PLANNING AHEAD

Broker Crafts D&O Backup Program So AIG Customers Can Bail Out If Necessary

Simple e-mail will activate an alternative coverage if AIG ratings fall below 'A-minus'

BY SUSANNE SCLAFANE

WHILE WORRIED AMERICAN INTERNATIONAL GROUP policyholders were calling their brokers last week, a handful were comfortably sitting tight with recently renewed AIG directors and officers coverage and a previously negotiated backup plan to instantly replace the carrier if required.

Southwest Airlines is among the insureds in the latter group, confirmed the airline's risk manager, retail broker and wholesale broker, who all described a contingency plan that the wholesaler developed 90 days ago—in advance of the July renewal of a multimillion-dollar D&O liability program on which AIG was the primary carrier.

Peter Taffae, managing director of Executive Perils, the Los Angeles-based wholesaler, said that since he crafted that contingency plan for Southwest, he has put five such options in place for D&O insurance buyers in the three-month timeframe.

"We felt there was some possibility of AIG having some trouble," said Mr. Taffae, noting that AIG's stock price had dipped to about $25 or $30 at the time from a high of $70 over the past year. That drop and a simple gut feeling prompted him to raise the issue of backup plans with Southwest and the retailer on the Southwest account.

"My job is to protect the client against the worst-case scenario," he said, describing the "moral dilemma" he wrestled with at the time. "Nothing had really happened. It was too early to start ringing any bells," but there was a potential that something would.

On the other hand, the client and the brokers had good, long-term relationships with AIG, Mr. Taffae said, noting that the carrier writes the aviation coverage as well.

In addition, the D&O policy up for renewal, with limits well in excess of $100 million, was a very sophisticated one—pages and pages long that are all manuscripted, meaning they were specially tailored for the specific insured.

SOUTHWEST AIRLINES IS AMONG THE INSUREDS that renewed a longstanding AIG D&O program but had a previously negotiated backup plan in place if AIG's insurance arm runs into serious trouble.

"We didn't want to lose that," he said.

Christopher Thorn, Southwest Airlines risk manager, noted that AIG has been one of Southwest's insurers at least since he came on board eight years ago—"and probably from the beginning."

"AIG has had the reputation of being one of the strongest companies in the world. You always look to them as quality paper," Mr. Thorn said, although he added that the downfall of Bear Stearns in the spring did raise questions about whether issues arising from mortgage-backed securities could affect the insurance community—"especially insurance carriers like AIG providing insurance to back that."

"We were thinking this might be a minor hiccup or a temporary problem," Mr. Thorn said. "But still in the back of our minds was the question, what if it's not?"

Jaimie Hayne, chief executive officer of Catto & Catto LLP in San Antonio, Texas, a partner firm in the Assurex Global network, is the retail broker on the Southwest account. AIG had "just come off the downgrade from 'A-double-plus' to 'A-plus,'" Mr. Hayne noted, referring to A.M. Best's mid-June downgrade of AIG's domestic life and retirement subsidiaries.

(A.M. Best dropped the property-casualty insurance company ratings, which had been at "A-plus" since May 2005, to "A" on Sept. 15, 2008.)

While the June downgrade gave credibility to more dire prospects that Mr. Taffae was warning about, the idea that what happened to Bear Stearns could happen to AIG, "we really thought was a very, very remote possibility," according to Mr. Hayne.

"We had no intention—and we have no intention of trying to move from AIG. They've done an outstanding job for all of us," the retail broker said.

Mr. Thorn agreed. The relationship with AIG "is not something we wanted to throw away just off the bat," he said. A creative

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"outside-of-the-box solution" from Mr. Taffae "allowed us to have our cake and eat it, too," Mr. Thorn explained, noting that he and Southwest's CFO and treasurer unanimously agreed to pursue Mr. Taffae's solution.

The solution was to renew the multicarrier program with AIG continuing as the primary insurer, and to pay an additional fee to get a proposal and quote from an alternative lead carrier. The pricing and terms for that alternative program are locked in for 12 months—not 30 days, as is industry practice, Mr. Taffae said.

Mr. Taffae refers to the solution as a "supercontinuity option," expanding on the term "continuity," which in the liability insurance world refers to making sure that coverage is consistently maintained without gaps as the insurance is renewed each year.

Another feature of the supercontinuity option, he said, is language stating that it will only be available if A.M. Best downgrades the financial strength rating of any AIG insurance subsidiary to "A-minus" or lower. This protects the carrier against moral hazard—the possibility of the buyer announcing a multimillion-dollar claim and the desire to accept the alternative tower.

In the event a downgrade does occur, "I just send an e-mail" to get the alternative program done, Mr. Taffae said, noting that AIG has agreed that its participation will be cancelled pro-rata in that situation and the new tower will go into effect.

"It is never in the insured's best interest to go in to negotiate terms and conditions or premiums at a time of crisis. Anytime you can pre-negotiate when things are still okay, you're better off," Mr. Thorn said.

While coverage terms are not precisely the same as the renewal terms with AIG, Mr. Taffae pointed out that the backup carrier was making a two-year commitment.

"The terms are acceptable," Mr. Taffae said, noting that Southwest could, if it chooses, invoke this option eight months from now (12 months after the renewal) and the carrier would be committed to providing 12 months of coverage.

"We had to negotiate and underwrite and broker a deal that has a lifespan of 24 months in a changing environment," he said, noting that the airline industry has some significant challenges related to fuel costs.

Mr. Thorn is comforted by the prospect of having two companies to choose from going forward. "I could replace AIG with another insurance company, but how do I know they're not the one next week having the problems?" he said.

Mr. Taffae said he has placed four other D&O programs with supercontinuity options—for AIG and another troubled carrier. The fees for the alternatives have fallen in the range of 1 or 2 percent of the total premium, he said. NU