August 2009

BRC

The Betterley Report

PRIVATE COMPANY MANAGEMENT LIABILITY INSURANCE MARKET SURVEY 2009

Stability in a Quiet Market?

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 the growing Private Company Management Liability market. This product combines several lines of coverage for so-called business practices risks into a single policy.*

We have focused this Market Survey on the Private Company market; similar products are available for public companies, but premium pricing and coverage forms can be quite different. Also, the Private Company market is growing faster, has more carriers active in developing products, and shows more innovation, so we decided to limit the Survey to these carriers.

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, and how fast it is growing. Although we have not added any new sections to our tables, there are a few new forms and adjustments to existing forms, as carriers try to get an edge on their competitors.

Unfortunately, we have been unable to update AIG/AIU's listing. Despite numerous calls and emails to their Executive Liability section, there has been no response. Since we generally will not enter a carrier's information for them (that is, without their approval), we are continuing their information from 2008. As AIG/AIU is a major source of Management Liability insurance, we did not want to omit them from the Survey. We believe that the current forms are similar to the new product described in our 2008 Report, so we are using that information in this year's version. However, please note that this listing is based on 2008 information, and that further investigation is encouraged.

Considering the turmoil being experienced by AIG/AIU (soon to be known as Chartis), we hope their lack of response is a result of their distraction, not a lack of interest in this line. For this article, we will refer to the company as AIU.

We have selected sixteen carriers for this year's Survey. 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.

NEXT ISSUE

October 2009

Side A D&O DIC Products Market Survey

Table of Contents

INTRODUCTION

The insurance coverage that we call Private Company Management Liability Combined Products is a combination of various lines, all of which are generally related to the insured's business practices. The core coverages are Liability forms, but some additional lines (other than Liability, such as Crime or Kidnap & Ransom) are available from some carriers.

Although combined policies have been around for some time, special forms for private companies began to become prominent when Executive Risk (now part of Chubb) brought out its first policy in 1995.

The Management Liability Combined Product is generally appropriate for privately-held companies. Publicly-traded companies are a very different risk, especially for D&O, and therefore (and not surprisingly) typically not eligible for this product line.

Not all carriers offer the same lines of coverage. Most include the following core Liability coverages:

- Directors & Officers
- Employment Practices
- Third-party Discrimination and Harassment
- Fiduciary

Some carriers also offer one or more of the following:

- Side A D&O
- Kidnap & Ransom
- Crime
- Intellectual Property Liability (rarely)
- Internet Liability
- Identity Theft
- Miscellaneous Professional Liability
- Employed Legal Counsel
- Media Liability
- Crisis Response
- Workplace Violence

By combining various exposures into one policy, the insured is less likely to encounter disputes between carriers, the administrative burden for both insured and carrier is lessened, and premium economies can be achieved.

This is particularly apparent for insureds comparing standalone EPLI policies with a Combined Product that includes EPL and D&O. Many have found that EPL can be added to the D&O policy (changing therefore to a Combined policy) for an additional premium of 15 percent. In the past, adding EPL to a D&O policy resulted in less broad EPL coverage. However, the EPL portion of today's Management Liability product is greatly improved, making the combination far more attractive.

One additional benefit of a Combined product is that insureds can choose to combine several lines into a single aggregate limit of liability, or even a multiyear aggregate. We do not see many insureds combining aggregates, since the premium for this coverage has been relatively attractive. When (if?) rates increase, perhaps we will see more insureds accepting multiline aggregates in an effort to control premiums, but the reverse seems to be happening – fewer carriers even offer multiline aggregate limits, perhaps based on the market's chilly reception to the concept.

An insured is not required to buy each coverage. It can pick and choose according to its needs (and budget). However, carriers generally require that an insured purchase either the D&O or EPL coverage in order to qualify for the Combined product.

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 useful for our readers.

To be sure we were covering the key carriers, we have reviewed the list with some of the most prominent observers of the Management Liability market, who have confirmed we did not omit any significant markets.

There is some activity with new coverage forms; carriers are rolling out improved – and simplified – policies on a regular basis. Several carriers report plans to rewrite their offerings to enhance and, in some cases, simplify, their policies.

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.

