February 2015

The Betterley Report

Technology Errors & Omissions Market Survey – 2015:

More Competitive Than Most Specialty Lines

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Highlights of This Issue

- Pressure from Clients Drives Sales of Cyber Extensions
- But Surprisingly, Total Premium Volume Near Flat
- Loss Ratios Remain Very Attractive in the Small-to-Midsized Insured Market

Next Issue
April
Intellectual Property and Media Liability Market Survey 2015

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Editor's Note: *In this issue of The Betterley Report, we present our fifteenth annual evaluation of technology errors and omissions (E&O) insurance, in which we review 27 of the leading carriers active in the market (down from 28 in our 2014 survey). Tech E&O is not immune from the continuing expansion of carriers into the specialty insurance segment, and carriers look to this expanding opportunity to help fuel their growth.*

For 2015, we have removed coverage of Protective Specialty, which has withdrawn from the tech E&O market. We did not add any new carriers to our review.

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.

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.

For updated information on this and other Betterley Report *coverage of specialty insurance products, please see our blog,* The Betterley Report on Specialty Insurance Products, *which can be found at* ***www.betterley.com/blog***.

List of Tables

Introduction

Coverage for the liability arising out of the design and manufacturing of technology-related products, the creation and implementation of software, and the provision of related services is a growing business, with specialty coverages designed to cover the errors and omissions (E&O) liability that may not be covered under traditional liability policies. Tech E&O coverages can be purchased for technology consultants, systems integrators, application service providers, Internet service providers, Internet retailers, cloud services providers, network electronics manufacturers, medical technology manufacturers, and telecom companies. With a wide variety of coverages available, and each written on a nonstandard form, insureds and their advisers can be confused and bewildered at the choices.

Coverage for breach of data privacy continues to be the hot topic in tech E&O product discussions, as both service providers and site owners grow increasingly anxious about loss of data. While most of the news has been about data breaches suffered by site owners, technology service providers have been—or ought to be—concerned about their own exposures. When we talk with our tech E&O readers, many express worry about their exposures both emanating from their client work *and* for breaches of their own data security.

There is confusion in the marketplace about data privacy coverage for service providers. This coverage is generally referred to as tech E&O and covers the professional liability exposure of the service provider. But what about the data breach that is not the fault of the service provider but that involves client data that it controls?

Our approach, adopted in 2012, makes the information presented more helpful to the readers. Our goal is to clarify the coverages for each of the three types of risk.

A service provider's data breach risk can arise from any or all of the following:

- its failure to prevent a breach of its client's data, which is a third-party exposure and should be covered under an E&O form,
- a breach of its own data, which would not be covered under E&O and is a first-party cover just like data breach coverage is in a cyberpolicy, and
- a breach of client data while in its possession, perhaps through a network breach, theft of a laptop, or similar means.

Some carriers and brokers seem to assume that a claim for any client data breach is a result of a professional error or omission and therefore covered by the basic tech E&O policy. Our concern, though, is that coverage for breach of data that is not a result of an error or omission might also be needed.

Take for example a situation in which the tech provider finds that some of its client data has been breached. Wouldn't the client expect the provider

Companies in this Survey

The full report includes a list of 27 markets for this coverage, along with underwriter contact information, and gives you a detailed analysis of distinctive features of each carrier's offerings. **Learn more about *The Betterley Report,* and subscribe on IRMI.com**.

to arrange (or at least pay for) the response? Wouldn't the provider want to step in and make the client whole? And wouldn't that help reduce the chance of an E&O claim? We think the answer is "yes" to all of these questions.

For more on this topic, please see our discussion on data privacy beginning on page 6.

Tech E&O policy provisions should always be reviewed in connection with the insured's commercial general liability (CGL) policy provisions, especially with respect to new or emerging exposures of concern. Some carrier markets offer coordinated E&O and CGL coverage, whereas other markets may offer monoline E&O only. Coverage not provided or excluded by an E&O policy may well be addressed by the CGL. Given the complexity of the coverage choices, a good insurance broker can offer a lot of useful advice to prospective insureds, and their value in negotiating coverage is not to be underestimated.

