



The Actuarial Profession

making financial sense of the future

GIRO XXX 2003 Convention

US D&O and PI
14-17 October 2003
City Hall, Cardiff

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US D&O, E&O and Med-Mal Liability

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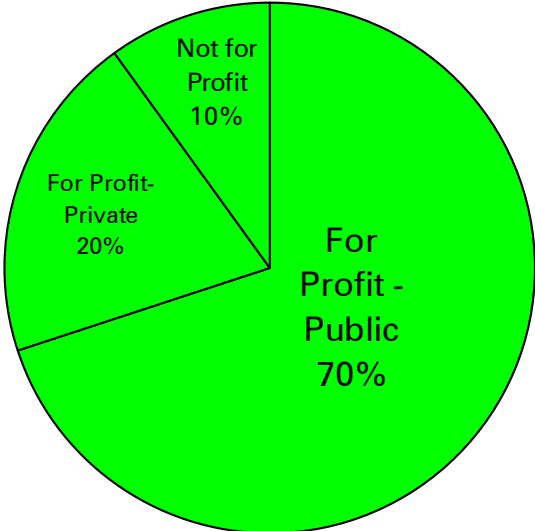
The D&O Insurance Market

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

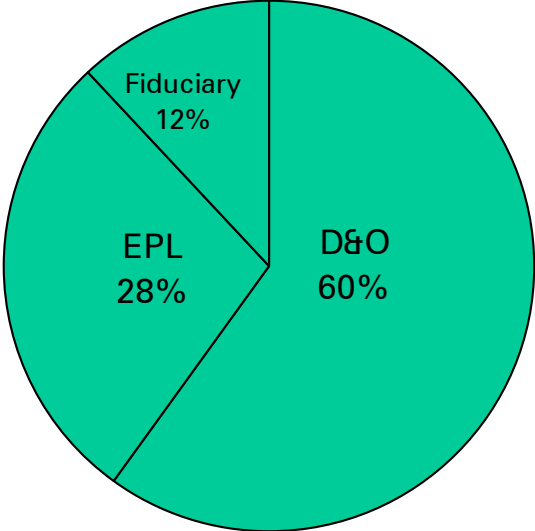
Public insureds represent the largest share of the market

Estimated 2002 Distribution of Premium by Segment

By Ownership Type



By Coverage Type

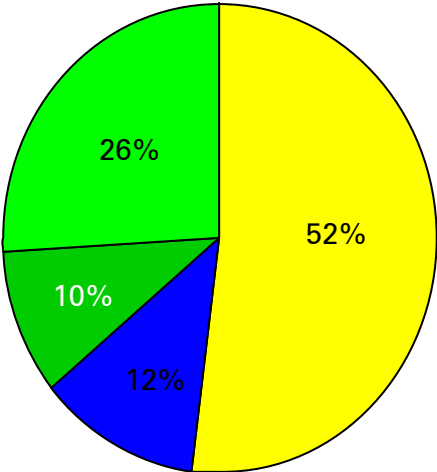


2002 D&O Liability Survey

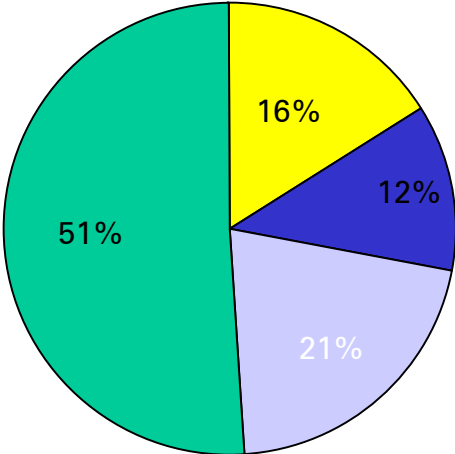
- Survey of claim and purchasing patterns
- Reflects market in second half of 2002
- 2187 US participants
 - 44% - 500 or more shareholders
 - 42% - under 500 shareholders
 - 14% - not for profit
- Annual update of survey that began over 20 years ago

Claimant distribution varies significantly by ownership type

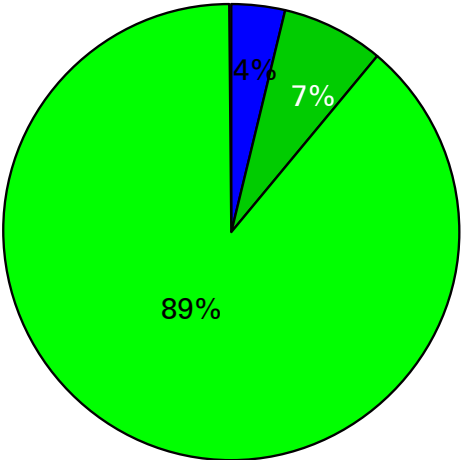
Public
70% of market



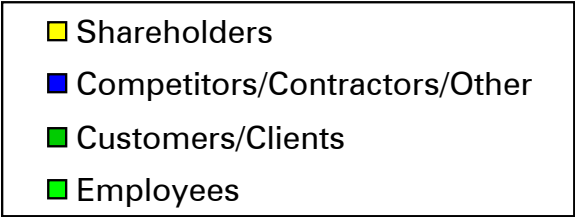
Private
20% of market



Not for Profit
10% of market

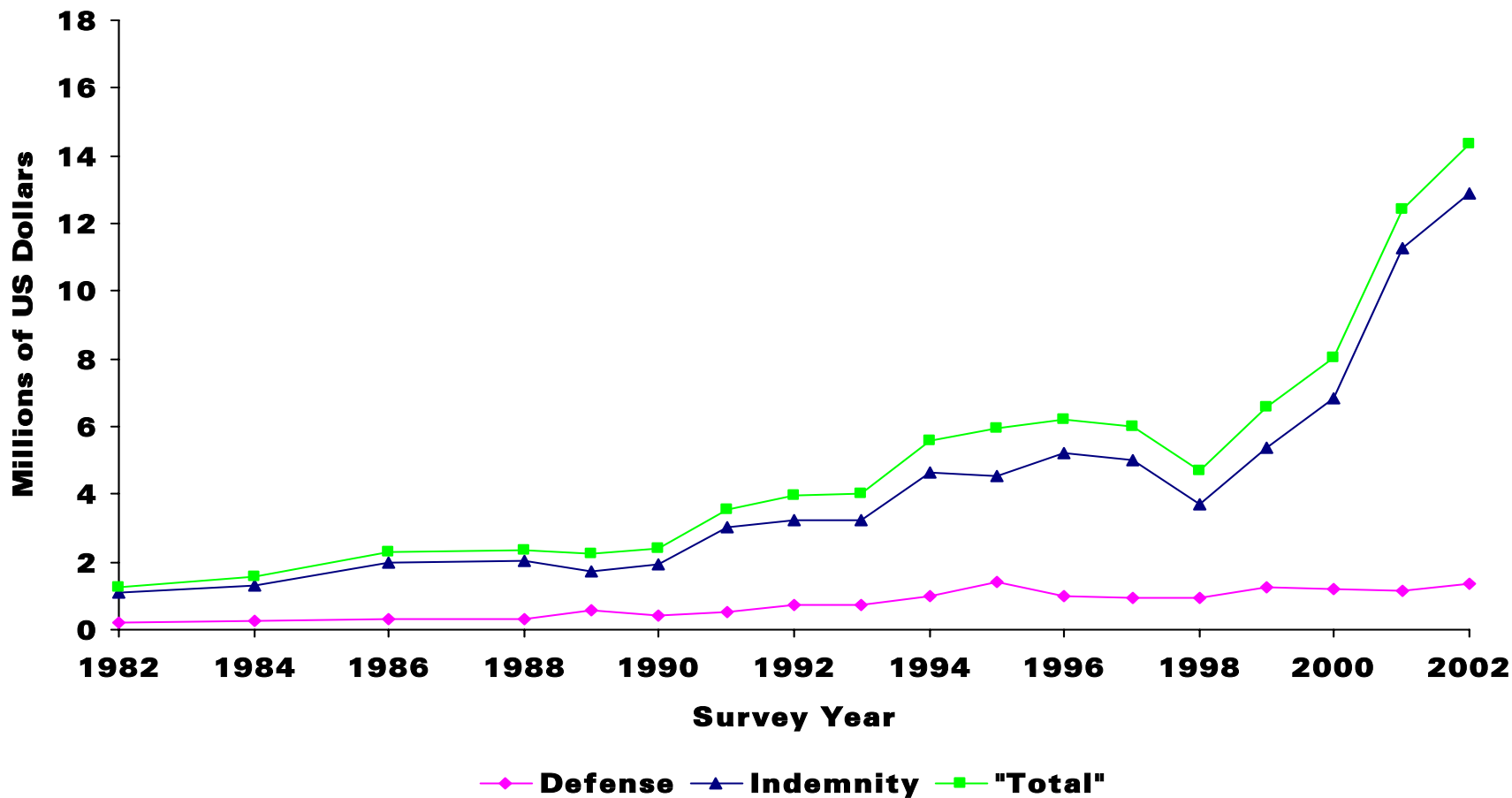


- Large average severity shareholder suits dominate the claims against public companies
- Employee suits dominate claims against private and not-for-profit companies
- Severity of loss is typically a more significant driver of profitability for public exposures while frequency of loss is more of an issue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



