

Systemic Risk and Professional Liability

Antitrust Notice

- The Casualty Actuarial Society is committed to adhering strictly to the letter and spirit of the antitrust laws. Seminars conducted under the auspices of the CAS are designed solely to provide a forum for the expression of various points of view on topics described in the programs or agendas for such meetings.
- Under no circumstances shall CAS seminars be used as a means for competing companies or firms to reach any understanding – expressed or implied – that restricts competition or in any way impairs the ability of members to exercise independent business judgment regarding matters affecting competition.
- It is the responsibility of all seminar participants to be aware of antitrust regulations, to prevent any written or verbal discussions that appear to violate these laws, and to adhere in every respect to the CAS antitrust compliance policy.

Systemic Risk and Professional Liability

Jane C. Taylor, FCAS, MAAA, JD
CAS 2012 RPM Seminar
March 21, 2012
Philadelphia, PA

Systemic Risk and Professional Insurance

- **Professional Insurance Definition & Examples**
- **General Systemic Risks**
 - **Impact of Economic Crisis – Direct and Indirect**
- **Specific Systemic Risks**
 - **Health Care Professional Liability**
 - **Lawyers' Professional Liability**
 - **Accountants' Professional Liability**
 - **Directors' and Officers' Coverage**

Professional Insurance

- **Definition –**
 - Protects professionals against negligence and other claims initiated by their patients /clients
 - General liability insurance - excludes claims arising out of business or professional practices
 - Claims-Made Coverage – mostly
 - Occurrence or Quasi Occurrence - now available

Professional Insurance

- **North Carolina Department of Insurance Actuarial Division - Required Reporting Categories CY Data**

- Physicians and Surgeons (excluding OB/GYN)
- Obstetrics-Gynecology (Surgery class)
- Dentists and Oral Surgeons
- Nurse Practitioners
- Other Health Care Professionals
- Hospitals
- Other Health Care Facilities
- Lawyers
- Accountants
- Engineers and Architects
- Other Professionals



Medical
Professional

Professional Insurance

- Medical Professional
- Legal Professional
- Accounting Professional
- D&O – Important Category

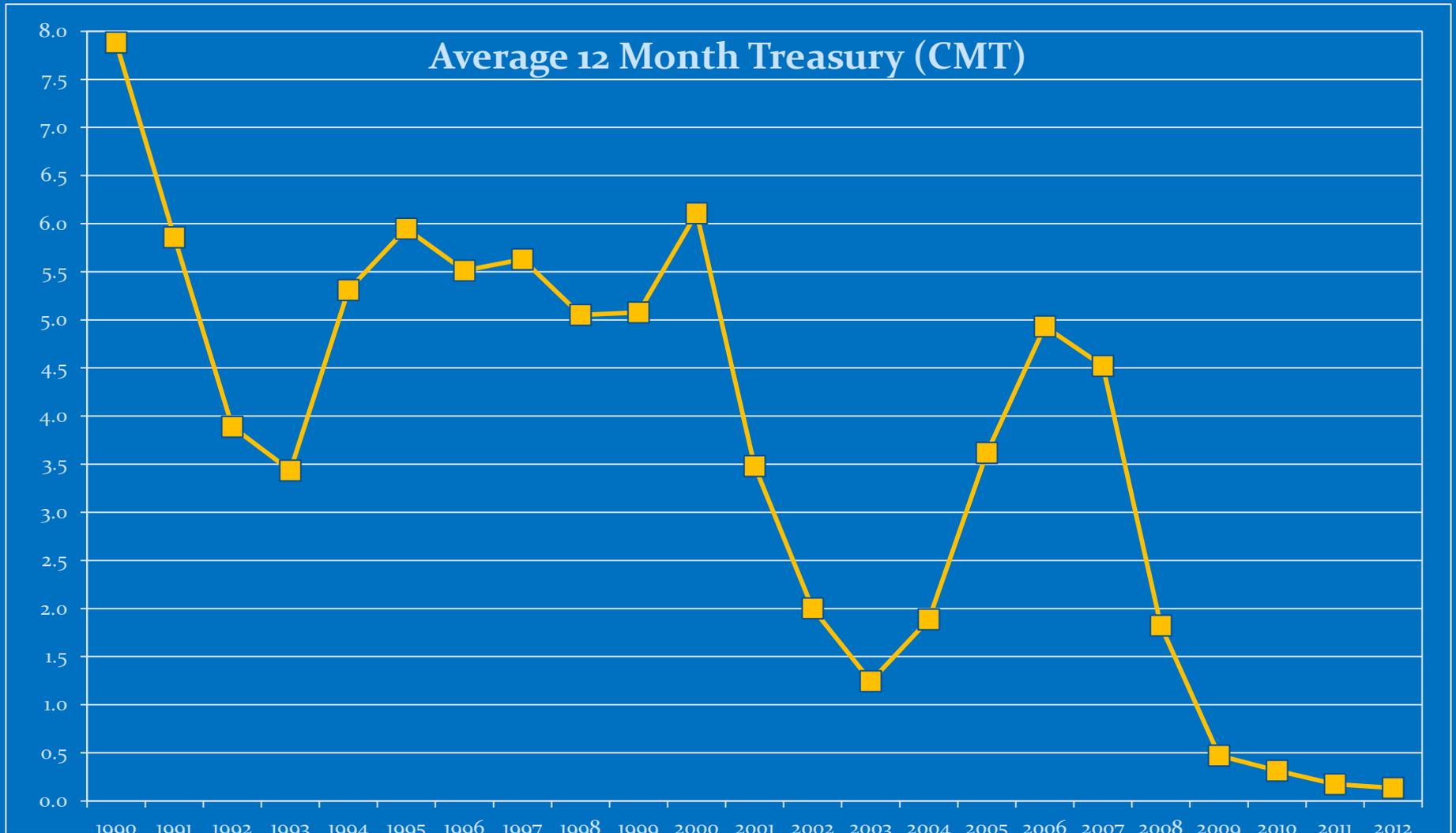
General Systemic Risks

- Impact on All Professional Insurance
 - Investments and Rate of Return
 - Prolonged?
 - Bounce Back or Danger?
 - Hyper Inflation ?
 - Deflation?
- Economic Crisis

