The Next Wave

Excess Casualty Markets Brace for 2010

Four experts discuss the business of insuring catastrophic liabilities.

Commercial insurance entities can be susceptible to catastrophic liability and that vulnerability can affect a company's prospects. On Nov. 13, 2009, four industry experts offered their take on tower coverage claims severity and catastrophic claims in an A.M. Best webcast from our global headquarters in Oldwick, N.J.

The following is an edited version of the webcast transcript. The full transcript is available at *http://www.ambest.com/excesscasualty09/ec09-webcast-transcript.pdf*. A video reply is available at *www.ambest.com/excesscasualty09*.

Jeremy Johnson

Chartis

Jeremy Johnson is president of cat excess liability for Chartis. For the past 15 years Chartis has been providing large limits of liability to Fortune 2000 companies.

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Earl Billy Gunn is with the law firm of Weinberg, Wheeler, Hudgins, Gunn & Dial. The firm has offices in Atlanta, Las Vegas and Miami and specializes in defending catastrophic cases.

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Neal Glazer

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Neal Glazer is a partner with the law firm of D'Amato and Lynch in New York. The firm represents insurers, mostly on complex coverage issues.

Tower Coverage

MCDONALD: Let's start at the basic level, here, a tower. Can you explain basically what is a tower and how does it work?

JOHNSON: Well, essentially a tower is the ultimate source of protection against a lawsuit that has the capacity or the potential to cripple that organization—whether it's crippling it financially or logistically. And, in my mind, it's an asset. It's a very valuable asset for the organization and it provides both financial protection in the form of insurance and then access to expertise in defense.

MCDONALD: David, why are they necessary? I know that they're interesting and all that but people are telling us that they're becoming more and more necessary, more and more common. Why is that?

BRESNAHAN: The need for a tower is obvious if you look at the magnitude of the losses that the industry's paying. We provided an exhibit that will be scrolling for our audience right now (see "Two Years of Paid Losses," page 42) that will detail a number of the large losses we're aware of that the market has had to pay out on. Now Chartis operates in a lead umbrella, middle excess as well as Jeremy's operation, the top of the tower. So our claims organization has a front row seat, if you will, to the largest claims that the industry has paid.

MCDONALD: A lot of companies do have umbrella policies. Why isn't that good enough?

BRESNAHAN: Well, again, as you're looking at these loss values you'll see they're staggering and they would envelope an umbrella policy very quickly. But in addition to the loss

Webcast moderators: Lee McDonald, group vice president and Marilyn Ostermiller, assistant vice president, A.M. Best Co.

values you'll also notice a wide variety of accident years. So these are all losses that have been paid by the market in 2007 and 2008, yet the occurrences go back seven, eight, nine years—to give you a sense of how long it takes for these claims to play out. You'd also notice a pretty wide variety of industries represented on the list that leads me to conclude that any business is susceptible to a very large loss.

GLAZER: There's another reason why an umbrella coverage alone is insufficient. Many higher-layer insurers will simply not follow or write umbrella coverage because they're typically written on an occurrence basis, which allows for several years of coverage to apply to the same loss. Higher-layer insurers will insist upon their own policy forms, often Bermuda-type, integrated occurrence policies which will lock a common cause loss with multiple claimants into one policy year.

Claims Severity

MCDONALD: I know when we've talked with you in the past you've talked about severity and that it's headed up. Give us some of the worst-case things you're seeing right now.

JOHNSON: Well, we're seeing a pretty dramatic increase in severity. And we're seeing whether it's in our book or whether we're looking at the published settlements and verdicts that we can access. We're seeing that severity is dramatically outpacing inflation and there are a number of data sources in addition to our own information that we can look at to see how severity is progressing. So just looking at some information from 2008, most of this information is going to be about verdicts. It's quite hard to get settlement information. We'll look at the top 10 jury awards from 2008, most of which were personal injury or property damage. We'll see that the average, 2008 to 2007, more than doubled and the largest claim—2007 it was about $107 million; 2008 it was actually about $350 million. So just in the top 10 verdicts you see a pretty dramatic escalation. We also look at a report that the *National Law Journal* puts out, the top 100 verdicts. Looking at the averages year over year there we see again a significant escalation. So your average premises liability claim is up about 11%, auto up about 23% and wrongful death actually more than doubling. Then we look at our own book, my book, as I said earlier, we're putting up large limits really toward the top of a tower, so our average attachment is going to be about $200 million. But we're seeing a growing number of claims that are getting to our limits and actually getting through our limits. We're not lowering our attachments and we're not lowering our limits; so, in other words, the claims are getting larger.

Catastrophe Claims

MCDONALD: Let's talk about if you're in a tower situation and there is a catastrophic claim…you have multiple layers. Billy, what happens? And what are some of the issues that come up and how does that play out?

GUNN: Companies that have good claims histories often think that they're not really subject to any sort of catastrophic claim. And then one day somebody driving a company car runs into a school bus and it rolls down a hill with 60 children in it. They've got a catastrophic claim.

