The Betterley Report

CyberRisk Market Survey 2004:
Continuing Innovation, and Growth Opportunities Galore

By: Richard S. Betterley, CMC
President
Betterley Risk Consultants, Inc.

Editor's Note: In this issue of The Betterley Report, *we present our annual review and evaluation of insurance products designed to protect against the unique risks of doing business in the land of e-commerce. When describing the insurance products for e-commerce risks, we will refer to them by the more common name,* CyberRisk.

Our focus is on coverage for organizations that offer products and services via the Internet, such as retailers of products or services, and content providers. We did not focus on coverage for organizations that are simply using the Internet for tasks such as e-mail, nor on technology providers that support e-commerce, such as Internet Service Providers, technology consultants and software developers. Also, this survey does not cover the business of offering insurance products or services over the Internet.

The types of coverage offered by CyberRisk insurers vary dramatically. Some carriers offer coverage for a wide range of business activities, while others are more limited. For the insured (or its advisors) looking for proper coverage, choosing the right product is a challenge.

We have tried to present a variety of coverages to illustrate what is available in the market. Ten sources of insurance (eight carriers, some with multiple products, and two wholesalers) are included in this survey. They represent the core of the CyberRisk insurance market.

We welcome CNA to our survey; their new product, CNANetProtect is expected to be a strong competitor to the more established offerings. We also welcome Euclid Managers, writing on behalf of Hudson Insurance (owned by OdysseyRe). ClickStream connected services liability coverage is a third-party cover only, targeting small- and mid-sized insureds.

Reflecting a change in name and ownership, Sacia Risk Solutions is now listed as Digital Risk Managers (DRM) in our tables, continuing to offer its WebNet Protection policy underwritten by Arch Specialty.

Finally, The Hartford also offers products that address CyberRisk exposures, but again was unable to respond to our requests for information.

A company included in last year's survey, Insure Trust, an MGU out of Atlanta, has ceased underwriting CyberRisk policies, and is no longer included in our survey.

Most of the carriers offer multiple CyberRisk products, so crafting the coverage for each insured requires the best in risk identification and knowledge of the individual covers. More than many insurance coverages, CyberRisk requires experienced risk professionals to craft the proper coverage.

Because of the dramatic impact of Terrorism exposures on insurance coverages, we include a special table entitled Terrorism Coverage &/or Exclusions. This table summarizes the most common carrier's stance toward the exposure of loss due to terrorist acts. Carriers offer limited Terrorism coverage mandated by the Terrorism Risk Insurance Act, which allows insureds to

NEXT ISSUE

August 2004:

Private Company Management Liability Market Survey

Our exclusive evaluation of combination policies covering D & O, Employment, Fiduciary and other management liabilities

List of Tables

reject the coverage. A big question facing all insureds and carriers is whether TRIA will be extended. It is possible that it will not, and we would then expect carriers to stop offering Terrorism coverage on any basis other than as a stand-alone product.

While each insurance carrier's were contacted in order 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.

Rather than reproduce the carriers' exact policy wording (which can be voluminous), we have in many cases 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 information, 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.

INTRODUCTION

As with all of our Market Survey subjects, CyberRisk coverage represents a new or recently developed form of coverage designed to address the needs of new risks confronting organizations. CyberRisk coverage epitomizes new insurance products, presenting insurance product managers with challenges as they learn what their insureds need and what they, the carriers, can prudently cover.

Most carriers are convinced that their best opportunities are in selling CyberRisk coverage to mainstream companies with significant CyberRisk exposure. Many of those prospective insureds are already the carrier's customers, looking for coverage not present in traditional policies.

Specific opportunities in CyberRisk are recognized by Chubb, Zurich and St. Paul Travelers, with special products for financial institutions.

There are many types of traditional insurance risks faced by CyberRisk organizations, and not surprisingly, many traditional policies are sold to these organizations. Often, these policies are adapted to cover the special risks of CyberRisk activity. Carriers have developed very different products to address what they think CyberRisk companies need. So we have provided a special table (Product Description) that lets each carrier describe the coverage it is offering in its own words . This table is vital to the reader's understanding of the various—and varied—products offered.