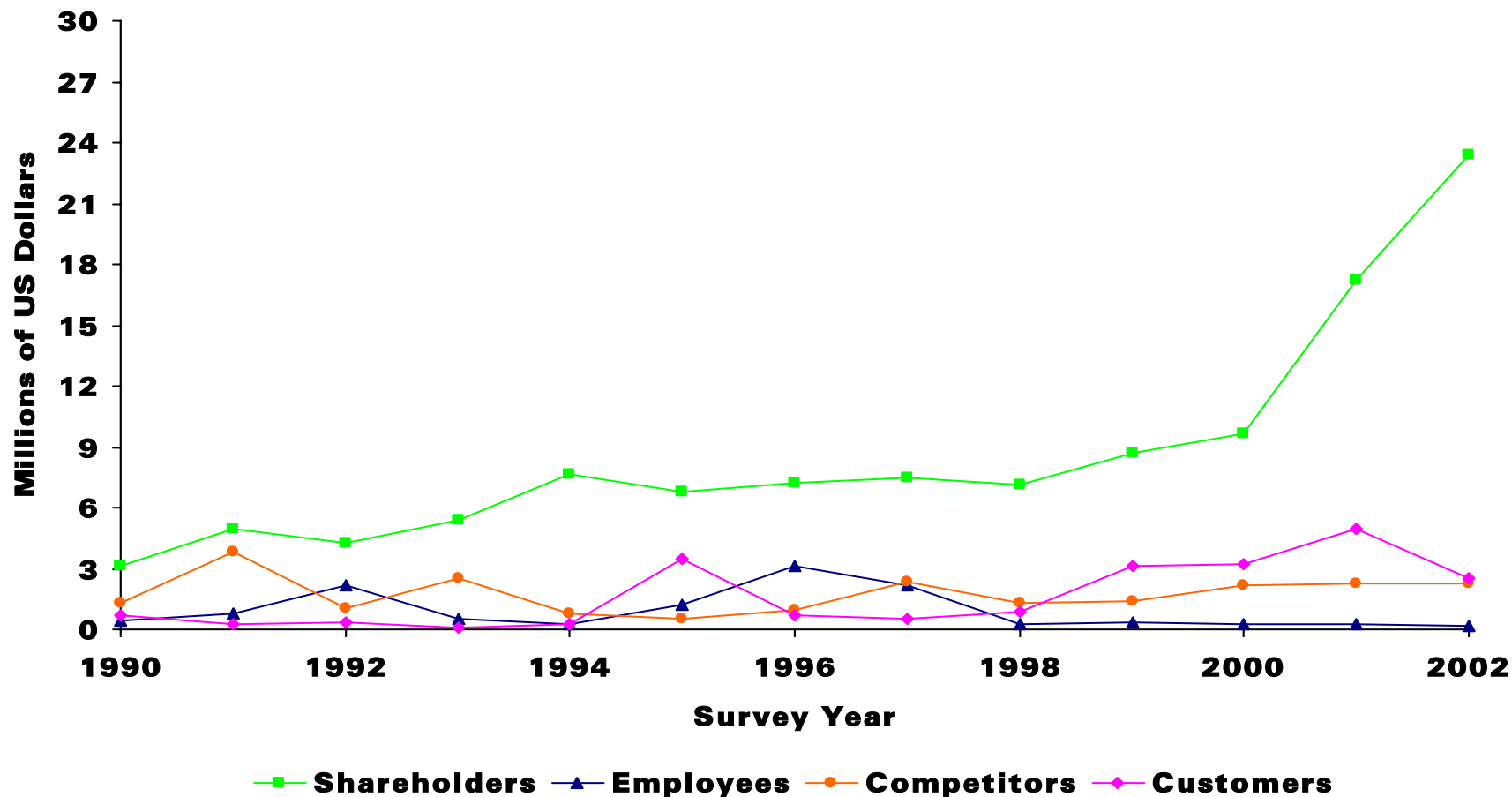
Source: 2002 Tillinghast D&O Survey (distribution of number of claims)

Average Claim Severity – For-Profit Risks



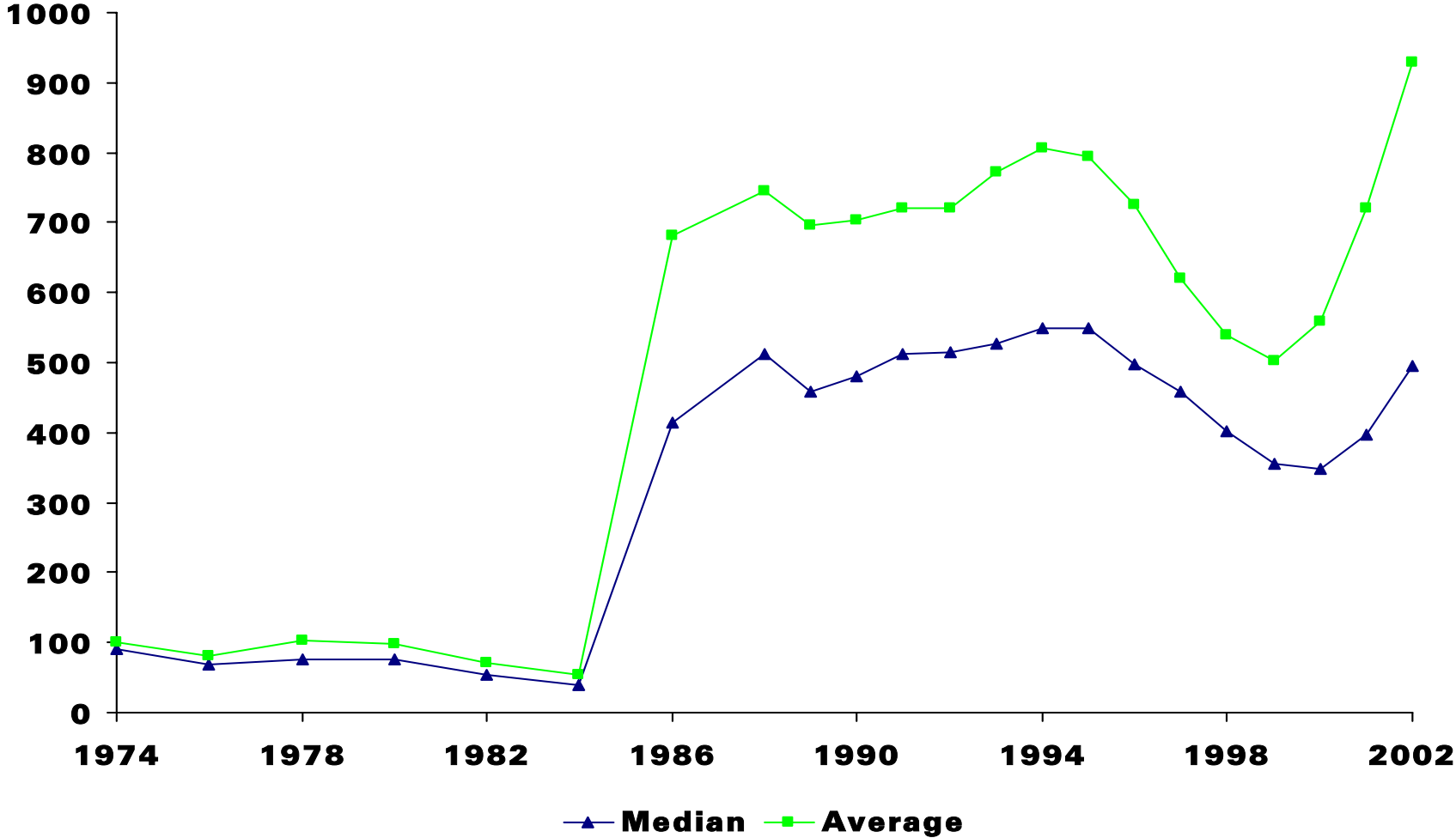
Source: 2002 Tillinghast D&O Survey. Severity of claims closed with payment.