But to demonstrate or illustrate the practical issues that come up, I want to just talk about a case for a minute and this is all public record, so nothing's being revealed. I'm involved in representing a small, privately held corporation. It's been in business since the

Two Years of Paid Losses by Excess Towers: 2007 and 2008

Accident Year	Policyholder's Industry	Total Loss (million)*	Type of Loss
2001	Media	$100	ERISA class stock-drop/SEC investigation/Securities litigation
2000	Insurance	$140	Fair Labor Standards Act (FLSA) class action
2002	Communications	$712	Securities/Shareholder Class litigation
2005	Consumer Products	$250**	Products liability litigation
2003	Pharmaceuticals	$158	Securities/Shareholder Class litigation
2002	Railroads	$203**	Derailment
2003	Health Care	$600	Securities/Shareholder Class litigation
2001	Computers	$92	Securities/Shareholder and Derivative litigation
2004	Automotive	$228	Securities/Shareholder Class litigation
1999	Energy	$260**	Pipeline explosion
2002	Computers	$100**	Failure of automated system developed by insured
2002	Computers	$140	Securities/Shareholder and Derivative litigation
2002	Health Care	$395	Class Action – Unnecessary heart surgeries
2003	Pharmaceuticals	$81	Securities/Shareholder and Derivative litigation
2003	Manufacturer	$153	Plant explosion
2005	Railroads	$580**	Derailment
2001	Pharmaceuticals	$165	Securities/Shareholder and Derivative litigation
2005	Energy	$850**	Plant fire and explosion
2002	Consumer Products	$2,975	Securities/Shareholder Class litigation
2006	Health Care	$895	Securities/Shareholder and Derivative litigation
1999	Pharmaceuticals	$1,400	Product Liability litigation
2004	Consulting	$110	E&O in provision of actual services to pension plan

Total Exposure: Over $10 Billion

*Amounts have been rounded to nearest million. **Estimate for pending claim.

***Estimate as claims litigation continued after settlement.

Source: Lexington Insurance Co.

1890s. It's got a great reputation. One of its products is not a pharmaceutical but it's similar to that. The FDA has been keeping an eye on this class of product for over 30 years. In 1990 a physician published an unsolicited article in the *New England Journal of Medicine*, touting this product: that if you used it in a way it had not been used before, you could get great diagnostic results with certain tests. And, in light of that article, sales soared. It became the gold standard for use in connection with this procedure and in 2003 a physician approached the company and said, "Perhaps you manufactured a bad lot because I have found five cases of kidney failure that I think I can relate to your product."

The response was, "We've been selling this for over 110 years, this is news to us. Please come see us." He did, and with his help they compiled information on these patients and concluded ultimately that, perhaps rarely, you could have this problem. And lawsuits started filtering in after the physician published his findings.

Over the next few years more lawsuits were filed. In 2008, the FDA decided to make the product a prescription product. So they recalled it off the shelves and that resulted in lawyers advertising and now they have over 900 claims.

Now they have towers of coverage for all of those years. And initially, when there were just a few claims, the primary carrier thought that this was something that it was going to be able to handle. It became apparent that they were going to exhaust their coverage so they started settling cases in ways that I'm not sure I understand but it set a tone. It set a tone that the people higher up have to deal with because the lawyers' expectation changed. Then when you find yourself with 900 cases and you've got this layer of coverage, everybody wants their own law firm, companies have different settlement strategies, some companies would issue a reservation of rights, so they don't have any real interest in spending their $25 million while they've got their rights reserved. Some companies would issue just a denial of coverage and then you've got a gap in your coverage. It makes it paralyzing to try to resolve the litigation.

Forms: US, London, Bermuda

OSTERMILLER: One thing that further complicates this whole thing are the forms. How do coverage and forms differ among the carriers in the U.S. and Bermuda and London?

GLAZER: Following on this increase in capacity we've all been talking about . . . one of the things that this has created is a tremendous effort on the part of both incoming capacity and existing insurers to enhance their existing forms. Umbrella, Bermuda or integrated insurance coverages. In fact, we've had two clients ask us to do across-the-board coverage comparisons among six or seven different forms of the same type.

Umbrella coverages, for the most part, are pretty standard, but there is a major push on to try and expand the coverage and enhance it—narrowing exclusions, giving add-ons that insurers wouldn't have contemplated before. Among the Bermuda forms there are some subtle but dramatic differences. For example, in the way they handle expected or intended loss. The XL and 00 forms handle it dramatically different than the CAD SS02 form. And so it's incumbent upon brokers to understand these subtle differences and how they may apply to their particular account. If you've got a pharmaceutical, top tier, second tier or products manufacturer, that difference in form can have a dramatic difference in the type of coverage that's available.

If you've got a chemical company, for example, with major pollution exposures, the type of pollution exclusions that these carriers offer or will grant in terms of exceptions to the exclusion can make a dramatic difference. So I think brokers these days may have a harder job than they've ever had in keeping track of the forms because there's such a push for enhancements, amendments and loosening of terms.

MCDONALD: Billy, is the form used ever a major factor at litigation or is it generally more an issue of liability and coverage?

GUNN: Well, the form can be a major factor. Say you have eight policies and one in the middle form intended or expected. They have a different view of what that is and all of a sudden they're saying, "we don't have coverage." Well, you can get into litigation over that. That's going to take years, perhaps. How do you deal with the claimants when you don't know what you have? And how can they deal with you when they don't know what you have?

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> — Neal Glazer

Broker Exposures

MCDONALD: When brokers are involved in helping to create liability towers are there any issues that may come back to brokers? Do they have any exposure or liability in this process?

GLAZER: Well, there are probably a fair number of brokers watching this webcast so it's a sensitive subject but one needs only to harken back, for example, to the litigation between Silverstein and the World Trade Center insurers after 9/11. Where, for whatever reason, the policy was not actually issued and there was a grand dispute that went on for years about what the policy should have had in it. So, if a broker is not making sure the actual policy is issued and that, issued, it matches up with the binder and the placement, the policyholder is going to turn to them. If the coverage doesn't turn out to be what the policyholder thought he was buying, who's he going to look to first? If the limits are not sufficient or if it's with an insurer that not responsive or not financially capable of responding to claims, they're going to look to the broker as well. So, brokers have many potential exposures in tower coverages, especially when you're dealing with a larger number of insurers and bigger numbers. The bigger the numbers of limits, the bigger the exposures of the broker for getting it wrong. BR