

# **Reserving for D&O Liability**

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## Defining D&O

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- Directors & Officers Liability
  - A. Personal coverage
  - B. Corporate reimbursement coverage
  - C. Entity coverage
- Employment practices liability
- Fiduciary liability

## 2002 D&O Liability Survey

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- Survey of claim and purchasing patterns
- Reflects market in second half of 2002
- 2187 US participants
  - 44% - 500 or more shareholders
  - 42% - under 500 shareholders
  - 14% - not for profit
- Annual update of survey that began over 20 years ago

# Drivers of D&O Performance

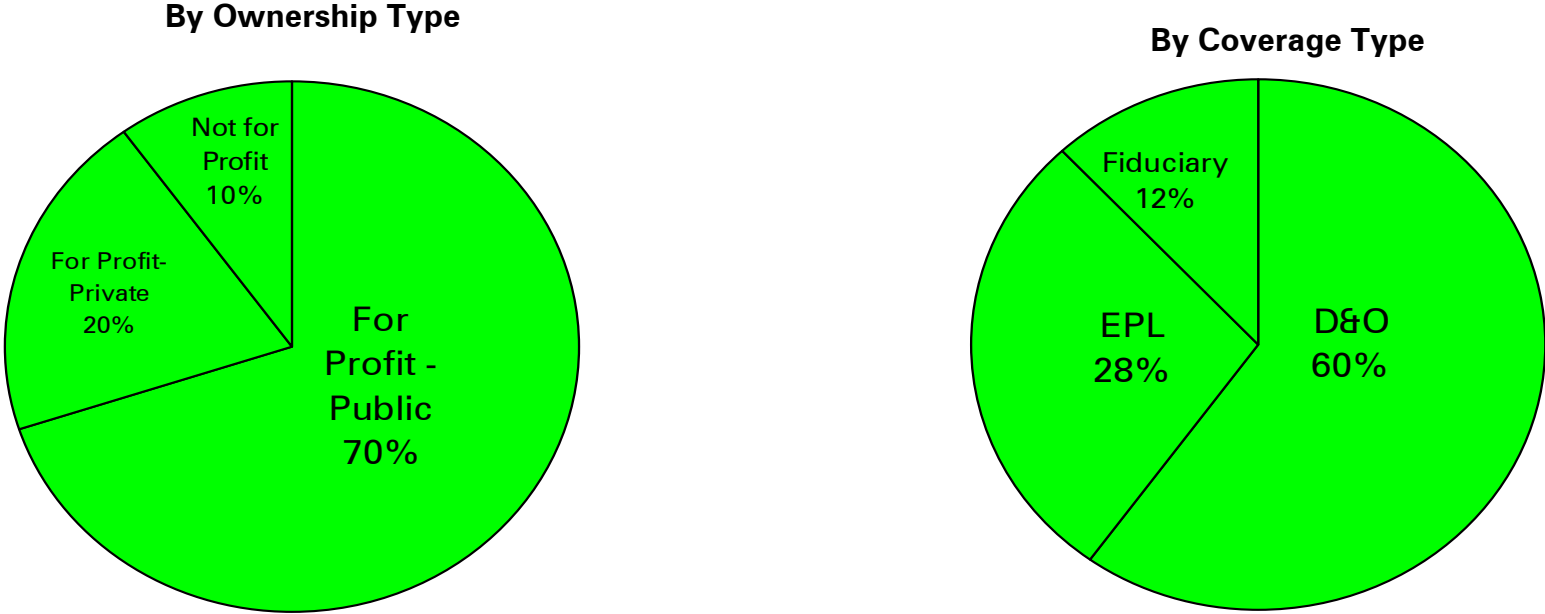
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- Legislation, SEC regulations and court rulings
  - Impact of Private Securities Litigation Reform Act of 1995 (“PSLRA”)
  - Sarbanes-Oxley, SEC certification requirement (2002)
- Changes in loss costs
  - Frequency of class actions
  - Timing and severity of securities claims
  - EPL trends
- Insured type or behavior
  - M&A or IPO activity
  - Rating downgrades
  - Restatement of financial results
- Pricing trends
- Economic conditions
  - Bankruptcies, layoffs, stock market decline

# Public insureds represent the largest share of the market

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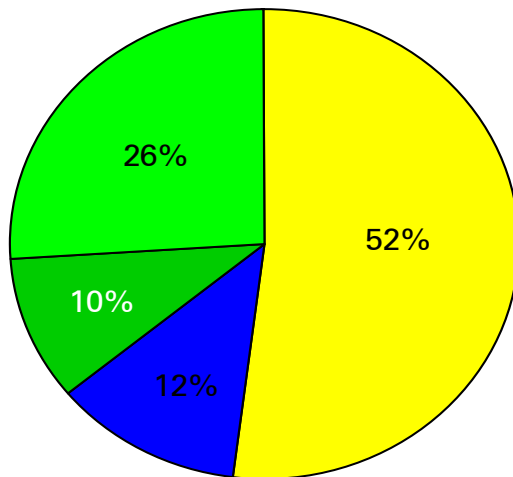
Estimated 2002 Distribution of Premium by Segment