General Systemic Risks

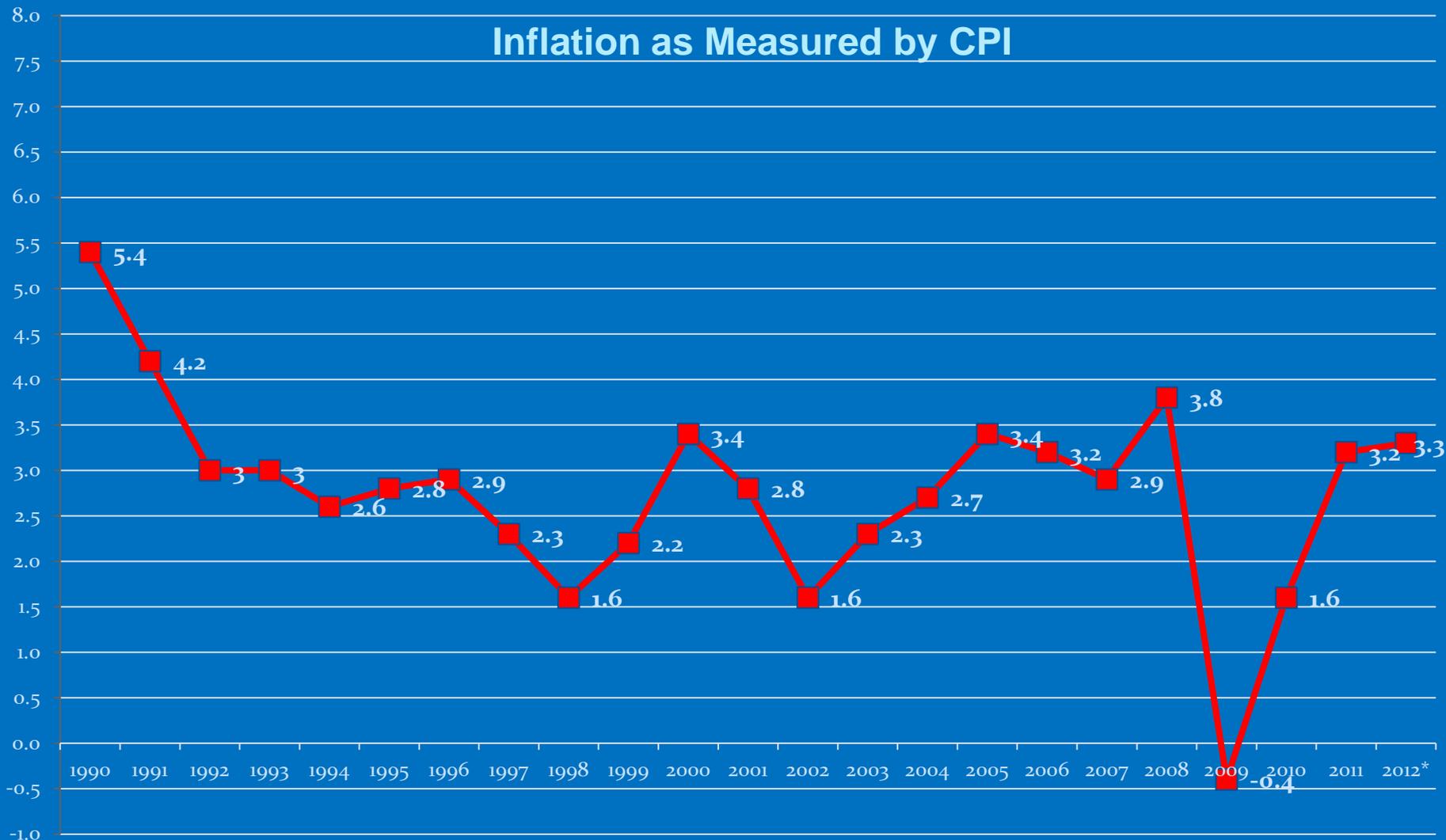
- Impact on All Professional Insurance
 - Investments and Rate of Return
 - Prolonged?
 - Bounce Back or Danger?
 - Hyper Inflation ?
 - Deflation?

