Insurance Times**:** D&O struggling to recover after Enron, WTC

Adequate pricing, higher retentions cited by panelists at PLUS D&O Liability Symposium

June 25, 2002, Vol. XXI No. 13

NEW YORK — Enron, the World Trade Center attack, and other recent disasters have made directors and officers liability one of the worst performing lines of insurance in 2000 and 2001. It is only through adequate pricing, higher retentions and improved management behavior that the D&O line will recover, panelists told the PLUS D&O Liability & Insurance Issues Symposium.

Enron proved many insurers weren't tracking their exposure, according to Lance Dalzell-Piper, underwriting director for Faraday, a broker focused, London market insurance/reinsurance operation. "Multi-lines still have a place, but we lost sight of it in a soft market," he said. "As brokers, we looked to find premiums at an average, but started putting more coverage in one market in more than one year. We must find better ways to align insurance through the use of co-insurance instead of allocation. It's a relatively new solution to get clients back in line."

But co-insurance in itself is not going to solve the problem, according to Dalzell-Piper.

"There needs to be a shift in the way we talk about this insurance. We're not just talking co-insurance but retentions in the 8 or 9 figures. Those are the kinds of changes that need to take place," he said. Dalzell-Piper said underwriters lost control of these specific areas. "We've got to get back to pricing appropriately."

Examining prevalent loss trends, Peter W. Wilson, executive vice president of Global Specialty Lines for CNA, noted that Enron is a valuable lesson to the industry.

"You better know what your tolerance for risk is," he said. "Ravaged by Enron and the WTC disaster, D&O is the worst performing line in 2000 and 2001."

According to Greg Flood, COO of National Union Fire Company, companies have to start looking at behavior. "You have to look at co-insurance and retention more closely," he said. "You have to defend cases more diligently; make a stand against a case otherwise someone's going to end up paying for it."

"We're not sure where the next Enron will come from, where the next earthquake will strike, we can't know. You have to price significantly higher to pay for that risk," said John Kuhn, president of the Financial Insurance Solutions (FIS) division of Kemper Insurance.

"Next year, we will find accountants cracking down on their clients."

Going forward, there needs to be a reasonable market for D&O, according to David McElroy, senior vice president of Hartford Specialty, a subsidiary of The Hartford Financial Services Group, Inc.

"There are different sections in the D&O market that need to be underwritten differently," he cautioned. "The retentions we talk about with Fortune 500 companies may not apply with technical businesses."

Looking at how the industry drives behavior, McElroy noted that "companies are going to fight as vigorously as you want them to. We are living in a world where market caps and trading programs exist. Our job is to find out which ones we can take a chance on for profitability."

Companies such as Enron and Tyco have taught our industry a lesson, said Anthony Giacco, senior vice president at Executive Liability Underwriters. He noted that the new SEC commissioners know what is at stake. "Declaring bankruptcy because of accounting procedures means things are going to have to change," he said.

"People will be spending more time scrutinizing prospectuses and the most vigilant talent will be auditing and sitting on these boards," he said, adding, "Congress will push aggressively that accounting measures are up to speed."

Ralph Jones, president and CEO at Chubb & Son, noted that because of rate changing, 2002 will be a tough year.

“In 1997 we did away with allocation. Now we’re seeing settlement value and claims value going up,” he said.

“As an industry, we had false hopes of security reform and we didn’t push for prices. We had inadequate pricing that locked us in for three years. It’s hard enough to price for one year, let alone three years.”

Jones alluded to the 1997-98 years as the “perfect storm”, where the market, insurance and reinsurance all contributed to the downfall. “We had a blind eye and there was a false sense of complacency,” he explained, adding,

“Fundamentally, we need a change. Notwithstanding price changes, the product has more value than ever. We need to underwrite and price properly.”

Wilson noted that as a result of Enron, future claims handling has to be different. “Years ago in a soft market there was a bundling of everything together,” he explained.

“Risks were not correlated appropriately to bundle together. Products such as D&O, fiduciary, etc., were all put together under the guise of ease of administration. This was not a terribly bright thing to do.”

While there are certain coverages that can be bundled under a single cover, Enron clearly highlights that it’s all about protecting the individual, according to Wilson.

“What we’ve done is dilute a product that is now not responsive. The hard market will unbundled these products, but it’s likely that when a soft market returns, people won’t learn their lessons and will start to rebundle.”

The panel was moderated by Christopher J. Cavallaro, RPLU, ARC Excess & Surplus, LLC.