Average Indemnity Severity by Claimant Type



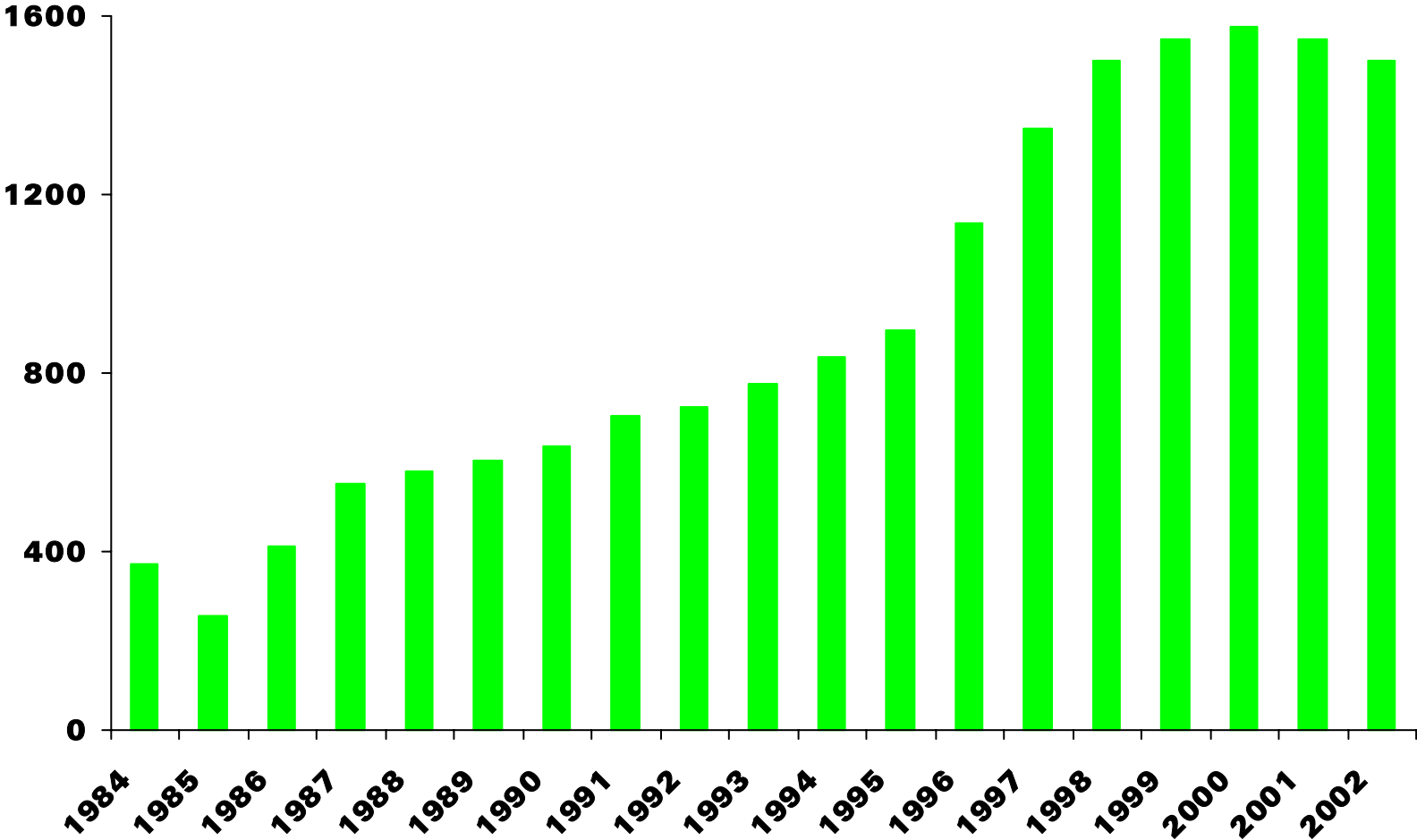
Source: 2002 Tillinghast D&O Survey. Severity of claims closed with payment.

D&O Premium Index – US, For-Profit Only



Source: 2002 Tillinghast D&O Survey.

Full D&O Limits Capacity (\$ Millions)



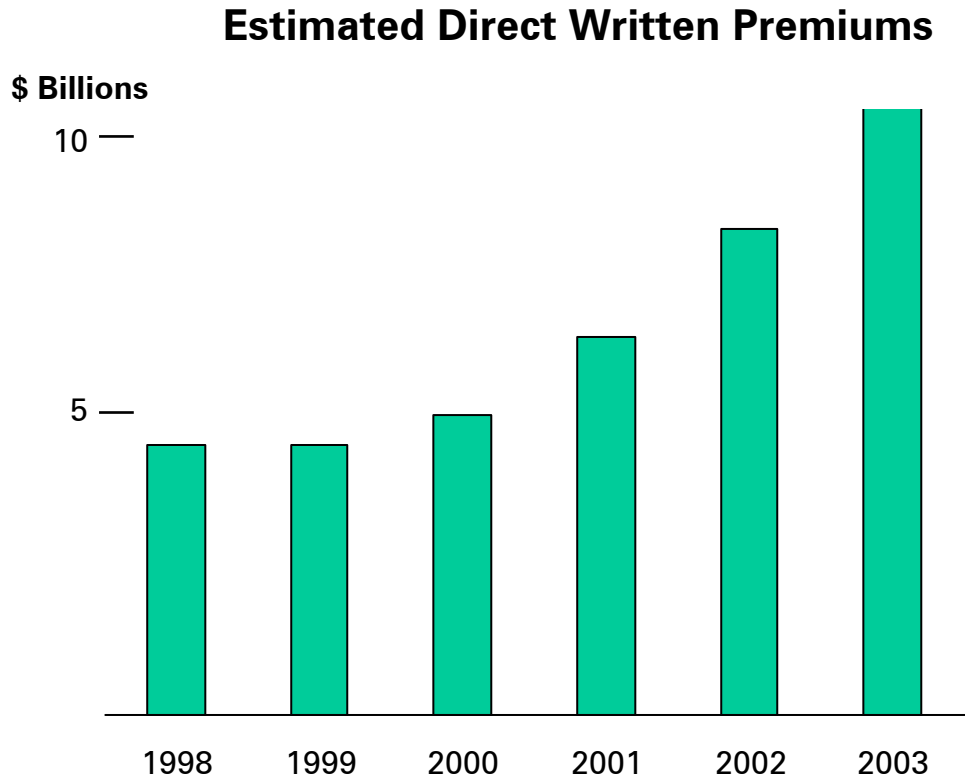
Source: 2002 Tillinghast D&O Survey.

Typical Limits and Retentions

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



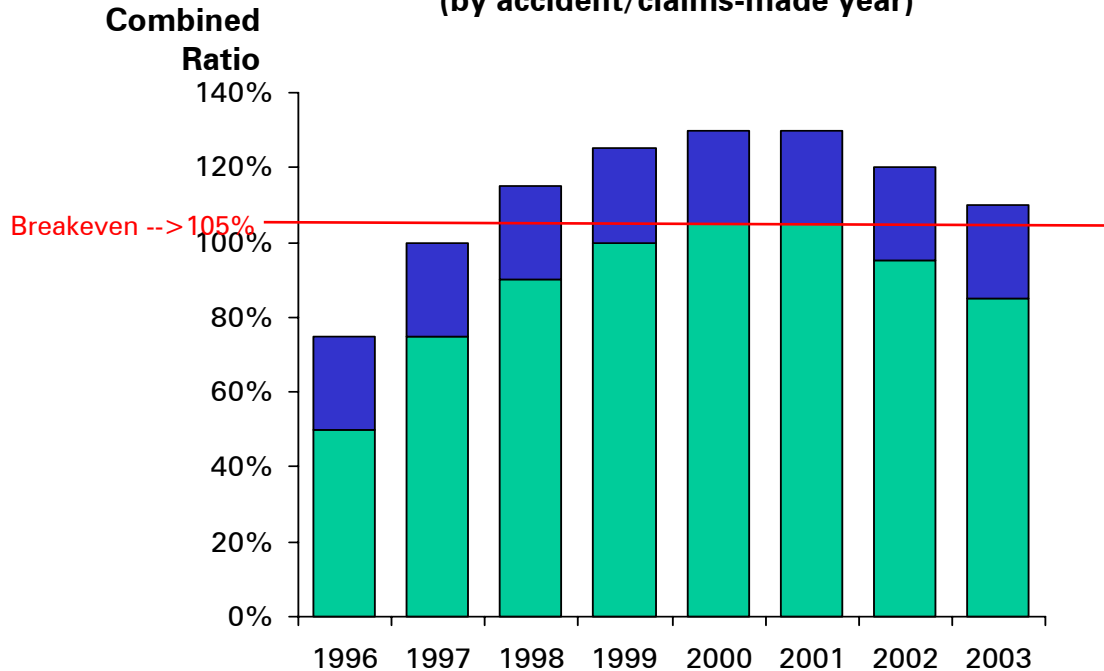
Growth Drivers

- 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.

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)



Key Trends

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

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

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

Drivers of D&O Performance

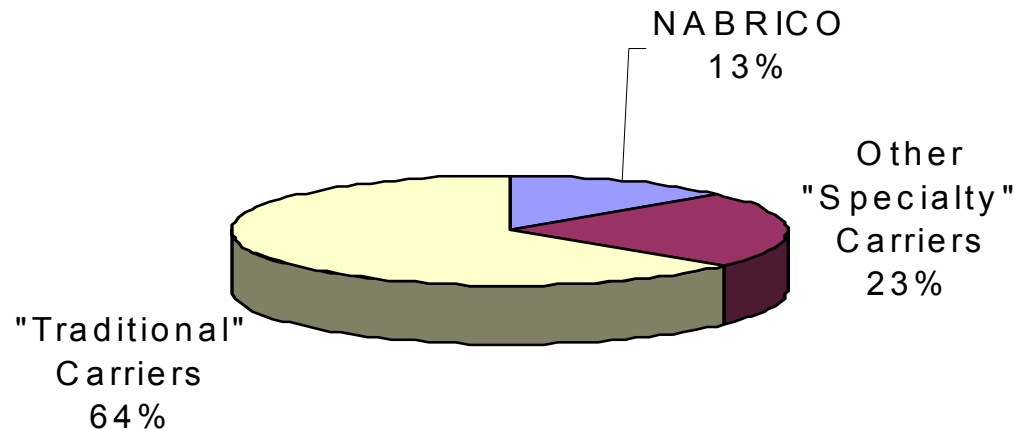
- Legislation, SEC regulations and court rulings
 - Impact of Private Securities Litigation Reform Act of 1995 (“PSLRA”)
 - Sarbanes-Oxley, SEC certification requirement (2002)
- Changes in loss costs
 - Frequency of class actions
 - Timing and severity of securities claims
 - EPL trends
- Insured type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

The E&O Liability Market

	<u>Estimated 2001 DWP (000)</u>
"Traditional" Specialty Areas	
Lawyers Professional Liability	\$1,000,000
Accountants Professional Liability	400,000
Architects & Engineers Professional Liability	400,000
Insurance Agents/Brokers Professional Liability	150,000
Subtotal "Traditional" Specialty Areas	\$1,950,000
Other Miscellaneous Professional Liability	\$800,000

The Lawyers E&O market totals approximately \$1.0 billion, and is serviced by 3 general types of insurers

**Lawyers E & O
Distribution of Estimated 2001 DWP**



Source: A.M. Best, Marketstance, IMR, industry press, Tillinghast estimates.

