GIRO XXX
2003 Convention

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

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GIRO XXX
2003 Convention
Douglas Collins
14-17 October 2003
City Hall, Cardiff
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
- For Profit - Public: 70%
- For Profit - Private: 20%
- Not for Profit: 10%

By Coverage Type
- D&O: 60%
- EPL: 28%
- Fiduciary: 12%
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

- 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

Average Indemnity Severity by Claimant Type

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

<table>
<thead>
<tr>
<th>Type / Size</th>
<th>Limits</th>
<th>Retentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>NFP, FP&lt; 500sh</td>
<td>$1m to $10m</td>
<td>$5k to $250k</td>
</tr>
<tr>
<td>FP &gt; 500sh</td>
<td>$10m to $50m</td>
<td>$250k to $1m</td>
</tr>
<tr>
<td>&lt;$1B mkt cap</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FP &gt; $1B mkt cap</td>
<td>Over $50m</td>
<td>$1m to $5m+</td>
</tr>
</tbody>
</table>

Source: 2002 Tillinghast D&O Survey.
D&O Market Premiums have doubled since 2000

Estimated Direct Written Premiums

<table>
<thead>
<tr>
<th>$ Billions</th>
<th>10 —</th>
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<tbody>
<tr>
<td>1998</td>
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<td>1999</td>
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<td>2000</td>
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<td>2001</td>
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<tr>
<td>2002</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
</tr>
</tbody>
</table>

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.

(by accident/claims-made year)

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.
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

<table>
<thead>
<tr>
<th>&quot;Traditional&quot; Specialty Areas</th>
<th>Estimated 2001 DWP (000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lawyers Professional Liability</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Accountants Professional Liability</td>
<td>400,000</td>
</tr>
<tr>
<td>Architects &amp; Engineers Professional Liability</td>
<td>400,000</td>
</tr>
<tr>
<td>Insurance Agents/Brokers Professional Liability</td>
<td>150,000</td>
</tr>
<tr>
<td><strong>Subtotal &quot;Traditional&quot; Specialty Areas</strong></td>
<td><strong>$1,950,000</strong></td>
</tr>
<tr>
<td>Other Miscellaneous Professional Liability</td>
<td>$800,000</td>
</tr>
</tbody>
</table>
The Lawyers E&O market totals approximately $1.0 billion, and is serviced by 3 general types of insurers.

Source: A.M. Best, Marketstance, IMR, industry press, Tillinghast estimates.
A large number of “traditional” carriers write Lawyers E&O...

<table>
<thead>
<tr>
<th>Adminal Carolina Casualty</th>
<th>Deerfield Evanston</th>
<th>American Equity Northland</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIG/Lexington</td>
<td>Hartford/Nutmeg</td>
<td>Colony Preferred National</td>
</tr>
<tr>
<td>AIG/National Union</td>
<td>Hartford/Pacific</td>
<td></td>
</tr>
<tr>
<td>Chicago Interstate</td>
<td>Liberty Mutual</td>
<td>St. Paul</td>
</tr>
<tr>
<td>CNA</td>
<td>Old Republic</td>
<td>Star</td>
</tr>
<tr>
<td>Chubb/Executive Risk</td>
<td>Philadelphia</td>
<td>TIG</td>
</tr>
<tr>
<td>Clarendon</td>
<td>Redland</td>
<td>Tudor</td>
</tr>
<tr>
<td>Great American</td>
<td>Royal/DPIC</td>
<td>United National</td>
</tr>
<tr>
<td>Travelers/Gulf</td>
<td>SAFECO</td>
<td>Westport</td>
</tr>
<tr>
<td>Kemper</td>
<td>Scottsdale</td>
<td>Zurich</td>
</tr>
</tbody>
</table>

Source: Crittenden’s Specialty Coverages Insider and conversations with Tillinghast clients.
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

Source: NABRICO, AMBest’s, Crittenden’s Specialty Coverages Insider
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

Source: Crittenden’s Specialty Coverages Insider, industry press.
Medical malpractice is the largest professional liability line, accounting for $6.3 billion in DWP in 2000

Total Commercial Liability Premiums, Excluding Auto Liability

- Medical Malpractice: $6.3 Billion
- CMP Liability: $9.5 Billion
- E&O: $2.75 Billion
- D&O**: $5.0 Billion
- Products Liability: $1.9 Billion
- Other Liability*: $25.7 Billion

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.
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.
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**

Source: A.M. Best’s Aggregates & Averages, Net Loss and DCC Schedule P Part 2 — Occurrence and Claims Made.
The importance and size of alternative markets has fluctuated over time with changes in market conditions.

Medical Malpractice Premiums and Premium Equivalents

- 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.

