Institute and Faculty of Actuaries

Directors & Officers Pricing

Karen Dayal
Gemma Dawson
Shamim Ashraf

15 April 2015

Aims

- This session aims to summarise the findings of the D&O Insurance working party's research and surveys carried out during 2014. It is aimed at actuaries working in the D&O line of business or actuaries wanting to learn more about D&O
- Actuaries work in Non US D&O insurance feels still at infancy
- The aims of the working party have been:
- to understand the pricing risks around this class of business;
- collating any claims data we do have – forming a database of losses;
- exploring ideas for proxies and indicators of D&O risk.

So far

- Library of D&O terms and articles of interest
- Timeline of D&O events
- Commonly used Rating factors
- UW survey
- Claims Survey

- IT'S NOT TOO LATE TO PARTICIPATE!

Brief Intro to D&O Insurance

- Claims made – many notifications – does a claim relate back to a notification
- Cover for Insured directors and Officers
- Personal protection to a D&O if breached duty, negligent, error, misstatement
- Cover for attending investigations into company's affairs
- Defence costs big part of claim
- Companies may indemnify the D&Os for eg defence costs, can then claim these costs back from D&O policy
- E.g. Breach of regulations
  Disqualification of Directors
  Environmental
  Serious Fraud

Brief Intro to D&O Insurance

- Side A – individual protection where company cannot or does not indemnify them
- Side B – company reimburses individual D&O and then company must claim from Insurer
- Side A and Side B – dispute where claim falls, differing deductibles (side A smaller/nil deductible).
- Main common exclusions – Trustee liability, Fraud, Prior claims, Pollution claims
- Main common extensions – Pension Fund Trustees, Outside Board, ERP, Spousal Liability
- Legal Framework different in regions
- US D&O market is very different:
- Very litigious, more data available.

Glossary & Library

Title	Topic	Region	Author	Published Yr
Financial Lines Europe, Claims Intelligence Report	Claims Intelligence	Europe	Chartis / AIG	2012
D&O pricing, not as easy as ABC (handouts)	Pricing	Global	GIRO	2006
Directors & Officers: Current Headlines	Sub-Prime	Global	GIRO	2009
Directors' & Officers' Liability Insurance Benchmarking Report 2010	Market Overview	UK	Airmic	2011
Increase in M&A suits: Game changer for D&O Underwriters?	M&A Suits Development	USA	Willis	2013
PI and D&O	Pricing / Reserving	Global	GIRO	2011
US D&O and PI	Market Overview	USA	GIRO	2003
The Use of Quantitative Modeling in the Directors & Officers (D&O) Liability Insurance Market	Pricing	USA	Adriana M. Rojas Mora, Georgia State University	2009
Quarterly D&O Pricing Index Report: 2014 Q1	Pricing	USA	AON	2014
D&O Insurance: A Practical Guide for Risk Managers	Market Overview	UK	Airmic	2012

Glossary

- 1) What is the SOX act?
  - A) A short position taken in American Football
  - B) A word used in Scrabble to get rid of a pesky “X”
  - C) Legislation enacted in response to the corporate governance and financial scandals of 2002. Its goal was to heighten corporate responsibility and transparency.

Glossary

- 2) What is a “Swing Plan”?
  - A) A type of ballroom dancing
  - B) Instructions on how to construct a playground swing
  - C) A provision in a reinsurance contracts that mean as the losses covered by the insurance contract increases, so does the premium charged.

Glossary

- 3) Which of the following is not a D&O insurance term?
  - A) Dodd Frank Clause
  - B) Hammer Clause
  - C) Clawback Provision
  - D) X-side Cover?

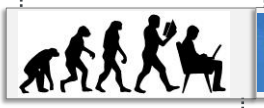
Timeline of events

1930s
Great Depression - Creation of Securities Acts of 1933 and 1934

1960s
Market Growth

1980s
Market Crash & Insurance Crisis

1995s
Private Securities Litigation Reform Act (PSLRA)



1940s / 1950s
D&O Liability Awareness Increases

1960s / 1970s
Capacity Increases

1990s
Tech, IPO Boom

Timeline of events

2001-03
Hard Market

2007
Financial Crisis and Recession Begin

2013
Widespread Acceptance of D&O Insurance, More Disciplined D&O Market

2001
Terrorist Attacks

2002
Sarbanes Oxley (SOX) Act

2010
Put in place to prevent corporations from being "too big to fail." Creates a myriad of regulations for which D&O policies evolve to respond.