State of the Market

In 2008, many of us that comment on the commercial property and casualty insurance industry anticipated that rates would be increasing during 2009. A combination of increased combined ratios, lowered returns (or losses) on insurance company investments, and potential deterioration in D&O and EPL loss experience attributable to a severe recession pointed toward higher rates. However, this is proving to have been premature. Carriers are still competing for business through price (which is very powerful when insureds are doing everything they can to lower overhead), with carriers eager to steal away a competitor's insured through a lower premium quote. Incumbent carriers are resisting this attempt by matching the premiums, resulting in a drifting down of average premiums.

Adding to this problem for carriers is that insureds are reducing coverage in order to save premium, sometimes dropping coverages not seen as vital, reducing limits, and increasing retentions. From the carrier's perspective, this results in less exposure, but also less premium collected.

When this will end, nobody knows. Carriers need to charge adequate rates, and insured's can't keep reducing coverage forever.

State of the Market – Growth, Rates, Deductibles

The volume of business (gross written premium) is essentially flat, as continuing softness in rates combined with cutbacks in coverage makes for an environment in which a carrier is happy just to get as much premium as they did from the expiring policy. We are optimistic, though, that premiums will resume their climb as insureds recover from the recession.

Based on confidential conversations, we found:

- Premium growth (2009 projected versus 2008) is essentially flat
- Rates are down 5 to 10 percent for good insureds, a bit more (10 to 20 percent?) for the most attractive and aggressive insureds
- Deductibles are flat to declining
- Reinsurance support is flat

Remember – every insured likes a lower price, but nobody likes a claim denial either.

State of the Market – Claims

Because of the large number of coverages in the Management Liability product line, we did not solicit information about claims experience. Anecdotally, we understand the product is reasonably profitable. EPL portions are not so profitable, but the line in general seems to be. The amount of competition still evident with these products certainly indicates that the carriers find them attractive.

For example, several carriers report loss ratios in the range of 45 to 55 percent or less. Carriers that have been offering the product for a longer time generally experience loss ratios higher than this, as their book of business matures.

Again, much of the claims pressure is on the EPL line, which is not surprising when one considers the claims experience for monoline EPLI products. As the uneven economic prosperity continues be a factor, increasing claims frequency is expected, which may push rates higher as well.

We expect to see that this claims pressure will, over the long-term, push rates and deductibles higher. We do not foresee a restriction in coverage breadth or availability.

LINES OF COVERAGE AVAILABLE

As we noted in the Introduction, there is a core group of coverages offered by almost all carriers (D&O, EPL, Third Party, and Fiduciary). An insured must buy D&O or EPL, at minimum, to qualify for the product.

Where carriers differ is in the other coverages they offer. In the table *Lines of Coverage Available*, the coverages that an insured can choose are shown by carrier. Note that a few carriers report offering coverage only in a separate policy. Since the coverage is offered (even if separately), we showed it as available, but indicated that it was not part of the Management Liability policy.

There is a significant difference between carriers in the coverages an insured can choose. Depending on their comfort, perceived expertise, and perception of market interest, carriers offer an array of coverages. Carriers continue to add Internet Liability and/or Professional Liability options to their Management Liability products.

Intellectual Property coverage had been an option for a few carriers, but as we found in our biennial report on monoline IP policies, carriers are not very interested in offering this type of coverage. We had hoped that IP protection would become a standard offering in Management Liability policies, but it does not appear that this is going to happen.

TARGET MARKETS

Carriers focus this product on smaller and midsized companies, as shown in our Market Information table. Many carriers specify their target market as companies with up to a certain number of employees or amount of assets. We find both of these to be guidelines, not absolutes. Certainly, larger private companies can buy Management Liability policies if they are an attractive risk.

The real barrier for many carriers is companies that expect to go public. The D&O risk for pre-IPO companies is far greater than for companies that expect to stay private, so many carriers will not write, or restrict coverage for, these insureds.

With carriers that are willing to write companies that are pre-IPO, coverage restrictions, such as SEC exclusions, should be watched for.

Some carriers report a lack of interest in technology companies, which is understandable considering their volatility.

