Integro Managing Principal Louise Pennington prepares to answer a question about coverage changes. There’s a sea change occurring in the market, she said, explaining that public companies are now getting broader coverage extensions than private companies.

"There are all these extensions of coverage now being granted for public companies that suddenly are not available for private companies. It’s a complete sea change,” said Louise Pennington, managing principal for Integro Insurance Brokers in New York, citing the highly competitive public-company D&O market as a key driver of the difference.

Pennington and other broker executives, speaking at a session on coverage issues at Advisen’s Management Liability Insights Conference, pointed to bells and whistles like a change in the definition of claim in Chartis’ Edge forms for public companies introduced within the last year. That change expands the claim definition back in time to capture informal notices of inquiry from regulators, granting coverage for responses to such investigations.

Private companies are exposed to regulatory investigations, although not necessarily from the Securities & Exchange Commission, Pennington said. That same backwards extension of the timeframe for the coverage of regulatory exposure, however, "is not in any private company form that I’m aware of to date," she said.

(Editor’s Note: Chartis introduced two Edge forms since 2010: Executive Edge in May 2010, covering the costs of responding to informal investigations of individual directors and officers; and Investigation Edge, unveiled this year to cover similar costs for the entity.)

Pennington also noted that most insured-vs.-insured (IVI) exclusion language today “is probably better from an insured's perspective in a public-company form than in a private-company form.”
In particular, brokers explain that Chartis, as well as other carriers attempting to replicate the Edge innovations by endorsement, replace the IVI exclusion with an Entity-vs.-Insured exclusion. By doing so, they bring previously excluded coverage back to increasingly common situations where directors or officers leave a board or company, and then former directors or officers sue current ones or vice versa.

Referring generally to the comparatively greater breadth of coverage available on public company D&O policies, Pennington said: “That’s a very new dynamic that speaks to the incredibly competitive picture of the [public-company] marketplace we’re all working in. It also speaks to the fact that we are so focused on public company issues because information is so readily available.”

“[Public company] information is on overload,” she said.

Another panelist, Phil Norton, vice chair for the Midwest Region at A.J. Gallagher in Chicago, provided a history of private coverage, which supported Pennington’s view that private-company coverage had been broader than public-company coverage until recently.

Private companies always had entity coverage, for example, Norton said. In addition, throughout the late 1990s, private companies saw broad employment practices liability coverage bundled into their D&O policies—coverage that was available without exclusions for downsizing or intentional acts.

“Where we need to go next is to get some of these Edge endorsements added for the private company,” Norton said. “Get rid of the IVI exclusion. Why not? We did it for those big dangerous public companies. Let’s do it for the private. I can’t believe that I’m being told, ‘That’s too dangerous.’”

Norton put all the “Edge-type endorsements” on a personal wish list that he would like to see D&O carriers introduce for private company clients, during a videotaped interview with Advisen.

Later, the only carrier representative on the panel, Michael Price, senior vice president of Arch Insurance Group, addressed an audience member with similar concerns, agreeing that certain claims currently denied as a result of the IVI are actually insurable.
“I do think this is a big deal for private companies, and I think you [brokers] should try to go get that [removed],” Price said. From a carrier perspective, however, he warned against a knee-jerk reaction to expand coverage to respond to public-company form changes without introducing dramatic price changes.

There are claims that “have been rightly denied but for the wrong reason,” he said, referring, for example, to a merger-and-acquisition claim for a private company where the former founder sells out to a private equity firm. Over time, representations and warranties are breached, fueling a lawsuit from the former director and a denial based on the IVI exclusion, he said.

“For $7,000 per mil, I’m not sure private company underwriters are thinking they are reps-and-warranties underwriters and are pricing to that risk,” Price concluded.

But these claims are growing, he added. “Buyers’ remorse happens,” especially in a down economy, he said, adding that the claims “tend to get emotional, unsettleable and expensive.”

The underwriter also highlighted the presence of full entity coverage on private company forms—for any wrongful act, error or omission—and the potential for the combination of entity coverage and duty-to-defend provisions “to reach around” exclusions like pollution exclusions to provide defense cost coverage for regulatory investigations.

