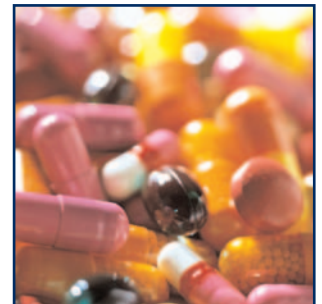
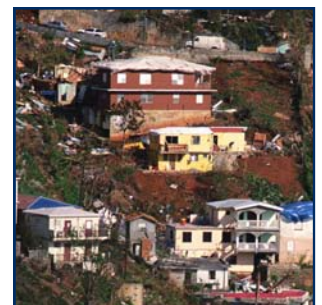
Marketplace Realities
& Risk Management Solutions

2007

Special Report on Executive Risks

August 2007 Edition





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Marketplace Realities 2007
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Foreword

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August 2007

All Roads Lead to the Boardroom

In the pursuit of reward – whether it be market share, growth, profit, leadership, innovation, fame, adulation, legacy or any other individual or corporate goal – we incur degrees of risk. In today's world, virtually everything that a company does or possesses has the potential to cause or become caught up in events that result in grievous damage to reputation, loss of market share, and/or impairment of earnings and net worth. From the mundane to the exotic, risks across the organization have exhibited remarkable capacity for volatility and severity in the context of ever-increasing globality, interdependency and application of advanced systems technologies. The following are examples of behaviors and events that can lead to disaster – and already have. They are not scenarios; they are headlines without the names:

- Loss of customer data through security breach or sheer laxity in procedures.
- Importation of goods that can sicken, injure or kill.
- Back-dating stock options.
- Employee discrimination. Customer discrimination.
- Predatory pricing practices and other forms of marketplace manipulation.
- Concentration of assets in areas exposed to natural catastrophe perils.
- Malfeasance in financial asset management.

Citations and Trends

This issue of *Marketplace Realities 2007* is devoted to **Executive Risks** – the Management Liability suite of coverage instruments that includes:

- **Directors & Officers Liability** (D&O)
- **Fiduciary Liability**
- **Employment Practices Liability** (EPL)
- **E&O / Cyber Risks**
- **Fidelity**

The citations of loss frequency, severity and associated trends are stark and compelling:

D&O – Mega claims, those with cash settlements of $100 million or greater, reached an all-time high of 14 in 2006, exceeding the 2005 number by almost a third. In the first six months of this year, there were 10 D&O settlements announced where the cash payout exceeded the $100 million mark; the total settlement dollars for these 10 exceeded $6.5 billion.

Foreword (cont.)

Willis

August 2007

Cyber Risk – In the past nine months, there have been more that 240 reported security breaches exposing personal data files on nearly 60 million individuals. A single retailer's data breach, affecting as many as 46 million people, might ultimately result in a loss approaching $300 million.

Fiduciary – One law firm made a big splash last year when it filed suit against 10 major employers, alleging that their 401(k) fees and fee disclosures were "excessive," "undisclosed," and "illegal." Even with uncertain outcomes, these suits clearly have potentially widespread implications for employers, since approximately 40 million Americans have $2.5 trillion in assets in some 417,000 401(k) plans.

EPL – There were approximately 80,000 Equal Employment Opportunity Commission (EEOC) filings in 2006, only a slight increase from 2005, but the EEOC continues to focus on systemic discrimination (potentially resulting in larger cases).

Risk Management Solutions

Our report focuses on risk management solutions. We examine current and expected marketplace conditions, recent court cases, legislative and regulatory developments, policy terms and conditions, and risk transfer strategies – all with an eye toward the many vectors of risk, their potential to generate boardroom-level events, and the tools you need to manage them while seeking great reward.