General Systemic Risks

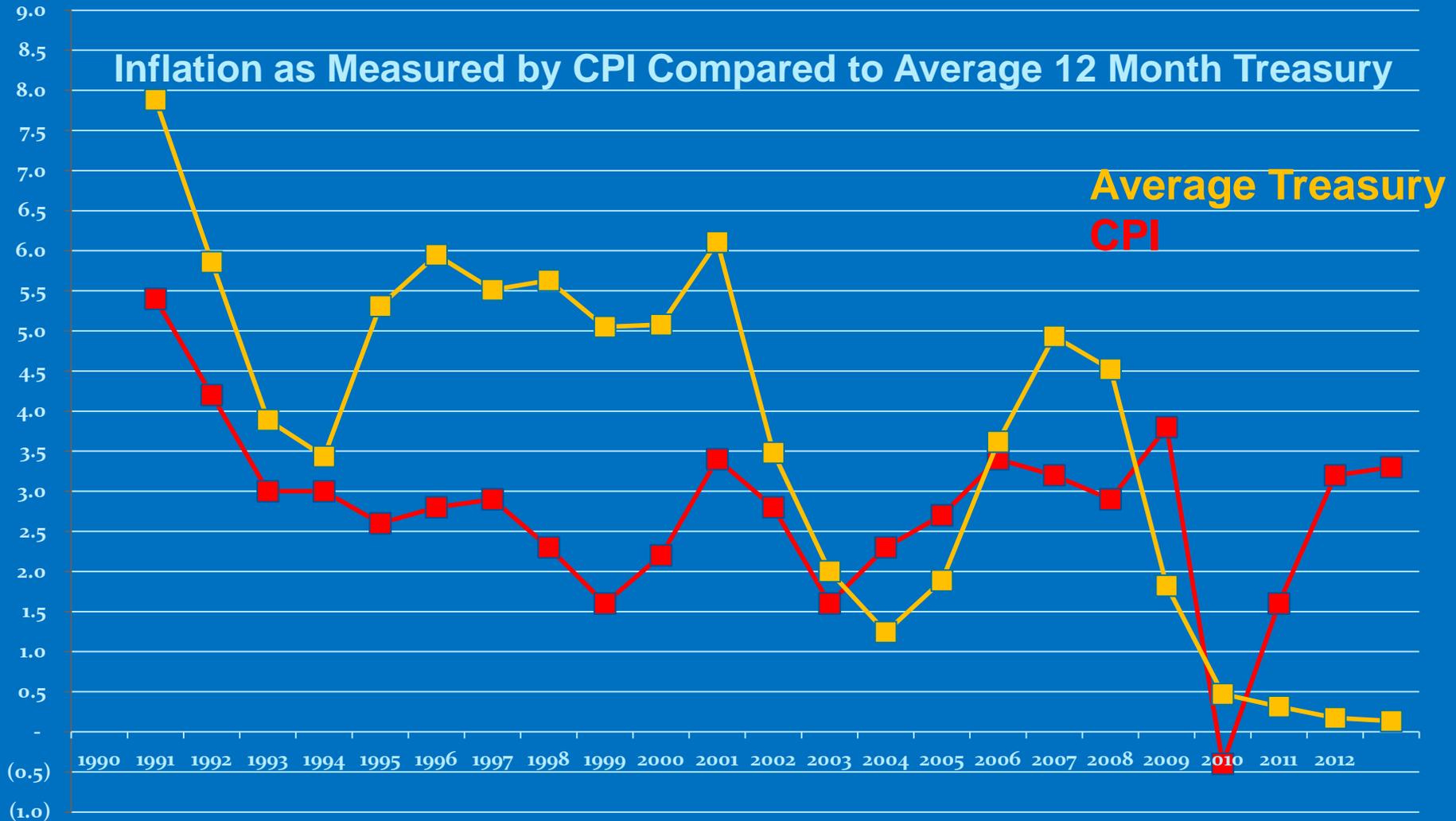


Source: US Department of the Treasury

General Systemic Risks



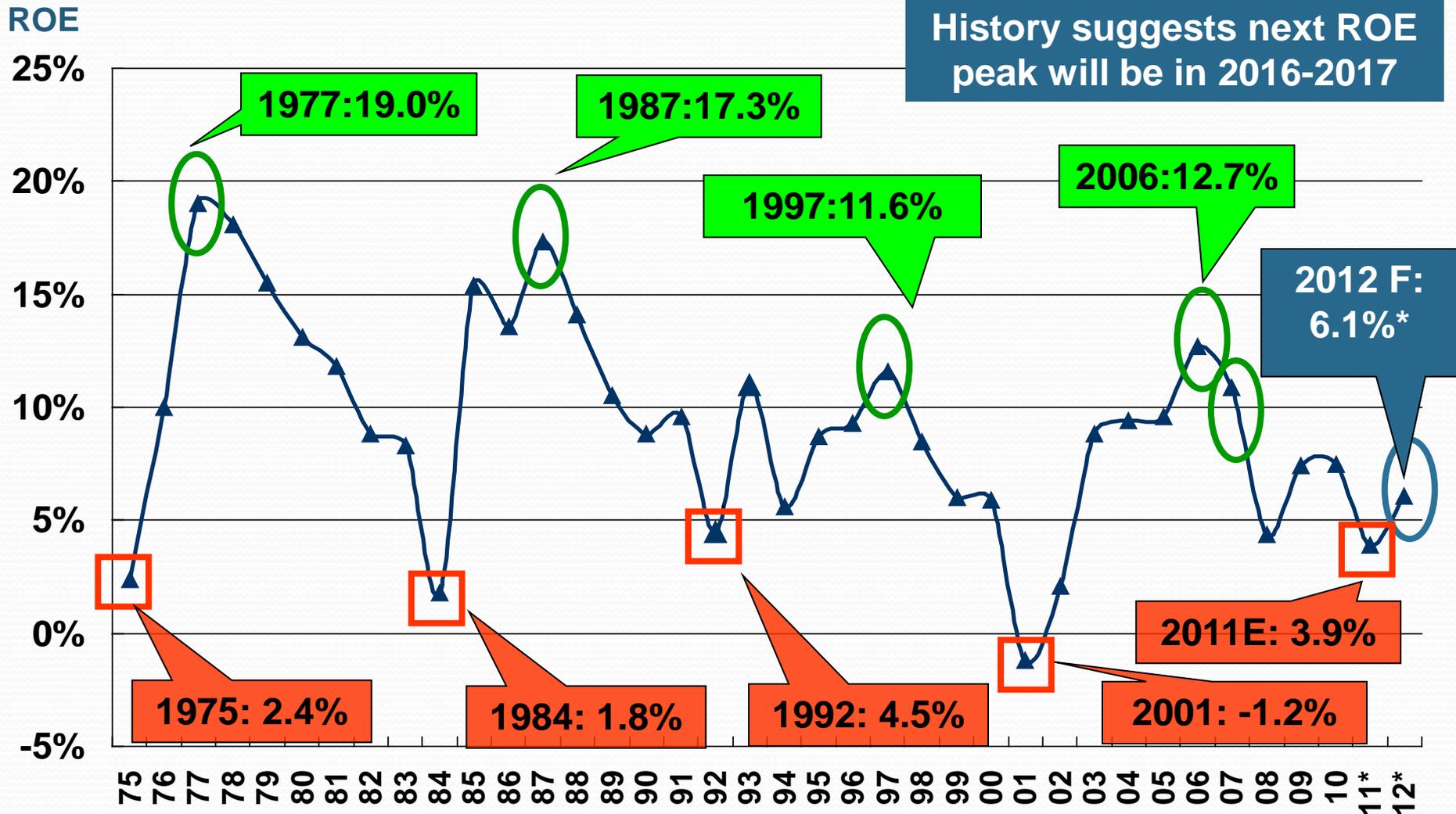
General Systemic Risks



General Systemic Risks

- Economic Crisis
 - Market Cycles
 - Release of Reserves

Profitability Peaks & Troughs in the P/C Insurance Industry, 1975 – 2012* Estimated



