D&O underwriters urged to move Fortune 500 to higher retentions, co-insurance

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Higher risk retentions, a move toward co-insurance, tougher laws and greater integrity of directors and officers are necessary to keep the Director and Officers (D&O) liability market viable for Fortune 500 companies, senior executives told the Professional Liability Underwriting Society (PLUS), D&O Symposium.

Underwriting Fortune 500 businesses is getting more and more difficult, according to Robert Cox, senior vice president, Chubb Specialty Insurance.

"Today, these companies are highly visible and the probability of loss is extremely high," he said. "There isn't a whole lot of risk to spread. They will always be big targets of plaintiffs' attorneys. In the past, we have underwritten a name rather than underwriting the risk. We've got to do a better job than that."

Offsetting a Fortune 500's book of business is a key point, said Thomas L. Gamble, executive vice president, ARCH Capital Group. "We need to be asking questions and getting answers. We need to be more detailed in the analysis, have higher retentions, move toward co-insurance and pre-allocation, and then we will have a better chance."

While the industry has gotten smarter at controlling limits, Peter Wilson, president and COO, CNA Global Specialty Underwriting, noted that it depends on each carrier's willingness to accept the volatility. "There are techniques underwriters can use today on these companies; clues to help them determine where the problems lie," he said.

"Loss costs are going up and best efforts are going out – and that has got to change," said John A. Kuhn, president/FIS, Kemper Insurance Companies. "The insurance industry must deal with D&O's sins of the past."

What hurt insurers most was extending coverages, said Michael D. Pierce, president – Executive Liability, Great American Insurance Company. "We started going with three-year coverages."

Whether failure of the law or corporate greed, everybody missed the boat or looked the other way, said Cox. Wall Street missed it. Even D&O underwriters missed it.

"Rounding errors has been a big problem," he said. "This only happens in a rising economy. An economic bull market combined with greed is ripe for D&O's set up for a fall."

According to Greg Flood, COO, National Union Fire Insurance Co., whole price earnings and stock options pushed companies to the edge.

"We insure the frailty of human nature," he said. "You've got rock star CEOs who are getting unbelievable options, so some D&O writers felt, if CEOs have all these perks, why can't I get an extra buck?"

Citing a Cornerstone Research study, John A. Rafferty, vice president, Hartford Financial Products, said that prior to the passage of the Private Securities Litigation Reform Act (Reform Act), average securities lawsuit settlements were $7.8 million; post Reform Act they were $24.9 million.

Securities Lawsuit

"Maximum securities lawsuit settlements pre Reform Act were $67.5 million. Post Reform Act they were $3.19 billion."

Flood said that it will take years for companies to dig themselves out of the mess. "All of us have to come to the realization that these costs are a permanent part of doing business."

Cox noted that prices continue to move up from loss experience. "We still have a tremendous amount of issues floating throughout the system we won't be able to address through price increases alone."

Reviewing the Sarbanes-Oxley Act, senior executives said it wouldn't solve all the problems with directors and officers litigation and liability exposure for insurers, but it would force directors and officers to be more focused to do the right thing. Cox said that while the Act gives the Securities and Exchange Commission (SEC) new powers to bring a variety of new administrative and criminal actions against directors and officers, increasing litigation costs and complexities, insurers shouldn't be lulled into complacency.

"It may dissuade some bad behavior in corporate America, but some bad people find ways around legislation and plaintiffs' attorneys will also find ways to get around it."

Rafferty noted that meaningful fines and jail sentences are the two most powerful tools to use to keep this behavior in check.

Gamble added that boards of directors need to operate in a team environment.

"There must be confidence and integrity in upper management and if there are problems, it is incumbent upon them to make a change," he said. "With Enron and Tyco, were the directors and officers asking the right questions? Everyone must be held to a standard."

The panel was moderated by Michael Cavallaro, RPLU, broker, ARC Express and Surplus, Professional Risk Facilities, Inc. ❐