We also invite you to access recent, related webcasts and publications via the Willis web site, www.willis.com:

- **Kidnap and Extortion: Best Practices for a World at Risk** (*Webcast July 17*)
  www.willis.com/Extras/Webcasts/2007%20Archive.aspx
- **How Global Has Your Global D&O Program Become?** (*Webcast August 7*)
  www.willis.com/Extras/Webcasts/2007%20Archive.aspx
- **How Global Has Your Global D&O Program Become?** (*Alert Bulletin July 30*)
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Marketplace Realities 2007
& Risk Management Solutions

Directors & Officers Liability
August 2007

Overview

At the five-year mark, Sarbanes-Oxley appears to be doing what it was intended to do: reduce the frequency of significant corporate fraud. In 2006, we saw the lowest number of securities class actions filed in the last decade, and the trend appears to be holding, with 59 companies sued in securities class action lawsuits during the first half of 2007, compared to 53 filings in the second half of 2006.[1] The good news is that while the projections for securities class action filings for the full 2007 year are slightly higher than the 2006 totals, frequency is still *significantly below* historical norms.

There is another side to the loss/claim coin, of course: severity. The numbers on that side of the coin are climbing. Mega claims, those with cash settlements of $100 million or greater, reached an all-time high of 14 in 2006, exceeding the 2005 number by almost a third. In the first six months of this year, there were 10 Directors & Officers (D&O) settlements announced where the cash payout exceeded the $100 million mark; the total settlement dollars for these 10 exceeded $6.5 billion, according to news reports. This includes the recent Tyco settlement of $3 billion, the largest D&O claim settlement of all time. But it is important to note that the size of all D&O claims may also be climbing. Excluding the settlements that exceeded $1 billion, the average settlement in 2006 rose to $45 million, roughly twice the average ($22.6 million) for all post-reform settlements through 2005.[2]

Key Trends and Rulings

Shareholder Derivative Suits and Options Backdating

Shareholder derivative suits (as opposed to security claims) remain on the rise. Over 45 percent of cases settled in 2006 generated a partner derivative action and the severity of derivative claims has increased.[3] Last year, Time Warner and HealthSouth settled derivative actions for $200 million and $100 million, respectively. [See *ER Alert* "Anatomy of a D&O Derivative Claim," March 2005].

Last year was also marked by a flurry of investigations into company options backdating practices. By mid-year 2007, there were 30 securities class actions and 160 shareholder derivative actions based on options backdating, options springloading or hiring-related options timing.[4] Recent settlements of options backdating cases have resulted in "corporate therapeutics," disgorgements and modest plaintiff attorneys' fees, with litigation on the most contentious cases still to come. The backdating class action trend is the first D&O trend to focus primarily on insuring agreement A (or the A-Side) of the D&O insurance contract. We just saw the first full criminal trial over stock-option backdating end in a guilty verdict for the former CEO of Brocade Communications, sending shock waves through those companies awaiting prosecution.

Willis

Subprime Lending

The new hot topic for plaintiffs' law firms has migrated from options backdating to subprime lending. According to an analyst report in the first quarter, underwriters are concerned with potential bankruptcies and the following blame-game that could result in non-indemnifiable claims.[5] There is also speculation that the next wave of A-Side claims could stem from the mortgage market meltdown.

Opt-Out Settlements

Lately some plaintiffs have improved their lot by opting out of class actions and going it alone. In the most notable recent settlement, in *State of Alaska v. Time Warner*, the plaintiff received an usually high settlement ratio: $50 million in recoveries from $60 million in alleged investment losses. Carriers' severity assumptions may begin to be affected by the possibility of opt-out cases dragging on after the main class actions have been settled.