“Duty-to-defend and entity coverage are a very powerful combination. I think that is why there’s a hesitancy to react the minute the public market does something,” he said.
$15B Private D&O Market Largely Untapped: Advisen

BY SUSANNE SCLAfan

The potential size of the management liability insurance market for privately held and nonprofit companies could be a staggering figure of $15 billion or more, but annual writings currently top off at less than one-fifth of that total, experts said recently.

David Bradford, president of the Research & Editorial Group of Advisen Ltd., put forth the estimate at Advisen’s Management Liability Insights Conference in late September, referencing a figure derived using Advisen’s Market Insight database of policy information as a starting point.

Specifically, Advisen took the average premium associated with different business size categories in the database and multiplied those by the number of businesses represented (with more than $1 million in revenue) to develop the $15 billion estimate of the potential size of the marketplace, Bradford explained.

Contrasting the $15 billion figure, he said the current written premium level is somewhere between $2.5 billion and $3 billion.

In addition to Bradford, two dozen industry executives specializing in this space spoke at the one-day, eight-session educational and networking conference held in New York in late September, sharing views on market potential and insights on how to increase the insurance market, among other topics.

At one session, Steve Anderson, executive managing director for Beecher Carlson in New York, speculated that Bradford’s $15 billion figure was “dramatically understated,” bolstering his view with observations of current economic and employment trends.
Specifically, Anderson suggested that aging workers are retiring later, which means that recent college graduates are no longer finding jobs available that those older workers would have left vacant in a stronger economy. The new workforce entrants will have two options—working at Applebees or setting up private businesses on their own, he asserted.

Many will opt for the latter, and those startups will be service- and technology-oriented businesses, Anderson continued, noting that because they will be seeking clients among the Coca-Colas and Microsofts of the world they will have to buy the insurance. Their clients will demand it contractually, he said.

Bradford, gauging the potential market size another way—in terms of the number of privately held businesses—said that Internal Revenue Service data revealed more than 30 million total U.S. businesses in 2007, the latest year for which data is available. Eliminating sole proprietorships, which make up the bulk of the total, and noting that only about 18,000 companies are publicly traded, there are 9 million left, Bradford said. “That is a pretty staggering number.”

Capturing some share of those 9 million private and nonprofit companies in the management liability insurance market remains a challenge to carriers, however.

“It’s a shoe-leather type of market to get to. Business is not going to come to you,” Bradford said, echoing the remarks of co-panelist Tony Galban, senior vice president and Global D&O product manager for Chubb & Son in Warren, N.J.

“To an enormous extent, we still haven’t sold it,” Galban said. While figures vary among estimators, they all point to the fact that only one-in-four or five private companies buy management liability coverage.

“The upside to the business continues to be the opportunity to sell to the new buyer,” Galban said. “I get frustrated with our business [because] we beat up on ourselves for the existing pool of business, [but] in fact the collective challenge to us as a group is the new sale.”

Galban noted that the business “continues to be relatively less attractive to major brokers” than to independent agents, who are better positioned to sell a product that doesn’t command high-premium-dollar levels. At one point, he said nonprofit programs could come in as low as $1,200-$1,300, and privates at $10,000 (for $1 million of limit) making efficiency a paramount goal for insurers who want to expand in this market.
The same is true for brokers, Anderson said. Brokers cannot do the same amount of work they do on large public firms and “not lose their shirts,” he said, referencing to high-touch activities such as policy comparisons of excess writers.

In Beecher Carlson’s book there are 1,200 placements with less than $20,000 premiums for privately held and nonprofit firms, he reported. His firm’s strategy instead to get to this point was to scour the market to find the best terms available, to use that information to put together an ideal program and to convince a carrier to write the program, he said without revealing the market.

Conference speakers and attendees generally agreed it is easier to sell D&O and EPL coverage to nonprofits than to private firms. Galban, for example, cited the maturity of the nonprofit market, while Bradford noted the presence of sophisticated board members that understand the need for the coverage.
D&O Exec:
Private Company D&O Not as Profitable as Believed

BY SUSANNE SCLAFANE

The popular assumption that private company directors and officers liability insurance is a profitable segment for carriers is off base, an underwriting executive said recently.

“IT would like to make clear that there are lots of claims—both on a frequency basis and on a severity basis,” said Jeff Klenk, senior vice president of Hartford-based Travelers, attacking what he said is “a longstanding belief that private D&O is free coverage to sell [or] that there is no loss content.”