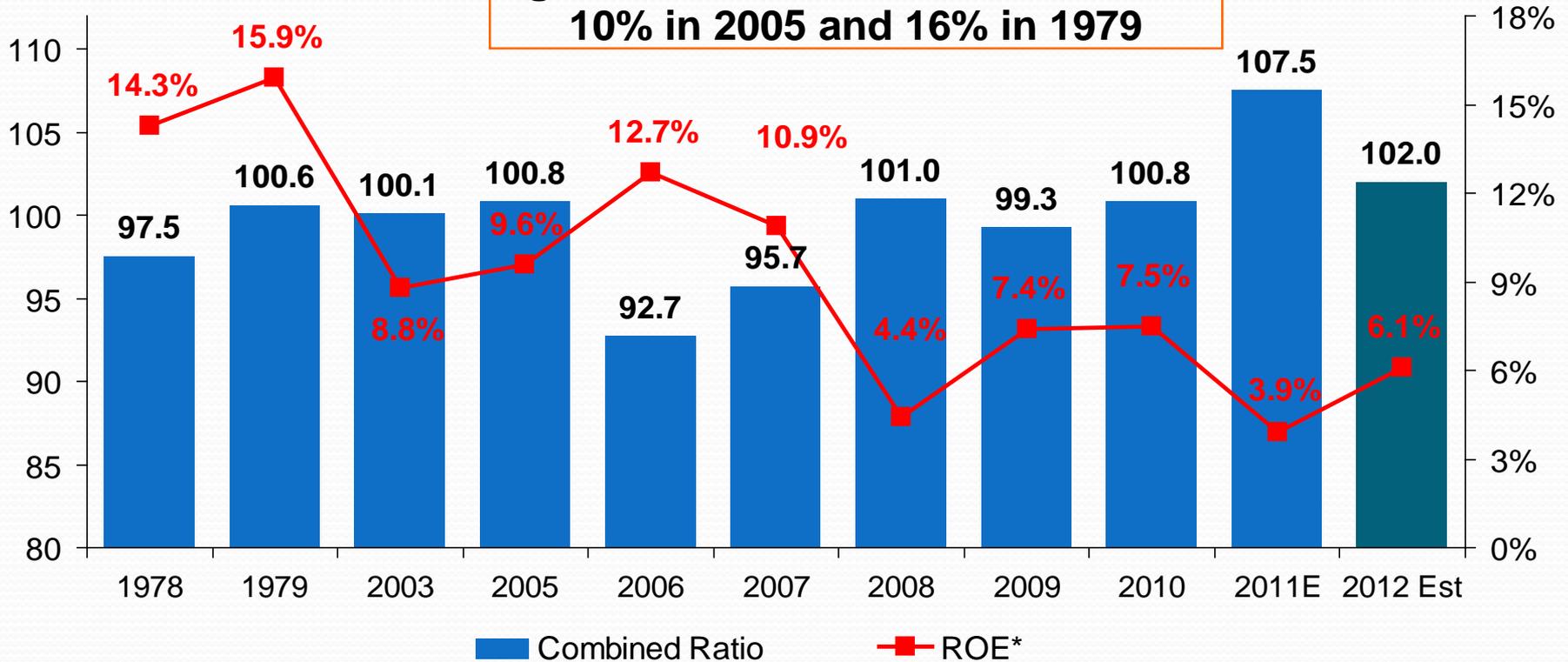
*Profitability = P/C insurer ROEs. 2011-12 figures are A.M. Best estimates. Note: Data for 2008-2012 exclude mortgage and financial guaranty insurers. For 2011:Q3 ROAS = 1.9% including M&FG.

Source: Insurance Information Institute; NAIC, ISO, A.M. Best.

A 100 Combined Ratio Isn't What It Once Was: Investment Impact on ROEs

Combined Ratio / ROE

A combined ratio of about 100 generated ~7.5% ROE in 2009/10, 10% in 2005 and 16% in 1979

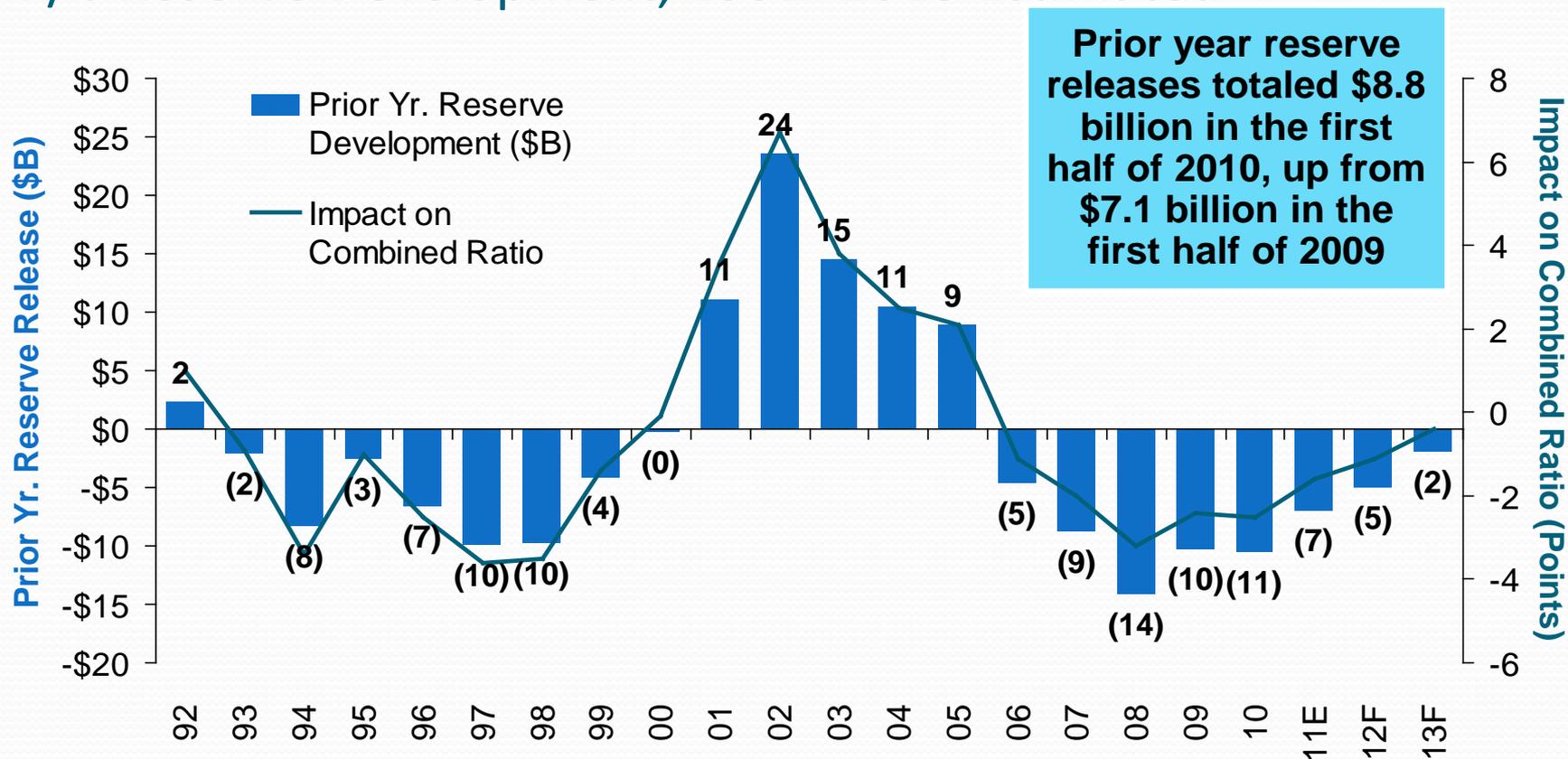


Combined Ratios Must Be Lower in Today's Depressed Investment Environment to Generate Risk Appropriate ROEs

* 2008 -2010 figures are return on average surplus and exclude mortgage and financial guaranty insurers. 2011-12 combined ratios are A.M. Best estimate excl. M&FG insurers.

