



THE BETTERLEY REPORT

CYBERRISK MARKET SURVEY 2003: CARRIERS PUSHING HARD TO OFFER SUPERIOR PRODUCTS

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Editor's Note: In this issue 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 call it CyberRisk, which seems to be the more popular name.

Our focus is on coverage for organizations that offer products and services via the Internet, such as Internet Service Providers, retailers of products or services, web designers, content providers, and consultants. We did not focus on coverage for organizations that are simply using the Internet for tasks such as e-mail. 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 can be a challenge.

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

Last year, we reported that XL was developing CyberRisk coverage, but this year, have been told they do not offer such a product.

CNA is in the process of releasing a CyberRisk product, but it was not ready in time for this survey. We look forward to reviewing it when it is released. The Hartford also has a form, but they did not respond to several requests for information.

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 most carrier's stance toward the exposure of loss due to terrorist acts. This year, of course, the impact of TRIA is being felt, as carriers now have the inspiration and support of the Federal reinsurance backstop for this difficult exposure.

Terror risk is a tough exposure to underwrite, especially for CyberRisk. It is good to see that the TRIA coverages are available for CyberRisk insureds.

While each insurance carrier was 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.

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), we in many cases 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 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.

NEXT ISSUE:

August 2003:

*Private Company Management Liability
Market Survey*

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

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INTRODUCTION

As with all of our Market Surveys, E-commerce coverage represents a new or recently developed form of coverage designed to address the needs of new risks confronting organizations. E-commerce coverage epitomizes new insurance products, presenting insurance product managers with challenges as they learn what their insured's need, and what the carriers can prudently cover.

Most carriers are convinced that their best opportunities are to sell CyberRisk coverage to mainstream companies that have significant CyberRisk exposures. 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, with special products for Financial Institutions (St. Paul's to be released later this year).

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; we have provided a special table (Product Description) that lets the carrier describe in its own words the coverage it is offering. 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.

CNA's new product (not yet formally released) will offer the following, according to Jill Tellez of CNA:

- State-of-the-art Insurance Addressing Electronic Risks of Companies in all Industry Sectors
- Preferred risks will have strong contract wording, effective quality control, sound financial condition and a clean claim history. Will also consider the harder to place accounts.
- Low Risk Electronic Activities:
 - Access - local only (i.e. e-mail, web-browsing, enterprise system use)
 - Presence - electronic corporate brochureware; un-monitored information exchanges (i.e., chat rooms, bulletin boards), free advise, collection of contact information of others
 - Procurement of goods and services - non-production
- Medium Risk Electronic Activities – Any or all of Low Risk Activities, plus:
 - Access - remote
 - Presence - monitored information exchanges, collection of private information of others, or collaboration and third-party interactions (i.e., VPNs)
- High Risk Electronic Activities – Any or all of Low and Medium Risk Activities, plus:
 - Presence - commercial transactions (i.e., selling advertising space, selling goods or services of yours or others), manufacturing/production interface or management
 - Procurement of goods and services - production

• Coverage Highlights

First Party:

- Electronic Theft of Money, Securities, Goods, Services, Intangible Property by External Sources
- Loss to Data or Software through willful and malicious acts of others
- Business Interruption and Extra Expense for loss of income from those acts

Third Party:

- Content/Electronic Publishing Injury
- Privacy/Breach of Confidentiality Injury
- Network Security Liability
- Professional Liability

Coverage Parameters:

- First-Party Coverage is based on occurrence; Third-Party Coverage is claims made
- Standard or manuscript policy forms offered
- Primary and excess coverages available

Staff:

- Expertise in e-Business risk assessment, network security and technology
- Strong partnerships with Network Security and Law Firms
- Dedicated claims staff
- Superior servicing standards

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STATE OF THE MARKET

We now believe that we have enough quality data about the volume of business and growth rates of CyberRisk insurance products that we can present it for the first time in our Report. Information about changes in rates and retentions or deductibles is also available, and discussed below.

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. Of seven responding, four see stability in reinsurance support, while three report that capacity has shrunk or rates have increased.

VOLUME AND GROWTH RATES

The volume of business written is difficult to estimate, but appears to be in the range of \$110-\$125 million (compared with \$75-\$100 million in 2002). Much of this volume is written by one very dominant carrier.

In order to secure an adequate response, and reduce the chance of inflated answers, we promised the respondents complete confidentiality. The following, therefore, does not identify the carriers, but we believe they are accurate.