Klenk made the remarks when he moderated a panel during Advisen’s Management Liability Insights Conference in late September. His panelists, who were brokers, talked about ways to sell more management liability policies to private companies. We need claims examples, the brokers said, repeatedly during the session and throughout the conference.

In addition to providing specific examples, Klenk referred to an observation made earlier during the conference by another underwriter—Tony Galban, senior vice president and global D&O product manager for Chubb.

Responding to a question about the level of carrier combined ratios, Galban said, “This is insurance that is being used.”

“That’s code for, there are losses,” Klenk said, referring specifically to the D&O component of policies that typically include employment practices liability and other coverages.

“I’m being very specific. The private D&O component, [considering] premium and loss content, is not an overly profitable line of business.”

Earlier in the day, Mike Smith, president of global financial lines for Chartis, also weighed in on the claims question by providing his firm’s estimate of the number of D&O claims for both private and nonprofit firms—29,000-30,000
over the last three years for the industry overall.

Giving some sense of severity, Smith said the average level of defense and indemnity is $400,000. He also cited a settlement for a health care institution that came in at $400 million, as well as a $75 million settlement for a hospitality firm, without providing details of the allegations.

“The point is these are large and significant claims and there are a lot of them,” Smith said. “And that excludes EPLI which is a huge [claims] driver,” he said, noting the nation’s 20 percent unemployment rate when job seekers who have given up looking are added to more official counts.

Smith, during a morning keynote address, also warned underwriters about emerging risks that could impact profitability now and in the future.

“It’s a risky world and getting riskier,” he said. “Fifty-six thousand companies filed for bankruptcy last year. Put that in perspective. There are only 18,000 U.S. public companies, he noted.

Smith sees more risks emerging from regulatory enforcement actions that might not be on every underwriter’s—or buyer’s—radar screen.

While there’s a lot of talk about the Foreign Corrupt Practices Act public company world, 78 percent of individuals charged with criminal offenses were affiliated with private businesses, he asserted.

Smith also discussed the potential for exchanges for trading private company shares to generate shareholder and regulatory claims. He specifically referred to SecondMarket, an exchange market on which investors could have buy shares of the likes of Facebook, Twitter, LinkedIn, and Zynga before they go public.

“I will guarantee that eventually someone will buy something on one of those sites, those shares will go down significantly, and that investor will sue somebody,” he said. “It’s not regulated right now,” but regulation and enforcement is potentially on the horizon, he suggested.

In the nonprofit world, Smith said bankruptcy trustees and attorneys general are a cause for concern.

“Bernie Madoff was the single biggest event,” he said. Not only did some nonprofit directors wake up one day to find endowments slashed by 50 per-
Fifty-six thousand companies filed for bankruptcy last year. Put that in perspective. There are only 18,000 U.S. public companies, he noted.

Mike Smith, President of Global Financial Lines, Chartis

cent or more, but now some are subject to clawbacks for profits they allegedly earned.

Turning to attorneys general, Smith noted that an AG sued a charity in California saying $2.8 million of assets were wasted, while a Michigan AG sued nonprofit health care organizations for allegedly diverting funds from nonprofit operations to for-profit ventures. In addition, in Kansas, the AG sued a hospital system that abandoned a rural facility alleging the nonprofit had responsibility to find new operators for the abandoned facility.

Widening his discussion to discuss unpredictable impacts of the Greek debt crisis and other global economic changes, Smith warned underwriters about using the past to project the future. “If the world changes in a significant way, where there is a new normal, what’s happened in the past may or may not be relevant.”

Later, Klenk and his broker panelists gave examples of past claims that could help convince buyers of the need to purchase D&O insurance.

“We have a yarn manufacturer in the middle of nowhere that had a multimillion antitrust claim that was picked up under the D&O policy,” Klenk said, also citing increasingly common claims arising from mergers and acquisitions and non-compete agreements.

Dennis Donovan, executive vice president of S.H. Smith & Company, a Hartford, Conn.-based wholesaler, described a multi-million acquisition-related loss for a private company whose main business was providing bags of top soil to Home Depot and other store chains. The public company that acquired the soil supplier had woefully underestimated the value of the “big hill [of soil] in the back of the building,” Donovan said.