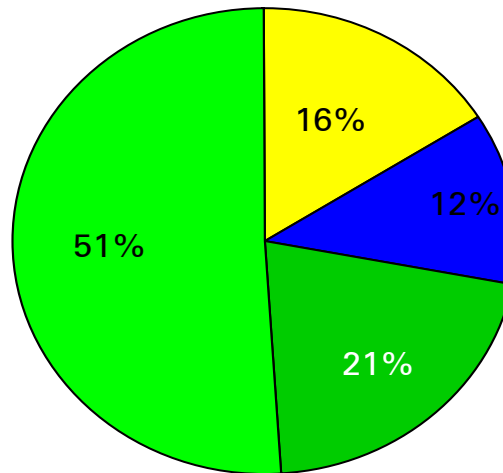
Source: 2002 Tillinghast D&O Survey, Tillinghast estimates.

# Claimant distribution varies significantly by ownership type

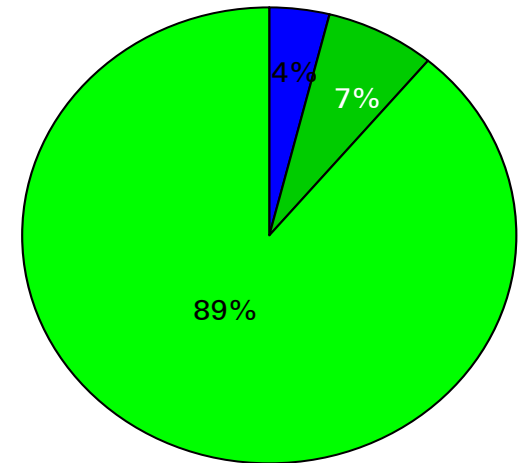
**Public**  
70% of market



**Private**  
20% of market



**Not for Profit**  
10% of market

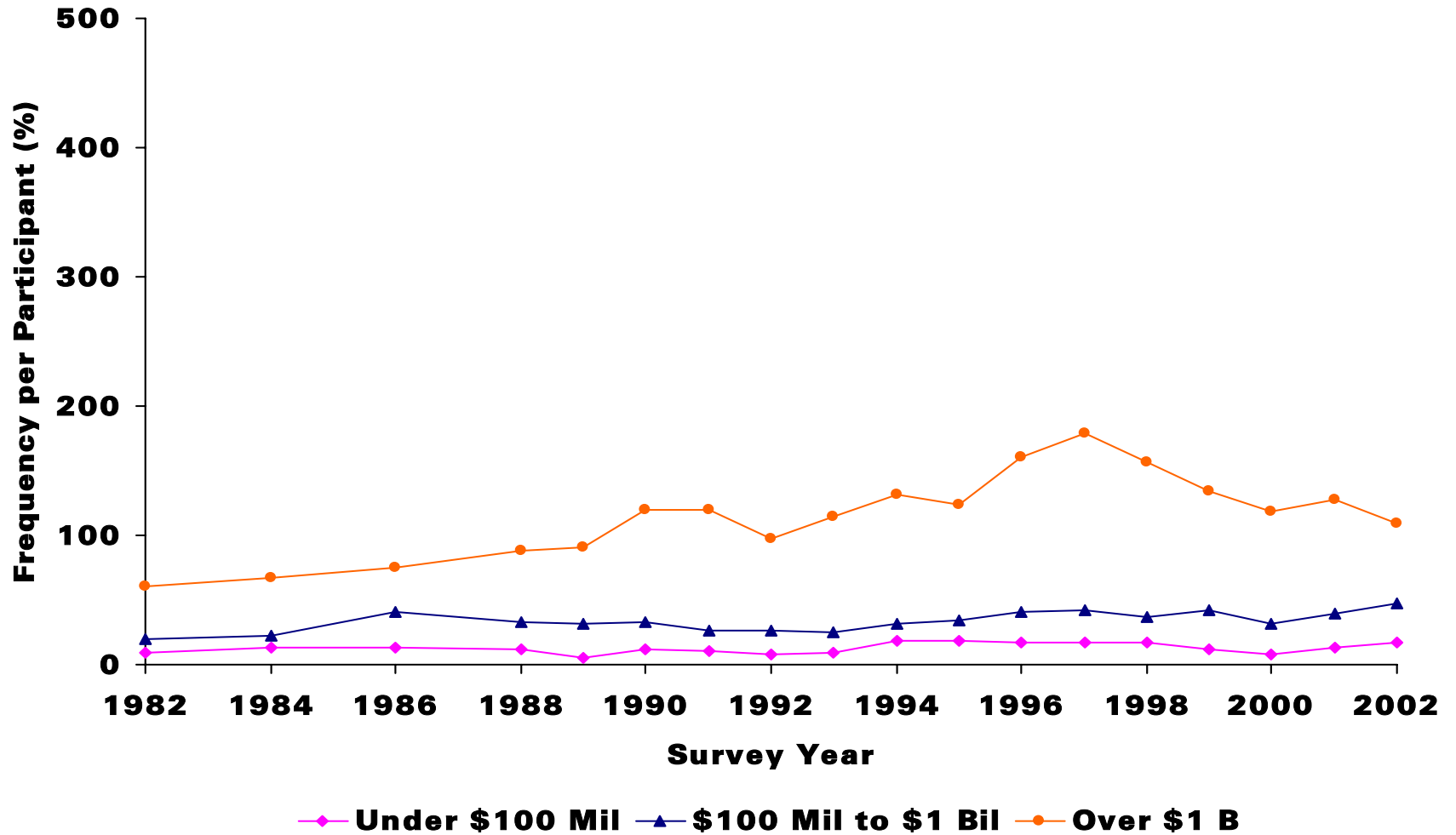


- Large average severity shareholder suits dominate the claims against public companies