Corporate Indemnification and the Thompson Memorandum

"Although once a well-settled employment practice, access to indemnification and advancement is no longer a foregone conclusion."[6] So Willis reported earlier this year, but is the pendulum swinging back? As mentioned in our *Top 10 Court Awards & Settlements* (January 2007), the courts recently chastised prosecutors for pressuring KPMG to withhold payment of legal fees from 16 former executives. The decision not to extend indemnification was allegedly part of the company's effort to demonstrate that it was truly cooperating with the government's investigation. In response to the growing wave of criticism by the bar and the bench, the Justice Department's original Thompson Memo was superseded by the McNulty Memo, which offered new guidance on judging corporate cooperation and denying executives indemnification. As a result, we have been examining the presumptive indemnification provisions in traditional D&O programs (A+B+C), as well as discussing the benefits of A-Side Difference in Conditions (DIC) coverage. (Watch for our coming *Alert* on A-Side purchasing trends.)

The Supreme Court is Alive and Well

Cases are already beginning to turn on a recent Supreme Court decision resolving a split between lower courts on the requirement that plaintiffs prove that defendants acted with the intent to deceive (*scienter*) in federal securities fraud claims. The Court raised the threshold that plaintiffs must cross in initial pleadings, concluding that an allegation that officials intended to deceive must be "cogent and at least as compelling as any plausible opposing inference one could draw from the facts alleged." Although there are still mixed opinions on the impact of the decision, *Tellabs Inc., et al. vs. Makor Issues & Rights, Ltd., et al.* is expected to increase the early dismissal rates of shareholder suits.

The business community notched another victory this month in *Credit Suisse v. Billing*. Here, the Supreme Court ruled that antitrust laws do not apply to the process of selling new stock after their initial offering on stock markets. The Court's decision that federal securities law preempted the suit was a significant win for investment banks who otherwise would have faced three times the damages in lawsuits brought forth under federal antitrust laws (versus the penalties awardable under securities rules).[7]

Court watchers will stay tuned for the Supreme Court's anticipated 2008 review of *Stoneridge Investment Partners LLC v. Scientific-Atlanta, Inc.*, which squarely puts to the test the theory of scheme liability, i.e., whether third parties, such as investment banks, lawyers, auditors and vendors, can be held liable for fraud committed by companies with which they do business.

Future Outlook: M&A

Merger and acquisition (M&A) activity is expected to remain strong through the second half of 2007 due to the huge war chest available to both private equity and hedge funds. Although securities class actions are declining, the M&A boom is fueling another type of shareholder class action: court fights resulting from public companies going private. These suits are expensive to defend and are often settled fairly quickly to keep deals alive; not a good thing, from the perspective of a D&O carrier.

Marketplace Conditions

D&O Limits and Capacity

The marketplace remains robust, with over $2 billion in global capacity available in the US and international markets. Despite the availability of significant limits, new facilities continue to join an already saturated marketplace, providing insureds numerous options. As reported last year, we continue to experience a strategic deployment of limits by various carriers, with a growing trend toward concentration of limits in A-Side D&O capacity. We also see an abundance of capacity in the excess layers, no doubt attributable to favorable excess rates.

Pricing

Premium levels remain competitive, fueled principally by the abundance of available capacity combined with the decrease in securities class actions and the continuing profitability of US Property/Casualty insurers. These factors set the stage for potential pricing reductions in the 10 to 15 percent range, with greater reductions possible for companies with positive risk differentiation.

The premium price drivers remain constant: industry classification, ownership structures (public vs. private), market capitalization and claims activity. Private companies, perceived by underwriters as having diminished exposures, enjoy the most favorable rates.

Flexibility is also evident in areas that historically have not seen attractive pricing, such as run-off, prior-acts programs and initial public offerings.

Terms and Conditions

In lock step with the favorable rates, D&O carriers continue to demonstrate flexibility with policy terms and conditions. As in years past, several hot button issues predominate. Many items on the hot button list will be familiar, albeit in some cases with new twists.

- Evolution of non-rescindable coverage from the A-Side to the rest of the contract with non-rescindable B and C insuring agreements
- Affirmative coverage for certain Section 11 and 12 claims (Securities Act of 1933)
- Increased scrutiny of excess forms, in part to assure that follow-form excess policies actually do follow the underlying form (*Note:* uniform excess forms are now accepted by most major London carriers, and Bermuda insurers are expected to follow.)