A large number of “traditional” carriers write Lawyers E&O...

Admiral
Carolina Casualty

AIG /Lexington
AIG /National Union

Chicago
Interstate

~~CNA~~

Chubb/Executive Risk

~~Clarendon~~

~~Great American~~

Travelers/Gulf

Kemper

Deerfield
Evanston

Hartford/Nutmeg
Hartford/Pacific

Liberty Mutual

Old Republic

~~Philadelphia~~

Redland

~~Royal/DPIC~~

SAFECO

~~Scottsdale~~

American Equity
Northland

Colony
Preferred National

St. Paul

~~Star~~

~~TIG~~

Tudor

United National

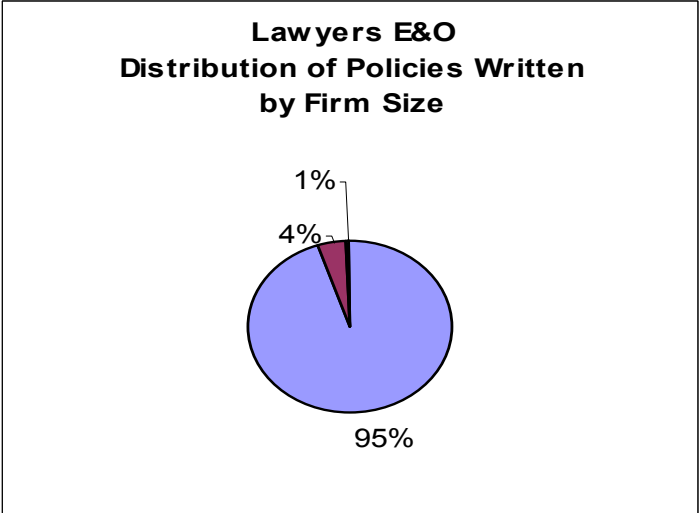
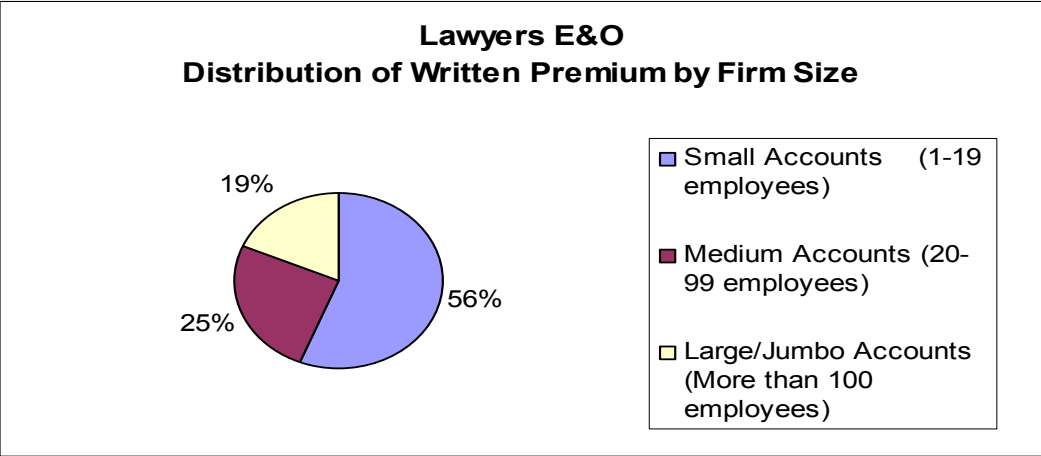
Westport

Zurich

In addition, the following are significant Lawyers E&O “speciality” insurers

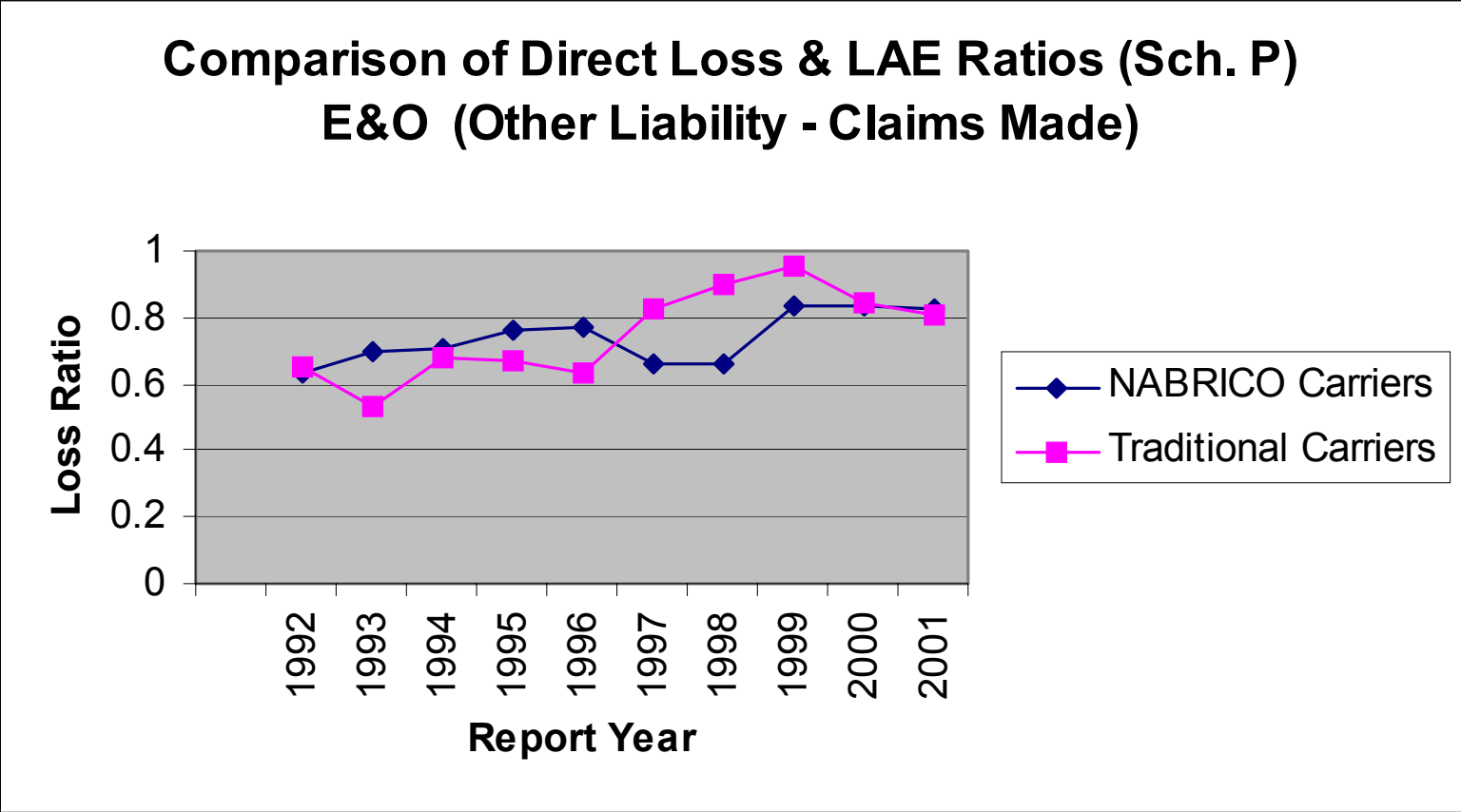
American National Lawyers Insurance Reciprocal RRG
Association of Trial Lawyers Assurance RRG
Attorneys Insurance Mutual of Alabama
Attorneys Insurance Mutual RRG
Attorneys Liability Assurance Society RRG
Attorneys Liability Protection Society RRG
Bar Plan Mutual Insurance Company
Florida Lawyers Mutual Insurance Company
Illinois State Bar Association Mutual Insurance Company
Lawyers Mutual Insurance Company
Lawyers Mutual Insurance Company of Kentucky
Lawyers Mutual Insurance Company of North Carolina
Legal Mutual Liability Insurance Society of Maryland
Michigan Lawyers Mutual Insurance Company
Minnesota Lawyers Mutual Insurance Company
Ohio Bar Liability Insurance Company
Oklahoma Attorneys Mutual Insurance Company
Oregon State Bar Professional Liability Fund
Texas Lawyers Insurance Exchange
Wisconsin Lawyers Mutual Insurance Company

