D&O Market Turn Looming, Especially For Subprime-Bitten Financial Institutions

BY SUSANNE SCLAFANE

THE EERIE SILENCE that has set in over the directors and officers liability insurance marketplace could be an indication of a looming hard market that will strike on Jan. 1, 2009, one leading broker suggests.

Peter Taffae, managing director of Executive Perils, a Los Angeles-based wholesale brokerage, speculated that mega-sized D&O insurance claims from some of the world’s largest financial firms will drive higher losses onto the books of reinsurers, fueling a Jan. 1 market turn.

“Do you know how it gets really, really quiet right before a hurricane hits? That’s where we are right now,” he said.

While all other experts interviewed by NU in mid-October said they see a hard market coming, most were not predicting such a fast reversal in rate declines for commercial businesses (those that are not financial institutions), which are still experiencing the benefits of soft pricing.

The fact anyone is even talking about a hard D&O market now is “a big change,” according to Michael Turk, senior consultant for Towers Perrin in Stamford, Conn.

“For a long time, people were saying we would have a soft market for a few more years,” said Mr. Turk, who puts together Towers Perrin’s annual survey of D&O buyers—noting that the last report, published in June, reported average premium declines of 14 percent.

Mr. Turk recalled that when he was presenting survey conclusions at insurance conferences in the spring, concerns were being raised about mounting claims from subprime issues and the possibility that D&O insurance losses could reach $3 billion to $9 billion.

“I was making the argument that people were ignoring the bigger impact—the impact of the declining rates we’ve seen for the last three years,” he said. “Those were more long-term effects, and we didn’t see any real signs that would be changing.”

The subprime and credit crises have since ignited a worldwide crisis in the financial markets. The likes of Bear Stearns, Lehman Brothers and even General Electric have had securities lawsuits filed against them, Mr. Taffae said, noting that such large firms typically buy $200-to-$300 million D&O towers. Firms like these “are going to run through defense costs. These are all policy-limit losses,” he added.

Most carriers on a well-placed D&O program of that size don’t keep much exposure net of reinsurance, he said, noting carriers like Chubb and American International Group are exceptions, meaning reinsurers will get hit for the others, he said.

“Jan. 1 is a huge treaty renewal date, and I’m already hearing about reinsurers cutting back capacity,” he noted, adding that “when carriers have to take higher nets, they get a lot more discriminating.”

Priya Cherian Huskins, a partner and senior vice president for Woodruff-Sawyer in San Francisco, said her firm’s proprietary securities litigation database shows suits on the rise and big settlements on the horizon.

“What that means for the D&O industry is that prices will harden. While I cannot predict when it will be, it will be sooner rather than later,” she said, noting carriers can no longer sustain profits with investment income, and that “they’re going to have to look at just raw premium.”

How High Is ‘Up’ For D&O Prices?

BY SUSANNE SCLAFANE

XPERTS OFFERED INSIGHTS on how high prices might rise when the directors and officers liability market hardens by referencing historical indexes of D&O prices by quarter.

“I don’t see evidence to suggest that it would be any less than [the prior] peak in third-quarter 2002,” said Jennifer Fahey, Aon’s national D&O practice director, referring to a point when prices were 163 percent higher than the first recorded date of Aon’s pricing index in 2001.

That doesn’t mean every firm will experience that kind of impact on the next renewal, she noted. “The reality is that it builds on a quarterly basis—changing from a soft market, to one of pricing stabilization, to small increases, to considerable increases. While it may hit an individual risk manager on a renewal as a spike, if history is a guide, the reality has not been one that would suggest that...”

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Mr. Taffae noted that one factor working against a hard market coming soon is the appearance of new markets and reappearance of some older ones now willing to provide higher levels of capacity. Among them, he listed:

- **Berkley Pro**, a recently formed division of W.R. Berkley staffed with former AIG executives.
- **Freedom Specialty**, a division of Nationwide.
- **IronPro**, a division of Ironshore.

He added that another D&O market participant, Crum & Forster, saw its financial strength rating upgraded to “A” from “A-minus” in June.

David Bradford, chief knowledge officer for New York-based Advisen, said his firm’s models reveal the property-casualty market will “bottom out” in second-quarter 2009, and that “D&O may lead the bottoming out.”

Mr. Bradford spoke to NU two weeks before his firm released its latest report confirming his prediction and estimating that subprime losses will add 229 points to the loss ratio for the financial institutions segment of the D&O market.