New and Interesting

Stable premium volume despite more insureds as favorable loss ratios drive rates down: Although rates are in slight decline, the exposure base increases attributable to accelerating interest in the tech sector leads to no significant change in industry gross written. Compounding this problem is that more carriers are slicing up the market.

Demand by third parties continues to drive the market: Technology product and services providers, the audience for this coverage, is seeing greatly increased demand for proof of privacy insurance by their business partners. These clients are concerned about technology risk and want proof that their vendors are covered. Proper coverage and significant limits are required by new or existing vendors if they want to do business with many organizations.

We think that this demand will be a strong force in growing the market for technology E&O products. While, historically, many technology companies have been reluctant to buy coverage, the demand by clients to buy it or perhaps lose a valuable business relationship will greatly expand this market. As more and more data is held by multiple parties, the desire for protection is increasing—a positive for the market segment.

Increased interest by risk management service providers in supporting technology E&O insurers: As in the cyber/privacy market segment, risk management service providers are seeing that they can greatly extend their reach by providing their services through an insurance policy. We think that it is a natural fit for carriers to identify quality vendors that can help the insureds avoid data breaches and to provide cost-effective responses if a breach occurs.

State of the Market

The tech E&O market is an attractive place for carriers, as economic growth is faster than in other areas. However, exposures are more difficult to evaluate, at least compared with more traditional risks.

Still, the technology sector isn't exactly new. Some carriers have been writing this line for 30 or more years. Change comes fast, though, so sources of claims can appear suddenly and unpredictably. That is one reason we are glad to see increasing interest by the reinsurers in this line. This interest is helping carriers offer higher limits than they might ordinarily be willing to provide.

Annual premium volume information about the tech E&O market is hard to come by. As in years past, we surveyed participating tech E&O product managers, asking them for a range of gross written premiums for US-based insureds and for non-US-based insureds.

Several key carriers will not provide information about their own premium volume, so we are concerned about the reliability of any premium estimates. Interest is clearly strong, though, as insureds and their business partners see the need for coverage in a world where litigation alleging technology E&O or data breach is all too common. Unfortunately, rates remain somewhat weak, and that interest is being spread over more insurers.

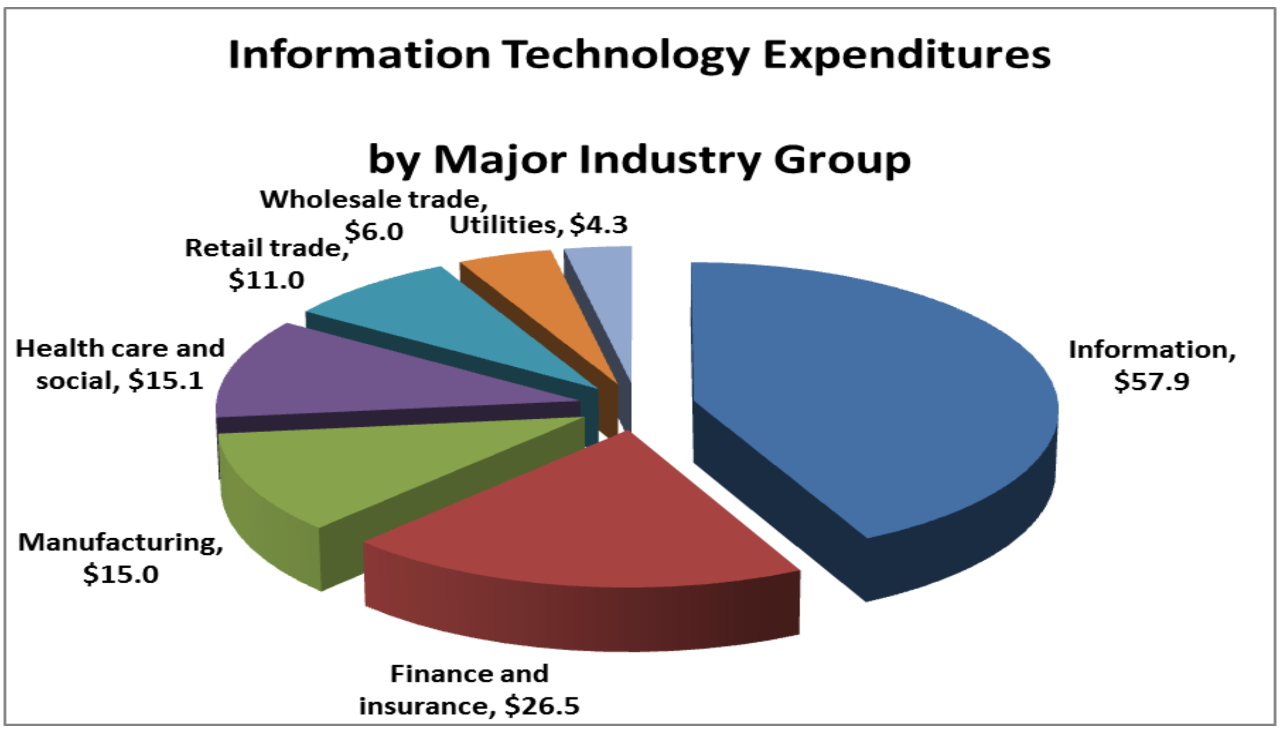
Only seven carriers responded with information about premium volume.