Small firms comprise the majority of the Lawyers E&O market



Source: IMR Data

Recent loss ratios for Lawyers E&O have been similar for NABRICO and traditional carriers

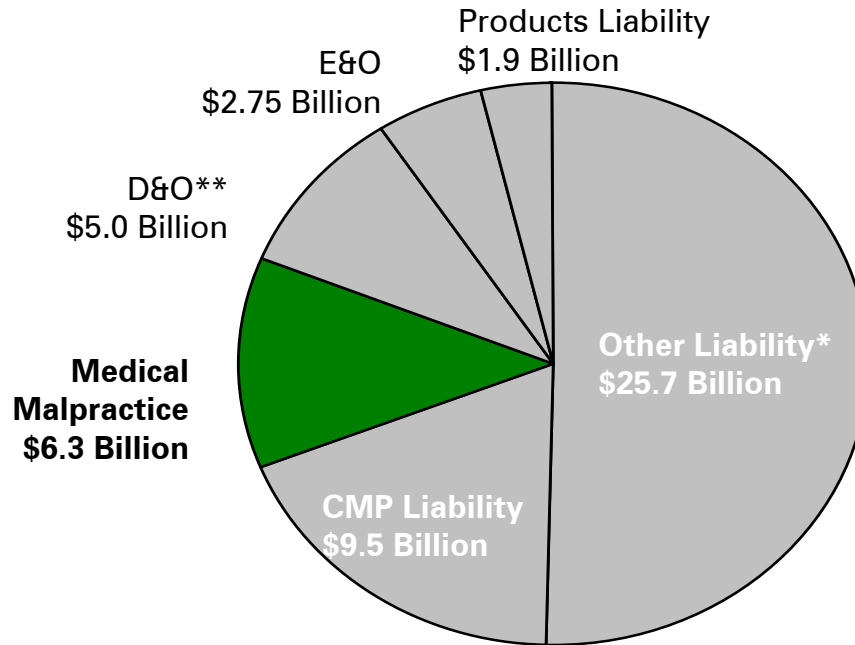


Drivers of E&O performance

- Overall economic outlook
 - Claim activity generally increases in certain practice areas as the economy slows
 - Lower investment returns increase pressure for rate adequacy
- Insured demographics
 - Practice areas/location/firm size/internal controls
- Evolving case law/jury attitudes/legal trends
- Specific market conditions
 - Coverage changes
 - Pricing trends

Medical malpractice is the largest professional liability line, accounting for \$6.3 billion in DWP in 2000

Total Commercial Liability Premiums, Excluding Auto Liability



2000 DWP: \$53 Billion

*Consists predominantly of premises and completed operations coverages; also includes umbrella, excess and some non-medical malpractice professional liability written on an occurrence basis.

**Includes D&O, fiduciary and employment practices liability coverages.

Source: A.M. Best; Tillinghast estimates.

OFFICIAL SYMPATHY SURVEY

In the Continuing Battle Over Medical Malpractice Costs, Whom Do You Feel Sorry for?



A. The poor, downtrodden doctors



B. The lowly, underpaid lawyers



C. The small, struggling insurance industry

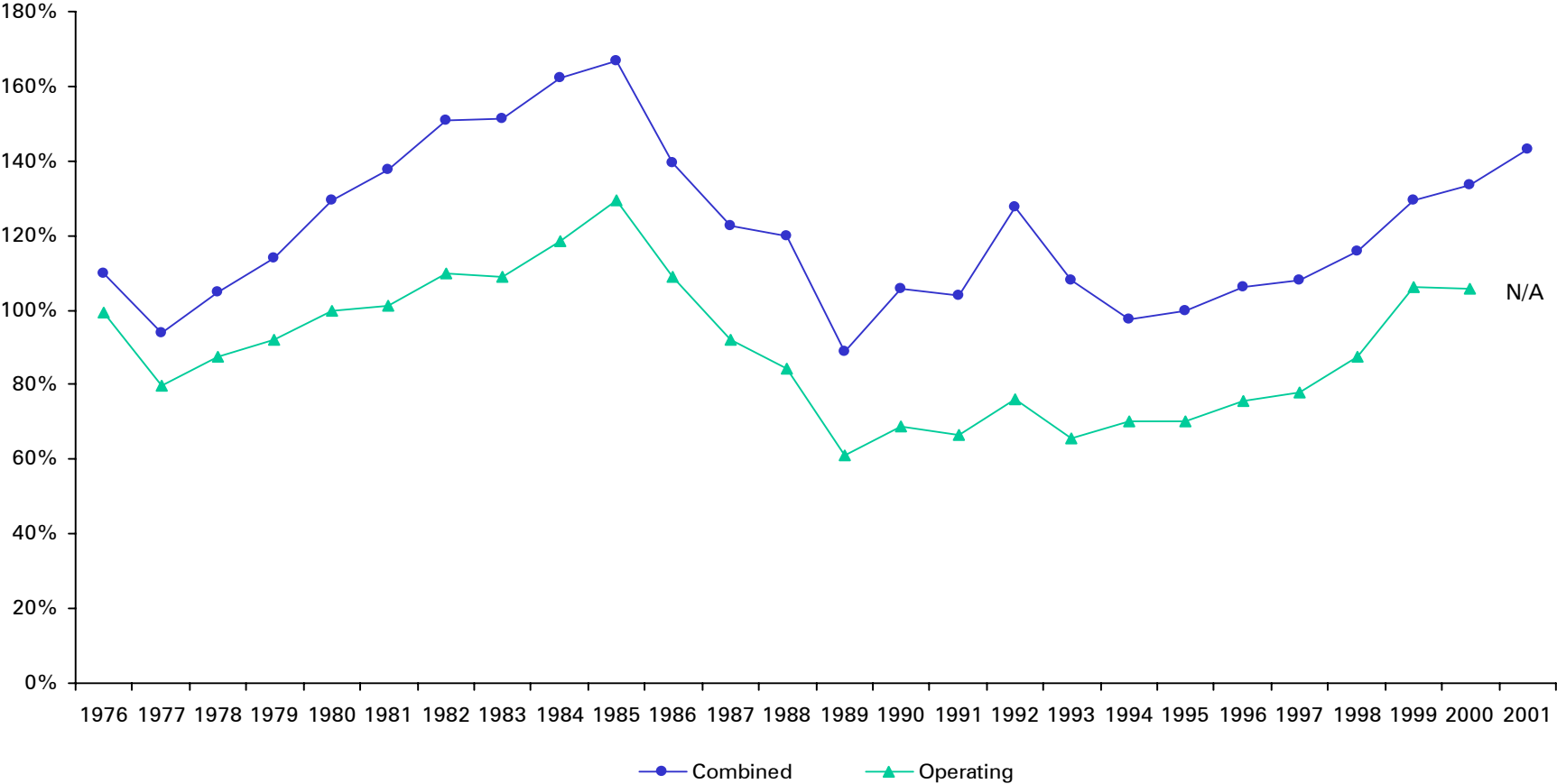
Note: You can only vote for one.

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Financial Results

Combined ratios and operating ratios for the line have deteriorated steadily since 1994

Industry Medical Malpractice Ratios, CY Basis



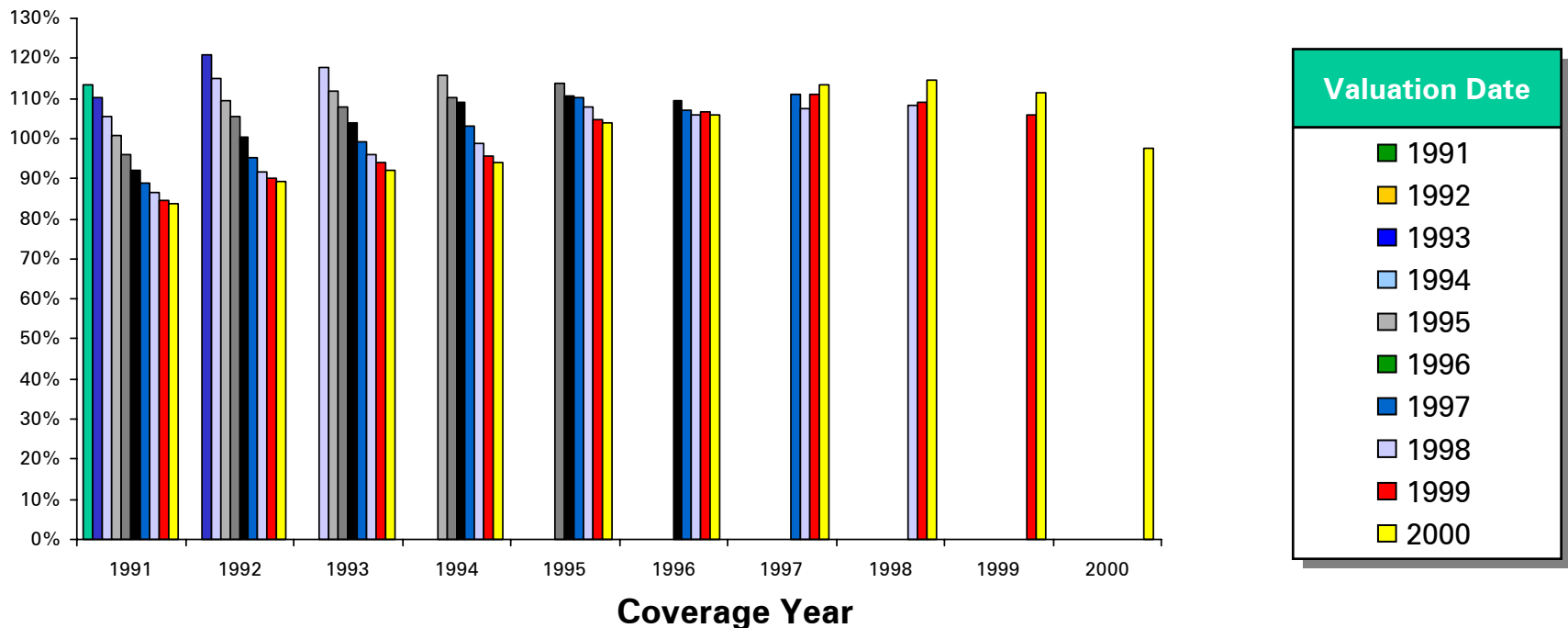
Source: A.M. Best.

