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MARKET REACTION

# Fiduciary Goes From Throw-In To Sticker Shock

## Still, fiduciary pricing starts to soften, despite gains in claim frequency and severity

BY SUSANNE SCLAFANE

MOST FIDUCIARY LIABILITY insurers agree that tag-along securities cases are their most worrisome exposure. And ironically, according to experts, back before Enron, fiduciary liability underwriting was itself a tag-along exercise.

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>
> Peter Taffae, President Executive Perils

"A few years ago, placing fiduciary coverage was basically an afterthought to [directors and officers liability]," said Jay Desjardins, a director in Aon's Financial Services Group in Philadelphia and national product leader for fiduciary.

"You'd place your D&O coverage and the same carriers would also write you a separate line of fiduciary. It was relatively inexpensive. Deductibles were very low," he said. "Today underwriting is not taken much more seriously, but very seriously."

In describing the fiduciary liability insurance market environment of past years, several insurer representatives refer to the line as having been "a throw-in," and Mr. Desjardins agrees.

While fiduciary was sometimes thrown into a coverage package with D&O insurance, it was often purchased as a standalone product, he said.

However, the term "throw-in" is appropriate "because pricing was very low on a cost-per-million basis," he said, noting that "even some large insureds with significant plan assets were able to secure fiduciary liability coverage for $3,000-to-$5,000 per million through the same carriers that wrote the D&O."

Today, "for large employers, certainly $20,000 to $40,000 per million is certainly within the norm," he noted, adding that increases in retention, exclusions related to securities claims, and tie-ins of limits between D&O and fiduciary coverage are also part of the current landscape.

"It's a whole new ballgame" for publicly traded companies looking to buy fiduciary coverage, according to Peter Taffae, president of Executive Perils, a Los Angeles-based wholesale brokerage. The tag-along suits "caught the underwriting community by complete surprise. And it takes at least a year for the reaction to catch up [through] renewals."

When plaintiffs' lawyers started to "double-dip" with filings of securities suits on behalf of shareholders and parallel suits on behalf of employees with company stock in their pension plans, "it was devastating, quite frankly," Mr. Taffae said. For example, he said that Enron cost one large fiduciary insurer $50 million. "They had $50 million up [in limit] and they were getting approximately $1,500 per million."

"Think about it. They got $75,000 and they paid out $50 million," Mr. Taffae said. (Other experts put typical premiums at $3,000, which would double the figure to $150,000) "The pricing is not D&O pricing by any means. But they're getting D&O hits" on fiduciary, he said.

John Coonan, vice president and fiduciary product manager for Chubb & Son in Kansas City, Mo., described changes in pricing and terms with a specific example.

In 2001, for a Fortune 500 company that had a number of plans—usually a defined benefit plan and a 401(k) plan with company stock in it—it wasn't unusual for Chubb to write a $25 million limit with a deductible in the range of $100,000 to $500,000 for a premium of about $125,000.

In 2003, "that same company would be greeted from us with a desire to not put out more than $10 million in limit." And while the range of deductibles would be the same for non-securities claims, there would be a separate retention for tag-alongs in the range of $2 million up to $5 million, he said, adding that the pricing would fall between $200,000 and $400,000.

"That's a pretty radical adjustment. And the real question is, 'Is that enough?' and we don't know the answer right now," he said.

According to Mr. Desjardins, "more than anything," the insurance market reaction to tag-along suits has been increased retentions for securities claims.

Other strategies include putting sublimits on securities claims or tying D&O and fiduciary policy limits together on securities claims. Explaining the latter, he said, for example, if a carrier writes a D&O policy with a $15 million limit, and the fiduciary policy also with a $15 million limit, then for a securities claim, the



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carrier might say, "'the most we're ever going to pay is $15 million.' You see that somewhat."

"Another major way" carriers deal with the situation of having two limits exposed to a single claim is by "monitoring the overall capacity they're willing to put forth," he said. So in the past, a carrier might have offered a $25 million D&O limit and a $25 million fiduciary limit. Now, the same carrier may only put out $25 million in total. In other words, even though they will write two separate policies with two separate limits "and no tie-in of any kind," the limits might be $15 million on D&O and $10 million of fiduciary, he said.

Still, "the outright securities exclusion is not uncommon by any means. I don't want to downplay that. It's certainly out there," he added.

Mr. Taffae went further, arguing that "most insurance companies are addressing the [tag-along claims] issue with securities exclusions."

Mr. Coonan said that "we have some of those on the books, although they're not very popular," noting that Chubb also floated the unpopular idea of policies that provided only defense cost coverage for securities claims. Most customers still buy traditional coverage, accepting higher premiums and retentions, as well as lower limits than they used to buy from a single carrier, he said.

From Mr. Taffae's vantage point, insureds "have a real void" in coverage now. "Tying limits together is basically the same thing" as excluding securities claims, he said, going on to give a hypothetical example of two $100 million towers of coverage on D&O and fiduciary that pay out only $125 million on a $200 million claim.

In his example, Carrier One writes the primary $25 million layer of both policies with a tie-in or "non-pyramiding endorsement." Carrier Two writes the next $25 million layer, also with the endorsement. Carrier Three writes the third $25 million layer of the fiduciary policy and the fourth $25 million of D&O, and two different carriers fill in the two remaining layers.

The primary layers of both policies are only good for $25 million, as are the next from Carrier Two, he explained, noting that Carrier Three also only pays $25 million. "You're better off having eight different carriers. But you can't really do that because I don't think there are eight carriers that really, really have $25 million in capacity," he said.

While such restrictive conditions are a reality, most market participants confirmed that prices are no longer soaring.

Rhonda Prussack, vice president and product manager for fiduciary liability insurance at National Union in New York, observed that "oftentimes, as the D&O market goes, so goes the fiduciary market. And while it took a little longer to happen, now the softening that we're seeing the D&O, is starting to happen in fiduciary"

But "it's really crazy," she added. "We're seeing more claims than ever. We're seeing more severe claims than ever, so there's absolutely no logic behind the softening," she said, noting that premium increases that were in the 20-to-40 percent range last year, and as high as 200-to-300 percent two years ago, now average 10-to-15 percent.

The changes toward softer pricing evident in the fiduciary liability market over the last six months "are really driven by the D&O market primarily," Mr. Desjardins said, noting that D&O capacity has increased. "But the changes are likely to be short-lived," he added, also noting there has been no decline in loss severity.

Mr. Coonan, who said there's a possibility that prices are still "woefully inadequate" in spite of the hikes of recent years, presented a sobering statistic at the Professional Liability Underwriting Society symposium in April. He noted that while all the potential mega-claims are from Fortune 500, publicly traded companies, the premiums that attached to the Fortune 500 part of Chubb's book two years ago were roughly 15 percent of the total premiums written, because many small companies buy fiduciary.

"If you put that picture up against the size of the damages alleged in the hundreds of millions and billions of dollars, it makes it a real stretch to connect premium with what looks like a horrendous outcome," he said. NU