Source: Insurance Information Institute from A.M. Best and ISO data

P/C Reserve Development, 1992–2013 Estimated



Reserve Releases Remained Strong in 2010 But Tapered Off in 2011. Releases Are Expected to Further Diminish in 2012 and 2103

Note: 2005 reserve development excludes a \$6 billion loss portfolio transfer between American Re and Munich Re. Including this transaction, total prior year adverse development in 2005 was \$7 billion. The data from 2000 and subsequent years excludes development from financial guaranty and mortgage insurance.

Sources: Barclays Capital; A.M. Best.

General Systemic Risks

- **Government / Regulatory Changes**
 - **Sarbanes-Oxley – Public Companies - 2002**
 - **Dodd-Frank – “Wall Street Reform & Consumer Protection Act” - 2010**
 - **Federal Insurance Office –filled 2011**
 - **Gather information about the insurance industry**
 - **Service to minorities, low & moderate income**
 - **Service to underserved communities**
 - **Federal Reserve - Banking Oversight & MetLife**

General Systemic Risks

- **Government / Regulatory Changes**
 - **Federal Reserve - Banking Oversight**
 - MetLife failed Federal Reserve banking stress test
 - A.M. Best Company comments:
 - “The outlook for all ratings is stable.”
 - “A.M. Best will continue to monitor the situation at MetLife.”
 - Fitch comments:
 - “... the Federal Reserve's latest stress test results are inconsistent with both our view of MetLife's capital position and MetLife's reported insurance regulatory capital measures.”

General Systemic Risks

- **Government / Regulatory Changes (Cont)**
 - **California Insurance Commissioner Jones:**
 - "I believe the Federal Reserve's 'stress test' is directed primarily at non-insurer financial institutions and the non-insurance operations of institutions with insurance subsidiaries."
 - "The methodology utilized for analyzing and stress testing banks is not intended to measure insurance solvency as the business models are quite different."

General Systemic Risks

- **Government / Regulatory Changes (Cont)**
 - **NAIC's ORSA – Own Risk & Solvency**
 - **Assessment – Feedback Pilot Project – 2012**
 - **Large companies to start**

General Systemic Risks

- **Government / Regulatory Changes (Cont)**
 - Encourage Chief Risk Officer Position
 - 02/27/12 description of “needed skills”
 - Advanced Masters (or Doctorate) degree in business with an emphasis in mathematics, quantitative science, finance, economics or accounting
 - Relevant professional designations might include: **CERA**, **CFA**, **CPA**, **CQM**, **FCAS**, **FSA**, and/or **MAAA**
 - [Emphasis added]
-

Knowledge and Skills Needed

- **To: Own Risk and Solvency Assessment (E) Subgroup**
- **From: Select Chief Risk Officers from CRO Council [sic]**
- **Date: February 27, 2012**
- **Re: Knowledge and Skills Needed for a Potential State and/or NAIC ERM Specialist**
- The following comments reflect the thoughts of a few Chief Risk Officers regarding the knowledge and skills needed for a potential state insurance department and/or NAIC ERM specialist:
- Balanced skill set that includes strong quantitative acumen and sharp strategic/business sense
- Strong interpersonal, communication, collaboration and leadership skills to interface with both internal and external constituents
- Ability to distill complexity into salient points, as well as counsel others in making sound risk-based business decisions

Knowledge and Skills Needed (Cont)

- Ability to lead directly and indirectly i.e., across a matrix organizational structure
- Ability to work in a teamwork environment and provide leadership without necessarily having direct authority over members of the team
- Ability to navigate and resolve conflict, including being able to effect change and resolve conflict
- Must be comfortable dealing with both complexity and ambiguity and be able to explore multiple solutions to a problem (understand how to frame an issue, evaluate potential options, weigh costs/benefits, decide, implement, etc.)
- Must be able to present/defend solutions/positions based on an analysis of facts (quantitative/qualitative) and business implications
- 15+ years of experience in a senior capacity in the areas of insurance risk, financial, actuarial and/or investment management
- An advanced Masters (or Doctorate) degree in business with an emphasis in mathematics, quantitative science, finance, economics or accounting
- Relevant professional designations might include: CERA CFA, CPA, CQM, FCAS, FSA, and/or MAAA

General Systemic Risks

- Government / Regulatory Changes (Cont)
 - Solvency II – 2014 (???)

Specific Systemic Risks: Medical

- Patient Protection & Affordable Care Act – 2010
 - Reforms private health insurance
 - Increases insurance coverage for pre-existing conditions
 - Expands access to insurance
 - Too few medical providers
 - More insureds in system

Specific Systemic Risks: Medical

- Looming crisis in primary care - *The Atlantic*
 - “The Doctor Is Out: Young Talent Is Turning Away From Primary Care”
 - <http://www.theatlantic.com/health/archive/2012/03/the-doctor-is-out-you...>
- Estimated shortfall of doctors - 30,000 in the next couple of years.
- Where are all the new doctors?
 - Specialty groups and hospitals
 - Better hours
 - More pay during first years of employment



Specific Systemic Risks: Medical

- “Nursing shortage through 2020” – American Nurses Association in *Nursing World*
 - Median age of nurses: 46
 - 50% of workforce nearing retirement age
 - Increasing elderly population in US to require more nurses
- Overwork → injury, fatigue, errors
- Nurses becoming Physicians Assistants / Nurse Practitioners
 - Better pay
 - More autonomy