Financial Results

Reserve redundancies are masking the true deterioration of results as carriers steadily draw down reserves set aside for business written in the early 1990s

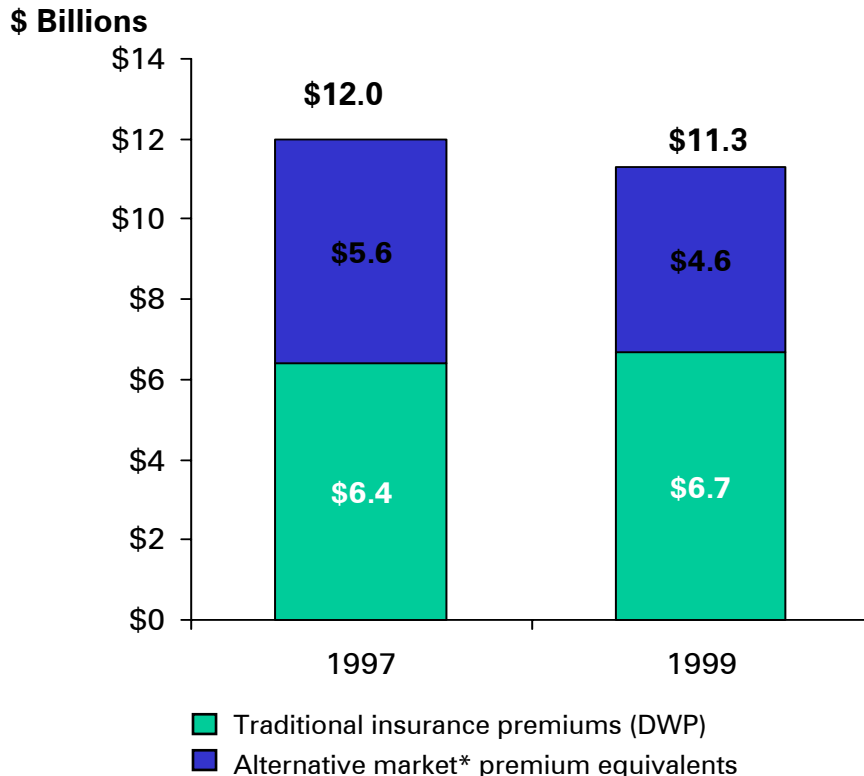
- Reserves appear to have turned deficient sometime in the past two to three years

**Ultimate Projected Loss at Different Valuation Points
Coverage Years 1991 – 2000**



The importance and size of alternative markets has fluctuated over time with changes in market conditions

Medical Malpractice Premiums and Premium Equivalents



Commentary

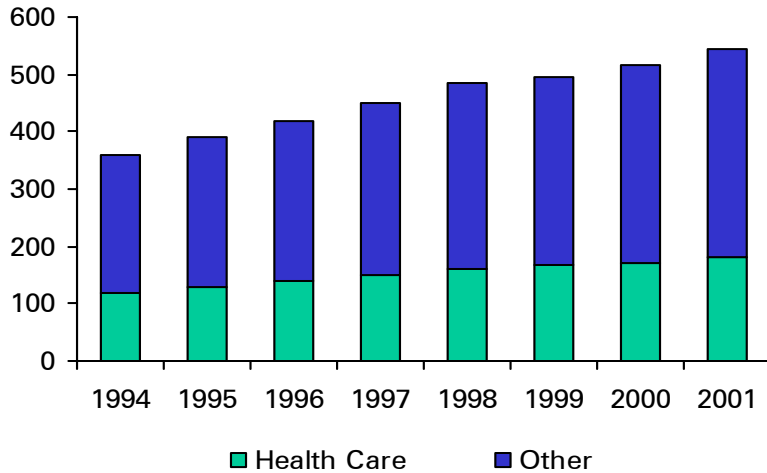
- Total medical malpractice premiums and premium equivalents contracted between 1997 and 1999 with rate reductions in the traditional markets causing movement out of ART market
- As market conditions have hardened, premiums are shifting back to the alternative markets
- The number of captives grew 2.4% in 2000 and 5.9% in 2001

*Includes off-shore premiums, premiums written by individual state JUAs and amounts paid to fund alternative risk management programs, such as trusts and risk retention groups.

Source: For alternative market premium equivalents: Conning, "Medical Malpractice Insurance, A Prescription for Chaos," 2001; For traditional insurance premiums (DWP): A.M. Best's Aggregates & Averages, Schedule P Part I.

A substantial portion of the alternative market is managed through captives domiciled in the Cayman Islands

Growth in Cayman Captives



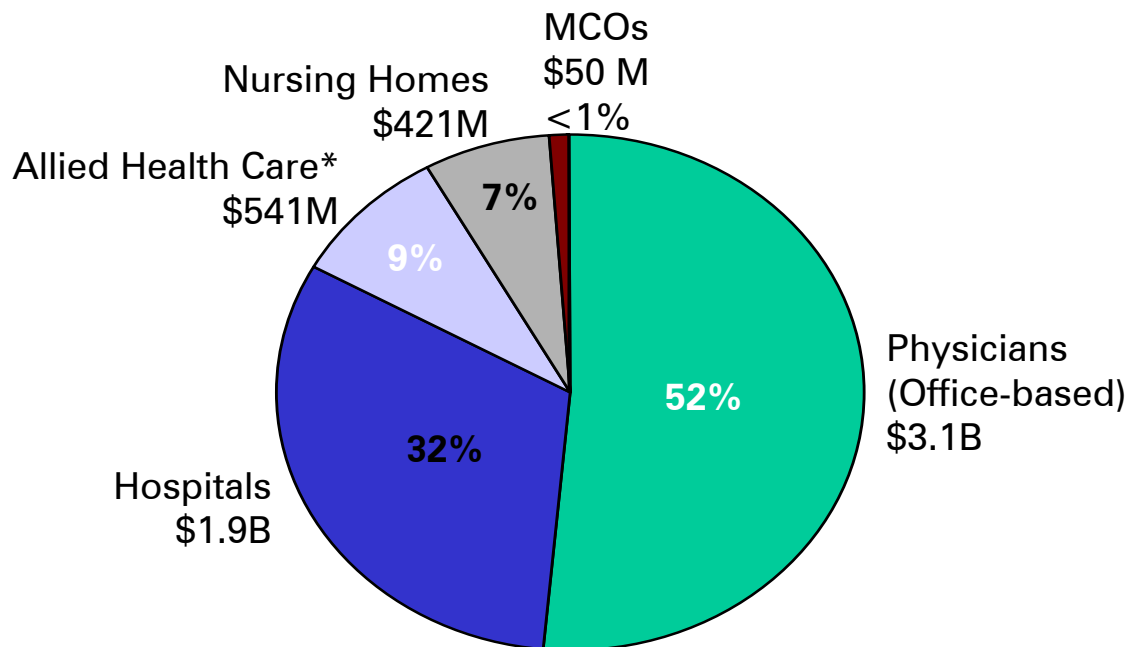
Health Care Captives in the Cayman Islands by Type — 2000

Type of Captive	Number	Premium Volume	Assets
Hospital System	126	\$680,354,244	\$3,900,568,348
Physician Group	34	\$26,339,037	\$169,649,263
Long-term Care	20	\$41,348,283	\$63,382,269
Total	180	\$748,041,564	\$4,133,599,880

Source: Cayman Islands Monetary Authority; Tillinghast estimates.

The physicians market accounts for the largest share of traditional premiums; health systems typically utilize alternative mechanisms to manage their liability exposure

Medical Malpractice Estimated Premium by Type of Customer, 1999



In addition to traditional premiums of \$1.9 billion, hospitals paid between \$4 billion and \$5 billion to fund alternative risk programs in 1999

*Includes all non-M.D. practitioners, with dental being the largest portion.

Source: Conning, "Medical Malpractice Insurance, A Prescription for Chaos," 2001.