Common Rating Factors

Subclass	Exposure Measure
Commercial	Market Cap
Pension Transfer Liability	Turnover / Fees
Financial Institutions	Fund Size
Fund	No. of Shares
Non-Profit	
Venture Capital & Private Equity	
SME – Small & Medium-Sized Enterprises	
Non-US Large (> £500m assets)	
Public Offering of Securities Insurance	

Common Rating Factors

General Factors		

Common Rating Factors

General Factors		
Limit / Attachment	Financial Ratios	Audit Information
Claims Experience	Historical Share Price	Corporate Governance
General Operations	Current Share Price	Wordings
Domicile	No. of &/or Types of Shares	Composite PI/D&O/Crime
Industry Splits	Investment Strategy	Change in Control
Board Composition & Experience	Marketing / Fund Launch Info	IPO Date
Number of Board Members	Composition of Investors	Side Cover Type A/B/C
Run-Off Period	ADR Listing	Cyber as Add-On
US Exposure	Board Member Exit	
Binder / Direct	Credit Rating	
Listings –US / Private / Other	Retroactive Date	
Composite PI/D&O/Crime		

UW Survey

- Survey of Underwriters to gain insight into how they view the world of D&O
- Always interesting to hear the opinions of Underwriters (different views from Actuaries)
- Especially so for D&O

- It's not to late for Underwriters to participate (more surveys at the front or ask us after for an electronic copy)

UW Survey

- Now for some audience participation…

- To help, the survey has so far been filled in by Underwriters:

  - Working in companies & syndicates of all sizes
  - With experience of writing D&O insurance for between 5 and 35 years
  - Who write both primary and excess business
  - Insuring small, medium and large companies

- … So quite a range

UW Survey

1. What scenarios can you foresee giving rise to catastrophic D&O losses?

- N__e!
- US sh___holder class actions
- C__er insu__nce exposure
- Systemic br__ery
- Pr___ fixing
- Acc___ting fraud
- Stock m___t crash
- Col___se of single large entity
- Reg___ory investigations

UW Survey

1. What scenarios can you foresee giving rise to catastrophic D&O losses?

- None!
- US shareholder class actions
- Cyber insurance exposure
- Systemic bribery
- Price fixing
- Accounting fraud
- Stock market crash
- Collapse of single large entity
- Regulatory investigations

UW Survey

2. What are the most significant factors you consider in assessing the riskiness of D&O business?

- Degree of US exposure
- Countries of operation
- Sector
- Financial strength of company
- Historic share price
- Recent changes in ownership
- Management experience
- Corporate governance
- Past claims experience
- Terms & conditions

UW Survey

3. What features are desirable in your D&O pricing models?

- Flexibility (make allowance for aspects of risk that don't fit the model)
- Ability to populate submissions
- Ease of use
- Utilisation of UW's expertise to benchmark individual risks in a consistent fashion
- Speed of use
- Data capture for portfolio analysis
- Transparent methodology
- Ability to update model quickly (no long-term "release dates")
- Used as guide rather than price generator

UW Survey

4. How can actuaries add value to the pricing process?

- BLANK
- Using wider market statistics not available to UWs to assess main areas of exposure
- Bespoke analysis for small portfolios
- Taking time to understand the limitations of pricing models, especially for this class
- Not trying to control pricing

Claims survey

- As well as a survey of Underwriters, we are aiming to capture claims data.
- Main problem facing Pricing actuaries (& Reserving ones): NOT ENOUGH CREDIBLE DATA
- The key objectives are:

1. Sub class analysis
2. Loss distributions – size and frequency of losses
3. Incorporation of claims information into the Pricing process
4. Claims inflation assumptions

Claims Survey

- Here comes the science bit…

- Fill out an NDA
- Complete the spreadsheet template as fully as possible

Public Listed (Y/N)?	Company Ticker	Commercial D&O (Y/N)	FI D&O (Y/N)	Inception Date	Expiry Date	Date Notified	Open / Closed	Date Settled	Slip Lead	Defence costs included in Excess (Y/N)	Defence costs included in Limit (Y/N)	Defence Costs Excess (USD)	Indemnity Excess (USD)

- Some broad policy information

YOA	No. policies	GWP	Industry split	Primary %	Excess %		Please provide:
							Mapping used for Industry
							Any Primary or Excess (non treaty) definition used
							Premium - Gross of RI and Net of Commission
							Any other definitions used

#JustDOIt

#NotAssociatedwithNike

#Questions?