

# Excess Casualty



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Hello, I'm Lee McDonald with A.M. Best Co. and welcome to our webcast, the Next Wave, Excess Casualty Markets Must Brace for 2010. I'm joined today by Marilyn Ostermiller of A.M. Best. This webcast is sponsored by Lexington Insurance, a Chartis company. We're going to talk about high levels of liability coverage including liability towers and catastrophic levels of casualty cover. We'll talk about brokers, risk managers, insureds and participating insurers need to know about strategies for coverage and also why some ways of structuring liability layers may create their own issues.

**OSTERMILLER:** We have four guests today. We have Earl Billy Gunn with the law firm of Weinberg, Wheeler, Hudgins, Gunn & Dial. Billy will provide our perspective on dealing with the consequences of layers of liability, how it works and how to avoid possible entanglements. We have Neal Glazer, an attorney with D'Amato and Lynch. Neal represents insurers on major casualty claims and has drafted many casualty policy and endorsements in use in today's insurance market. We have Jeremy Johnson, president of cat excess liability, Chartis. Jeremy will help explain why high levels of cover are increasingly in demand, and how those levels help protect against the unexpected. Finally, David J. Bresnahan is executive vice president, Casualty, Healthcare, Programs at Lexington Insurance Co. David will discuss what he's hearing from broker and risk manager clients. Neal, could you tell us a little more about your area of expertise?

**GLAZER:** We represent insurers only - mostly on complex coverage issues. My groups personally handle major casualty claims, often involving towers of insurance like those we'll be discussing today. We've also drafted literally hundreds of policies and endorsements in the casualty lines of insurance.

**OSTERMILLER:** Thank you, Neal. David, you've been with Lexington for 10 years.

**BRESNAHAN:** I've been in the business of underwriting my entire career - nearly 20 years now that I've been in the business. My responsibilities at Lexington are for our casualty business and along with Jeremy Johnson I'll be doing my

best to represent what Chartis is seeing across its company in the excess casualty arena.

**OSTERMILLER:** Billy, could you tell us something about your practice?

**GUNN:** My law firm has offices in Atlanta, Los Vegas and Miami and we specialize in defending catastrophic cases. The firm's 10 years old. We've had over 200 trials in that period of time. We do a lot of mediations and case resolutions.

**OSTERMILLER:** Thank you. Jeremy, you're originally from the U.K. What else would be helpful for our audience to know?

**JOHNSON:** I run a division that for the last 15 years at Chartis has been providing large limits of liability to Fortune 2000 companies. So, up to 150 million dollars of liability for casualty, directors and officers and employment practice liability, etc.

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

**JOHNSON:** 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, let's integrate you and Jeremy. 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 detail a number of the large losses we're aware of that the market has had to pay out on. 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:** As you're looking at these loss values you'll see they're staggering and they would envelop an umbrella policy very quickly. But in addition to the loss values, you'll also notice a wide variety of accident years. So losses that have been paid by the market in 2007 and 2008, 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 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 an 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.

**JOHNSON:** Dave made a point about severity approaching any industry and it's interesting for us when we look at where the claims come from. They generally don't come from where we expect them to come from. So we underwrite a large tower, we underwrite a large risk and we think we're underwriting for "X" and the claim comes from "Y."

**MCDONALD:** 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 it whether it's in our in 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's 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—in 2008 was actually about \$350 million. We also look at a report that the National Law Journal puts out, the top 100 verdicts. Looking at the averages year over year, 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. It's unfortunate that it really takes a claim for a company to acknowledge and understand what their severity risk is. Punitive damage is still a very real factor in ascertaining limits of liability and ascertaining the potential for a large verdict or large settlement. I know the Supreme Court has made some efforts to put a box around the ratio between punitive and compensatory and limit it to under 10 times. It's still very much open to interpretation by the state courts. We're still seeing very large multiples of punitive damages for a case that ultimately does go to a verdict.

We're also seeing more and more verdicts entailing punitive. So, last year, it was about 4% of cases that went to a verdict had a punitive component to them. That compares to 3% the years before.

**GUNN:** And with the underlying liability numbers going up, even if you have a multiplier, that's going way up, too. And I can assure you that just in what I would call a 'garden-variety' wrongful death case, it's not unusual these days to see eight-figure verdicts when in the past it would be \$1 million or \$2 million.

**MCDONALD:** I guess the third leg would be defense costs.

**GLAZER:** Defense expenses – I can tell you that they are increasing geometrically, especially on mass tort cases where you have hundreds or thousands of claimants. When you have a case involving bodily injury, it's virtually impossible to have a class action certified. So what you have is a mélange of multidistrict litigations involving federal court cases, you'll have a smattering of state court cases, you'll also have some foreign cases and it is not unusual to see defense expenses now from a third to a half of the indemnity loss. Depending on whether defense expenses are outside the limits of insurance or inside is a major problem in the latter case as it pushes the loss up through the layers. In the former case, the insurer is bearing those expenses until it's paid its layer in settlement. So that's another large component of severity that the statistics don't always reflect.