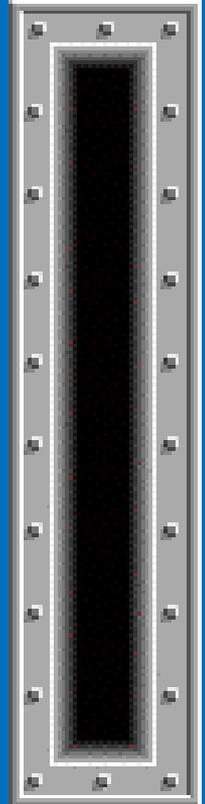


Specific Systemic Risks: Medical

- Lack of access to revolving credit for law firms
 - Fewer lawsuits at beginning of crisis
 - Frequency declined in 2010
 - Statute of Limitations creating uptick in claims
 - "While many hospitals have grown accustomed to declining professional liability costs, the underlying claim frequency and severity cost drivers have entered a period of growth. Whether commercially insured or self-insured, hospitals and physicians should prepare for increases to their professional liability costs in the coming years." ~Aon 2010 *Hospital Professional Liability and Physician Liability Benchmark Analysis*

Specific Systemic Risks: Medical

- Increased frequency of large claims
 - In 2011 - 7 states had largest ever medical malpractice awards in cases ranging from inadequate staffing at nursing homes to medical negligence in hospitals
 - ~ Ian Thompson, Hiscox SVP
- Losses > \$ 5 Million
 - 0.25% of all losses in 2000
 - 0.7% of all losses in 2011
 - 1.0% of all losses in 2014 (predicted)



Specific Systemic Risks: Medical

- **Technology**
 - Lower risk – airway management, CAT scans
 - Robotics – surgeon sued for death
- **Increased use of Physicians Assistants / Nurse Practitioners**
 - Insufficient data to determine impact
- **Uninsured now insured**

Specific Systemic Risks: Legal

- Lack of access to revolving credit for law firms
 - Fewer lawsuits at beginning of crisis
 - Frequency declined in 2010
 - Statute of Limitations creating uptick in claims

Specific Systemic Risks: Legal

- Broker survey of six largest insurers of legal professional liability (Ames & Gough)
- 4 of 6 had increased frequency in 2011
 - 3 had increases between 6% and 10%
 - 1 had increase of 11% to 20%
- Real estate –largest count for 4 of 6
 - Continued fall out from real estate collapse
 - Title Insurance involvement
- Collection & Bankruptcy and Corporate & Securities – other generators of claims

Specific Systemic Risks: Legal

- Technology
 - Lower risk –
 - Benefit of dual calendaring (fewer missed deadlines),
 - Legal research on line more up-to-date
 - Higher risk –
 - Information sent through the internet
 - Cloud storage

Specific Systemic Risks: Accountants

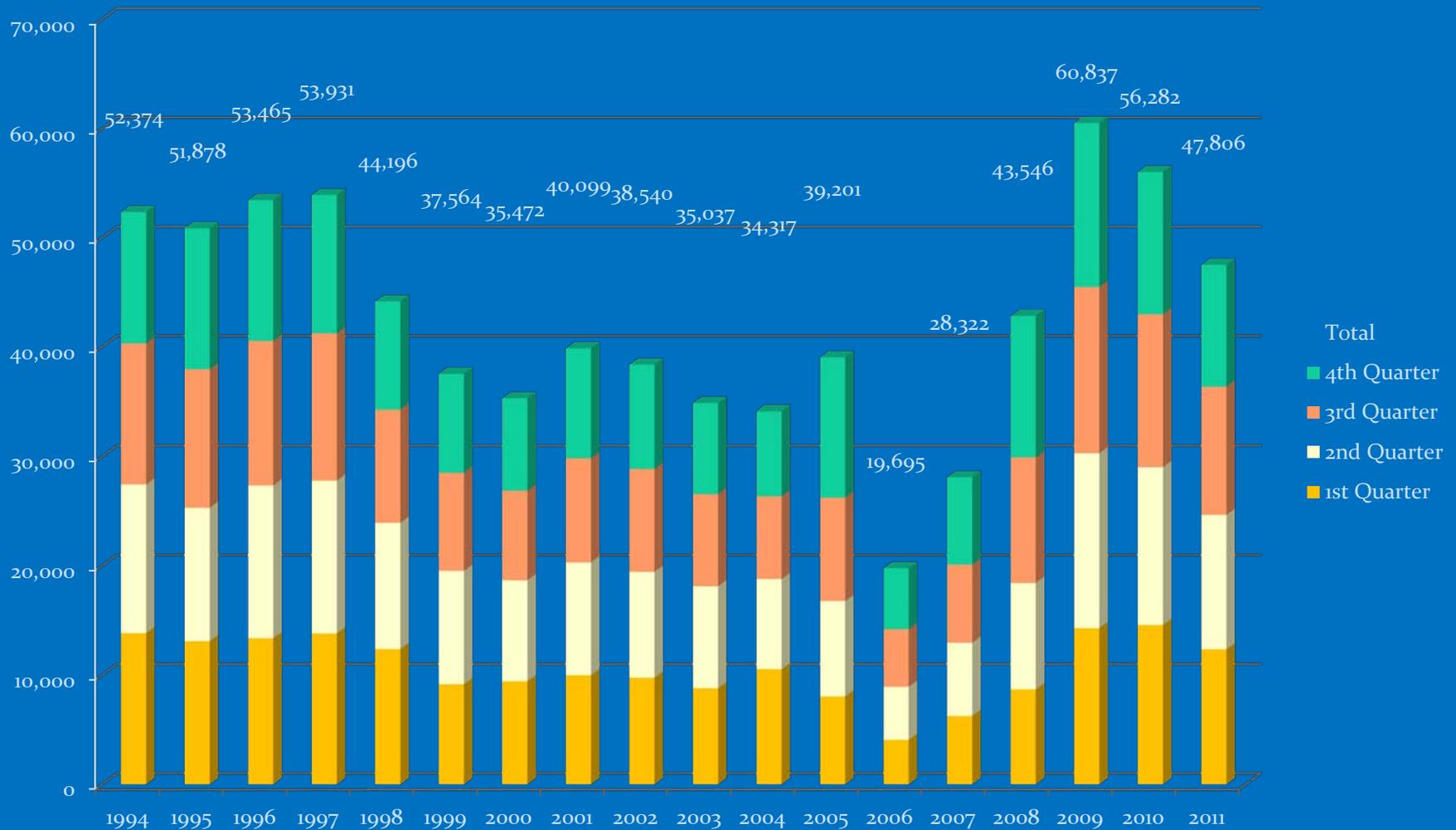
- Similar to Legal Professional Liability in current trends
- Technology
 - Lower risk –
 - More mechanized and computer supported work – particularly tax
 - More & more current info from the internet
 - Higher risk –
 - Information sent through the internet
 - Cloud storage

Systemic Risk:D&O: What is it?