- Employee suits dominate claims against private and not-for-profit companies
- Severity of loss is typically a more significant driver of profitability for public exposures while frequency of loss is more of an issue for the profitability of private exposures

- Shareholders
- Competitors/Contractors/Other
- Customers/Clients
- Employees

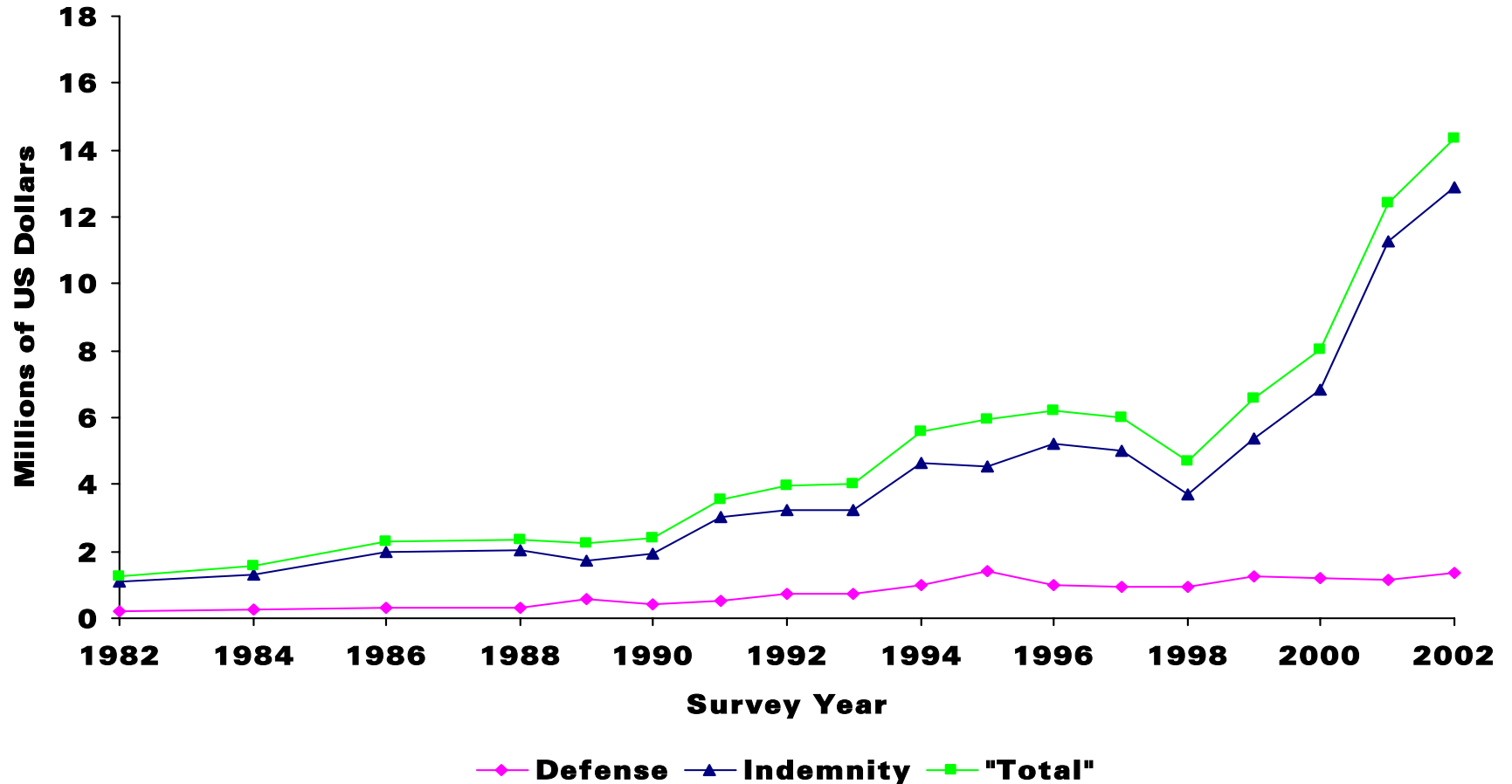
Source: 2002 Tillinghast D&O Survey (distribution of number of claims)

