property values and crowds. In fact, the security at the recent winter Olympics in Salt Lake City was hard not to notice but generally taken in stride by the public. All of this is intended to lessen the financial impact of a terrorist attack but nothing can be aimed, so it seems, at the conditions that might tend to lead to motivating terrorism in the first place. Only our national foreign policy could be, arguably, aimed at the sources of terrorism. Could the insurance industry be interested in trying to influence public policy in the way the administration deals with sources of terrorism rather than trying to lobby for government as the reinsurer of last resort?

Terrorism has been around for a long time, but has not been a big problem for America until recent years. A coordinated attack such as that of 9/11 with multiple perpetrators who all died and left no clear set of demands, is unprecedented and is more precisely defined more as massive mayhem, anarchy, or vandalism rather than terrorism that, by definition, is usually accompanied by demands. In fact, actual destruction or killing would be seen as counterproductive in the classic terrorism scenario. There is, however, considerable evidence that a major goal of the terrorists is to remove U.S. troops from Saudi Arabia where they remain stationed in considerable numbers to protect our oil assets, since the Gulf War.

After 9/11 the insurance industry rushed to modify the standard terrorism definition in order to encompass the Trade Center-type

event and, then exclude it. Many insureds received unwelcome endorsements eliminating or drastically reducing terrorism coverage in light of 9/11. Whether this could be considered cowardly or unpatriotic or simply an overreaction was, perhaps, less important than the implied assumption that this could happen again. In fact, worse events have been predicted, most recently by no less a figure than the legendary investor and owner of one of the largest Reinsurance Companies, Warren Buffett. He raised the ante by predicting a nuclear attack on the United States.

Led by such voices as Buffett, the insurance industry is demanding that the federal government be its reinsurer of last resort. So far, the political will does not seem to favor legislation, preferring to let the marketplace solve the problem. Although some new capital is flowing into the market given the prospect of sharply higher rates, not much of it is chasing the terrorism peril and, consequently, many insureds are “going bare” until industry and government can get their act together.

In the wake of 9/11 many actions began to be weighed on a scale of patriotic versus unpatriotic. Although the airline industry received a quick government bailout, citizens were encouraged not to change their lifestyle but, rather to dine out, travel, and shop as a sort of patriotic duty, i.e.: “We can’t let them think they won.” Congress, in the House passed version of a terrorism reinsurance bill, decided to add “baggage” to it—tort reform, a perennial favorite of business interests and a Republican Party platform issue. The Senate may not pass a bill at all, fearing that, in conference, any bill approved will likely contain “tort reform.” Democrats have expressed annoyance at this cynical tactic to take advantage of the Trade Center tragedy to bring in the completely unrelated and contentious matter of tort reform. In as much as the Democrats rallied behind the Republican President after 9/11 to approve an unprecedented war powers resolution, and to help to quickly pass the Patriot’s Act with only one dissenting vote, this act of patriotism was not requited by the Republicans’ sneak attack on tort reform.

**Russell Tyldesley, CPCU,** is an insurance and bonding agent and owns his own agency in Laurel, Maryland. Tyldesley also holds the professional designation of Chartered Property Casualty Underwriter.

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The irony is that tort reform has always been aimed at protecting business interests and saving them from some of the consequences of their negligence. An argument could be made that the government, in failing to act to reinsure business interests of the insurance companies, is inconsistent with support for tort reform. What may be behind this seeming contradiction is that government itself may be seen as the culprit in pursuing policies that exacerbate the terrorism risk. By providing reinsurance backing to private industry, it would bring the full consequences of terrorism losses to the public treasury as a more visible "tax" on Americans than the more invisible increases of real estate, products, and services hit with ever-escalating costs of insurance. In economics this would be described as externalities that are often not counted in a full cost assessment. The cost to society of disposing of nuclear waste from power plants was never used to calculate the cost of a kilowatt hour when compared to other energy alternatives. That is a good example of externalities.

The insurance lobby is strong, and campaign donations are legendary, so it does seem that larger issues are preventing government relief. A plausible guess is that catastrophe reinsurance by government has the potential to draw more public scrutiny to the nexus of foreign policy and terrorism. The need is not trivial. The insurance industry will likely pay in excess of \$50 billion to settle all claims associated with the World Trade Center. The entire industry capital and surplus is hardly more than \$300 billion. This is a major hit, and, of course, the largest single insured loss ever.