Klenk suggested that claims activity is already having some impact on the insurance market. “We’ve seen some smaller carriers that were being aggressive...start to pull out of states. We’re seeing fractures in the market on some of that newer competition,” he said.
Local Distribution
Key To Private D&O Sales Success, Chubb Exec Says

By Susanne Sclafane

What can carriers do to increase sales of management liability policies to private companies?

Go local and get more efficient, says Tony Galban, senior vice president and global D&O product manager for Chubb.

Galban shared his firm’s secret sauce for reeling in new prospects during Advisen’s Management Liability Insights Conference recently.

Distinguishing the business from public-company business, he said “public business tends to come to you” if you’re a D&O underwriter. “You don’t even have to look” for it.

In contrast, “private business is in the nooks and crannies of the world, and it really helps if you have the distribution [and] the local presence,” Galban said.

David Bradford, president of the Research & Editorial Group of Advisen Ltd., noted that Advisen’s data shows 82 insurance groups writing management liability insurance for private companies and nonprofits, with representative of 35 of those carriers in the conference audience. In spite of the high figures, Chartis and Chubb command one-third of the market, Bradford said, putting Chartis’s market share for the 2008-2011 period at 17.8 percent and Chubb’s at 15.5 percent.

“Yes it’s crowded,” Galban said, explaining that the private and nonprofit space is “perceived as a nice safe place to be in if you have to be in specialty lines.”

Another attractive feature of the segment is that it’s very sticky. “This book of business does not go to market every year,” he said.
But there’s not a ton of premium to be made on each policy, he said. Indeed, speakers at the conference put the average premiums in the $10,000-$12,000 range for private companies and at less than one-tenth of that for nonprofits.

“You have to be willing to understand that these are lower-premium items, that these things require less time, that you need more serious modeling… If you approach the privately held business like you’re a Fortune 200 D&O underwriter, you’re going to have a very hard time,” Galban said.

Summing up the ingredients in Chubb’s secret sauce, he listed three:

- Distribution is very important to this business.
- Service is enormously valuable
- You have to look at underwriting tools that reduce your expense ratios.

“With 82 players, you better be leaner in the process. You better have tools that will help you process the business in a more effective way”—from renewal centers all the way down to predictive models,” Galban said, later suggesting that this could be an “interesting space for electronic sales” over the Internet.

“We have branches making it possible to do business locally,” Galban said.

This business “continues to be relatively less attractive to major brokers,” he said. “I have always thought [it] could best be sold by independent agents,” he said, noting that there’s a need for education from underwriters and wholesalers.

At a separate session, Jeff Klenk, senior vice president of Travelers, also cited “being local” as a key to success. “I have personally found that that local connection to the [independent insurance] agency [and] local community is the thing that connects us to that insured more than financial rating,” he said.

Klenk, who moderated a panel of brokers, asked his session participants what they would like private and nonprofit D&O underwriters to do better.

Drew Gunn, senior vice president and director of Oswald Companies, responded: “Most of our clients, when they have a loss assume that it’s insured somehow, someway. There’s been talk about the difficulties of insuring intellectual property and antitrust claims,” he said, referring to carrier complaints about overly broad coverage grants.
At an earlier session, Galban noted that his worst claim memory had his company paying to put handicapped ramps into a restaurant chain before some policy-language refinement.

“Do we expect you to cover handicapped ramps or settlements of IP suits? No,” Gunn said. “But defense, for sure,” he said.

Dennis Donavan, executive vice president for S.H. Smith, said his wish would be for carriers to arm the distribution force with “legitimate claims information” that would induce sales from 80 percent of the private company market that does not buy management liability coverage.

John Ergastolo, an executive vice president for Arthur J. Gallagher, put lower retention levels on his wish list. “A $25,000-retention is a tremendous amount of money to some of these organizations,” he said.

Ergastolo also said that carriers are moving in the right direction by expanding their product suites to add cyber and other coverages. “If you can make it cost-efficient, blend it into the policy [with] a shared limit, [then] in and of itself it might not be a tremendous exposure, but we know it’s there….That would be tremendously appealing to small buyers,” he said.

Gunn stressed the need for fair claims handling on the claims-made policies. “It shouldn’t be a gotcha game,” he said, giving a hypothetical example of a denial for failure to report a circumstance that might lead to a claim three months in advance of a renewal date. “Show the intent to provide the coverage on a good-faith basis,” he said.