- Heightened awareness of global implications
- Tailored personal conduct exclusions
- Narrowing the imputation of knowledge provision and the definition of *application*
- Focusing on the definition of *claim* and modifying claims reporting triggers
- A new generation of A-Side DIC and primary forms

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[1] *Cornerstone Research Securities Class Action Case Filings 2007 Mid-Year Assessment*
[2] *Cornerstone Research Securities Class Action Settlements 2006 Review and Analysis*
[3] *Cornerstone Research Securities Class Action Settlements 2006 Review and Analysis*
[4] *D&O Diary* (As of June 20, 2007), dandodiary.blogspot.com
[5] *US Equity Research*, Bear Stearns, March 13, 2007
[6] *FINEX ER: A Boardroom Guide 2007*
[7] "High Court Backs Banks in Antitrust Suit on IPOs," *Washington Post*, June 19, 2007

Fiduciary Liability

August 2007

Overview

It seems these days that all eyes – at least all regulatory eyes – are on retirement savings plans. The Securities and Exchange Commission (SEC) is reexamining mutual fund fees and fee disclosures, with an eye to the fact that mutual funds are the number one asset category in 401(k) pension plans. The US Department of Labor has several initiatives that address plan fees and expenses. Congress, too, has been analyzing 401(k) ideas, with more hearings to follow, and state regulatory authorities are actively investigating undisclosed revenue sharing deals that have been found to be part of the mutual fund and variable annuity world.

Perhaps jumping the gun, one law firm made a big splash last year when it filed suit against 10 major employers alleging that their 401(k) fees and fee disclosures were "excessive," "undisclosed," and "illegal." Even with uncertain outcomes, these suits clearly have potentially widespread implications for employers, since approximately 40 million Americans have $2.5 trillion in assets in some 417,000 401(k) plans.[1] The issue of fees and fee disclosure affects more than just the organizations offering 401(k) plans to their employees – it resonates in the world of financial institutions, especially those that service 401(k) plans.

Meanwhile, the fiduciary community is still absorbing the impact of the Pension Protection Act of 2006 (PPA), the most significant change to pension plans since the Employee Retirement Income Security Act (ERISA) of 1974. While the PPA does many things, two are particularly important for this discussion. First, the act significantly changes the funding rules for traditional defined benefit plans. While the goal is funding protection for certain financially challenged industries, this change effectively sets higher funding requirements for the broader base of defined benefit plans. When combined with new Financial Accounting Board requirements on pension accounting, it could mean substantially increased burdens on pension fund sponsors. The second major change is immunity for cash balance plans from allegations of age discrimination. As this protection is not retroactive, however, it is providing little protection for existing plans with ongoing litigation.

The number one driver of Fiduciary Liability premiums and retentions has for some time been ERISA tag-along claims. *ERISA tag-along* is the popular name given to cases brought under ERISA, typically in tandem with a Directors & Officers (D&O) stock-drop securities case. Historically, Fiduciary Liability was a desired class of business for carriers, marked by low retentions and competitive premiums. However, the recent wave of ERISA tag-along claims exposed Fiduciary Liability policyholders to securities-like exposures and litigation. After several renewal cycles of tightened capacity, increased premiums and retentions, along with narrowed coverage, the marketplace for Fiduciary Liability has stabilized. This is due to several factors.

- Over the past few years, carriers have carefully managed capacity, strategically deploying limits between D&O and Fiduciary programs.
- Fiduciary retentions have been increasing. On many large accounts, there is a separate Fiduciary securities claims retention, which often matches the D&O securities claims retention.
- The litigation environment for tag-along claims is (arguably) improving.
- A robust stock market and a decrease in securities class actions have also helped.