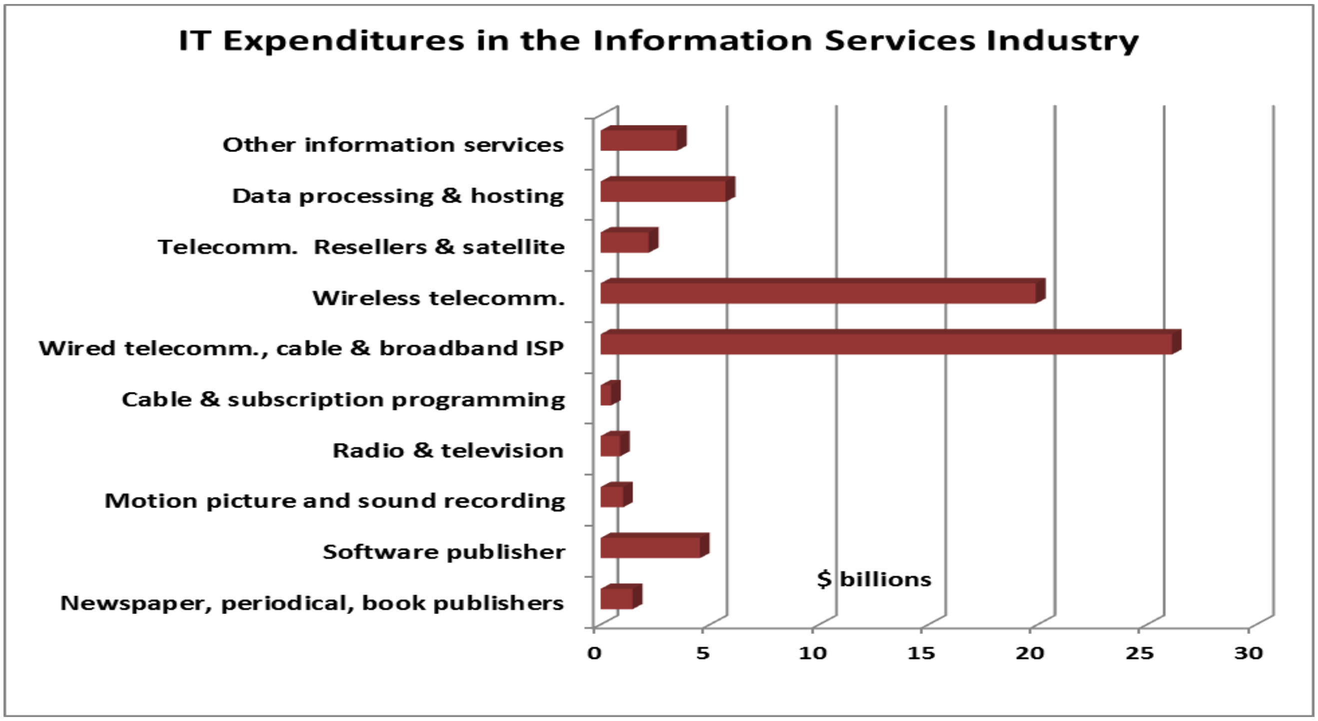
When asked about the carrier's estimate of the total gross written premium in the United States, the responses were of such as wide range as to be unusable. Of the seven (which included several, but not all, of the largest carriers), we heard:

- $600 million–700 million
- $800 million–$1 billion
- $3 billion–3.1 billion

We suspect that the carriers themselves don't know. If the holdouts would share their information with us (confidentially), we would all be better off. We do respect the reluctance to share proprietary information, though.

