



# THE BETTERLEY REPORT

EMPLOYMENT PRACTICES LIABILITY INSURANCE MARKET SURVEY 2007:  
CONTINUING SOFTNESS IN RATES/CONTINUING PRODUCT INNOVATION

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*Editor's Note: In this issue of The Betterley Report, we present our annual review and evaluation of the changing Employment Practices Liability market. In this review, we not only identify the carriers and the differences in their offerings, we also evaluate the state of the market—how healthy the line is, whether it is growing, and what the claims experience is. In particular, we focused on capacity, as well as rate and retention trend.*

*This issue reviews the twenty-five carrier products that form the core of this market, although other carriers offer EPLI in some form (particularly as a part of a D&O or Management Liability policy). We have not added any new carriers to our survey, as this is a relatively mature line of business that is not attracting new competitors of note.*

*Readers may also wish to read our Private Company Management Liability Market Survey (August 2007), which reviews so-called "Management Liability" products that can include EPLI.*

*While each insurance carrier was contacted to obtain this information, we have tested their responses against our own experience and knowledge. Where they conflict, we have reviewed the inconsistencies with the carriers. However, the evaluation and conclusions are our own.*

*In most cases, we examined actual policy forms and endorsements provided by the carrier. Rather than reproduce their exact policy wording (which can be voluminous), in many cases we have paraphrased their wording, in the interest of space and simplicity. Of course, the insurance policies govern the coverage provided, and the carriers are not responsible for our interpretation of their policies or survey responses.*

*In the use of this material, the reader should understand that the information applies to the standard products of the carriers, and that special arrangements of coverage, cost, and other variables may be available on a negotiated basis. Professional counsel should be sought before any action or decision is made in the use of this information.*

## INTRODUCTION

We have been closely following the EPLI market since 1991. In the beginning, there were five carriers active in this market; now, there are perhaps 50 to 55 carriers active in the market. While there are other carriers offering EPLI, we believe they represent a trivial portion of the market. In particular, add-on coverage to package products appears to be limited to smaller employers, as carriers recognize the importance of underwriting and claims expertise vital to EPLI success.

For our survey, we focus on the most prominent carriers writing the most business, or those that offer some unique product or service. While this omits some carriers, we believe that it makes the information more readable.

To be certain we were covering the key carriers, we have reviewed the list with some of the most prominent observers of the EPLI market, who have confirmed we did not omit any significant carriers. Those carriers may disagree.

## NEXT ISSUE:

February 2008  
*Technology Errors and Omissions  
Market Survey*

**LIST OF TABLES**

Contact and Product Information . . . . .9  
 Market Information... . . . . 14  
 Limits, Deductibles, Coinsurance . . . . . 16  
 Typical Premiums . . . . . 17  
 Limits Usually Purchased by Insured ... . . . . 18  
 Special Coverages . . . . . 19  
 Third-Party Coverage . . . . . 21  
 Policy Type Who is Insured, Definition of Claim . . . . 23  
 Claims Reporting . . . . . 28  
 Prior Acts . . . . . 31  
 Coverage Territory . . . . . 32  
 Definition of Coverage . . . . . 33  
 Exclusions . . . . . 44  
 Risk Management Services . . . . . 49

Some notes on the tables: in the *Exclusions* tables, the entry “no” means that the exclusion is not present in the policy. Of course, if coverage is not present (because it is not included in a definition or insuring agreement), then the absence of an exclusion does not necessarily mean coverage exists.

Product innovation began to slacken in 2001 as carriers, reacting to the late 2001 market tightening, concentrated on profitability. This concentration continued through 2003. We think this focus on profitability was healthy for both carriers and insureds (since only a healthy market can protect employers against the financial consequences of EPL suits). A change in the market occurred in 2004 as rate reductions were being applied selectively; reductions were even more common in 2005, continuing into 2006 and 2007. It appears that 2008 will be even more competitive, as carriers seem to have moved from moderate rate reductions to “how much do we need to cut rates to keep the account?” pricing.

Carriers are reporting significantly more competition on renewal, and are generally making the effort to retain good accounts as needed; employers with poor EPL practices will continue to find stable rates and, in some cases, increasing rates.