New concerns are emerging. Executives and board members who participated in backdating decisions and also act as fiduciaries for the 401(k) plan are now being named in options backdating ERISA lawsuits. The number of ERISA or 401(k) options backdating lawsuits now totals five.[2] Another area of concern is M&A activity, which is expected to remain strong through the second half of 2007. M&A activity is one of the most frequent triggers of ERISA lawsuits. Any reductions or eliminations in benefits or cash balance conversions can increase the likelihood of a suit.

Marketplace Conditions

Limits and Capacity

With increased Fiduciary Liability claims activity over calculated last few years, the prevailing underwriting approach has been one of caution. Many have calculated that such claims activity precludes profitability at *any* level, discouraging new carriers from entering the market.

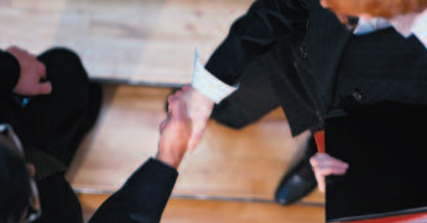
Over the course of the last six months, we have seen a softening of these underwriting views, contributing significantly to a capacity spurt that now exceeds $500 million. As a result, there are more carriers with a risk appetite for primary placements. Previously, the options for primary layers were limited to a few markets and available to only select risks. This additional capacity is also available to spill over into excess placements as well. The result is a more competitive and stable market for Fiduciary Liability then we have seen in several years.

Pricing

With greater capacity comes greater premium flexibility. All indications point to more stable premium levels, and in some cases price competition. Overall, premium renewals are flat or are producing reductions of 10 to 15 percent. In some cases, reductions are even greater.

As is the case with D&O coverage, private companies and nonprofit organizations may realize the greatest premium competitiveness. Public companies will fare well with solid risk fundamentals: no employer securities, no under-funded plans and no ERISA litigation.

Premium savings, however, are not beyond the reach of companies whose plans contain sizable amounts of employer securities and/or significant merger and acquisition activity if underwriters have some cushion by virtue of separate and/or higher retentions.



Terms and Conditions

Buyers will also be pleased with the trend in terms and conditions. A sampling of some key provisions now available in the Fiduciary marketplace includes:

- Non-rescindable coverage for non-indemnifiable claims made available by most insurers (or for the contract as a whole by select markets)
- Broader severability of the application and exclusions
- Priority of payments now routinely granted, although special attention should be paid to the actual wording
- Tailored personal conduct exclusions
- Expanded definitions of *claim* and *plan*
- Choice-of-counsel accommodations
- Side-A derivative pollution coverage
- Tailored notice of claims triggers
- Bordereau reporting for larger insureds

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[1] *Forbes,* December 11, 2006 and *Investment News*, March 12, 2007
[2] *D&O Diary* (As of June 20, 2007), dandodiary.blogspot.com

Marketplace Realities 2007
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Employment Practices Liability
August 2007

Overview

In the typically close match between employers and employees on Employment Practices Liability (EPL) matters, points have recently been scored by both sides in the courts.

Advantage employees: Earlier this year, the Ninth Circuit Court of Appeals ruled in favor of the plaintiffs once again in *Dukes v. Wal-Mart*, upholding a lower court ruling that more than 1.5 million female Wal-Mart employees could join the huge gender discrimination suit. Wal-Mart said it would ask a 15-member panel of the Ninth Circuit Court to review the case rather than the three-judge panel that made the recent ruling in support of the lower court's earlier decision.[1] Given all of the likely appeals, any final decision or settlement can be expected to take years.

Deuce: Employers scored a major victory when class certification was denied in *Guitierrez v. Johnson & Johnson*, where the employer put up a strong defense.

Advantage employers: As discussed in our May Newsletter, a pro-employer ruling was handed down in *Ledbetter v. Goodyear Tire & Rubber Co*. The Supreme Court held that a former employee could not sue the company for the cumulative effect of paying her less than it paid men in the same position.This ruling potentially provides critical protection to employers against discrimination for past events.