On other fronts the insurance industry is dealing with the consequences of many toxic waste dumps, flawed "super fund" legislation, asbestos and black lung claims, and many environment-related contingencies. None of these types of losses were contemplated at the time coverage was written and, again, amounts to a hidden tax on the economy as the perpetrators take bankruptcy protection. An issue that has not yet gotten much attention is the effect of global warming on weather patterns that create unusual and unpredictable climate conditions. The insurance industry is paying attention. If, as seems most scientific studies suggest, releases

of carbon dioxide and other particulates into the air from automobile exhaust, fossil fuel power plants, and other controllable sources are creating a greenhouse effect that is trapping heat in the atmosphere and causing the polar icecaps to melt, glaciers to retreat, and shifts in ocean currents, then, to the extent that public policy controls the levels of particulates allowed into the air, government again could be the culprit. In the last 12 months, the State of Montana has received less than one inch of rain. The soil in some areas is bone dry as deep as two feet and many parts of the state resemble desert. Lack of rain and adequate snow melts has certainly contributed to a rash of giant fires over vast areas of the western mountain states. On the other hand, West Virginia has had two 100-year floods in the past year. The devastation and death toll are especially great due to coal-mining activities that have stripped large expanses of woodland and forest of its natural vegetative cover that would otherwise mitigate the runoffs from violent rainstorms. The Bush Administration has recently approved mining techniques that will be even harsher on the environment, allowing the tops of mountains to be completely cut off to allow for easier extraction of coal, and allowing the acid runoff from mine tailings to be carried away by rivers and streams. The coal industry was, of course, a leading contributor in the election campaign and promises to the industry carried the state for Bush, which was the margin of victory. The effects of climate-related events on insurance policies of all types are impossible to overstate. The entire industry can be brought down if climate-related disasters lose their predictability. Even the government may not be able to reinsure the consequences of its own "policies."

Citizens of California were not the only ones faked out by Enron's manipulations of energy markets. Eleven major insurance companies wrote surety bonds, totaling almost \$2 billion, to guarantee delivery contracts that turned out to be sham transactions with controlled partnerships. Many of these insurers are refusing to pay claims brought by various obligees including, most prominently, J.P. Morgan Chase Bank. The insurers argue that Chase actually helped engineer and finance the

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very sham companies that they now look to the insurers for reimbursement, after Enron defaulted all its contracts. J.P. Morgan Chase has sued the sureties and has petitioned the courts to enforce its claims. Trial is scheduled to start in October in New York City. Citygroup was also a beneficiary under some surety bonds and its own subsidiary, Travelers, may have some liability. Citigroup recently announced its intention to divest itself of its Travelers subsidiary. The irony is that, in the world of suretyship, contracts and regulations are sacred. These 11 insurers may well prefer a more regulated world when it comes to underwriting the surety risk. There was a time when utility companies were among the most preferred clients of sureties, demanding and getting the lowest rates actuarially possible. But utilities have long been vested with a public interest that has served to protect them from the stresses of markets in return for a guaranteed, if modest, rate of return on equity. The business of suretyship has long eschewed a rapid growth business plan in favor of steady, sustainable, profitable operations. It is, perhaps, an important footnote to mention, that with the merger trend of the past couple of decades, the insurance company managements are increasingly being invaded by banker and investor types that have never been satisfied with the plodding rate of "old-economy" business paradigms. Time will tell whether the

day of the underwriter will return to prominence in setting the strategic plan. Lest one think that a mere \$2 billion exposure is a proverbial drop in the bucket, the entire bonding industry does only about \$3 billion in top-line revenues in a year and, by the way, it fears that it may have other "Enrons" on non-cancelable bonds. Enron has been described as the surety industry's 9/11.

It would be ironic, indeed, if private industry begins to connect the dots and sees a danger in some of government's more regressive social policies. A perceived bias of government toward industry may turn out to be industries' Achilles' heel. Free market freedom can have its blow backs. In fact, what appears to be unbridled, gloves-off competition often turns out, on closer analysis, to be frantic political and lobbying efforts aimed at gaming the system and obtaining the latest feeding of corporate welfare. It has been said that capitalism's real aim is monopoly. I think we all still feel that monopoly is anathema to what American stands for, unless it is a regulated monopoly freely chosen by the public in a democratic process. If we can get the public-private economic system more in balance, we may find that it leads to a more balanced and long-term political outlook, and may return us to a more aboriginal balance of nature with more predictable outcomes. ■

# Member Spotlight

## George Kolczun Jr., CPCU, ARM, AAI



**G**eorge Kolczun has served on the Risk Management Committee for more than 10 years and is the current section chairman. He brings more than 30 years of experience in the insurance industry to

his present position of account executive and chief operating officer of Rooney Insurance Agency, Inc. in Tulsa, Oklahoma.

