Finding Serenity: Thoughtful Risk Management in Turbulent Times

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By Louise Pennington and Tara Cummins

Aftershocks

In September 2008, the subprime credit meltdown significantly impacted American International Group (AIG), a prominent player in the professional liability insurance marketplace. The situation culminated with an extension of $85 billion in potential credit from the government, as well as the appointment of Edward Liddy as AIG's Chief Executive Officer. It was reported that as of October 3rd, $61 billion of the original $85 billion has been drawn down. On October 9th, public reports noted that over $37 billion in "additional liquidity" was being provided to AIG's insurance subsidiaries. In the short term, AIG will be selling portions of the company and determining how the remaining AIG entities will be shaped for the future.

Other insurers have felt, and continue to experience, significant financial impact as downgrades and losses to investment portfolios take their toll. Some of these insurers are also "household" names, such as The Hartford, XL Capital, MetLife, and many others.

Policyholder perspectives of the market turbulence and their reactions 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 Board itself 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 also important to be armed with answers to the following questions:

- How are the insurer's 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 yet 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. The subprime reduction of available credit has not significantly decreased professional liability insurance capacity to date for commercial risks (although for financial institutions the market is hardening). 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.

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. And as we enter the next chapter of the credit crisis, underwriters will become even more rigorous in their underwriting protocols than in the past. Businesses must, therefore, have a comprehensive risk marketing strategy in place to advantageously renew or revise their current risk profile and distinguish themselves 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.

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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 headquarter office is located at One State Street, 9th Floor, New York, NY 10004. Call 877-688-8701 and visit www.integrogroup.com.

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