Of the eleven markets, six responded with information about growth rates (2003 projected writings over 2002). They broke down as follows (growth rate and number responding):

- Negative growth 0
- 0 to 10 percent 1
- 11 to 25 percent 1
- 26 to 50 percent 0
- 51 to 100 percent 1
- Over 100 percent 3

Five carriers provided volume of business information.

- Under \$1 million 0
- \$1 to \$5 million 1
- \$5 to \$10 million 3
- \$10 to \$25 million 0
- \$25 to \$50 million 0
- \$50 to \$100 million 1
- Over \$100 million 0

Note that only one carrier reports business volume exceeding \$50 million; none of the other carriers report more than \$10 million.

STATE OF THE MARKET - RATES

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

Rates for CyberRisk insurance, like all commercial insurance, are definitely rising. But, the increases are relatively moderate, although several carriers report they are not applying any across the board increase.

CARRIER'S OWN RATES

Carriers report that they are trying to achieve rate increases of 10 to 50 percent, with most clustering in the 15 to 20 percent range. The consensus seems to be 10 percent for good risks, with higher rates for problem accounts. This seems to reflect the industry's overall drive for higher premiums, rather than any particular problem (or opportunity) in the CyberRisk market. These increases seem pretty moderate, and reflect the eagerness carriers have to grow this market.

Minimum premiums don't seem to be on the rise, whereas last year carriers focusing on smaller insureds in particular reported that they planned to raise the lowest premiums at which they will offer coverage.

COMPETITOR'S RATES

Carriers estimate that their competitors will also increase rates (no surprise in this market), but that the range will be generally 10 to 20 percent.

**STATE OF THE MARKET —
RETENTIONS**

The retentions or deductibles that carriers are willing to write are changing rapidly. This seems to result from a desire to improve loss ratios while minimizing rate increases.

CARRIER'S OWN RETENTIONS

Half of the carriers report that they do not plan to increase retentions, while others report plans to increase a range of 25 to 200 percent. The balance plan moderate increases (25 percent or so).

COMPETITOR'S RETENTIONS

Without exception, carriers are projecting that their competitors will increase retentions exactly as much as the carrier plans to increase its own retentions.

CAPACITY AND RETENTIONS

Significant liability limits capacity remains, and reasonable (account appropriate) retentions or deductibles are available. For example, AIG, Chubb, and Zurich have \$25 million capacity in house, depending on which product they are offering, with St. Paul 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, when required, the assessment is free to the applicant.

Such an assessment can be very useful to the applicant, even if they do not buy the coverage. In particular, a favorable assessment can 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 website, 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. We expect that more carriers will soon be offering combined property and liability programs.

Note that St. Paul offers CyberRisk exposure property coverage via its standard property forms, but 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 Chubb only offers it in its financial institutions product. Media/Professional indicates that this coverage is not available. St. Paul offers the coverage on its Networker product, which as noted can be bought in combination with its CyberRisk products.

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 last year, but the implementation of TRIA changes that completely. As noted in our April 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, 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), and Sacia (three years) offer various length and terms. St. Paul 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 insured to select counsel, subject to carrier's approval, which will not be unreasonably withheld. 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 in Employment Practices and Management Liability products.

PRIOR ACTS COVERAGE

All carriers offer prior acts coverage, with previous coverage sometimes required by Chubb Safety'Net, Evanston, Media/Pro, Sacia, St. Paul, 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 the U.S. For example, a well-known legal case in Germany was brought against a U.S. e-commerce portal, was based on German legal standards, and was brought in Germany. 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 it is contained 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, but are not always, included in an CyberRisk policy. These are:

- Errors & Omissions
- Virus
- Unauthorized Access
- Security Breach
- Personal Injury
- Advertising Injury
- Loss of Use
- Resulting Business Interruption
- Copyright Infringement
- Trademark or Service Mark 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 the IP Market Survey 2003).

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.

SUMMARY

It was an interesting year for CyberRisk – at a time when the commercial P&C market continues to struggle, carriers are innovating and keeping rate increases at a reasonable level. While there has been a general elimination of occurrence forms, the market is strong, with new products from ACE, AIG, CNA, Chubb, and St. Paul, with Zurich pushing hard to increase its book.

We continue to emphasize that the most important product feature a carrier can offer is to provide a secure, consistent market for its insureds. While product innovation is valuable, buying insurance from carriers with commitment is the best strategy an insured can follow.

In addition, a carrier that offers worldwide capability, high-quality risk mitigation services, and a deep underwriting team is a necessary part of a quality program of protection. These features are not an option, but a critical part of a successful CyberRisk risk financing plan.



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:

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- Target and prohibited markets
- Capacity, deductibles and commission ranges
- Sample premiums
- Critical coverage and claims differences
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