To check these estimates with an independent source, we again asked MarketStance for its estimate. According to Dr. Fritz Yohn, CEO of MarketStance (www.marketstance.com), "Recognizing that Tech E&O is part of the broad E&O market, we focused our Tech E&O premium estimate on those NAICS classifications that represent what has been described as the Technology market in *The Betterley Report.* Based on these data, we estimate the total U.S.-based premium for Tech E&O products to be $800 million." Note: this compares to $785 million estimate last year.





Many "tech companies" still do not purchase E&O coverage, so it may be of interest to examine economic activity in the technology sector. Look at the accompanying charts to see who is buying tech products and services (previous page) and what types (above). This gives us some insight into where the opportunities are for tech E&O insurance to be sold (both charts provided by MarketStance).

Non-US premium estimates were also difficult to come by. Our participants mostly answered "don't know," although the range of those that did was $350 million to $2 billion. Again, we have no confidence in these estimates.

Data on premium growth and rate direction was not well reported. Established carriers seemed to be experiencing premium growth in the range of 5–10 percent, with one standout reporting almost 33 percent growth (this is a mid-level provider specializing in the smaller- and medium-sized insured). Some of the growth is likely a result of the improving US economy, but we believe that growth is also coming from additional requirements for proof of insurance required by customer contracts.

It is also likely that there is much more premium written in the more traditional markets, but it is not being reported as tech E&O. We continue to expect that there are many more potential insureds that need tech E&O but either are not aware of its existence or underestimate its value. This is likely to be true for the smaller service firms.

We asked carriers about the health and interest of the reinsurance market that supports tech E&O products, and they generally reported that reinsurers still like the product. Stable or increasing interest in tech E&O product support was reported by the responding carriers, although reinsurers are asking more probing questions about the risks accepted than in the past.

Rates and Retentions

We asked the carriers whether or not they planned rate decreases (or increases) during the upcoming year and what they expected of their competitors. Many offered their thoughts.

It seems that the general commercial market trend to softening rates is also present in the tech E&O market, as many carriers expect their competitors' rates to decrease as much as 5 percent. When reporting on their own rates, a similar range was reported. There was no expectation of increases in rates, except of course for insureds with claims histories.

The market is also being affected by increasing competition from package/program products designed to wrap E&O and traditional coverages into a single product.

The level of retentions or deductibles that carriers are willing to write continues to be flat. Isolated prospective insureds may be able to achieve lower retentions, but we don't believe that it represents any type of trend.

However, there is one very large concern that we have: as the continuing attacks on data show, even well-run organizations are vulnerable to data breaches. This will undoubtedly lead to increased tech E&O claims, increasing retentions and perhaps constrictions in the market. Will data security risk become a large source of E&O claims, and if so, what will that mean for the tech E&O market? It will affect a far wider swath of tech providers than just the security firms; we are sure of that.

Target Markets and Prohibited Insureds

Unlike most of our surveys, there are significant classes of business that some carriers indicate are prohibited. Problem classes seem to include financial transaction systems, Internet service providers, adult content providers, security-focused risks, and higher educational institutions.

Read the "Target Markets" table carefully as a guide to which carriers like (or don't like) certain classes of business, but also keep in mind these can change and are often subject to reconsideration.

Capacity and Retentions

Significant liability-limits capacity remains, and reasonable (account appropriate) retentions or deductibles are available. $25 million can be provided by the carriers focused on the larger insureds, and even the smaller market offers limits of $5 million–10 million. Higher limits can be arranged through excess markets.