The top 10 writers account for roughly 46% of total medical malpractice premiums

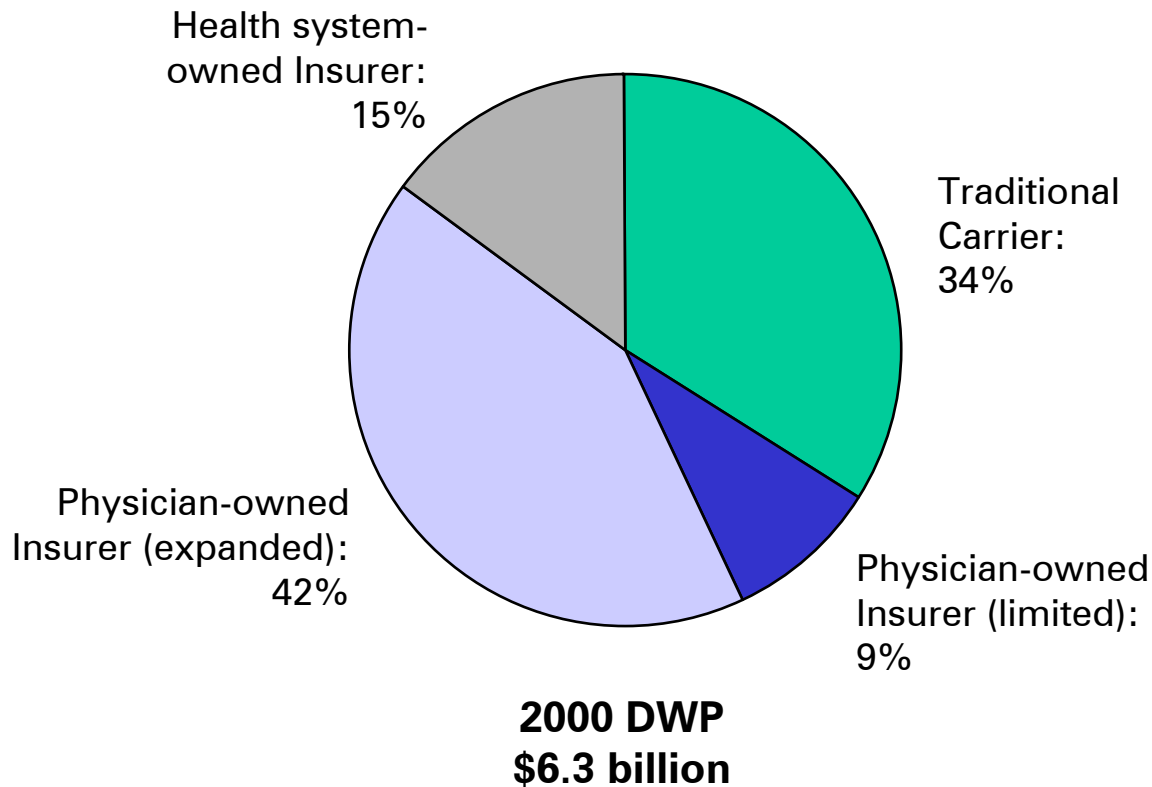
Group		2000 Direct Written Premium*	
		\$Millions	\$ Total
1	St Paul Companies	\$575	9.1%
2	MLMIC Group	\$500	7.9%
3	GE Capital Insurance Group	\$321	5.0%
4	Health Care Indemnity Inc	\$243	3.9%
5	CNA Insurance Companies	\$232	3.7%
6	Zurich/Farmers Group	\$212	3.7%
7	NORCAL Group	\$210	3.4%
8	MIIX Group	\$205	3.3%
9	Doctors Company Ins Group	\$205	3.3%
10	PHICO Group	\$182	2.9%
Top 10		\$2,911	46%
Top 20		\$4,323	69%
Top 30		\$5,154	82%

*Calendar year data based on a group (vs. individual company) basis.
Source: A.M. Best's Aggregates & Averages.

Competitive Landscape

Physician-owned carriers account for half of traditional medical malpractice premiums

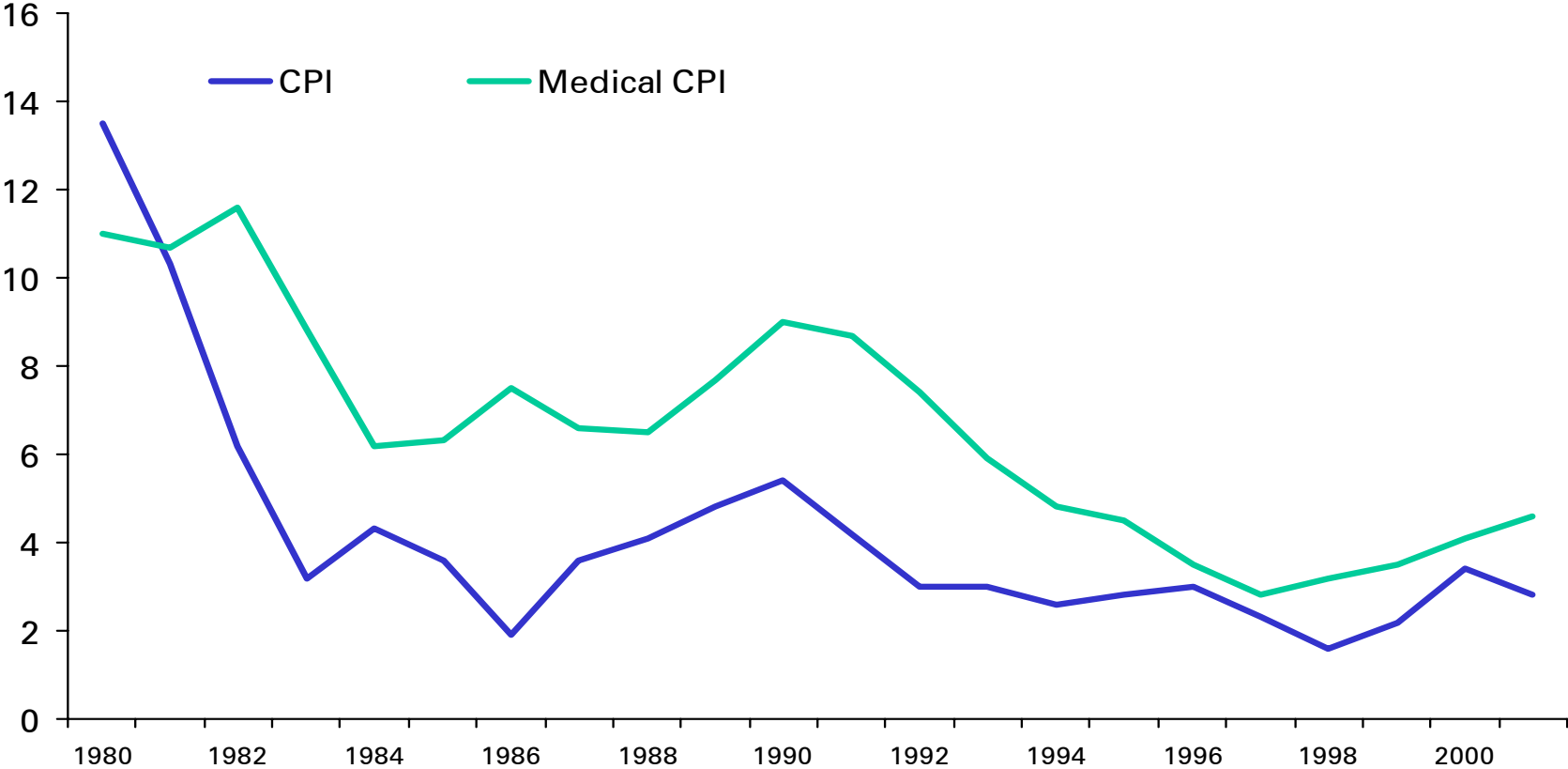
Medical Malpractice Premiums, By Type of Insurer