LIMITS AND DEDUCTIBLES

Different coverages offer different limits and deductibles, so we refer you to the *Limits and Deductibles* table. Insureds are generally looking for higher limits (above $5 million) for D&O and/or EPL only. They do not typically buy limits above $2 to $3 million for lines such as Fiduciary.

Our table *Limits Options Available and Cost* shows the three that are typically offered:

- Carrier Offers Separate Annual Aggregate For Each Coverage – this means the carrier will offer a separate annual aggregate for each line of coverage, so that a blowout loss in, for example, EPL, does not erode the coverage for D&O.

- Carrier Offers Combined Annual Aggregate For All Coverages – this means the carrier will offer a single annual aggregate for the entire policy, so that a blowout loss in, for example, EPL, will erode the coverage for D&O. This is dangerous, since risk managers and/or insurance brokers do not find it much fun when informing the directors that their coverage has evaporated because there was a big EPL claim!

- Carrier Offers Combined Multiyear Aggregate For All Coverages – this means the carrier will offer a single aggregate for the entire policy, both coverages and term, so that a blowout loss in, for example, EPL, will erode the coverage for D&O. This can also be dangerous, for the same reasons, and the chances of it happening are greater, because claims can accumulate over the multiple-year term of the policy.

There is a premium discount offered for insureds that opt for other-than annual per-coverage aggregates. Typical discounts are shown in the table.

To counter the risk of inadequate aggregate limits, most carriers offer reinstatement of limits options (generally subject to negotiation and underwriting). Only Arch, C.V. Starr, HCC, and NAS do not offer reinstatement opportunities.

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. All but one of the participating carriers provided useful information.

Since limits often equate to the size of the insured, we specified employers ranging from $10 million to $500 million in annual sales. The results are summarized in the attached table *D&O Limits*. 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 evidence that many smaller employers still do not buy enough limits, content to have insurance, even if it is inadequate. We hope that cost cutting by insureds won't result in coverage that is even less adequate.

POLICY TYPE AND DEFINITION OF INSURED

When considering the issue of Duty-to-Defend versus Indemnify forms, there is a lot of flexibility in how these policies respond to a claim. A number of the carriers offer the insured the flexibility to decide at the time of the loss whether the claim will be defended by the carrier or by the insured. All policies reviewed can be written on a Duty-to-Defend form, but a number of carriers offer the insured the option of an Indemnity form as well. In earlier years, all carriers except AIU offered this option at the time the policy was purchased; AIU allowed the choice for each claim at the time of the claim, giving the insured the most flexibility. We now see more carriers offering the same flexibility as AIU, to the benefit of the insureds.

The Definition of Insured varies from policy to policy, and from coverage to coverage. The most significant difference is in the EPL line, where coverage for independent contractors, leased employees, and part-time employees is not automatically included in most policies.

Other coverage observations:

- 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.

- Whether, or not, the entity is covered, and whether, or not, the policy includes a Spousal Extension, is important for any comparison of D&O.

So-called Side A issues have become critical for publicly-traded companies in the U.S., following the well-publicized coverage problems of Enron, WorldCom, and Adelphia directors. Private company directors and officers are probably not as concerned as their publicly-traded company counterparts about the risk of corporate bankruptcy limiting their coverage, or rescission of the policy completely eliminating coverage. A few carriers have, or are creating, individual D&O policies in response, but most of the carriers report that they have seen little or no demand for specific individual (Side A) products. Several report they are willing to provide their policy with Side A coverage only for D&O, but that there has been very little demand.

All carriers offer coverage for the entity; most include it automatically, while a few carriers make it an option. We find few insureds choosing D&O coverage without including the entity, and most (if not all) proposals include the option.

Spousal Extensions include the insured's spouse for coverage, and are available from each carrier.

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.

Having said that, we note that, as with all claims-made policies, the insured needs to be cautious about notice provisions. If they have an indication that they might have a claim, are they required to report it to the carrier? Would it be covered if it became a claim? What if they change carriers and the new carrier denies the claim as having been reported to a previous carrier?

For an insured that is not changing carriers, this may not be important, but many smaller insureds frequently do change, and need to be careful about situations where notice of a potential claim ends up precluding coverage.

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.