# Claim Frequency by Asset Size - For-Profit



Source: 2002 Tillinghast D&O Survey

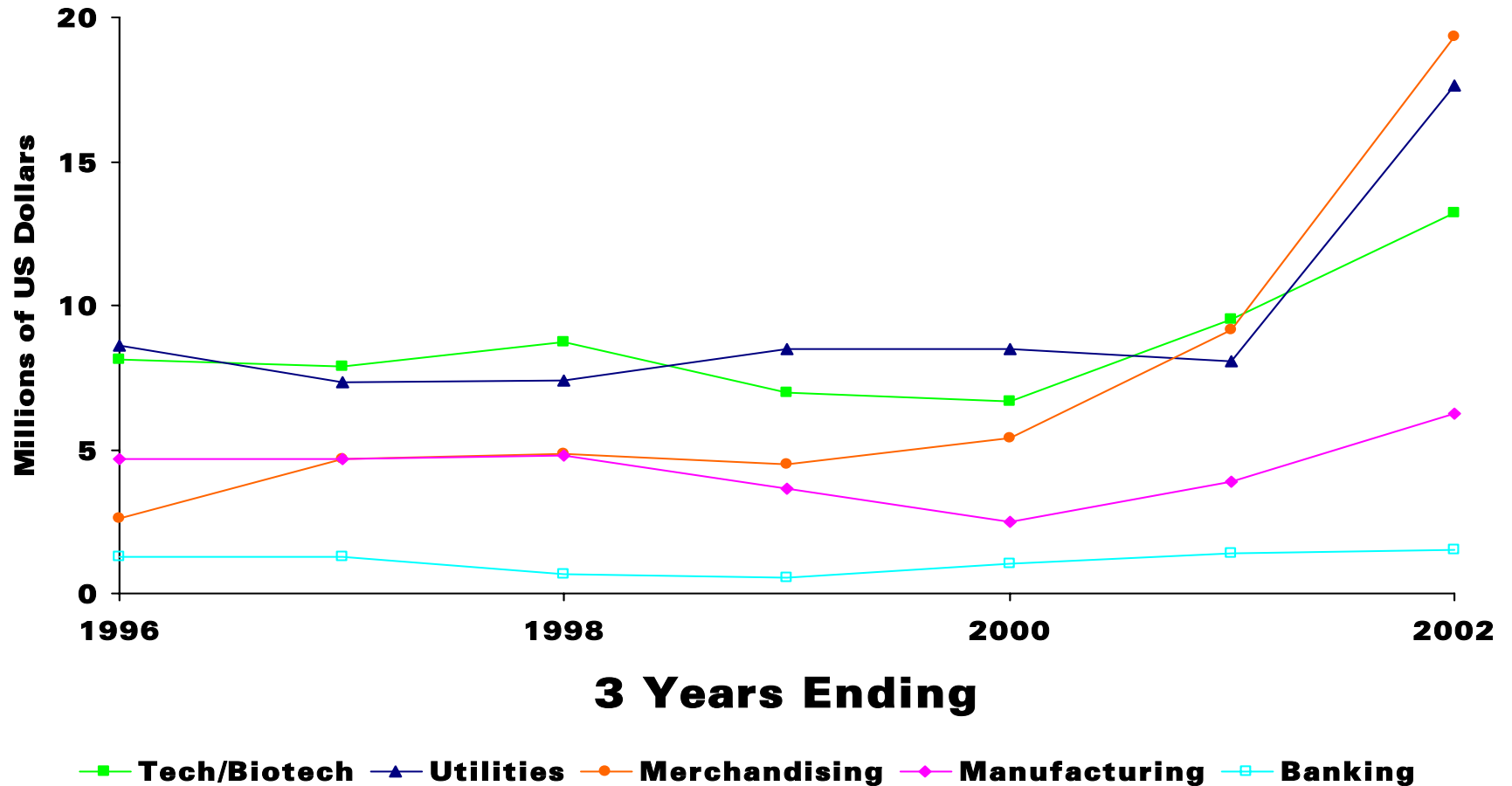
# Average Claim Severity - For-Profit Risks



Source: 2002 Tillinghast D&O Survey. Severity of claims closed with payment.