**NEW AND INTERESTING**

Carriers continue to look for prudent new ways to meet the coverage needs of employers, and there has been some notable innovation since we last reported on the EPLI market in our December 2006 *Report*.

**WAGE & HOUR COVERAGE**

The biggest news continues to be in the coverage for Wage and Hour claims. Lawsuits alleging improper payment of overtime wages have been very much in the news for the past several years. Employees classified as exempt and therefore not owed overtime have sometimes been able to bring successful claims that they are, in fact, owed overtime. Prominent class action lawsuits have created huge legal bills for the targeted employers.

It is not always clear whether, or not, Wage and Hour claims are covered in a typical EPLI policy, and our participating carriers are reluctant, in many cases, to provide definitive information. Generally, it seems that a Wage and Hour claim that involves other covered allegations will at least get the insured a defense.

Because of this uncertainty, we have started to ask carriers for more definitive information about this coverage (or lack thereof); their responses are in our *Special Coverages and Cost* table. Note that at least one carrier (Chubb) did not think that the question as we posed it was really answerable. With respect, we note their nonanswer. Large carriers are unfortunately the subject of much coverage litigation, and taking a definitive position in the necessarily brief form of our tables can create potential problems.

More interestingly, several carriers have brought out definitive coverage. This coverage can be for Defense Only, or for Defense and Settlement, sometimes subject to sublimits. There are only two carriers indicating that they offer Defense and Settlement coverage: AVEMCO and Evanston.

In 2007, six new carriers offering a Defense Only coverage include:

- Beazley
- Great American – unknown sublimit
- Houston Casualty – unknown sublimit
- Monitor (Admiral or Carolina Casualty) – negotiable sublimit
- NAS
- Navigators – up to \$100,000 sublimit
- PLIS – unknown sublimit

- Professional Underwriters Agency (Lloyd’s market) – \$150,000 sublimit
- Travelers Bond’s Private and Nonprofit product – unknown sublimit
- U.S. Risk Underwriters – unknown sublimit

**NONEMPLOYMENT COVERAGE**

For several years we have reported on the coverage many carriers offer for discrimination or harassment-based lawsuits by plaintiffs that do not have an employment relationship with the insured. We have begun to ask additional questions, since this increasingly common coverage can differ from carrier to carrier.

For example, some carriers offer coverage only in circumstances where there is a business relationship between the plaintiff and the insured. Although rare, other carriers limit coverage to harassment only (not discrimination), and some carriers limit the harassment coverage to sexual harassment only.

Our *Third-party Coverage* table provides more details.

**PRODUCT INNOVATION**

Noteworthy product enhancements continue, including:

- Violent Act Protection option from AIG Lexington
- Fair Labor Standards Act endorsement for defense coverage up to \$500,000 from PLIS
- New or additional risk management services from AVEMCO and Houston Casualty

**STATE OF THE MARKET — RATES AND RETENTIONS**

Although three of the eleven carriers responding reported plans to hold rates and retentions flat (and one carrier even reported plans to increase rates), we think that this is their hope, not their expectation. Seven of the eleven carriers reported plans to reduce rates, which we think is much more likely.

The best evidence of this in our survey is the carrier’s expectations for their competitors—seven of the eleven expect their competitors to reduce rates up to 10 percent,

and four expect decreases of 11 to 25 percent. We think this is a much more realistic view of the current market. Upper-middle and large employers appear likely to gain the highest decreases, though the soft market will make for attractive renewals for all but the most unattractive risks.

**CARRIER’S VIEW OF RATE PLANS**

We continue to experience fewer carriers willing to discuss their rates and volume, but based upon the responses we receive and our discussions with underwriters, brokers, and insureds, we believe we have good insight into the market direction.