Future tiebreaker? Court watchers and large companies across the nation will stay tuned for the Supreme Court's review of a Denver federal appeals court decision in *Sprint/United Management Company v. Mendelsohn*, determining how a claim of discrimination can be proved and the extent to which seemingly unrelated evidence can be introduced.

Otherwise, the EPL world has been marked by some noteworthy trends:

- There were approximately 80,000 Equal Employment Opportunity Commission (EEOC) filings in 2006, only a slight increase from 2005, but the EEOC continues to focus on systemic discrimination (potentially resulting in larger cases).There has been an increase in the frequency of retaliation cases as a result of the Supreme Court's decision in *Burlington Northern v. White*, which permits actions where the alleged retaliation is non-pecuniary in nature.
- E-discovery is still an evolving issue. Plaintiffs' attorneys could potentially use costly e-discovery requirements as leverage for early settlements.

Legislative Activity: ENDA

Pending is the Employment Non-Discrimination Act (ENDA), a federal bill that would prohibit discrimination against employees on the basis of sexual orientation or gender identity. Currently, federal law provides legal protection against employment discrimination on the basis of race, gender, religion, national origin and disability, but not sexual orientation or gender identity. It is unclear who would fall under ENDA's protection and what would be required of employers. It is also too early to tell how carriers would react if the current bill is passed, but we may see endorsements excluding compliance costs.

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EPL Limits and Capacity

Over the last six months, we have seen the continued resurgence of EPL capacity in both the international and domestic marketplaces – even for large multinational companies. This current momentum can take some by surprise, following as it does the limits reduction strategy of last year by a prominent Bermuda insurer. Today, we have a new catastrophic coverage facility in Bermuda with up to $100 million available in a block for a single risk, as well as significant blocks of limits of $50 million, for select risks. The new capacity increases the total limits available to well over $300 million.

On the US domestic front, capacity remains ample as new underwriters with a penchant for building an EPL portfolio have demonstrated renewed interest in the product line. These markets, along with long-standing EPL insurers, are providing buyers in most industry segments with a wealth of options.

In the private, nonprofit, and small to medium-sized account sector, the news is especially good: an abundance of capacity, rate competitiveness and broadening of coverage. (See the Directors & Officers Liability section of this report, as these companies often purchase their EPL coverage in a package with their D&O insurance).

Pricing

Most insureds are no doubt reaping the benefits of this dynamic marketplace as most carriers, eager for portfolio expansion, offer competitive premiums on primary as well excess layers (reflected in reduced excess limits factors, or the cost of the excess/additional layers of coverage). Premium reductions, however, have not been as pronounced for large financial institutions, which may still experience some pricing challenges due to claims activity. Relatively claims-free companies, demonstrating sound employment policies, may see premium reductions in the 10 to 15 percent range and in some cases more, depending on risk differentiation and retention levels.

Again, for privately held, small to medium-sized companies, pricing, limits and terms and conditions are highly negotiable, with a long list of qualified carriers competing for this business.

Terms and Conditions

More than any time in recent memory, the breadth of coverage under most EPL policies – whether underwritten in the domestic or international marketplaces – continues to expand. In light of underwriter flexibility, the following policy provisions may be negotiated:

- Early claim reporting incentives (providing insureds with a limited decrease on their deductible if insureds report a claim within a certain number of business days of the claim being made)
- Greater flexibility with duty-to-defend provisions
- Greater flexibility with insured's choice of counsel and in select cases, the elimination of the requirement for insureds to choose counsel from a list presented by the carrier
- Third-party coverage granted *without a questionnaire*
- Expanded wording on whistleblower claims
- Improved severability of the application
- Non-rescindable, non-indemnifiable claims extensions
- Split retentions for international exposures

- For small and medium-sized employers: wage and hour coverage (now more freely available on a sublimited and defense costs-only basis)
- Defense outside the limit of liability (for small private companies)

Minority and sensitivity training coverage extensions, previously a Bermuda-only feature, are now available for select accounts in the US marketplace.