CyberRisk insurance comes in a variety of forms, but we find it most helpful to divide coverage into property, theft or liability for surveying purposes. Some carriers offer liability only products, while others offer a combination of property, theft and liability coverage.

STATE OF THE MARKET

Annual premium volume information about the U.S. CyberRisk market is hard to come by, but in asking several of the product managers, we have concluded that the annual gross written premium is in the $150–200 million range. As one knowledgeable product manager said, CyberRisk coverage is still a new product line and will take a few years to really penetrate the marketplace.

This sounds right to us, but it seems odd that, with the proliferation of Web-channel commerce, there isn't more of a rush toward these specially-designed products. Perhaps the slow economy of the past few years combined with rising premiums in more traditional lines of insurance, has had something to do with this—or perhaps it is as simple as the slow growth in most new products. Either way, we think there is substantial growth yet to come. As the insureds—and especially their advisors—become more knowledgeable about CyberRisk insurance products, this market segment will grow dramatically.

We also asked carriers about the health and interest of the reinsurance market that supports CyberRisk products, and they generally reported that reinsurers still like the product. Stable or increasing interest in CyberRisk product support was reported by the responding carriers.

As for growth in premiums written, carriers are pretty reticent about responding, perhaps because there hasn't been as much growth as they might like. Nevertheless, we have seen widely varying growth, with individual carriers reporting growth ranging from under 10 to over 50 percent.

Premium volumes are similarly not widely reported. As in 2003, though, we saw one carrier writing a relatively large amount of business (well over $50 million), with other carriers fairly far behind. This can be a bit misleading, though, because CyberRisk coverages are often written as a part of other products and not reported separately for premium purposes.

State of the Market—Rates

We asked the carriers whether they planned rate increases (or decreases) during the upcoming year and what they expected their competitors to do. Most offered their thoughts.

Rates for CyberRisk insurance, like those of all commercial insurance, are definitely softening. Carriers report a plan to increase rates 10to25 percent, but we wonder if this market will allow them to get that. Troubled insureds will undoubtedly face significant increases, but the insured with very good claims experience and effective risk management controls may likely face no increase.

State of the Market—Retentions

The increase in retentions or deductibles that carriers are willing to write continues to moderate. Increases shown in 2003 were apparently enough to satisfy the underwriters, as well as meeting sales resistance in the market. It is doubtful that further increases will be asked of good insureds in 2004, and, except for the most troubled, even marginal insureds may be able to renew at the same rate as 2003.

CAPACITY AND RETENTIONS

Significant liability limits capacity remains, and reasonable (account-appropriate) retentions or deductibles are available. Chubb will entertain limits up to $50 million (for the liability portion of its P&C product), while AIG, Chubb (Safety'Net and Financial Institutions products) and Zurich have $25 million capacity in house.

CNA's new product can be purchased with up to a $15 million limit, and DRM and St. Paul Travelers are offering up to $10 million.

Most carriers can secure limits above those indicated when necessary, with AIG indicating additional placement capability of $50 million (for a total of $75 million).

Deductibles or retentions can be quite competitive; the table shows minimums, of course.

Carriers are still reluctant to state commissions, but they typically are similar to those paid on traditional commercial lines products.

SECURITY ASSESSMENT REQUIREMENTS

Carrier-required assessments of the prospective insured's security policies are rare now; the details are in the accompanying table. Typically, but not always, any required evaluation is free to the applicant.

Such an assessment can be very useful to the applicant, even if they do not buy the coverage. If they do, naurally, a favorable report should help lower the insured's premium.

Requirements often differ depending on whether the coverage is first party or third party, and can also vary depending upon the type of business the insured is in. Some assessments are as simple (and easy on the applicant) as a review of its Web site, while others require an onsite review by third party firms. Of course, the scale and intensity of the assessment is dependent not only on the carrier's underwriting philosophy, but also the nature and role of the applicant's business being considered.

COVERAGE

Property and Theft

The insurance industry offers property and theft (First-Party) coverage and liability (Third-Party) coverage; some carriers offer liability only, while others offer all types. We expect that more carriers will soon be offering combined property and liability programs.