**MCDONALD:** David, what are we hearing from your clients?

**BRESNAHAN:** We're seeing in excess casualty that the buying philosophies continue to evolve. You know it was only a year ago that we were both in an economic and financial crisis and I think it really shook many buyers to their core in regards to financial security. There was a lot of uncertainty in terms of trying to predict where the next shoe would drop and with that uncertainty I think buyers began to spread their risk around and diversify. Thankfully, today the insurance market is much more stable than it was a year ago. So risk managers are revisiting those decisions and in my opinion bringing a very thoughtful approach to how they're selecting where to transfer their long-tail risk transfer liabilities.

**MCDONALD:** What guidance are you giving them? What's your advice?

**JOHNSON:** I think when I'm putting together a tower, there's really two dynamics that should be looked at. There's the front end: the pricing, the cover, the financial security of the insurers and that's what most of our clients focus on. My advice would be to focus on the back end. Look to what could happen if you have a claim. You buy a policy not so you can just waive around a piece of paper or put it in a drawer and say I'm done, I've got my insurance. You buy an insurance policy that could cost hundreds of thousands, millions of dollars for the outside chance that you might have a catastrophic piece of litigation. And when you have that catastrophic piece of litigation what's going to happen? Are your adjusters going to be able to cooperate? Are they going

to be able to cooperate with you? Are they going to be able to cooperate with themselves? Are they going to be able to work out a strategy to approach the client? Are they going to be able to agree on coverage? Are they going to be able to work out and agree on a posture and an attitude towards the plaintiff? Are they capable of assessing the potential severity of a claim? You have to be able to evaluate the potential severity of the claim to figure out if you can and if you're prepared to go to trial. I think many of our brokers and our risk managers think about the front end and they focus on the front end. They focus on the price and building the tower and they don't ask their carriers and they don't ask themselves what could happen if I have a claim? If you have a claim, that claim is going to be getting not just risk manager-type attention, but general counsel, CFO, CEO and board of directors' attention. I think it's also worth looking at the tower not just as an insurance policy but as a strategic asset. You've got to have enough limit in the tower to be able to look a plaintiff in the face and say I'll go to trial. So if you don't have enough limit to be able to potentially absorb a negative verdict at trial, then you can't go to trial and the plaintiff is going to know that because the plaintiff is going to know how big your tower is. They're going to have leverage on you to settle for the amount that they want to settle at not what you want to settle at.

**MCDONALD:** Let's talk about a tower situation and 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 all of a sudden. But to illustrate the practical issues that come up, I want to just talk about a case for a minute. I'm involved in representing a small, privately held corporation. It's been in business since the 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 lawyer 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 dollars 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.

**OSTERMILLER:** Given this scenario, what are some of the problems in coordinating the towers of liability during a catastrophic excess claim?

**GLAZER:** Billy has given you a view from outside the tower, so to speak. As a lawyer for insurers, I'm one of those poor souls who frequently has to attend tower of insurer meeting to decide on the issues that Billy has brought up. And it runs the gamut. You have some towers that are the equivalent of the biblical tower of Babel with different insurers with different coverage issues, different settlement valuations, different defense strategies, different resolution strategies and it's very difficult to obtain consensus. You have 'ninja' insurers who want to fight to the bitter end. You have more rational insurers and then you have semi-comatose insurers who are asleep and in prayer that the loss will not hit their layer. In other cases, for example, I attended a meeting on Monday amongst insurers for a billion dollar plus pharmaceutical loss and the representatives of the insurers, lawyers and the claims representatives, very professional, very experienced and we have near unanimity on handling. So, it runs the gamut and it's not quite like herding cats, but more like herding cougars - trying to get consensus and unanimity of approach.

There are solutions to this and there are ways to handle it. It is incumbent upon an insured policyholder to meet with its tower of insurers early and often. To have regular briefing meetings on claims strategies, resolution strategies, try to gain consensus on what cases should be settled, which tried, and settled for how much. Some policyholders are very forthcoming with information and cooperative, some play hardball and adopt an adversarial situation. The latter, in my opinion and based on my experience, are gravely mistaken in that approach. So it is up to the policyholder to try and work with the tower despite the sometimes diverse interests within the tower to build unanimity and consensus of approach.

