

Louise Pennington and Tara Cummins

Aftershocks

In September 2008, the subprime credit meltdown began to significantly impact American International Group (AIG), a prominent player in the professional liability insurance marketplace. In November 2008, the U.S. government extended credit to AIG, along with an equity stake of nearly 80%, to assist the company through the credit crisis. As AIG prepares to post 2008 earnings, the insurer is now seeking to renegotiate its bailout terms and, in particular, the repayment provisions. Heavy losses for the company are anticipated.

Other insurers have also felt, and continue to experience, significant financial impact as downgrades and losses to investment portfolios take their toll. This scenario is not exclusive to the insurance industry. No industry seems immune to the global recession. As such, the import of true risk management, be it through risk transfer or otherwise, is of tantamount importance for all companies.

Policyholder perspectives of the market turbulence and their reactions to it have varied, ranging from immediate requests for alternative quotes both on mid-term and renewal business, to vigorous advocacy by seasoned risk managers wishing to continue relationships with incumbent insurers and discourage movement.

It is natural that the market will bear a wide range of client reactions. Because each client's risk profile and loss experience is unique, perspectives will differ. And when the coverage is Directors & Officers Liability insurance, the issue of "certainty" and "stability" rings much closer to home. It is for this reason that many risk managers may wonder if a confrontation with the C-suite and the Board, in order to maintain historic relationships, is "worth the fight" when alternatives may be readily available.

The most fundamental concern for all insureds, especially during economic tumult, is the assurance that the policy will be there to protect them when it is called upon to do so. Accordingly, constant and consistent due diligence and monitoring of the financial strength of each insurer that participates on an insured's insurance program is as critical as being aware of the alternatives.

Preparation

As the turbulent economy continues, insureds must spend risk dollars wisely. Healthy competition in the insurance marketplace creates an opportunity for clients to optimize policy premiums, terms and conditions. In appropriate circumstances, getting alternative bids to an insurance program may be prudent as it can foster competition, which may yield both premium and contract benefits to a client.

Now more than ever, however, clients must carefully consider the potential adverse effects of changing insurers, particularly in instances where a longstanding relationship between the insured and the insurer exists. Any new program participants must be reviewed with steadfast diligence, particularly in instances

where the insured is experiencing litigation or other claims activity. It is important to examine contractual language and, in particular, to scrutinize policy provisions relative to warranty statements, prior and pending litigation exclusions, or other policy provisions that could impair claims. Ultimately, the potential immediate benefits from premium savings and coverage enhancements must be balanced against the possible compromise of policy proceeds.

In order to combat the concerns that may arise directly from the Board and others in the C-suite, it is important to be armed with answers to the following questions:

- How are insurers' reserves posted and are they adequate?
- In the case of insolvency, will the insurer be able to pay claims?
- What recourse is available to policy holders in the event of a solvency issue at an insurer from the State Insurance agencies?
- What coverage is in force within the company's D&O program to protect the directors and officers in the event an insurer faces solvency issues?
- What happens if an insurance company sells its "renewal rights" to another company?
- What recourse is available to the insured in the event an insurance company is downgraded by A.M. Best, S&P, Moody's or others?
- What alternatives are available in the event that a company demands a mid-term change and what penalties, if any, may be imposed?

Being prepared with the answers to these questions and others related to financial turmoil offers a risk management professional the opportunity to be proactive in their assessment of the markets and reasoned in their decision making. In a rapidly shifting environment, quelling the concerns of each and every company's constituents is challenging—and a good offense is the best defense. By appreciating these concerns and other aspects of reserves, solvency, ratings and mid-program changes, and preparing for board inquiry and possible market events, risk managers will be best positioned to manage issues if they should arise.

Volatility

The soft arm of the current bifurcated D&O insurance market is partially attributable to adequate capacity. While premium rates for troubled financial institution clients are going up, there has not been a reduction in total insurance capacity to date for commercial risks. Recent downgrades and the current volatility in the insurance marketplace do raise a specter of questions, such as: will the need by insurance companies to maintain and retain their clients cause further downward pressure and premium erosion? Or will the inability or unwillingness of some insurers to continue to carry the going-forward exposures related to the recent financial crisis cause a contraction in the marketplace, and thus an inevitable hardening to both commercial and financial institution clients alike? With so many simultaneous events unfolding at such a rapid pace, it is too early to make predictions. What is clear is the potential size of recovery demands and number of filings of actions (be they class actions, regulatory or otherwise) may hit historic highs in 2009 which will ultimately have an impact upon the marketplace in the not too distant future.

Certainty

Underwriters are approaching their review of each and every insureds' risk with greater scrutiny. Some examples of the changes in their underwriting focus include closer reviews of company debt and investment portfolios, related lending flexibility and access to capital, as well as stock plan flexibility for a company's employee base. As the global economic crisis continues to unfold, it is certain that underwriters will become even more rigorous in their underwriting protocols than in the past. Businesses must, therefore, have a comprehensive and consistent risk management strategy and philosophy in place to be able to proactively take control over its exposures. This involves the review and possible revision of a company's current risk profile, so as to distinguish itself from others who may be similar in size or specialty but not in financial stability or management. Now more than ever, illuminating one's uniqueness as a company is imperative to the success of a renewal.

Louise Pennington is a Managing Principal with the Management Risk Practice in New York. An attorney by background, she specializes as a broker in D&O liability and insurance, securities litigation and professional liability issues.

Tara Cummins is a Senior Associate and Knowledge Manager for Integro. An attorney by background, she is located in the New York office.

About Integro

Integro is an insurance brokerage and risk management firm dedicated to serving the insurance and risk management needs of complex institutional risks. Integro has offices across North America, as well as in Bermuda and London. Its U.S. operations are headquartered at 1 State Street Plaza, 9th Floor, New York, NY 10004. Call 877-688-8701 and visit www.integrogroup.com.

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