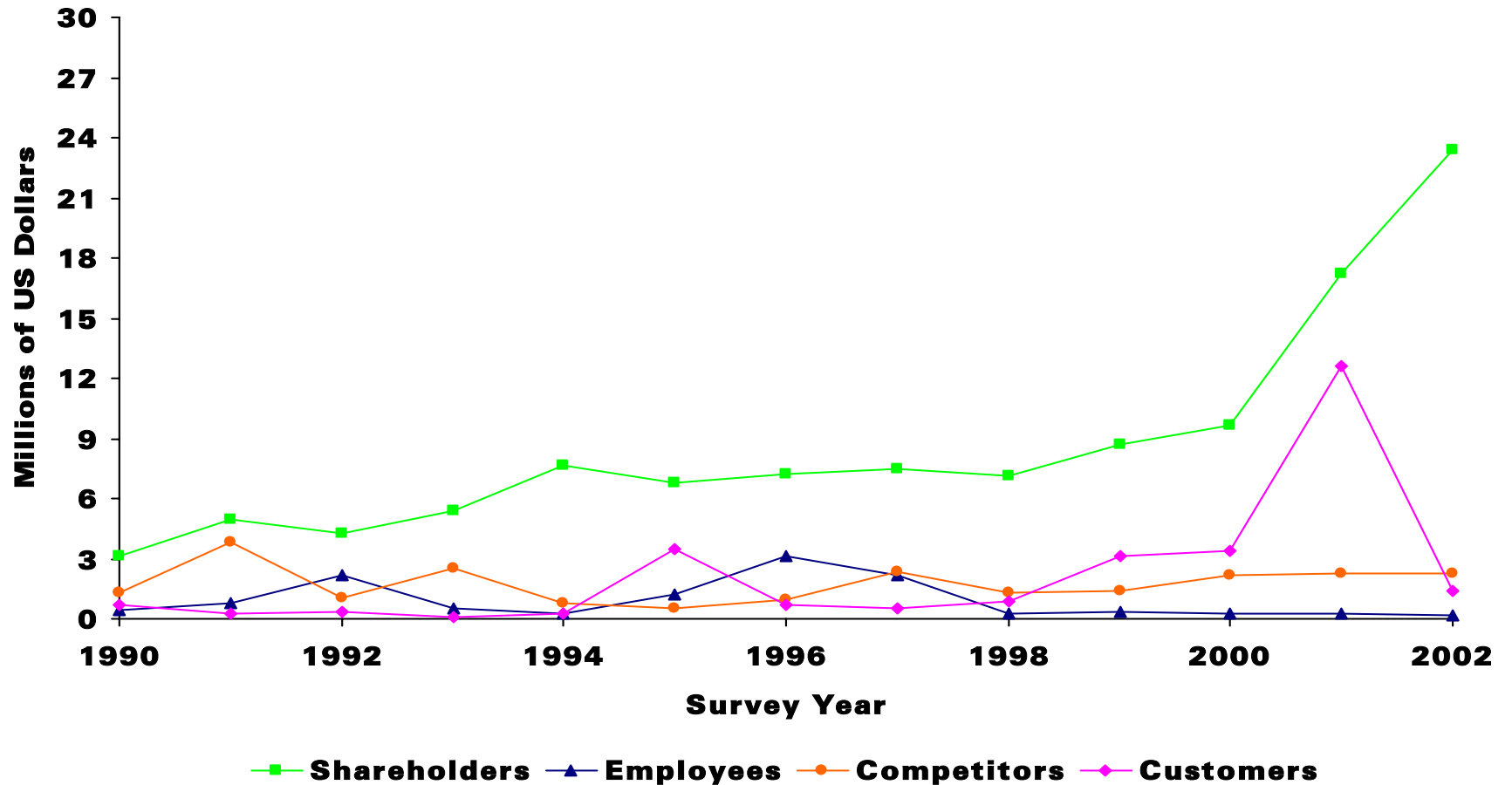


# Average Indemnity Severity by Business Class



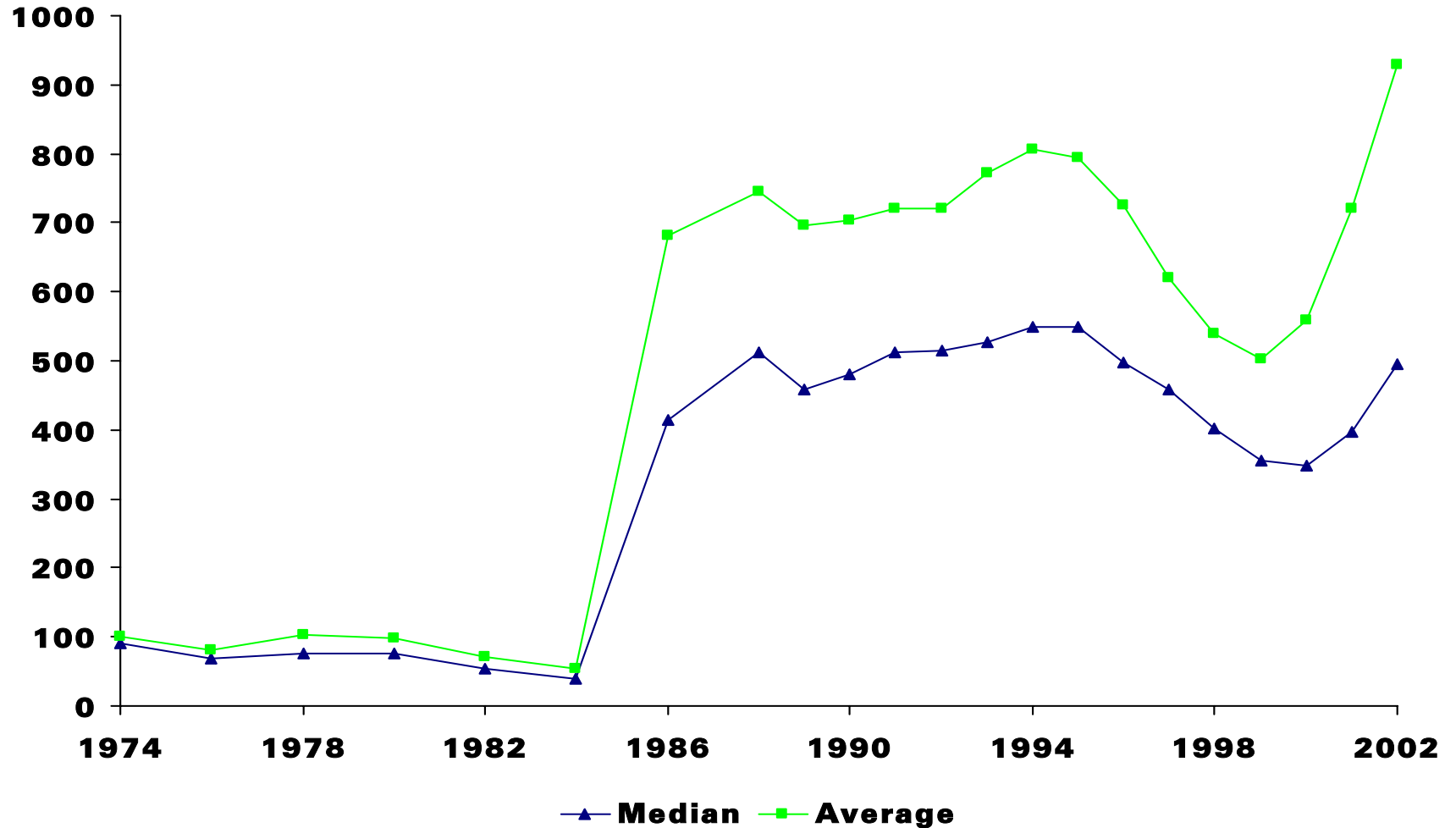
Source: 2002 Tillinghast D&O Survey. Severity of claims closed with payment.