Rate Trend	Focusing on Small- Mid-sized	Focusing on Large Employer	Focusing on All Sizes
Up	1		
Flat	2	1	
Down 0-10%	3	1	1
Down 11-25%	1		1
Down 26-40%			
Down 41-50%			
Up			

Rate Trend	Focusing on Small- Mid-sized	Focusing on Large Employer	Focusing on All Sizes
Up			
Flat			
Down 0-10%	4	2	1
Down 11-25%	3		1
Down 26-40%			
Down 41-50%			
Up			

**STATE OF THE MARKET — VOLUME**

The volume of business (gross written premium) is flat—a first for EPLI. Based on growth rates reported, and an assumption that \$1.66 billion written in 2006 was a reasonable basis, we estimate that since last year, gross written premiums have not increased.

Limited growth in new insureds written continues, especially in the less-than 50 employee segment. This segment has been targeted by several carriers as the larger employer market becomes saturated. Still, there are an awful lot of smaller employers (below 500 employees, and especially below 100) not buying EPLI. Considering the risk of noninsurance, this remains puzzling. A few carriers have tried to get to these insureds through BOP-type policies with low limits. The ISO product is a good example. Though it remains to be seen whether, or not, the smallest employers will ever embrace the need for EPLI protection.

With rates down, the increase in the number of insureds in the smallest employer market segment has contributed enough premium to hold the overall premium volume level.

In order to secure an adequate response, and reduce the chance of inflated answers, we promised the respondents complete confidentiality.

<b>Monoline Premium Volume Written</b>			
<b>Premium Volume</b> <small>(in millions)</small>	<b>Focusing on Small- Mid-sized</b>	<b>Focusing on Large Employer</b>	<b>Focusing on All Sizes</b>
\$1-5	1		
\$5-10	2	1	
\$10-25	2		
\$25-50	2		
\$50-100		1	2
\$100+			

<b>Monoline Premium Volume Growth</b>			
<b>Rate Trend</b>	<b>Focusing on Small- Mid-sized</b>	<b>Focusing on Large Employer</b>	<b>Focusing on All Sizes</b>
Down	2		
0-10%	3	2	1
10-25%	1		1
25-50%			
50-100%			
100%+			

**STATE OF THE MARKET — CLAIMS**

We continue to focus our *EPLI Market Survey* on products, not claims, but we keep our ear to the ground on claims as they affect coverage, pricing, and availability.

The frequency of claims continues to be costly for underwriters. Insureds have more covered claims than expected combined with increasing defense costs. This has increasingly been met by some carriers with mandatory higher deductibles.

There are two problem areas of claims: mass claims and Wage and Hour claims.

Mass (also called multiple plaintiff) claims, where brand name companies are targeted by multiple plaintiffs, who threaten coercive action unless the defendant settles quickly, are a big problem for carriers writing large companies. Carriers have seen some very large settlements for claims that employers would not fight, fearing reputational costs more than the costs to settle. These claims have made it difficult for brand name companies to buy EPLI coverage at the costs they would like.

Carriers that have a lot of experience with these types of claims use a variety of tools.

Some report mandatory deductibles of \$1 million plus, and coinsurance of 10 to 25 percent, for such insureds. Other carriers include policy language that applies the deductible to each claim, rather than a single deductible for the group of claims.

Carriers focusing on smaller to midsized employers have not seen mass claims as a problem (since most of their insureds are not as vulnerable to the pressure of such claims), and generally have not applied any special restrictions. However, they are encountering more than expected Wage and Hour claims. These are brought by employees alleging that they were not paid for all of the hours they worked, or that they were not paid the correct wage. This can add up to a very expensive claim, when multiplied by all of the affected employees.

**LIMITS, DEDUCTIBLES AND COINSURANCE**

The limits of coverage available have not changed much since last year; carriers seem to have bitten the ‘limits reduction bullet’ in 2002, and are satisfied that they have reduced their catastrophe exposure to a manageable level, using lower limits, and through reinsurance.

Deductibles seem steady, except for the retentions required of the largest employers, who are probably better off self-assuming all but the catastrophe claims anyway. Smaller and midsized employers continue to be able to obtain reasonable retentions (or deductibles) at reasonable premiums.

Please also see our discussion about mass claims in the Claims section (on page 4).