George has served a diverse range of clients including oil and gas exploration, drilling, manufacturing, chemical, oil and gas pipeline, aviation, and construction. He earned a bachelor of arts degree from Heidelberg College in addition to the following designations: Chartered Property Casualty Underwriter (CPCU) in 1979, Associate in Risk Management in 1973 (ARM),

and Accredited Advisor in Insurance (AAI) in 1983.

He joined Rooney Insurance Agency as vice president in 2000. Prior to joining Rooney Insurance, George served as senior vice president, client manager for Marsh USA. His previous positions also include executive vice president/branch manager, Johnson & Higgins, and senior vice president, Alexander & Alexander, Inc. He began his career with Devco Mutual Insurance Company as a technical representative.

In addition to his service to the insurance industry, George has been actively involved in his community as a member of the Tulsa Philharmonic Board of Directors, Junior Achievement Board of Directors, Tulsa Area United Way, the March of Dimes, and various local civic boards.

George continues to serve on the Risk Management Committee because he believes any contribution to the CPCU Society is really basic and that "all of the CPCU Society's sections are really built upon the risk management discipline." ■

## Educational Events Now Online!

Visit the CPCU Society's web site at [www.cpcusociety.org](http://www.cpcusociety.org) for an up-to-date list of educational events.

You will find the educational events in the Learning Center area of the Society's web site.



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# Successful Litigation Management

**W**ould you like to “talk” with the creator of “Ten Steps to Successful Litigation Management?”

If you did not attend the “Ten Steps to Successful Litigation Management” seminar on Sunday, October 20, 2002, at the CPCU Society’s 58th Annual Meeting and Seminars, here’s your opportunity to see what you missed, and to “discuss” issues with the speaker!

**Michael R. Boutot**—the creator and presenter of the program—serves as the director of litigation management for Crawford & Company. With more than 15 years of experience in the insurance claims industry, he has extensive experience in the area of litigation management and the creation of litigation management standards and guidelines. He serves on the Board of Advisors for the National Association of Insurance Litigation Management, and holds membership in the Defense Research Institute, American Bar Association, and several other key organizations. Michael has published several articles relative to litigation and litigation management, and is currently working on a book entitled: *Litigation Management in the 21st Century*.

## Here are Michael Boutot’s . . .

### Ten Steps to Successful Litigation Management—Litigation Management with Ease (E’s)

1. Enlist Partners
2. Establish Guidelines and Procedures
3. Eliminate Unnecessary Costs and Exposures
4. Enhance Relationships
5. Endorse and Support Legislation
6. Equip Personnel
7. Ensure Compliance
8. Encourage Use of Technology
9. Enforce Consistency
10. Expect the Best Results

To see Michael Boutot’s PowerPoint presentation, go to:  
[http://www.cpcusociety.org/?p\\_v=pg&p=18669](http://www.cpcusociety.org/?p_v=pg&p=18669)  
(This presentation takes approximately five minutes to download.)

Michael Boutot has agreed to host a discussion board on the Society’s web site. If you would like to post a question or comment, please do so and be sure to check back later to read Michael’s response! ■

# OSHA Targets Employers with High Industrial Accident Rates

by Bruce R. Fox, Esq.

**Editor's Note:** *This article appeared in the October 2002 LCQ newsletter, Vol. 13 No. 2, and is reprinted with permission.*



**T**he Occupational Safety and Health Administration (OSHA) has a policy regarding high accident rate employers that in February 2002 may have caught some employers off-guard. Under the SST program, also called the Site-Specific Targeting program, OSHA sent a letter to approximately 13,000 employers telling them that their workplace accident rate was higher than the national average. This determination was based on an OSHA survey of 80,000 work sites. The SST program is intended to supplement OSHA's general workplace site inspection and citation policies. The purpose of the program, according to OSHA, is to provide employers who are most at risk for workplace accidents with the advanced notification they need in order to begin taking corrective actions, where many employers do not have the risk assessment and abatement resources in-house to perform this function.

Upon notification of high-risk status, an employer has a number of options:

- Use its in-house risk management resources to appropriately respond.
- Obtain these resources from its workers compensation carrier, if the carrier offers such services.
- Hire outside resources.
- Utilize resources from OSHA's Consultant Services as administered by the states.