Note that St. Paul Travelers offers CyberRisk exposure property coverage via its standard property forms, but that these are available through their technology group for CyberRisk risks.

First-Party coverage protection against denial of Web services (hacker attacks) is still a hot topic due to continuing attacks on leading Internet sites. Most property products cover this risk, although subject to negotiation and individual underwriting.

Theft exposures are sometimes not well understood in CyberRisk risk assessments. The potential for traditional theft of money or goods via the Internet is often recognized, but theft or destruction of data, extortion, and theft of computing resources sometimes are not.

Terrorism Coverage

Terrorism coverage was pretty hard to find for CyberRisk in 2003, but the implementation of TRIA changed that completely. As noted in our April 2003 Report on Terrorism markets, TRIA coverage extends the base policy form by eliminating terrorism-related exclusions, but only for foreign-sourced, certified acts. This leaves the domestic and/or non-certified act excluded from non-specialized policies.

In our Terrorism Coverage table, all carriers have indicated that they, of course, have included TRIA coverage at the insured's option.

LIABILITY

The definition of *Insured* differs on many policies, but special requirements can usually be met. Many carriers do not automatically include subcontractors as insureds, although many can endorse coverage.

The definition of a claim also varies significantly, with some carriers going to great lengths to define a claim, others using wording such as "a demand seeking damages."

CLAIMS REPORTING, ERP OPTIONS AND COUNSEL

Each liability policy reviewed is a claims-made form (although Chubb's P&C form is a loss-reported form), so Extended Reporting Period (ERP) options are important.

The maximum ERP length is generally one year, although AIG (three year), Media/Professional (two years), DRM (three years), and Euclid (five years) offer various length and terms. St. Paul Travelers offers a very attractive unlimited length to its ERP.

Selection of counsel continues to be a delicate issue with insureds, but, as we frequently see in other new lines of coverage, carriers typically reserve the right to select, or at least approve, counsel.

AIG offers an optional Choice of Counsel form (insured chooses counsel), and Chubb, Media/Pro and Zurich allow the insured to select counsel, subject to carrier's approval, which will not be unreasonably withheld. DRM may allow the insured to choose counsel. Finally, Euclid allows the insured to choose counsel for claims outside of the U.S., Puerto Rico or Canada. As with all questions of counsel choice, we recommend that insureds discuss and agree with their carrier beforehand on the counsel they want to use.

Generally, carriers can impose the infamous "hammer clause" on lawsuits that an insured may not want to settle. The use of "soft" hammer clauses has not penetrated this product as it has Employment Practices and Management Liability products.

PRIOR ACTS COVERAGE

All carriers offer prior acts coverage, with previous coverage sometimes required by Chubb Safety'Net, DRM, Euclid, Evanston, Media/Pro, St. Paul Travelers and Zurich

TERRITORY

E-commerce is a worldwide business, and one of the liability problems is that the legal standards of many countries differ from those of the U.S. For example, a well-known case brought in Germany against a U.S. e-commerce portal was based on German legal standards. True worldwide coverage is important!

All carriers offer worldwide coverage if a suit is brought in the U.S., Canada, or possessions. True worldwide coverage (suit brought anywhere) is available from each of the carriers reviewed.

DEFINITION OF COVERED SERVICES

All carriers define the services they cover, whether in "boilerplate" terminology or on the declarations page, so it is important that it match the operations of the insured. Most carriers can adapt the language to meet the needs of the insured, but crafting that language carefully is important.

This is an area where omnibus wording is much needed, since the range of e-commerce activities can be vast and ever-changing.

Optional endorsements are available, including manuscripted coverages for special requirements of insureds.

Specific Coverages Included in Policy

We have identified eleven specific coverages that may be, but are not always, included in an CyberRisk policy. These are:

- Errors and Omissions
- Virus
- Unauthorized Access
- Security Breach
- Personal Injury
- Advertising Injury
- Loss of Use
- Resulting Business Interuption
- Copyright Infringement
- Trade or Servicemark Infringement
- Patent Infringement

Generally, insureds should be careful to review their exposures to these types of losses, and make sure they use carriers that are willing to offer the needed protections. Coverage for Patent Infringement, for example, is rarely (if ever) offered in basic CyberRisk forms, but can be purchased from several carriers as a separate Intellectual Property policy (as covered in IP Market Survey 2004).