### TARGET MARKETS

Carriers continue to be interested in most types of insureds, with the significant exceptions of employee leasing and temporary staffing, educational, religious, and public entities (which have specialty markets available). Law firms and entertainment industries are often cited as not desirable.

Also seen in the list of undesirable employers are extended-care (nursing home) facilities, real estate/property management companies, auto dealers, and technology companies. Technology companies can be shunned purely on the basis of the failure rate of many employers in that industry, but there are still many carriers that welcome these as insureds.

Few carriers avoid specific states, unless they have not yet been approved to write business in a particular state. California is often cited as a challenge (carriers requiring larger deductibles, for example), but it is such a large market, it can't easily be ignored.

Carriers also identify states in which their product may not be available due to regulatory restrictions, but since these can change, it is better to inquire of the carrier before rejecting it as a possible market.

### SAMPLE PRICING

We asked carriers to price out several sample applicants, using the following assumptions:

- 5,000 employees, \$10 million limit, \$100,000 deductible
- 500 employees, \$5 million limit, \$25,000 deductible
- 250 employees, \$1 million limit, \$25,000 deductible
- 100 employees, \$1 million limit, \$10,000 deductible
- 50 employees, \$1 million limit, \$2,500 deductible

We asked them to assume a “typical” insured, “typical” state, and no particular underwriting issues (problems). Prior Acts coverage was to be included.

The results are shown in the *Typical Premiums* table attached.

Ten carriers provided this information; others expressed reservations about their ability to sample price, since too many factors enter into the pricing equation. Good point, but we find employers and their risk management advisors are hungry for information about price ranges, and offer it here.

Please be cautious in using this information. Although it is a guide to the price competitiveness of a carrier, it is easy to be competitive when quoting a theoretical applicant. Also, individual carriers may be more or less competitive in a particular state or industry. Use the table as a guide to typical pricing, not a reason to reject a carrier as too expensive.

### TYPICAL LIMITS

As an indication of the maturity of this market, we are more often asked about the typical limits purchased by insureds, and less often about which types of employers buy coverage. Twenty-four carriers provided useful information about the typical, high, and lower limits purchased by the insureds.

Since limits often equate to the size of the insured, we specified employers ranging from 50 to 25,000 employees. The results are summarized in the attached *Typical Limits* table. The answers are merely an indication of the limits insureds select, and should not be used as an indication of sufficient limits.

To us, it is continuing evidence that many employers do not buy enough limits, content to have insurance, even if it is inadequate.

### SPECIAL COVERAGES

Several special coverages are becoming more necessary, so we asked for more specific information, and included the responses in the table *Special Coverages and Cost*. As noted earlier, we have added specific questions about Wage and Hour claims and additional questions about third-party coverages.

Coverage for either Punitive Damages or Intentional Acts can be prohibited by states, either by regulation or on the theory that such coverage is contrary to public policy (or both!). Almost every carrier offers separate coverage to fill in such potential gaps in coverage, either via most favorable venue wording, or with an offshore wraparound in a jurisdiction such as Bermuda that does not frown upon such coverage.

Several carriers are reluctant to disclose that they offer such coverage, fearing that regulators might attack their offshore solutions. We understand that there are 16 states that prohibit or restrict coverage for either Punitive Damages and/or Intentional Acts, including New York, Ohio, Florida, and California. Such additional coverage is vital in those states.

Coverage for suits brought by third parties, such as customers, continues to draw attention. With one exception, all carriers are offering this coverage in 2007; only Cincinnati does not, preferring to provide the coverage in their Umbrella form. Although early coverage forms applied to discrimination only, now more apply to both discrimination and harassment.

As in 2006, we asked about workplace violence coverage, few carriers offer it (Evanston and Hartford by optional endorsement, and both AIG Lexington and Chubb as a separate policy), thinking that it may be more of a property/business interruption coverage, far removed from EPL.

#### **WHO IS AN INSURED AND DEFINITION OF CLAIM**

As with definitions of coverage, this area has also shown a real convergence of approach, with less coverage distinction between carriers. For example, all carriers cover employees, although some specifically include seasonal or temporary employees in their definition. This raises a question: if a carrier covers employees, without limitation, does it need to specifically include seasonal or temporary employees? We think specific language is preferable.