# Average Indemnity Severity by Claimant Type



Source: 2002 Tillinghast D&O Survey. Severity of claims closed with payment.

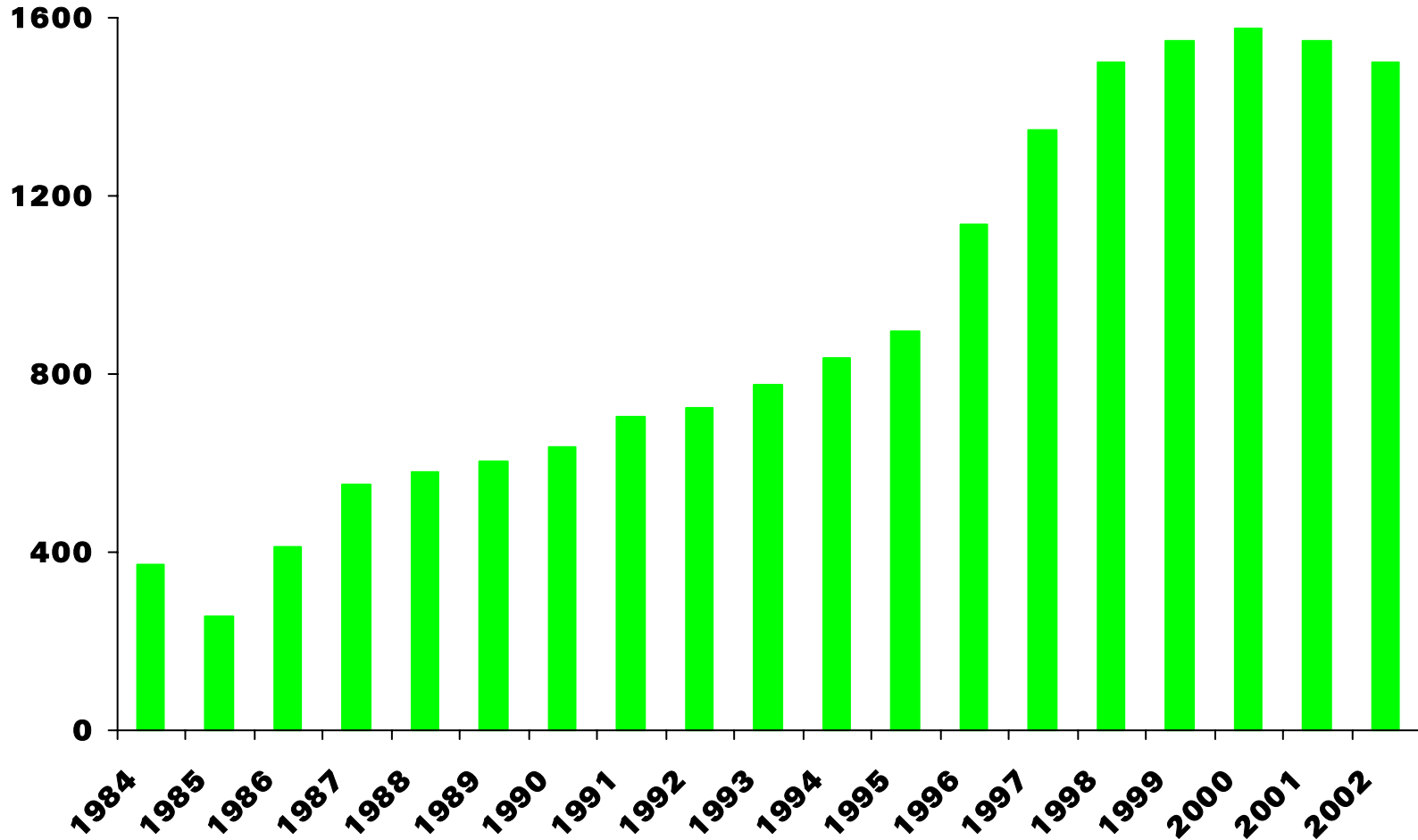
# D&O Premium Index - U.S., For-Profit Only