**OSTERMILLER:** Billy, how can multiple layers of liability work smoothly?

**GUNN:** Well, I think Neal is correct that early on you need face to face, candid discussions so everybody's position

is understood. Because these things play out over a period of time and you don't want to be late in the game bringing some company up to speed. If the bottom layer of coverage is from someone close to or at the very top also, that helps keep everything in line. It makes it easier when the time comes to make critical decisions because at the top and at the bottom you've got the same strategy and you know what you're doing and you can move.

**GLAZER:** I think it's fair to say that the more insurers you have in a tower, the greater the likelihood that as the baton is passed from layer to layer for responsibility for a claim, there's a greater possibility that the baton is going to be dropped. So not only is it incumbent on a policyholder and their representatives to meet early and often with the insurers, it's incumbent upon the insurers in each layer to stay abreast of a claim so that when the time comes for them to step up, they know what's going on and they have a plan on what to do and are in a position to respond.

**JOHNSON:** You know, I'll just take that one step further. I will generally sit above another Chartis company who's leading it. And when we handle the claim it gives us a huge, strategic advantage because we at the excess at the top have a very early perspective on what's going to happen. We know if things are starting to blow up down low in the primary, in the lead. And so it's an advantage to us, handling the claim and thus an advantage to our insureds, for whom we are handling the claim.

**GUNN:** Sometimes companies low in the tower see the writing on the wall and they just write a check and they're done. It creates another set of problems.

**OSTERMILLER:** Let's talk about that a little bit. That's the bottom layer. They write the check. They're done. Now what?

**GUNN:** Now you run the possibility that the people who are primarily responsible, don't like the law firm that's been handling it, so they bring in a different cast of characters. Or they have a completely different approach to the litigation. But you're dealing with the same cast of characters on the other side and changing their expectations and those relationships is very difficult.

**JOHNSON:** And you may have set a precedent in terms of the value of a particular claim. If you're looking at a mass tort and you throw in the towel early as a primary carrier for an elevated, pro-claimant settlement value that's going to translate all through the tower and potentially cause the claim to blow through the tower . . . and now have enough insurance, as opposed to a tower that manages holistically the view to a claim and to the value of each particular claim.

**GLAZER:** There's another variable in here on the insured policyholder's side. Some Fortune 2000 companies are much more effective in managing their claims than others. Some just hand it off to the insurers and leave the insurers to run with it. Others recognize that the company's reputation, its future claims experience and its cost of insurance are at stake and therefore take a much more proactive role. So it's not only the tower of insurers that have got to be awake and in control, but it's also up to the tower of insurers to make

sure the policyholder is managing the claims effectively.

**MCDONALD:** We've been expecting a hardening market for about a year but we've seen little evidence of a consistent trend. Can we expect more consistent hardening of the market on the P/C side in 2010?

**BRESNAHAN:** The short answer is yes. That's the advice I give clients when I have an opportunity to see them. But it's a qualified and complicated yes. I would agree that 2009 has been a very competitive year. There's been a lot of additional capacity enter the market in the last couple of years that's lead to what many people widely describe as a "soft" market. But, it's also important for clients to understand inside that soft market our excess rates are actually up fairly dramatically in the last 12 months. So, a year ago our excess rates were minus eight and you've seen them go minus six, minus four, minus two at present. So, the trend line is clearly back to flat and I would expect that excess rates are going to be rate positive in the first quarter of 2010. I would qualify my confidence in positive rates, though, to be more specifically directed at the lower end of a tower. So if you're talking about primary occurrence policies, lead umbrella occurrence policies and maybe that first excess layer, my opinion is those areas are definitely going to be rate positive next year because this glut of capacity that's entered the market is mainly focused in the higher areas. And it's not effective capacity down in the lead areas which I think is why many of the lead markets will be able to get positive rates very early in 2010.

**MCDONALD:** Capacity in the umbrella and excess marketplace continues to grow. As market conditions are expected to remain soft through the end of 2010, competition will continue in this casualty arena. In order to maintain and grow its excess casualty book, what coverage enhancements is Lexington intending to provide to prospects and customers?

**JOHNSON:** Dave has seen great improvement in his book. I've also seen rate improvement in my book which is in that high excess space, where certainly in the last year there has been more capacity coming in. I think we have about 300 million more capacity in the space that I play in than we had 18 months ago. But my book has moved positively on rates, so if I was negative 10 a year ago I'm barely negative three through nine months of this year. So, I see great improvement. And the book that I write and the customers that are buying need to buy large limits of \$500 million to \$1 billion of cover. They have claims. We constantly see claims. It's a book where, having given up rate for five, six years and seen severity increase, and seen inflation increase, not just simple inflation but medical cost inflation, construction cost inflation. It's a book that needs rates. I talked about how claims are bumping into our attachments much more frequently as they grow so we're going to see more claims. So I wouldn't necessarily acknowledge that it's going to continue to be soft in 2010. I think that the rate is needed there. And certainly there is competition. We at Chartis - whether that's Lexington or our Chartis lead group, or myself excess - we need to focus on selling our strengths

and one of our principal strengths that we have is the claims that we've been talking about, which I don't think any of our peers can really bring to the table, so certainly we need to focused on new product and Lexington has introduced something like 16 new products in the last nine months. Within my group we're working on a couple of new products we're not ready to announce yet, but I anticipate having something new to offer on both my excess casualty product and my financial lines product within the next two months to keep innovating.