Leased and contract employees may need coverage; a number of carriers extend coverage to these individuals if they are indemnifiable like employees.

Newly acquired organizations is one area in which carriers differ, and subsidiaries is another. Generally, we find less distinction between carriers than before.

What constitutes a claim, for the purposes of triggering coverage, is important. Carriers are generally similar in approach, including written demands, administrative processes, and arbitration. Oral demands are covered by some.

#### **DEFINITION OF COVERAGE**

The definition of coverage remains vitally important to the quality of the policy, but it is getting increasingly difficult to distinguish between carriers. The key sources of claims are covered well, and it is only by subjecting the policy wording to microscopic analysis that we can distinguish differences.

Most policies now contain all-inclusive wording that eliminates the need to enumerate perils. Carriers now frequently broaden their coverage by including language such as “and other protected classes.” This is a benefit for the insured, and makes the need to compare lists of perils less important.

Instead, the nuances of wording become more critical, and there are substantial differences between policies.

In general, we would encourage carriers to reduce the number of words and definitions they use, and use more all-inclusive (all-risk) wording. In the definitions of coverage, we are seeing more “all-risk” wording, and view this as better for both the carrier and the insured.

In analyzing coverage for this article, we struggle with how best to present our findings. On the one hand, we would like to list the covered items, and then identify whether all-inclusive wording is included (this is the approach used this year). Both carriers and readers seem to like a list of the covered items.

On the other hand, if all-inclusive wording is becoming prevalent, then listing items just takes up space.

#### **CLAIMS REPORTING AND EXTENDED REPORTING PERIOD**

When a claim has to be reported is an important distinction between policy forms. Most carriers require the Named Insured to report “as soon as practicable,” which seems reasonable. In practice, unless the insured has delayed reporting so long (and irresponsibly) as to compromise the defense of the claim, there is little practical difference between carriers.

Extended Reporting Period(ERP) protection is an under-appreciated feature of EPLI policies, one that will take on a growing importance if carriers lose interest in the market. We note that many carriers have shortened up the length of ERP they are offering.

All carriers offer an ERP, but length and cost differ. The shortest minimum period in our survey was three months. A variety of carriers offered at least one year, with three or more years available from eleven. Several carriers report that the ERP is negotiable in term and cost, which is dangerous for the insured. Make sure that this negotiation is done before the carrier loses interest in your EPLI business.

A long ERP could be enormously valuable should the EPLI carrier decide it did not want to continue.

### SELECTION OF COUNSEL

In previous years, we have been vocal in our criticism of carriers that do not allow the insured a voice in the selection of counsel. We believe that the relationship between counsel and client is a precious one, as trusting as the bond between patient and doctor.

At the same time, we agree with the concern of carriers that unqualified legal representation cannot be allowed, and that control over fees is necessary in a line like EPLI. Indeed, one carrier has told us that the primary reason they are reluctant to enter the smaller employer market is their belief that such employers often use improper counsel, and take employment actions without legal advice.

Therefore, we are pleased to report that, while most carriers continue to control the selection of counsel, almost all are very flexible in allowing the insured to select or approve counsel. If the insured requests specific counsel approval at the right time (during proposal negotiations), the carrier is likely to approve the insured's choice.

A few carriers offer the insured a choice of an indemnity policy, which allows the insured full control over selection of counsel. While some dispute our attraction to indemnity policies (since an uncovered allegation may not be defended by an indemnity policy), we still think control over counsel is of enough value to make indemnity policies worth consideration.

Note that the carriers that are primarily interested in larger employers are more likely to give selection of counsel to the insured; carriers that specialize in smaller insureds are less likely to be able to invest the time necessary to approve

special counsel requests, since they are charging correspondingly less premium. However, in our experience, carriers are generally willing to allow the use of the insured's choice of counsel, as long as they are clearly qualified. For the insured that asks, even the smaller carriers are willing to allow selection by the insured.

### CONSENT TO SETTLE

Carriers are still reluctant to allow insureds much control over settlement, understandably, since EPL suits often involve a good deal of emotion. Both employer and employee are often willing to continue their fight in court long after it makes economic sense to settle. Carriers are reluctant to fund such battles, of course.

