

Professional Liability/Errors & Omissions Insurance Industry Update

Every company provides goods, services or some combination of the two. Every business, therefore, has a potential exposure to products liability or professional liability, or some combination thereof. If either of these exposures is *uninsured* or *underinsured*, the result can be a damaging Directors & Officers (D&O) liability claim for breaches of fiduciary duty – failure to manage, failure to supervise, etc. – against the company's executives.

On the theory that most firms don't want to bet the farm on such claims, we devote this *Alert* to measuring the pulse of today's E&O insurance marketplace. (**Note:** For the distinct E&O issues of industries such as healthcare, construction and financial institutions, as well as for cyber liabilities, please consult our specialty practices or refer to the appropriate chapter in our 2005 *Marketplace Realities and Risk Management Solutions*, available on www.willis.com.)

Money Talks – Pricing and Self-Insured Retentions.

Following several years of rate increases, pressure from increased marketplace competition generally stabilized premiums in 2004. Last year, overall E&O pricing ranged from a decrease of 10 percent to an increase of 20 percent against the previous year. Our expectation for 2005 is that rates will continue to stabilize in most market segments, with some major exceptions discussed below in what are viewed as *high risk* areas. For those with high increased limits factors, or excess pricing levels, there may still be some price decreases available in the coming year. However, most markets are maintaining healthy retentions in an effort to sustain stability. As always, rates and terms vary to reflect industry and individual risk profiles.

Exposure. E&O insurance observers do not expect tort reform in the US to provide immediate, measurable relief from the current tide of E&O claims. One exception to this rule will be the transfer of cases into federal court in certain state jurisdictions (Louisiana, for example)

considered problematic by carriers. In underwriting, E&O carriers have always required a real understanding of and appreciation for a company's operational exposures, and this is unlikely to change. Across all professional segments, carriers report aggressive litigation from plaintiffs, often on matters that seem to strain credibility. It is not clear whether these cases are purely economically driven or are a reflection of an increasingly organized plaintiffs' bar. What does seem certain is that this trend is unlikely to be reversed anytime soon.

A Little T&C. There was some broadening in coverage terms and conditions in 2004 which we believe will continue through 2005. Perhaps the most heartening news is that there have been intimations in the London market that multiyear policies, long out of sight, may become commercially available again, at least for middle-market companies. That said, the Professional Liability/E&O marketplace is expected to remain quite diverse.

Lawyers. This class continues to be a challenge with a number of buyers experiencing an overflow of claims stemming from recent corporate financial debacles and regulatory enforcement proceedings. For firms of all sizes, claims are increasing in frequency and severity. Particularly hard hit are firms that specialize in intellectual property, securities (specifically corporate governance/Sarbanes-Oxley requirements), class action and mass tort. A highly specialized field, this market is currently in a state of disequilibrium with many buyers seeking more coverage at "reasonable" pricing, while insurers are often seeking to restrain or limit coverage at higher price levels on their more challenging accounts.

Along with areas of specialization, firm size is a key pricing determinant. Law firms fall into three categories. The most complex and problematic segment is the AmLaw 250 firms those with as many as 3,100 and no fewer than 140

attorneys. The middle market segment includes firms with 35 to 139 attorneys. The largest segment includes firms with fewer than 35 attorneys. Domestic carriers tend to dominate the small and middle market segments. Larger firms are more likely to combine both domestic and London markets in their placements, with London syndicates currently writing at least a portion of the program for 75 percent of the top AmLaw 250 firms.

During 2004, law firms experienced premium increases of up to 15 percent, with increases largely dependent on claims activity and geographic location. In 2005, firms may experience flat renewals or pricing decreases of up to five percent.

Accountants and Actuaries. Like lawyers, accountants and actuaries in the Professional Liability market continue to experience a contraction in coverage with narrower terms available at higher prices and at higher attachment points. More and more large firms are considering captives, at least for their self-insured retentions (see below).

Miscellaneous E&O. Insurers offer a variety of products ranging from miscellaneous coverage to policies focused on specific professions. Under a single E&O form, some carriers may insure up to 100 different professions against a broad range of Professional Liability exposures. Another approach is to distinguish between public and private companies, with the private company miscellaneous liability policy potentially providing the broadest coverage. In all cases, the description of covered services dictates the breadth of coverage provided.

Alternatives to E&O Coverage. There are two traditional alternatives to E&O coverage. The first is to simply transfer the exposure to a captive insurance company. This can be a successful strategy for those companies with a superior understanding of their exposures and whose risks are static (known and predictable). The key question then becomes whether this is satisfactory to clients who may contractually require the firm to maintain Professional Liability insurance. The final critical issue is how to capitalize those obligations transferred to the captive with reinsurance or with one's own cash flow?

The second alternative is to rely on indemnity and hold-harmless agreements from clients. There is no doubt that well-drafted exculpatory agreements can help protect companies against negligence claims. Even if such agreements are acceptable to clients and company stakeholders, they should not be viewed as providing complete immunity. Those afraid of fire employ fire doors and sprinklers as well as fire insurance; in addressing Professional Liability exposures, companies should consider

implementing hold-harmless provisions while also transferring the risk through a traditional insurance product or a captive.

The E&O Marketplace – Geography. While local markets can generally be accessed, London and the US remain the major centers for Professional Liability insurance and companies with risks of all sizes can readily access both. For US risks, the numbers speak for themselves: the Lloyd's share of the US E&O market now stands at 35 percent.

Executive Risks Regional Contacts

For further information, please contact any of the following:

Paul Wendler
One Glenlake
1 Glenlake Parkway, 11th floor
Atlanta, GA 30328
P- 404 224 5123
F- 404 229 4849
paul.wendler@willis.com

Steve Pincus
7 Hanover Square
7th Floor
New York, NY 10004
P- 212 837 0734
F- 212 509 4912
steve.pincus@willis.com

Tom Ciano
Three Copley Place
Suite 300
Boston, MA 02116
P- 617 351 7517
F- 617 351 7430
tom.ciano@willis.com

Todd Jones
5 Corporate Center
100 Matsonford Road
Radnor, PA 19087
P- 610 254 7284
F- 610 254 5600
todd.jones@willis.com

Brian Gauen
10 South LaSalle Street
Suite 3000
Chicago, IL 60603
P- 312 621 4855
F- 312 621 6870
brian.gauen@willis.com

Brenda Shelly
One Bush Street
San Francisco, CA 94104
P 415 291 1520
F- 415 398 4986
brenda.shelly@willis.com

Dan Vecchio
10 South LaSalle Street
Suite 3000
Chicago, IL 60603
P- 312 621 4799
F- 312 621 6870
dan.vecchio@willis.com

Guy Dodson
One Camomile Street
London EC3A 7LA
United Kingdom
P +44 (0) 20 7975 2800
F +44 (0) 20 7975 2584
dobsong@willis.com

Jim Iacino
1400 16th Street
Suite 400
Denver, CO 80202
P- 720 932 8203
F- 720 932 8138
jim.iacino@willis.com