Source: 2002 Tillinghast D&O Survey.

# Full D&O Limits Capacity (Millions)

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Source: 2002 Tillinghast D&O Survey.

# Typical Limits and Retentions

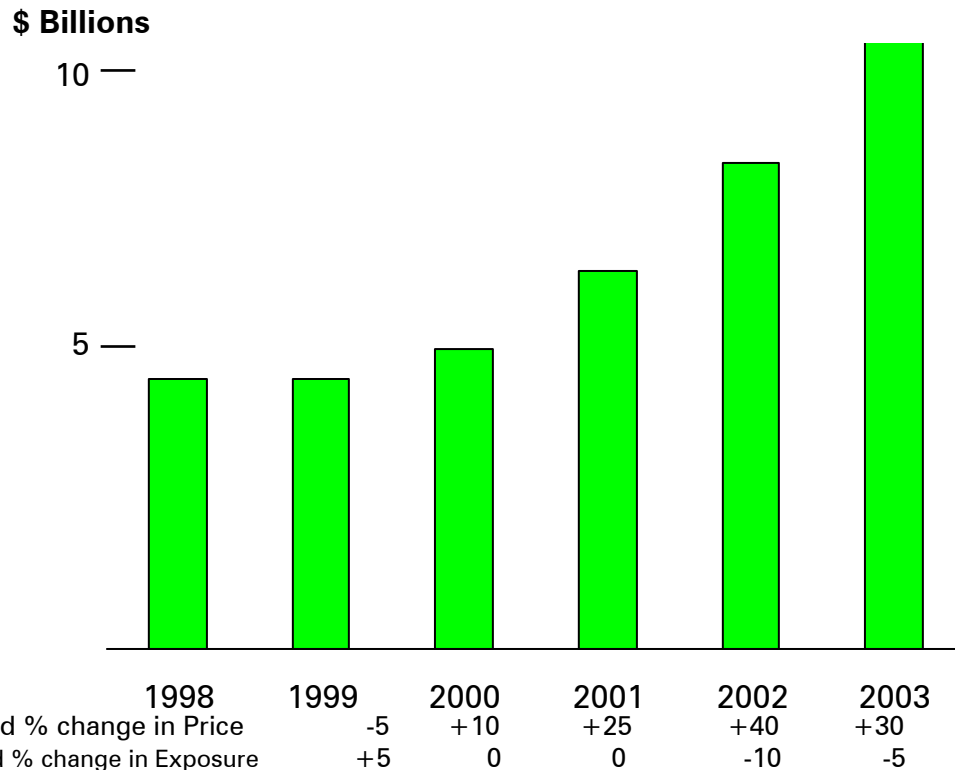
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Type / Size	Limits	Retentions
NFP, FP < 500sh	\$1m to \$10m	\$5k to \$250k
FP > 500sh <\$1B mkt cap	\$10m to \$50m	\$250k to \$1m
FP > \$1B mkt cap	Over \$50m	\$1m to \$5m+

Source: 2002 Tillinghast D&O Survey.