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

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**

<table>
<thead>
<tr>
<th>Type of Customer</th>
<th>Estimated Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physicians (Office-based)</td>
<td>$3.1B</td>
</tr>
<tr>
<td>Hospitals</td>
<td>$1.9B</td>
</tr>
<tr>
<td>Allied Health Care*</td>
<td>$541M</td>
</tr>
<tr>
<td>Nursing Homes</td>
<td>$421M</td>
</tr>
<tr>
<td>MCOs</td>
<td>$&lt;50 M</td>
</tr>
<tr>
<td></td>
<td>&lt;1%</td>
</tr>
</tbody>
</table>

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


In addition to traditional premiums of $1.9 billion, hospitals paid between $4 billion and $5 billion to fund alternative risk programs in 1999.
The top 10 writers account for roughly 46% of total medical malpractice premiums

<table>
<thead>
<tr>
<th>Group</th>
<th>2000 Direct Written Premium*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$Millions</td>
</tr>
<tr>
<td>1 St Paul Companies</td>
<td>$575</td>
</tr>
<tr>
<td>2 MLMIC Group</td>
<td>$500</td>
</tr>
<tr>
<td>3 GE Capital Insurance Group</td>
<td>$321</td>
</tr>
<tr>
<td>4 Health Care Indemnity Inc</td>
<td>$243</td>
</tr>
<tr>
<td>5 CNA Insurance Companies</td>
<td>$232</td>
</tr>
<tr>
<td>6 Zurich/Farmers Group</td>
<td>$212</td>
</tr>
<tr>
<td>7 NORCAL Group</td>
<td>$210</td>
</tr>
<tr>
<td>8 MIIX Group</td>
<td>$205</td>
</tr>
<tr>
<td>9 Doctors Company Ins Group</td>
<td>$205</td>
</tr>
<tr>
<td>10 PHICO Group</td>
<td>$182</td>
</tr>
<tr>
<td>Top 10</td>
<td>$2,911</td>
</tr>
<tr>
<td>Top 20</td>
<td>$4,323</td>
</tr>
<tr>
<td>Top 30</td>
<td>$5,154</td>
</tr>
</tbody>
</table>

*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

- **Physician-owned Insurer (expanded):** 42%
- **Physician-owned Insurer (limited):** 9%
- **Health system-owned Insurer:** 15%
- **Traditional Carrier:** 34%

2000 DWP
$6.3 billion

Sources: Tillinghast analysis of A.M. Best data, based on classification of individual company results reflecting definitions on facing page.
Issues and Opportunities
Rising overall health care costs

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

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

Source: Jury Verdict Research.
## Sample large rewards: 1997 versus 2000 - 2001

<table>
<thead>
<tr>
<th>1997</th>
<th>2000 - 2001</th>
</tr>
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<tbody>
<tr>
<td>June, Queens County, NY</td>
<td>January 2001, Dallas County, TX</td>
</tr>
<tr>
<td></td>
<td>May 2001, Bronx County, NY</td>
</tr>
<tr>
<td>March, Boone County, KY</td>
<td>January 2001, Philadelphia County, PA</td>
</tr>
<tr>
<td>November, Queens County, NY</td>
<td>May 2001, Nassau County, NY</td>
</tr>
<tr>
<td>September, Dade County, FL</td>
<td>March 2000, Los Angeles County, CA</td>
</tr>
<tr>
<td>May, LA County, CA</td>
<td>January 2001, Philadelphia County, PA</td>
</tr>
<tr>
<td>April, Oakland County, MI</td>
<td>August 2000, Kings County, NY</td>
</tr>
<tr>
<td>December, Philadelphia County, PA</td>
<td>June 2000, TX</td>
</tr>
<tr>
<td>June, Cuyahoga County, OH</td>
<td>September 2000, Escambia County, FL</td>
</tr>
<tr>
<td>May, US District, HI</td>
<td>December 2000, New Haven, CT</td>
</tr>
<tr>
<td>February, Kings County, NY</td>
<td>July 2000, Cuyahoga County, OH</td>
</tr>
<tr>
<td>April, Orange County, CA</td>
<td>September 2000, Philadelphia County, PA</td>
</tr>
<tr>
<td>October, Beaumont County, TX</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Source: Jury Verdict Research and West Law.</td>
</tr>
</tbody>
</table>

1997: $27,570,327
1997: $23,530,746
1997: $19,275,466
1997: $18,924,000
1997: $15,700,000
1997: $15,317,000
1997: $15,000,000
1997: $14,460,000
1997: $12,381,670
1997: $11,500,000
1997: $10,952,696
1997: $10,900,000

2000 – 2001: $269,000,000
2000 – 2001: $108,000,000
2000 – 2001: $100,000,000
2000 – 2001: $75,000,000
2000 – 2001: $60,686,150
2000 – 2001: $41,444,531
2000 – 2001: $32,676,410
2000 – 2001: $31,100,000
2000 – 2001: $30,000,000
2000 – 2001: $23,500,000
2000 – 2001: $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: Physicians Insurers Association of America (PIAA) claims report.
2001 results deteriorated significantly, as the industry took the opportunity to strengthen reserves.

Direct Combined Ratios — Medical Malpractice
Coverage Years 1996 – 2004

Reported results
Forecasted results

Breakeven 113%

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