Issues and Opportunities

Rising overall health care costs

YOY Percentage Changes, CPI vs. Medical CPI: 1980 – 2001

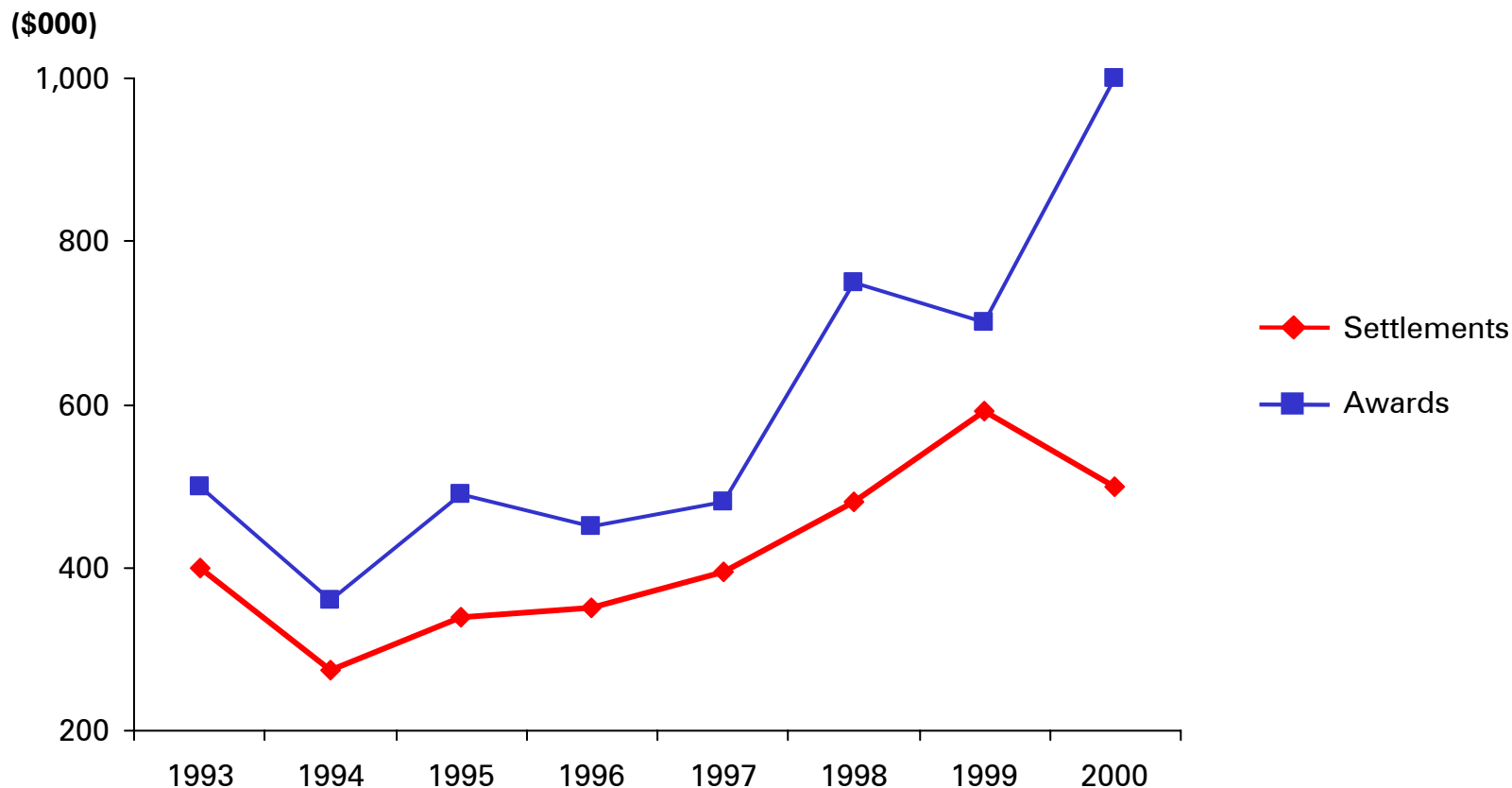


Source: Bureau of Labor Statistics.

Financial Results

Changes in the judicial environment and the health care system in general have led to a significant rise in malpractice awards and settlements

U.S. Median Medical Liability Awards and Settlements



Sample large rewards: 1997 versus 2000 - 2001

1997	
June, Queens County, NY	\$27,570,327
March, Boone County, KY	\$23,530,746
November, Queens County, NY	\$19,275,466
September, Dade County, FL	\$18,924,000
May, LA County, CA	\$15,700,000
April, Oakland County, MI	\$15,317,000
December, Philadelphia County, PA	\$15,000,000
June, Cuyahoga County, OH	\$14,460,000
May, US District, HI	\$12,381,670
February, Kings County, NY	\$11,500,000
April, Orange County, CA	\$10,952,696
October, Beaumont County, TX	\$10,900,000

2000 - 2001	
January 2001, Dallas County, TX	\$269,000,000
May 2001, Bronx County, NY	\$108,000,000
January 2001, Philadelphia County, PA	\$100,000,000
May 2001, Nassau County, NY	\$75,000,000
March 2000, Los Angeles County, CA	\$60,686,150
January 2001, Philadelphia County, PA	\$49,594,684
August 2000, Kings County, NY	\$41,444,531
June 2000, TX	\$32,676,410
September 2000, Escambia County, FL	\$31,100,000
December 2000, New Haven, CT	\$30,000,000
July 2000, Cuyahoga County, OH	\$23,500,000
September 2000, Philadelphia County, PA	\$22,400,000

Financial Results

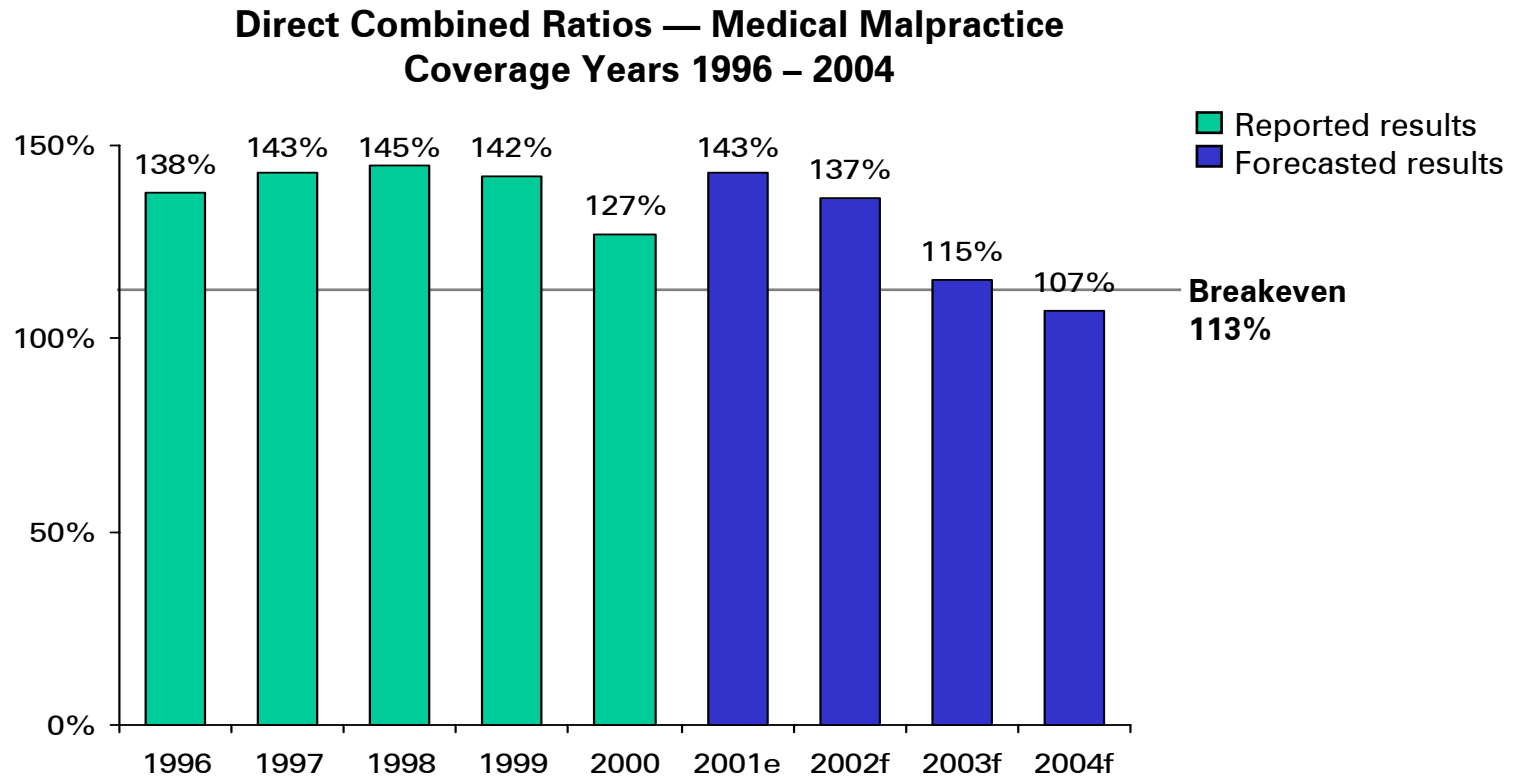
Factors contributing to the rising trend in medical malpractice liability awards and settlements

- Rise in public distrust of the medical profession and publicity about the number of medical errors
 - Public believes standards are declining, though actual malpractice is relatively rare
- Growth in patient advocacy and the popularity of patients rights bills
 - Overall, the public is very strongly in favor of specific consumer protections
 - According to a Kaiser survey*, 70% of those consumers surveyed think patients should be able to sue a health plan for malpractice
- Changes in the judicial environment
 - Easier to litigate and find counsel
 - Well funded and savvy plaintiff's bar
- Advent of managed care
 - Focus shifted from committed medical acts to omitted medical acts (i.e., refusal to treat and failure to diagnose)
 - Failure to diagnose breast cancer is now a leading cause of malpractice claims**
 - Loss of “intimacy” between doctor and patient
 - Primary care physicians pushed to see more patients
 - Expectations changed

*Source: *Kaiser Family Foundation Public Opinion Update* (Document No. 1500) 2001.

**Source: Physicians Insurers Association of America (PIAA) claims report.

2001 results deteriorated significantly, as the industry took the opportunity to strengthen reserves



Source: Historical results: Annual statement, Exhibit of Premium and Loss (statutory page 14 data).
Projected results: Tillinghast analysis of industry press reports, A.M. Best data and market experience.

Key success factors

- Affinity
- Home field advantage
 - Knowledge of medical providers
 - Knowledge of venues/rules
 - Access to defense counsel of choice
 - Politically active
 - Access to regulators
- Access to brokers that understand the business
- Proactive risk management culture in health system
 - Buy-in by senior management
 - Buy-in by medical staff
- Aggressive claims handling
 - Commitment to defend
 - Pool of experts
- Get price right