Chapter 6, "Bank Risk and Real Estate: An Asset Pricing Perspective," by Jianping Mei and Anthony Saunders, investigates how the changing nature of bank risk taking, especially in the real estate market, has affected the *ex ante* pricing of risk in the market for bank stocks. The time variation in bank risk premium is partly determined by interest rate and real estate market conditions.

Chapter 7, "Assessing the 'Santa Claus' Approach to Asset Allocation: Implications for Commercial Real Estate Investment," by Jianping Mei, provides evidence that banks take a backward-looking "Santa Claus" approach to asset allocation. The authors suggest this approach is inconsistent with optimal portfolio management. Thus, the "Santa Claus" strategy should be replaced by either a simple buy-and-hold strategy or a contrarian investment strategy.

Chapter 8, "The Time-variation of Risk for Life Insurance Companies," by Jianping Mei and Anthony Saunders, finds that expected excess returns on life insurance companies are predictable. By showing that the risk for life insurance companies is undercompensated, they provide evidence for the existence of government safety net in the market place.

Chapter 9, "The Return Distributions of Property Shares in Emerging Markets," by Kevin Lu and Jianping Mei, examines the return process of the emerging equity market and that of property indices. They find that the emerging market property indices are more volatile than both the respective market indices and the U.S. equity indices. In addition, a negative risk premium exists for the East Asian property markets during the Asian crisis.

Chapter 10, "Conditional Risk Premiums of Asian Real Estate Stocks," by Jianping Mei and Jiawei Hu, finds that conditional excess returns appear to move closely with one another, thus shedding light on market contagion in Asian countries.

Chapter 11, "Institutional Factors and Real Estate Returns: A Cross-Country Study," by Hsien-hsing Liao and Jianping Mei, is a study on the relationship between real estate returns and institutional factors, including an economic freedom indices, an economic efficiency index and other economic variables.

This book is useful to insurance researchers and practitioners although its focus is on the real estate market. First, insurance companies invest a significant amount of in the estate market. Better understanding of the real estate market helps insurers' investment decisions. Second, insurance becomes more integrated to the financial market along the securitization process. A good understanding of how asset pricing involves in the real estate market improve the quality of insurance research.

Carve-Outs in Workers' Compensation: An Analysis of the Experience in the California Construction Industry, by David I. Levine, Frank W. Neuhauser, Richard Reuben, Jeffrey S. Petersen, and Cristian Echeverria, 2002, Kalamazoo: W.E. Upjohn Institute for Employment Research

Reviewer: Glen Tickner, Workers' Compensation Board, Alberta, Canada

Although the term "crisis" has been much overused in reference to workers' compensation, the description had particular resonance in 1992. Benefits as a percentage of payrolls peaked at $1.68 (the most recent figure is less than $1.10); the combined ratio had jumped 7 points to 116 in one year. Among the many states in trouble, Maine notoriously stood out for insurers' unwillingness to write new business.

At a time when systems everywhere were desperate for innovation, Bechtel and the Pioneer Valley Building and Construction Trades Council negotiated a "carve-out," or special arrangement operating outside Massachusetts workers' compensation legislation. The results seemed almost too good to be true: claims fell by 80 percent and litigated cases dropped to zero, with overall costs falling by more than 50 percent.

Not surprisingly, the Bechtel example attracted the attention of other states. California, with the most litigious of workers' compensation systems, adopted enabling legislation in 1993. Three years later, eight carve-outs were operating in the state. Another eight had been added by 2001, at the time when the W.E. Upjohn Institute for Employment Research was completing its analysis of California's carve-outs.

California's own studies show that carve-outs reduce both litigation and overall costs. A recent California Department of Insurance document claims that "several carve-out programs, specifically those with an ombudsman, have had demonstrated success in reducing the level of litigation, returning workers to work more quickly, and reducing the overall cost burden on the system." Consequentially, California's "Garamendi Plan" for workers' compensation reform features legislation making it easier to form carve-outs.