Deductibles or retentions can be quite competitive; the "Limits, Deductibles, Coinsurance and Commissions" table shows minimums. Lower deductibles are generally available from the carriers offering lower limits, those that may best appeal to the smaller insureds that desire low deductibles.

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

Data Privacy

To capture information about the coverages that might be available for any of the three types, we created two simple tables to summarize the type of privacy coverage offered:

- Coverage Extensions and (sub) Limits Available for Tech E&O Insureds – Privacy Breach of Their Own Data, and

- Coverage Extensions and (sub) Limits Available for Tech E&O Insureds – Privacy Breach of Client Data.

The first table presents information about coverage for a breach of the tech provider's own data and limits available. The second provides information about a breach that involves the provider's client's data *while the data are within the provider's control*. This is breach response (also known as remediation) coverage and would apply even if the provider's liability is not involved (or not yet proven).

Carriers, brokers, and, most of all, insureds need to be clearer about the need to distinguish remediation coverage from E&O. Liability shouldn't be necessary for a tech E&O policy to respond to a breach that involves client data.

Media Liability

There is another type of coverage being made available on many tech E&O policies, which is media liability coverage. Much as we noted in our "Cyber/Privacy Market Survey" (June issue), media liability coverage is no longer just for traditional media companies. The increasing use of social media in particular is generating a lot of interest in this coverage, and so we include a table to capture information about the coverage and possible limits. It follows the "Privacy" tables and is titled "Coverage Extensions and (sub) Limits Available for Tech E&O Insureds – Media Liability."

Tech companies are particularly active in social media, making this added coverage especially useful, although perhaps presenting more than a negligible risk to the carrier.

Policy Features

With the wide variance in coverages included in tech E&O products, paying close attention to key features is important.

Coverage for liability arising out of the actions of subcontractors while working on behalf of the named insured is generally included in the basic policy form. However, most will not include coverage for the subcontractor itself, unless special arrangements are made.

The definition of products and services is critical for proper coverage; the policies define the products and/or services that are covered. There are two different ways this can be done: either the declarations page specifies the products and/or services covered (which comes from the application) or the policy definition itself defines the activities covered. Almost all of the carriers use policy definitions.

Either way, it is critical that the products and/or services of the insured be listed properly or defined as included in the policy. Wording is shown under "Definition of Products and/or Services Defined in Policy" included in the table "Definition of Products and Services."

Claims Reporting, ERP Options, and Counsel

Each liability policy reviewed is a claims-made form, so extended reporting period (ERP) options are important. All carriers offer a supplemental extended reporting provision, but they range in length. Carriers will sometimes negotiate additional optional periods and/or cost.

Selection of counsel continues to be a delicate issue with insureds, but as we frequently see in

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other new lines of coverage, carriers typically reserve the right to select, or at least approve, counsel. In practice, carriers are generally willing to use legal counsel that is satisfactory to both the insured and the insurer.

Carriers offer varying levels of control (or, at least, influence) in the selection of counsel, ranging from selection exclusively by the insurer to the choice of counsel by the insured. 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; as an example, several carriers reserve the right to choose counsel but indicate that pre-negotiated counsel will be considered on a case-by-case basis.

Generally, carriers can impose the infamous “hammer clause” on lawsuits that an insured may not want to settle. The “softened hammer clause” is making inroads in this market, led by Allied World, Argo Pro, Ascent, Beazley, Euclid, Ironshore, Philadelphia, and Travelers.

Carriers tell us that hammer clauses are rarely wielded (we love that image), but a soft hammer could be a valuable tool for an insured facing a tough E&O claim.

Prior Acts Coverage and Territory

All carriers offer prior acts coverage, with previous coverage usually required by all carriers, although many may require previous coverage based upon underwriting criteria.

All carriers offer worldwide coverage if a suit is brought in the United States, Canada, or possessions. True worldwide coverage (suit brought anywhere) is available from each of the carriers reviewed. Technology is a worldwide business, and one of the liability problems is that the legal standards of many countries differ from those of the United States.

Exclusions

Rather than try to recite them here, the information for each carrier is found in the “Exclusions” table. Exclusions are many and varied, as would be expected; please read those tables carefully.