# D&O market premiums have doubled since 2000

**Estimated Direct Written Premiums**



**Growth Drivers**

- Rapidly increasing rates
- Coverage terms and availability, which were generally broadening during the 1990's, contracted in 2002

Source: A.M. Best; industry press, Tillinghast estimates. Note: These are midpoints of a range of estimates, e.g., 2000 base range is \$4 billion to \$6 billion. As D&O financial results are combined with other liability coverages in the Annual Statement, precise figures are not available.

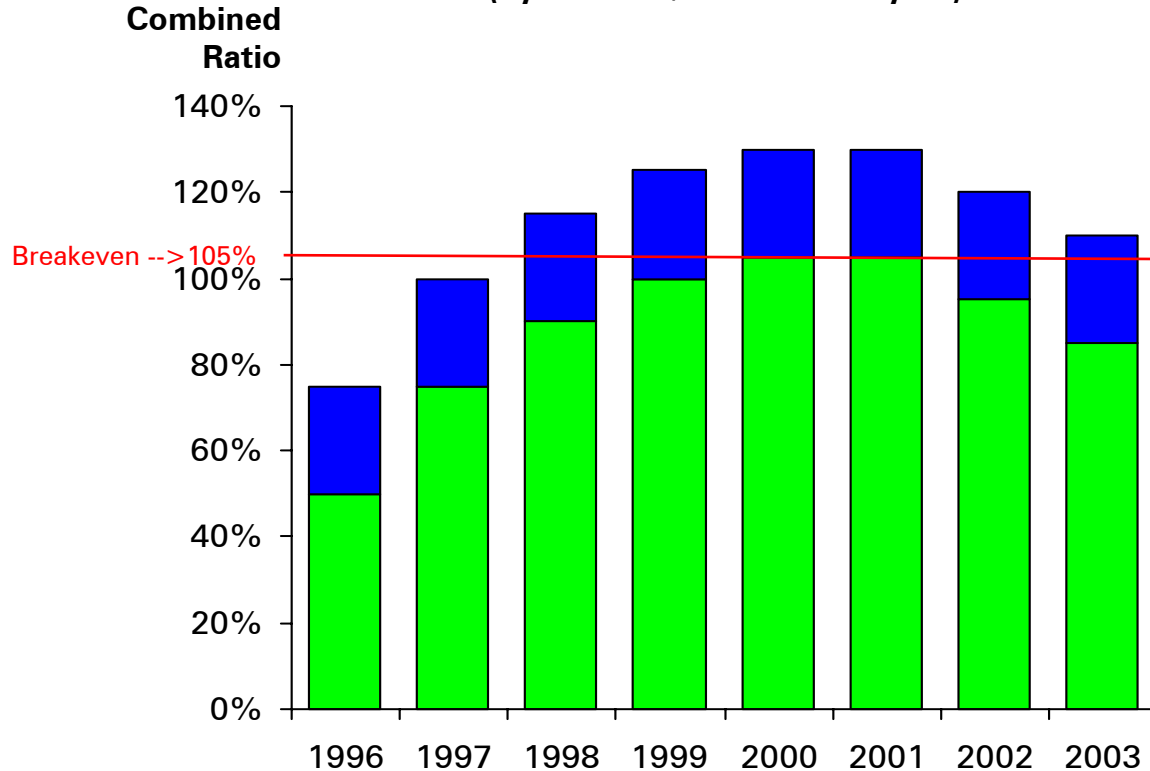
# The D&O market is highly concentrated: three players write almost half the business

Company	Estimated 2002 D&O DWP (\$ Millions)	Share of Market
1. AIG	\$1,500	19.0%
2. Chubb	1,200	15.0%
3. Lloyd's	800	10.0%
4. XL Insurance	400	5.0%
4. Old Republic	400	5.0%
6. Genesis	240	3.0%
6. Hartford Insurance	240	3.0%
6. ACE	240	3.0%
6. Zurich Insurance	240	3.0%
10. Admiral Insurance	200	2.5%
10. St. Paul	200	2.5%
12. Royal/Sun Alliance	160	2.0%
12. CNA Insurance	160	2.0%
12. Kemper	160	2.0%
12. Travelers	160	2.0%
<b>All other</b>	1,700	21.0%
<b>Total</b>	<b>\$8,000</b>	<b>100%</b>

Source: 2002 Tillinghast D&O Survey, Tillinghast estimates.,

# After several years of deteriorating results, the D&O market appears to be improving due to significant rate increases

**Estimated Industry Profitability, 1996 – 2003**  
(by accident/claims-made year)



Assumed earned % change in Price	-10	-10	-7.5	+2.5	+17.5	+32.5	+35
Assumed % change in loss cost	+10	+15	+15	+15	+20	+20	+20
Expected loss & LAE ratio	75	90	100	105	105	95	85

■ Loss & LAE Ratio    
 ■ Combined Ratio (25% underwriting expense ratio)

**Key Trends**

- Increasing claim frequency and severity changes will partially offset strengthening
- Breakeven based on opportunity cost approach

Source: Tillinghast estimates of loss ratios. A.M. Best for expense ratios.