What constitutes a "carve-out," and which of its features are responsible for this apparent success? Stripped to essentials, a carve-out is a special agreement between unions and contractors, operating outside a state's workers' compensation system. In practice, carve-outs incorporate a broad and varying range of reforms. Cost-control measures adopted by the eight agreements examined in this study include special medical arrangements, modified work programs, joint labor-management safety committees, medical evaluators, and preferred providers. In addition, the carve-outs may include arrangements tied to the collective agreement but unrelated to workers' compensation, such as no-strike provisions and restrictions on nonunion labor.

If carve-outs have one distinguishing characteristic, it is their emphasis on alternate dispute resolution and the central role of the carve-out ombudsman in reducing attorney involvement and friction costs. Even so, we find inconsistencies. While the California state system requires workers to pay their own attorney fees, the largest agreement (NECA/IBEW) reimbursed attorney fees on top of claim awards.

It's hard to reconcile this jumble of reforms with the miracle remedy described by Garamendi and the Bechtel reports. As the Upjohn research makes clear, enthusiasm for the carve-out model rests on slim evidence. The Bechtel results were published without reference to a control group, at a time when workers' compensation results were improving. Furthermore, the pre- and post-comparisons failed to match apples to apples. Pre-carve-out claims were evaluated after 20 months of cost development, compared to 12 months of development for post-carve-out claims.

The Upjohn study applies a more rigorous approach, comparing difference-in-differences across two control groups: electricians employed by companies that opted not to join the carve-out and nonelectricians (excluded from the carve-out) in companies covered by the carve-out. Testing claim frequency, injury rates, mean and median return to work times, medical and indemnity costs, reduced litigation, litigation costs, rate of disability, and attorney representation, the carve-out is found to have no statistically significant effect in almost every comparison. Only attorney representation and rate of disability showed significant improvement over one of the two control groups. On the other hand, improvement in return to work time was significantly *worse* than one of the control groups. The authors conclude that there is "no evidence of the large changes anticipated by early proponents of carve-outs."

The note of caution is welcome. Even so, one wishes that the study could have been extended. Of eight carve-outs, Upjohn's quantitative research covered only NECA/IBEW. Carve-out claims had a maximum of two years cost development, despite the authors' recognition that estimates of future costs rise substantially over time and that hearings normally occur at least two years after injury. Most seriously, their results were estimated on the outcomes of only 180 claims. Anyone familiar with the wide variation in workers' compensation claimant and injury characteristics would be unsurprised by the failure of such a small sample to yield significant results.

The absence of empirical support does not deter the authors from making a number of recommendations, most of an administrative nature, and generally sensible. However, they also favor review of all settlements "for adequacy by an arbitrator or agreed legal authority," a policy that would surely consume any efficiency gains an alternate dispute mechanism might provide.

Strangely, the authors neglect discussion of adequate reserving, other than to note that optimistic expectations of carve-out success may cause underestimation of liabilities. There is no mention of the potential for underfunded liabilities after the project on which a carve-out is based has terminated. The authors' omission is curious, given that their book appeared one year after the $1–$2 billion Unicover loss, sparked by the underpricing of workers' compensation carve-out business.

In light of the Unicover loss the authors could have been more hesitant in recommending that there is "no evidence against expanding carve-outs to other industries." This mild endorsement might have played a role in Garamendi's plan to encourage carve-outs by reducing the minimum premium threshold from $250,000 to $50,000, an idea since dropped. Considering the potential risks and shortage of evidence, a familiar recommendation is particularly germane in this instance: "future research is clearly called for."

Climate Risk and the Weather Market: Financial Risk Management With Weather Hedges, by Robert S. Dischel, 2002, London: Risk Books

Reviewer: Rick Gorvett, University of Illinois at Urbana-Champaign

At the time of writing this review, a sampling of recent financial risk management news includes the following items: Japan's first weather derivative involving high wave levels recently went on sale; a development bank is readying what would be only the second weather-related bond offering for placement in the capital markets; and there are new efforts in the areas of providing real-time weather information and of weather derivative portfolio management software. It seems as if the relatively new weather derivatives market is not going away anytime soon—certainly the risks to organizations, countries, and economies associated with weather volatility will not