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[1] "Wal-Mart to Fight Ruling in Suit," *Wall Street Journal*, February 7, 2007

Marketplace Realities 2007
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E&O / Cyber Risks
August 2007

Overview

Since the November 2006 edition of *Marketplace Realities 2007*, the epidemic of security breaches involving private information has not abated. In fact, during the intervening period, more than 240 reported breaches exposed personal data files (some with sensitive information about dependants or medical history) on nearly 60 million individuals, according to the Privacy Rights Clearinghouse. Intensified focus on privacy at all levels – company management, regulators, consumers, legislatures, credit card issuers, the security community and insurance underwriters – has apparently not reversed the incidence of chronic information security failures at companies both small and large, vulnerable and well defended.

Risk management focus on information privacy has been sharpened further by a much publicized retailer data breach and the mounting costs it is generating. Notable is not only the projected loss amount but also the range of exposures triggered, including defense costs for more than 20 class actions, costs to comply with various state security breach notification laws, investigation and public relations expenses, regulatory defense costs, claims by credit card issuers for costs to reissue cards and claims by merchants for fraud, business interruption and extra expense. The incident has shown what many in the risk management, security and underwriting communities have known for some time:

- Security breaches can be extensive – as many as 46 million individuals could be affected by this single retailer incident.
- Incidents can cause significant financial loss – media reports estimate the loss at between $100 million and $300 million.

Companies in all industry segments and professional firms that directly (or indirectly through outsourced service providers) hold or process personally identifiable information are looking at Cyber Risk insurance as a necessary part of a well designed insurance and risk management program. Consequently, purchase of Cyber Risk coverage is up significantly from our last report, as are the limits being considered.

Additional Exposure
Three recent developments are significant for their potential to increase liability.

- **State Security Breach Notification Laws –** At least 37 states have enacted (or are expected to enact by the end of the year) laws requiring companies to notify consumers of security breaches in which certain personal information about those consumers may have been acquired by an unauthorized person. Details of these state notification requirements vary widely.
- **Merchant Liability for Security Breaches –** On May 21, 2007, Minnesota enacted the Plastic Card Security Act and became the first state to pass a payment or credit card breach law. The Minnesota law enables financial institutions to file lawsuits to recover costs associated with a merchant security breach that exposes payment card data. California, Massachusetts, Illinois, Connecticut and Texas are considering similar laws. Now there is a direct path to merchant liability for expenses such as the cost to reissue credit cards – estimated at $20 to $50 per card. Given the fact that a breach can expose tens of thousands or even millions of cards, the financial consequences are potentially catastrophic.

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- **Increased Exposure under HIPAA –** In December 2006, a North Carolina Court of Appeals increased the exposure under the Health Insurance Portability and Accountability Act (HIPAA) when it found in *Acosta v. Faber* that a violation of the duties owed under HIPAA constituted a negligent act, thereby enabling private parties to bring negligence actions based on a HIPAA violation *even though HIPAA itself creates no private right of action*.

Marketplace Conditions

The list of key sources for Cyber Risk coverage remains unchanged: ACE, AIG, Arch, AXIS (Media/Pro), Beazley, CNA, Chubb, Darwin, Hudson (Euclid Managers), Hiscox and St Paul/Travelers. The policies, however, are expanding. Many Cyber Risk insurers now offer broad protection for liabilities arising from the loss of personally identifiable information (data privacy protection) and confidential corporate information. Many policies now cover costs for security breach notification, public relations expenses and regulatory defense. The mark insurers are approaching is the protection of such information anywhere: on the insured's network, off-line in paper form, with outsourced service providers or in mobile devices such as laptops and portable memory drives. Insurers that have lagged behind in offering first-party coverage (business interruption or extra expense caused by a computer attack on the insured's network) are adding the coverage to their forms.