All carriers offer an ERP, but length and cost differ. A variety of carriers offered at least one year, with three or more years available. Many carriers now report that the length is negotiable; make sure that this negotiation is completed before the carrier loses interest in your business!

Whether the ERP is one-way or two-way (bilateral) is important to know. One-way means the ERP is available only if the carrier cancels or refuses to renew. Two-way means the ERP can be purchased even if the insured cancels or does not renew, and is available from almost all carriers.

SELECTION OF COUNSEL

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 doctor and patient. While it is very important in EPL, it is even more important to the comfort and security of directors faced with a D&O suit.

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 D&O or 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.

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 D&O and 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. Of course, carriers are reluctant to fund such battles.

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.

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.

PRESET ALLOCATION OF COSTS

Few carriers are willing to agree in advance that defense costs will be allocated on a fixed, preset basis. Thus, it agrees that the defense costs of an uncovered allegation (if any) will be *x* percent of the total defense costs of the claim.

Carriers offer various options, including no preset allocation, allocation for defense costs only, defense costs and indemnity (securities claims only), and defense costs and indemnity (all claims).

We feel lukewarm about the benefits of preset allocation, but some find it attractive. For some, it is considered a possible solution to the Side A dilemma, but we do not find the argument convincing.

We have eliminated the tables for Terrorism coverage, Prior Acts, and Territory, as the carriers have very similar offerings in these areas.

Generally, we see the following:

- Terrorism: all are subject to TRIA coverage options
- Prior Acts: all offer it, and none require prior coverage
- Territory: all offer coverage for suits brought anywhere

EXCLUSIONS

Policy exclusions vary widely, but we recommend insureds and their advisors pay particular attention to professional liability and securities exclusions, as well as those relating to punitive damages and intentional acts.

RISK MANAGEMENT SERVICES

Our table *Risk Management Services* identifies the types of value-added services offered by carriers.

These services are primarily focused on EPLI and Kidnap/Ransom, with increased services to help mitigate D&O risk, offering the same type of benefit to the insured that, for example, loss control engineering does for Property insurance. We have not seen much in the way of new services in the non-EPLI coverage area, and in this market environment, do not expect to see much change.

Innovation in value-added services has slowed, but it is still 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 mutually benefit.

SUMMARY

The Private Company Management Liability market is a big one, served by a combination of very large participants such as AIU and Chubb, and a number of smaller carriers too numerous to mention. Some of these smaller carriers clearly have their sights set on growth as they make meaningful product improvements. The larger carriers are countering this with new forms of their own.

Information three years ago indicated that these smaller carriers were adding premium at a rapid clip, but that has slowed with the ongoing soft market. Insureds are very sensitive to premiums, and have been reluctant to change carriers for small reductions in cost. This has been a very good thing for the insureds and their insurers, who all benefit from a stable market that is not overly influenced by premium shopping. However, we hear that the velocity in turnover of insureds is higher than in the past, which is going to be bad for the industry and bad for the insureds, especially when they confront claims.

Having made this observation, there are times when changing to a new carrier makes sense, especially if there are additional coverages included at a similar total premium. We advise clients (and readers) that they should be cautious about changing carriers in a claims-made policy environment.

We welcome the product innovation ongoing in the Management Liability line. It's a good way for private-company (and nonprofit) insureds to buy coverages in an economical way. There are important management liability risks that would be a good fit in these policies, including privacy violations and Intellectual Property liability. Carriers are making inroads into including Privacy coverages in these policies, but we don't hold much hope for meaningful IP coverages.

The Betterley Report is a series of six 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 (where available)
- 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
- Side A D & O – *biennial*
- Intellectual Property (first- and third-party, as well as offense coverage) – *biennial*
- CyberRisk Policies
- Technology Risk Insurance
- Pollution Liability

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, for only $159.00 U.S., you will receive a full year of upcoming *Betterley Reports* PLUS access to our exclusive archive of reports dating back to 1999!

Only want a back issue? Order a 30-day trial subscription for only $50.00 U.S. and you will be able to select, view, and print one or more of the back issues of your choice.

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, go to: http://www.betterley.com/ordering_information.html

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

For additional information or to order a subscription go to: www.betterley.com

ISSN 1089-0513