The Consultant Services program is funded by the Department of Labor and administered through the states. In Pennsylvania the program is operated by Indiana University of Pennsylvania, which employs all consultants and operates independent from OSHA. The program is free for employers with less than 250 employees at a facility or 500 employees nationwide. In addition, the consultants do

not report to OSHA and are bound by confidentiality so that they cannot and will not report any workplace OSHA regulation violations. These consultants do not administer fines and they cannot guarantee that the work site will pass a future OSHA site inspection. The program allows for employers to designate certain sections or areas of the workplace for the consultants to examine and provide advice, rather than involving all locations and operations. Finally, there is no commitment by an employer who uses the program other than the commitment all employers have to continually assess and abate serious workplace hazards.

What the consultants will do is the following:

- Provide a detailed written analysis of potential workplace hazards.
- Assist in determining methods of abating these hazards.
- Assist employers in creating or modifying employee workplace training programs and materials.
- Establish and strengthen employee safety and health programs.
- Conduct a closing conference to discuss the findings, suggestions, and recommendations.

## Suggestions for High-Risk Employers

Employers who may be at risk of receiving an OSHA SST letter do not have to wait until receipt of the letter to take action. In fact, some employers may consider a proactive approach that reduces the high-risk statistic before the yearends, thus reducing the likelihood of receiving an OSHA letter. The first step is for the employer to determine whether it is in or close to high-risk status. OSHA calculates high-risk status by using the following formula:

$$\text{RATE} = N \times 200,000 / \text{Hours Worked}$$

(for all employees)

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# OSHA Targets Employers with High Industrial Accident Rates

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Where N = the number of incidents, and the 200,000 is the base equivalent for 100 full-time workers working 40 hours per week 50 weeks per year. For example, an employer who has 40 workplace accidents in one year where all employees worked a total of 500,000 hours would have a rate of 16 ( $40 \times 200,000 / 500,000$ ), which is very high. The national average last year was 3.

OSHA publishes workplace accident rate figures each year, which can be compared to the employer's rate calculation. If the employer's rate is well below the national average, then the employer does not have to do anything more than continue the current good practices, refining as circumstances may require. If the employer is at or close to the national average, then the employer should take some corrective action to reduce its accident rate statistic.

For more information on the OSHA SST Program as well as information on OSHA's February 2002 notification campaign, visit these web sites:

- [http://www.osha.gov/as/opa/foia/hot\\_8.html](http://www.osha.gov/as/opa/foia/hot_8.html)  
For an alphabetical list of all 13,000 employers receiving the letter, download the dBASE zip file at the end of the OSHA notice. Once the file has been extracted, use Microsoft Excel or any database or spreadsheet program to view.
- <http://www.natlsco.com/newsletter/02spring/OSHA.htm>
- [http://www.agc.org/content/public/PDF/Safety/log\\_usage.pdf](http://www.agc.org/content/public/PDF/Safety/log_usage.pdf)
- For general information on OSHA's SST program see the following:  
[http://www.imakenews.com/dhaugh/e\\_article000059193.cfm](http://www.imakenews.com/dhaugh/e_article000059193.cfm) ■

**Bruce R. Fox, Esq.,** has been practicing law in Boston, Massachusetts for more than 20 years. He is currently legal director for AMR Research, Inc. in Boston, where he specializes in legal issues that relate to technology. For many years Fox has been an adjunct professor for the master's in criminal justice program for police officers at Anna Maria College, and most recently at Suffolk University, where he teaches courses on technology and the law. Fox has worked closely with the Framingham Police Department to provide training seminars to criminal justice students, and writes extensively for national law journals. To reach Fox, please send an e-mail to [bfox211@aol.com](mailto:bfox211@aol.com).

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#### Editor

Kathleen A. Murphy, CPCU  
[murphys.kandb@attbi.com](mailto:murphys.kandb@attbi.com)

#### Section Chairman

George J. Kolczun Jr., CPCU  
Rooney Insurance Agency  
5601 S. 122nd E. Ave.  
Tulsa, OK 74146

#### Sections Manager

John Kelly, CPCU, ARM, AAI  
CPCU Society

#### Managing Editor

Michele A. Leps  
CPCU Society

#### Production Editor

Joan Satchell  
CPCU Society

#### Design

Susan Chesin  
CPCU Society

#### CPCU Society


Kahler Hall  
720 Providence Road  
PO Box 3009  
Malvern, PA 19355-0709  
(800) 932-2728  
[www.cpcusociety.org](http://www.cpcusociety.org)

#### Send articles and letters to:

Kathleen A. Murphy, CPCU  
c/o CPCU Society  
720 Providence Road  
PO Box 3009  
Malvern, PA 19355-0709  
[www.cpcusociety.org](http://www.cpcusociety.org)

\* denotes home address

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PO Box 3009  
Malvern, PA 19355-0709

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