The so-called "Hammer Clause" allows a carrier to limit its claim payment to no more than the amount it could have settled for plus defense costs. This protects the carrier against a "litigate at any cost" insured, while protecting the employer against a "settle it, who cares about the precedent" carrier.

The Hammer Clause causes both insured and insurer some unhappiness, so "soft" hammer clauses exist, which share the cost above the claim between the carrier and the insured. Originally offered by Royal, it is now a feature of many carrier's products.

Many carriers now offer similar coverage; the insurer's coinsurance participation is listed below:

- AIG/Executive Liability (larger employers)— 50 percent
- AVEMCO— 50 percent
- AXIS—unspecified percent
- Beazley—70 percent
- BISYS—70 percent
- Chubb—70 percent
- CNA (optional)— unspecified percent
- Great American— 50 percent
- Hartford (Premier Choice product)—70 percent
- Houston—50 percent
- Liberty—70 percent
- Monitor—75 percent
- NAS—50 percent
- PUA—80 percent
- RLI—unspecified percent
- Travelers—70 percent (private companies)
- XL—75 percent

Most carriers will not force an insured to settle, but are free from any additional cost (settlement or defense) obligations. A few policies continue to allow the carrier to settle without the insured's consent, which is very dangerous to the employer. In practice, if the insured has a good reason to continue the defense, carriers will not enforce their hammer clause.

### PRIOR ACTS COVERAGE

Prior Acts coverage is a very valuable protection that used to be difficult to obtain. Underwriters were reluctant to insure the prior activities of an employer, anticipating that only those organizations that needed coverage would buy Prior Acts protection.

This ignored the reality that the EPLI exposure is one that confronted all employers, and that even the best managed risks still needed coverage. Just because an insured wanted Prior Acts coverage, doesn't mean it was a higher-than-average risk.

As carriers competed for business, they were forced to offer Prior Acts protection, because EPLI is written on a claims-made basis. As they became more comfortable with the risk of a prior act, it became easier to offer the coverage even to new insureds. In fact, for many carriers, there is no additional cost for Prior Acts coverage.

Now most carriers include Prior Acts in their standard coverage, with the option of limiting the exposure via Retroactive Dates. Even those that do not include it in their standard form can include it by endorsement.

### TERRITORY

Coverage for events that take place outside of the U.S., Canada, or related territories is becoming important for more insureds than ever. All policies reviewed offer worldwide coverage for suits brought in the U.S. or Canada and territories. Most carriers also offer the option of true worldwide coverage (suits brought anywhere). The exceptions are Evanston and U.S. Risk.

### RISK MANAGEMENT SERVICES

Our table *Risk Management Services* identifies the types of value-added services offered by EPLI carriers. These services are particularly appropriate for EPLI, offering the same type of benefit to the insured that, for example, loss control engineering does for property insurance.

Innovation in value-added services is negligible, but could be a primary source of product innovation in the EPLI business, and one in which numerous vendors, including law firms, are competing for business. As with loss-control engineering, it presents the opportunity for carriers and insureds to benefit jointly. We hope that value-added services do not take a back seat as product innovation slows and expense control increases in importance.

### SUMMARY

Has the EPLI market excitement passed? In our opinion, not yet. The current rate cutting has obscured the real growth in the number of insureds, and product innovation, though less dramatic than in the 1990s, still offers improvement in the quality of coverage bought by employers. Although product innovation in the area of Wage and Hour claims defense is nowhere near as broad as settlement coverage, it does offer clearer protection for those employers caught up in such claims.

Rate reductions are occurring on an insured-by-insured basis, with no signs of the dramatic (50%) rate reductions seen in the late 1990s. And, we don't expect to see such dramatic reductions again.

Underwriters, while competing on price to retain insureds, remain generally disciplined in overall pricing, and for that we are thankful. Management Liability products for private companies are growing in number—both in the carriers that offer them, and in the insureds that buy them—but there is still a lot of good quality business written in the standalone EPLI market.



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