Unlike our other reports, we have categorized the exclusions into:

- General insurance exclusions (bankruptcy, dishonesty, intentional acts, expected or intended damages, Securities and Exchange Commission, unfair competition, piracy, and punitive damages)
- Product-related (product recall, cessation of support, direct property damage, direct bodily injury, loss of property, contingent bodily injury/property damage, prior to customer’s acceptance of your work, breach of warranty, and hardware)
- Service and security-related (contractual liability, cost estimates exceeded, performance delay, security breach, failure to prevent virus passing or data theft)
- Cyberrisk-related (personal injury, advertising injury, intellectual property, and public key infrastructure)

A few comments on some of the exclusions that are specific to tech E&O:

- Cost estimates exceeded—this refers to exclusions for claims by customers that the cost of a project exceeded the estimate or proposed fee. Carriers do not want to pay claims for poor pricing decisions of their insureds.

- Performance delay—this arises out of the insured's failure to meet project time deadlines and is included in policies to protect carriers against an insured's overly optimistic promises.

- Security breach or unauthorized access—this is a very important set of exclusions for any insured that offers services related to secure data, including e-commerce. Some carriers will provide coverage if the insured is providing services related to security, while others will include coverage as long as the breach is on the system of others (i.e., not the insured), which is, after all, the intent of E&O coverage.

- Intellectual property—infringement of patents, copyrights, or trademarks is a source of much litigation, and coverage is rarely available when an insured is sued. Each carrier handles this very differently; read this portion of the "Exclusions" table carefully.

- Public key infrastructure—the term used to describe technology that enables secure online transactions.

Risk Management Services

Supplemental loss avoidance and control services are now much more prevalent in technology E&O, of which we approve, considering the ability of such services to reduce or eliminate losses for the benefit of both insureds and insurers. Please see our "Risk Management Services" table for a description of the many services that carriers are including in their offerings to insureds.

Generally, the range of cyber-related risk management services offered is increasing, a trend we welcome. Insureds and their brokers should look carefully at the services offered and make use of them to help improve their exposure.

Summary

Technology E&O is an important coverage line, supporting the risk strategies of a key component of the US (and world) economy. Marketing (smaller tech companies may not buy E&O, large tech companies may not think they need it) and product design (exploding privacy risk the most important) present challenges, as does rate adequacy. Sharp underwriting skills are needed in this line of coverage, as numerous types of business segments seek coverage.

We continue to see signs that the middle market is getting serious about this coverage; carriers continue to move down market and are encountering smaller competitors. This presents a real opportunity for significant growth in premium as well as a way for middle market insureds to economically obtain expertise on how to handle a breach.

Privacy risk is now well recognized, and insurance should be seriously considered. While some form of self-insurance or self-retention might make sense for large organizations, especially those with existing captives, the high costs of a breach and the unpredictability of data loss may make risk transfer appealing. Combined with increasing pressure by business partners to show evidence of real coverage, the days of self-funding this risk may be about over.

We always encourage readers and their advisers to carefully consider the type of coverage that they need and whether or not the policy they are considering is really the right answer to their needs. The large carrier offering may not be the best one for them, but then again, the smaller carriers may not offer enough capacity.

* *

About the Author

Richard S. Betterley, CMC, is the president of Betterley Risk Consultants, an independent insurance and alternative risk management consulting firm. BRC, founded in 1932, provides independent advice and counsel on insurable risk, coverage, alternatives to traditional insurance, and related services to corporations, educational institutions, and other organizations throughout the United States. It does not sell insurance or related services.

Rick is a frequent speaker, author, and expert witness on specialty insurance products and related services. He is a member of the Professional Liability Underwriting Society and the Institute of Management Consultants. He joined the firm in 1975.

Rick created *The Betterley Report* in 1994 to be the objective source of information about specialty insurance products. Now published six times annually, *The Betterley Report* is known for its in-depth coverage of management liability, cyberrisk, privacy, and intellectual property, and media insurance products.

More recently, Rick created *The Betterley Report Blog on Specialty Insurance Products,* which offers readers updates on and insight into insurance products such as those covered in *The Betterley Report.* It provides him with a platform to more frequently and informally comment on product updates and newly announced products, as well as trends in the specialty insurance industry. **www.betterley.com/blog**

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