Currently, however, it’s still a soft D&O market for most businesses, he and others said. While financial institutions and real estate firms are seeing rate increases in the 20-to-40 percent range, those not hit hard by subprime or credit crunch issues are seeing rates fall 7.5 percent on average, Mr. Bradford noted.

Rodger Laurite, senior vice president and unit manager for financial services practice at insurance broker Lockton in Atlanta, said pricing for individual FI risks varies from one to the next. “We’ve had renewals that went flat. We had one that was an 80 percent increase,” he noted.

For non-FI (commercial) D&O risks, through September, decreases were anywhere from 5-to-30 percent. “As recently as two weeks ago, we had a renewal with a decrease of more than 20 percent,” he said.

“Logic would dictate that with the way litigation is headed, the [stock] market a mess, the economy in or close to recession, and the bankruptcies, you’ll see a lot of companies where eventually rates would go up—but I just haven’t seen it yet. There’s just a lot of capacity,” he said. “Even if you lost some AIG capacity, or you didn’t want to use all their capacity on a particular risk, there are so many others.”

So far, brokers and consultants say that high-rated carriers being evaluated to replace all or portions of D&O program layers written by AIG are necessarily able to charge higher prices for financial strength.

“I’m getting very mixed signals,” said Mr. Bradford. “Risk managers who are anxious to replace AIG and want to get off now, many times are paying a premium for flight to quality”—sometimes as much as 20 percent. “But in other cases, savvy risk managers who are willing to continue with AIG at the right terms are using AIG’s willingness to negotiate on premium as a lever to negotiate with others as well.”

Mr. Laurite said he hasn’t seen any insurers “taking advantage” of insureds on midterm replacements. “No one is saying, ‘if you want me, I’m going to charge double,’” he said. “There are other alternatives, and they know it. If they really want it, they’re going to have to be reasonable.”

Still, replacing AIG may mean paying more—simply because AIG has typically offered the most competitive pricing, he said. Giving an example of an account that renewed earlier this year, he said, “we looked at alternatives, [but] AIG blew everyone out of the water. So if we were to replace them today on a midterm cancellation, we’d have to tell the client, ‘We can do it, but you’re going to get it at the price that the other markets were quoting three months ago.’”

Asked whether AIG is now being even more aggressive as it fights to hold on to business, Mr. Laurite said he hasn’t seen that happening. However, “it’s kind of logical when you think about it,” he added. “They’re going to have to show a little something to hold on.”

On the other hand, he said, “I don’t see that happening wholesale, because eventually that’s going to catch up to you” as losses start to outpace premiums. “They’re not going to be going in and buying business just for the heck of it.”

Jennifer Fahey, national D&O practice director for Aon in New York, said she has not seen stable carriers try to charge higher prices for higher financial strength ratings. “They’re definitely talking about it, and I think we’ll see it in 2009,” she said.

As for troubled carriers, she added, “absolutely, we’re seeing very aggressive positions taken by insurers to maintain market share. I struggle with quantifying that only because but for that I think the market would have started turning now.”

Ms. Huskins cautioned that brokers will be wary of troubled carriers that either start really undercutting prices or slow down claims payments. “If a company is in the newspaper [headlines], it actually has to take a business-as-usual position….Otherwise brokers will lose confidence.”

Offering an analogy, she said: “When I buy sushi, there is something like sushi that is too cheap for me to want to eat.” In other words, she explained, “as a broker, I want a great price,” but safety is an issue. “It will make all of us nervous if it looks like you don’t have adequate premium—that at some point there won’t be enough to pay claims.”

**HOW HIGH IS 'UP'?**

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First-quarter 2009 would be a sharp upward spike.”

According to Aon’s index, D&O prices have decreased in recent quarters, with an index of 1.27 for fourth-quarter 2007 (indicating prices 27 percent higher than the 2001 base date), 1.24 for first-quarter 2008, and 1.23 for second-quarter 2008.

The second-quarter 2008 figure is 53 percent lower than the 2003 peak.

Splitting the pricing data for financial institutions and non-FI risks, Aon Managing Director Brian Wanat reported during a presentation at last week’s Professional Liability Underwriting Society meeting that in third-quarter 2008, non-FI prices were only 2 percent higher than 2001, while FI prices were 58 percent above the 2001 base.

Separately, Towers-Perrin, in its June report on D&O pricing trends, reported that prices in 2007 were 12 percent higher than in 2001, or 35 percent below average prices from the last peak in 2003.