- Side A coverage – Individual D&O's assets
- Side B coverage – Reimburses Company for monies used to indemnify D&O's
- Side C coverage – Securities claims



Business Bankruptcies



Systemic Risk:

D&O -The Counting Game

- A publicly-traded company, its law firm and auditor are sued in 7 lawsuits alleging the same violations over a two-year period. What is the relevant “Count”?
- Correct Answers
- 21 “defendant lawsuits”
- 1 to 7 “lawsuits”
- 1 “public company”

D&O: SCA Statistics

Heat Maps of the S&P 500 Securities Litigation™
Percentage of Companies Subject to New Filings
2000 - 2011

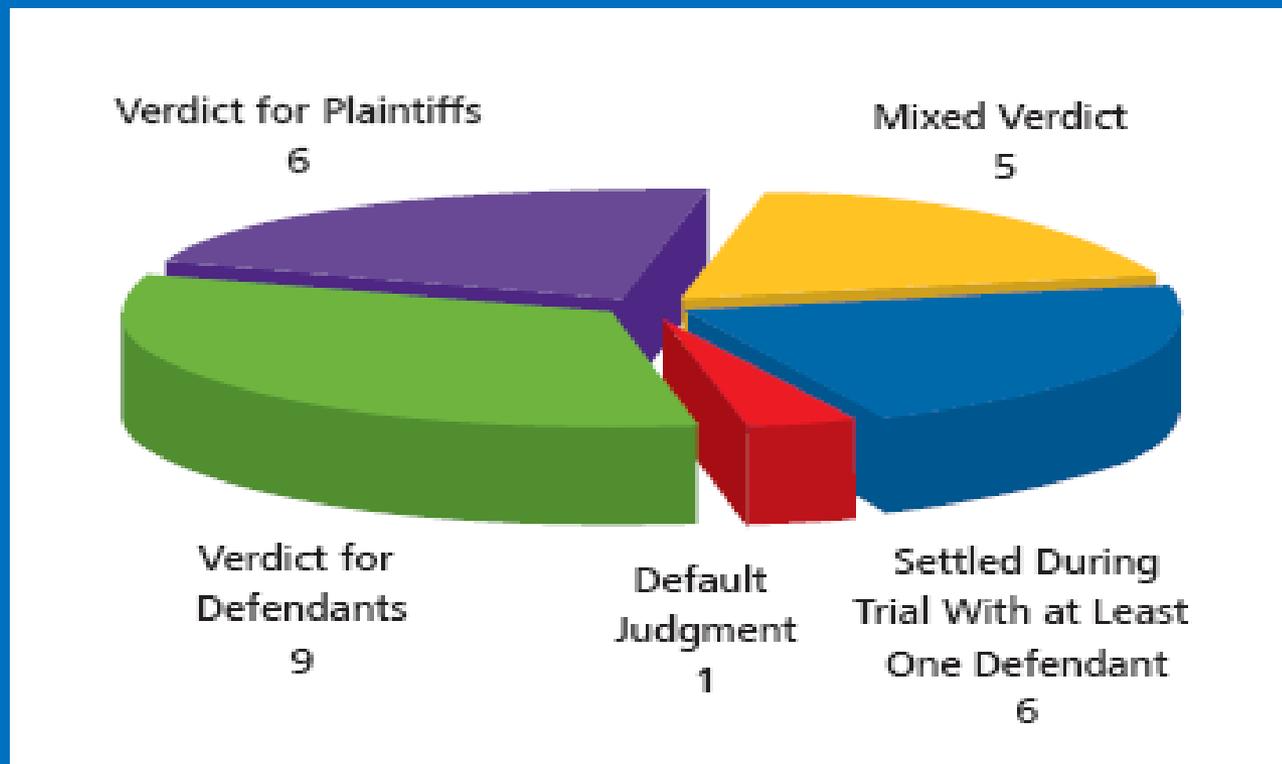
Description	Average 2000-2010	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Consumer Discretionary	5.3%	3.3%	2.4%	10.2%	4.6%	3.4%	10.3%	4.4%	5.7%	4.5%	3.8%	5.1%	3.8%
Consumer Staples	3.9%	7.3%	8.3%	2.9%	2.9%	2.7%	8.6%	2.8%	0.0%	2.6%	4.9%	0.0%	2.4%
Energy	2.1%	0.0%	0.0%	8.0%	0.0%	4.2%	0.0%	0.0%	0.0%	0.0%	2.6%	7.7%	0.0%
Financials	11.7%	4.2%	1.4%	16.7%	8.6%	19.3%	7.3%	2.4%	10.3%	31.2%	13.1%	10.3%	1.2%
Health Care	10.1%	2.6%	7.1%	15.2%	10.4%	10.6%	10.7%	6.9%	12.7%	13.7%	3.7%	15.4%	2.0%
Industrials	3.4%	2.8%	0.0%	6.0%	3.0%	8.5%	1.8%	0.0%	5.8%	3.6%	6.9%	0.0%	1.7%
Information Technology	6.6%	9.7%	18.2%	10.3%	5.2%	3.6%	7.5%	9.0%	2.6%	2.9%	0.0%	3.9%	6.6%
Materials	1.3%	4.1%	0.0%	0.0%	2.9%	0.0%	3.1%	0.0%	0.0%	0.0%	0.0%	3.2%	0.0%
Telecommunication Services	7.7%	23.1%	16.7%	15.4%	8.3%	0.0%	0.0%	0.0%	0.0%	0.0%	11.1%	0.0%	11.1%
Utilities	6.8%	5.0%	7.9%	40.5%	2.8%	5.7%	3.0%	0.0%	3.1%	3.2%	0.0%	0.0%	8.8%
All S&P 500 Companies	6.4%	5.0%	5.6%	12.0%	5.2%	7.2%	6.6%	3.6%	5.4%	9.2%	4.8%	5.4%	3.2%

D&O: SCA Statistics

Heat Maps of the S&P 500 Securities Litigation™
 Percentage of Market Capitalization Subject to New Filings
 2000 - 2011