Exclusions

Exclusions are many and varied, as would be expected; please read those tables carefully.

Rather than try to recite them here, the information for each carrier is found in the Exclusions table.

Risk Management Services

Carriers continue to augment the exposure identification and loss prevention services they offer their insureds. This is a tough area to operate in, because the range of e-commerce activity is extensive, not lending itself to a "one size fits all" approach.

We are pleased that carriers have identified these services as valuable to their insureds (and to their own loss ratios, we hope), and continue to broaden and strengthen their capabilities. More e-commerce-specific exposure identification and loss services are becoming available to insureds and their brokers. Several self-help services and resources are offered by carriers such as AIG, Chubb, DRM and St. Paul Travelers. Services from business partners of other carriers are also available, including CNA and Zurich.

Chubb's Financial Institution product offers a nice encouragement to insureds utilizing an independent network security survey—a first-year premium credit for the cost of the survey, up to a maximum of $25,000. This support for improved loss prevention is a welcome benefit to insureds.

Summary

While there have been a few changes in carriers interested in the CyberRisk marketplace, it has mostly been for the good, as quality carriers like CNA join their more established competitors. Improving risk management services and tighter underwriting mean the market has products that are more sound and reliable, which should create a strong platform for future growth.

With the increasing amount of business conducted and services offered through the Internet, specialized insurance products will continue to grow, perhaps taking business away from carriers not willing to enter this demanding, but growing, area of risk.

One big area of concern, applicable especially to CyberRisk policies, is whether or not TRIA will be extended. Policies offered with inception dates in 2005 may be a problem if Congress does not act soon. While this is a problem for all commercial insureds, it is particularly so for CyberRisk customers, as the risk of a terrorist attack via the Internet is hard to evaluate, and harder to protect against. We hope Congress will act soon to remove this coverage uncertainty.

THE BETTERLEY REPORT

The Betterley Report is a series of five comprehensive Reports published annually. Each Report exhaustively reviews a single hot insurance product, covering topics such as:

- The leading carriers and complete contact information
- Target and prohibited markets
- Capacity, deductibles and commission ranges
- Sample premiums
- Critical coverage and claims differences
- Risk Management services

Most *Betterley Reports* are produced annually, and range from 25 to 50 pages in length. Current analyses include:

- Employment Practices Liability Insurance (EPLI)
- Private Company Management Liability
- Terrorism Insurance Markets
- Intellectual Property (first- and third-party, as well as offense coverage)
- CyberRisk Policies
- Technology Risk Insurance

The Betterley Reports are a huge timesaver for busy Risk Management professionals who need to be up to date on insurance products for their clients. Need to identify and evaluate the coverage, capacity and contacts for your clients? We've done all the work for you!

Subscribe now, and get five *Betterley Reports* annually for only $347.00 US. You'll also receive *free* access to our Web site—which includes many of our previous reports. And, ***as a bonus***, we include (with your paid subscription) five of our most current Reports and a custom three-ring binder!

Need the best analysis of leading edge insurance products? Subscribe to *The Betterley Report*, your best source of objective advice on innovative insurance products. To order, or for more information, contact us at (877) 422-3366—or go to our Web site at betterley.com and select "Ordering Info."

BETTERLEY RISK CONSULTANTS, INC.
THIRTEEN LORING WAY • STERLING, MASSACHUSETTS 01564- 2465
PHONE (978) 422-3366 • FAX (978) 422-3365
TOLL FREE (877) 422-3366
E-MAIL RBETTERLEY@BETTERLEY.COM

The Betterley Report is published five times yearly by Betterley Risk Consultants, Inc. This material is copyrighted, with all rights reserved. Additional copies are available.

Annual subscription: $347. US
Single issues are available for $65. each ($95. for the EPLI Report).
ISSN 1089-0513

On-line version: $159. US or $50. US for 30-days
For additional information go to: www.betterley.com