Available capacity continues to range from $150 million to $250 million. Companies seeking catastrophe-level coverage should find the market capable of meeting their needs.

Pricing remains very competitive for companies with demonstrably strong information security risk management policies and procedures. Despite the losses borne by these insurers over the past six to eight months, pricing is generally down from a year ago, while coverage has expanded. Appetite varies by industry sector, with some insurers avoiding healthcare or financial institutions.

Suggestions for Risk Managers

As exposures increase and documented losses mount, risk managers would be well served to address any weaknesses in their current Cyber Risk coverage. Collaboration with IT departments to define exposure and the assessment of the practical limits on risk management controls are key parts of this process. While the Cyber Risk insurance market is maturing in terms of the underwriting process and appears to be offering more common terms and conditions, a substantial difference remains in various policy wordings. These need careful analysis, interpretation and customization.

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Marketplace Realities 2007
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Fidelity

August 2007

The most significant news in Fidelity has to do with changes in the requirements of the Employee Retirement Income Security Act (ERISA). These changes have modified the minimum Fidelity Bond limits for those companies funding their pension and welfare benefit plans with employer securities. In such instances, the minimum bond limit is now 10 percent of plan assets or $1,000,000, whichever is less. The previous limit was $500,000. While most clients will find that their existing comprehensive Crime programs or Financial Institution Bond limits already meet the new requirements, those who are underinsured will need to increase their existing limits when the law goes into effect on December 31, 2007.

Marketplace Conditions

Limits and Capacity

The overall capacity of the Fidelity market has changed little since the start of 2007. The combined capacity of Lloyd's and the domestic markets continues to hover around $320 million. The marketplace includes several recent entrants, notably Hanover Insurance Group and RVI. Lloyd's not only remains a solid alternative to the US market, particularly for larger financial institutions, but also continues to make inroads in the Commercial Crime area as well. Lloyd's markets could likely offer a total capacity of $130 million in limits. Swiss Re, with $50 million in excess capacity for financial institutions, remains conservative in pricing, but underwriters will now consider an attachment point of $25 million.

Bermuda has recently entered the Fidelity market as well, with $50 million in excess capacity. The Bermuda market seems a bit conservative in its pricing relative to the US and London markets on excess layers; however, we expect this will change as their book begins to grow.

Although the market capacity remains strong for large commercial and Fortune 1000 primary placements, the number of carriers willing to take a primary position on Fortune 500 accounts, large regional financial institutions and money center banks drops off significantly, leaving four or five leading markets.

Pricing

The significant market capacity for mid-sized Commercial Crime policies translates into some aggressive competition between carriers, often resulting in premium reductions in excess of 10 percent, particularly for accounts that were not actively marketed in recent years. While Fortune 500 and financial institution accounts do not generate the same competition, the current soft market should result in premium reductions. The greatest reductions are likely to be found on excess layers where loss experience continues to be quite good.

Willis

Terms and Conditions

In the Commercial Crime arena, we have seen no substantive changes to the breadth of coverage that markets are willing to offer. Clients should still be cognizant of the need to add Client Property coverage where appropriate and be sure that any attempt by underwriters to apply a sublimit does not leave policyholders underinsured. Furthermore, more markets (including some of the more historically conservative ones) are becoming comfortable offering Discovery contracts in place of the standard Loss Sustained Form. The opportunity to convert to a discovery contract improves significantly when the insured has not had any substantive changes in limits and/or the account has maintained a long-term relationship with the carrier.

As in the Commercial Crime market, the breadth of coverage afforded by the Financial Institution Bond market has not materially changed since the beginning of the year. One area of continued concern, however, involves extending coverage to outside agents. The limited capability of carriers to underwrite this exposure and the significant losses sustained by the market when extending coverage continue to be problematic for many underwriters.

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