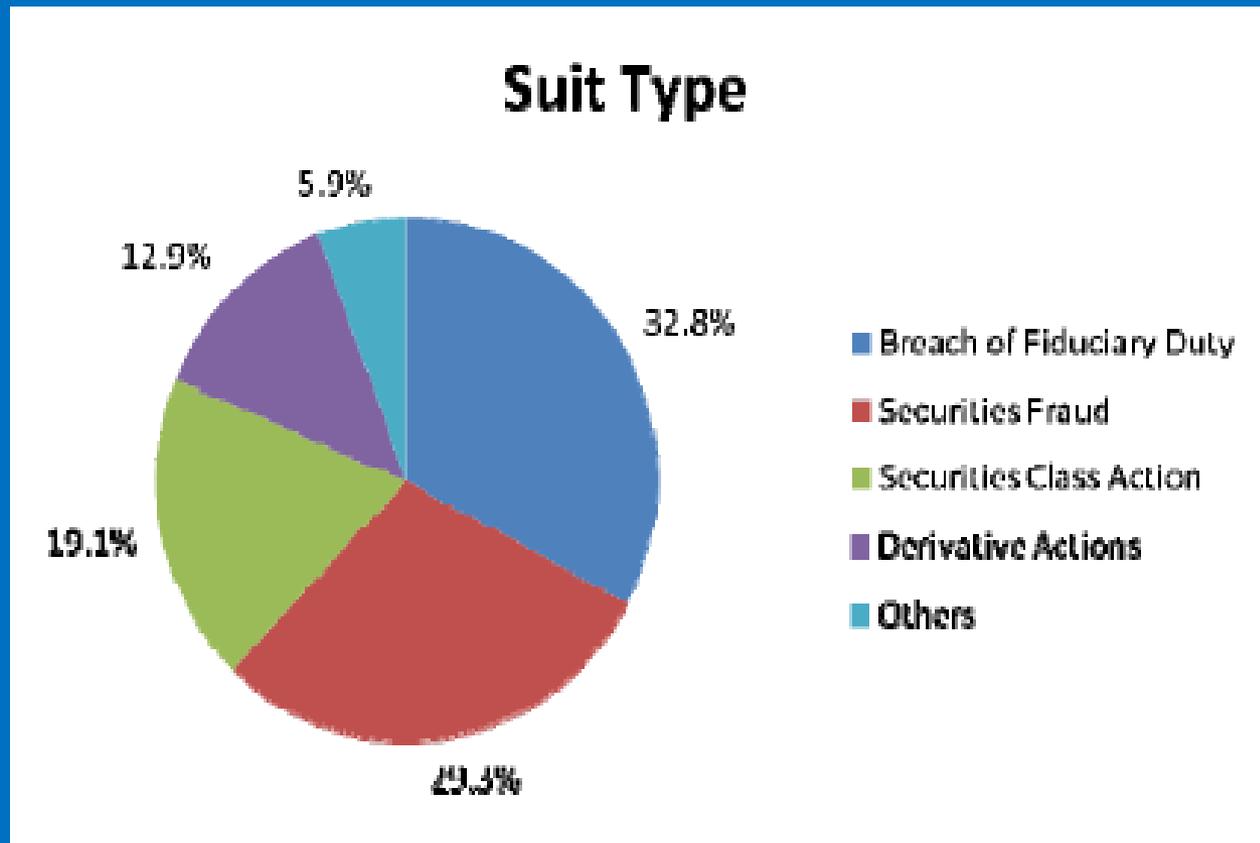
Description	Average 2000–2010	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Consumer Discretionary	7.3%	6.5%	1.3%	24.7%	2.0%	7.9%	5.7%	8.9%	4.4%	7.2%	1.9%	4.9%	4.6%
Consumer Staples	5.1%	34.5%	6.3%	0.3%	2.3%	0.1%	11.4%	0.8%	0.0%	2.6%	3.9%	0.0%	0.8%
Energy	3.2%	0.0%	0.0%	1.7%	0.0%	44.9%	0.0%	0.0%	0.0%	0.0%	0.9%	3.3%	0.0%
Financials	24.3%	3.3%	0.8%	29.2%	19.9%	46.1%	22.2%	8.2%	18.1%	55.0%	38.3%	31.1%	6.9%
Health Care	18.2%	11.0%	5.4%	35.2%	16.3%	24.1%	10.1%	18.1%	22.5%	20.0%	1.7%	33.7%	0.7%
Industrials	8.0%	3.9%	0.0%	13.3%	4.6%	8.8%	5.6%	0.0%	2.2%	26.4%	23.2%	0.0%	2.1%
Information Technology	9.3%	8.5%	37.6%	5.7%	1.0%	1.5%	12.4%	9.9%	4.2%	1.7%	0.0%	6.8%	11.1%
Materials	2.7%	8.6%	0.0%	0.0%	1.4%	0.0%	5.1%	0.0%	0.0%	0.0%	0.0%	12.5%	0.0%
Telecommunication Services	11.7%	39.5%	13.3%	19.9%	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.7%	0.0%	28.4%
Utilities	8.7%	5.6%	17.4%	51.0%	4.3%	4.8%	5.6%	0.0%	5.5%	4.0%	0.0%	0.0%	5.6%
All S&P 500 Companies	11.7%	11.1%	10.9%	18.8%	8.0%	17.7%	10.7%	6.7%	8.2%	16.2%	8.6%	11.2%	5.1%

Trial Verdicts



Source: NERA Economic Consulting

Suit Type



Source: Advisen

Specific Systemic Risks: D&O

- Macro-Economic Conditions
 - M&A Activity
 - Bankruptcies
 - Improvement / No improvement
- Dodd/Frank Financial Reform
 - Whistle-Blower Rewards
 - Salary Claw-backs
 - Study on Private Right of Action for Aiding and Abetting
 - Study on F-Cubed Case Resolution

Specific Systemic Risks: D&O

- Private and Non Profit D&O suits increasing
- Issues:
 - Owners in dispute
 - Family Members in dispute (many private companies family owned)
 - Emerging issues – Many exposures “still evolving”
 - ~ *Jeffery Klink, SVP of Travelers Bond and Financial Products*

Systemic Risk and Professional Liability

Jane C. Taylor, FCAS, MAAA, JD
CAS 2012 RPM Seminar
March 21, 2012
Philadelphia, PA