**BRESNAHAN:** Rubber really meets the road on innovation if it adds material value to a client at the time of a catastrophe and we had one higher education client out in the Midwest who had a horrible tragedy, a campus shooting where six students were killed and eight others injured. You know, fortunately, our excess casualty product had several enhancements that came into play immediately after that event. We had a crisis response coverage that provided for both a psychiatric and a grief counseling service to be there, as well as a world-class public relations firm to be on the ground the very next morning, helping that university engage with the grief-stricken families, helping them talk to law enforcement, helping them deal with the media circus that was buzzing around the campus following the incident. In addition to the crisis response coverages we also had an accidental death and dismemberment rider on the contract which provided for a 50,000 dollar death benefit to each of the killed students' families. So the university was able to give a 50,000 check with no strings attached to the families in recognition of this extraordinary hardship that they are going through. The key was all of these services and the death benefit payments – none of it eroded the limit of liability. None of it will ever show up in a loss run. And I think, most importantly, that client would tell you that those services made a material difference in how that claim ended up going for them.

**MCDONALD:** I'm a risk manager, maybe a broker might be involved at this point, I know I need to build a tower of liability. There's price, there's terms. What else is there? How do you think of that now?

**JOHNSON:** It's important to look at a carrier's commitment. And that's not just a commitment to underwriting, but a commitment to claims. There are a number of ways to gauge that but I think you can simply ask the question. You can ask the carrier what is the breadth and the depth of your team – of your adjusting team and your underwriting team? How can you show me your ability to handle and manage catastrophic litigation? Do you have a track record and have you handled catastrophic litigation? Do you have a network of relationships – a network of plaintiff relationships as well as defense relationships? Do you know the players in particular jurisdictions? Do you know where you're going to be up against a difficult judge in a difficult jurisdiction? Do you have the ability to discern between a case that should settle and a case that you should try? Do you have the ability to evaluate what the potential for an adverse verdict might be if you do go to trial? And the same on the underwriting

side. When you're building a tower, you want that tower to be available for years to come. You don't want blocked capacity jumping and jumping out of the tower.

**MCDONALD:** Billy, one of the things that comes up a lot is diversity. Don't put all your eggs in one basket. In towers, is that always the case? And what are both sides to that?

**GUNN:** I certainly understand the idea of spreading your risk around. If you have all your eggs in one basket and something happens to that basket, you've got problems. But you have to recognize that the more diverse you get, the more opportunity you have for stumbling blocks. Each new player is an opportunity to cause your process to screech to a halt or to complicate or to work to its detriment. So, like in most things, there are tradeoffs.

**MCDONALD:** So is there actually a relationship to that? The more spread apart it is, the greater the likelihood of friction?

**GUNN:** I don't know that it's necessarily friction, but certainly the more players there's a greater likelihood of running into disagreements. If you've got the same problem and two, three, four people are trying to take these different approaches, you can't get to where you need to be.

**GLAZER:** I guess the way I'd put it is more eggs doesn't necessarily mean better eggs. What a policyholder, what a broker should be asking themselves when these new players come in because of some perceived credit risk, with the more established players is in the immortal words of Butch Cassidy and the Sundance Kid when the posse was chasing them, inexorably is 'who are these people?' Are they players or are they amateurs? Am I actually gaining anything by having more diversity or am I giving up something?

**GUNN:** One thing that Jeremy talked about was continuity. Is this insurer going to stay with you? I think continuity can be tremendously important because your insurer gets to know you. Gets to know your product, your concerns, your approach to things and can help you accomplish your goals. And again, if you find yourself in a situation where you're having a pattern of claims from year to year and you've got different carriers for each year, you've got real potential for problems.

**MCDONALD:** OK. Jeremy, when you're looking at a tower, whether it's going to be built or one that exists, what do you use as benchmarks, rules of thumb, metrics? How do you evaluate that?

**JOHNSON:** Well, I would certainly counsel our clients and brokers to think in terms of maybe taking a metric and that's what we call limits to surface. As both Neal and Billy were saying, not all eggs are created equal, not all baskets are created equal. And over the past year in this kind of theme of diversification we have seen some capacity moved from very stable, very financially secure carriers such as ourselves and some of our larger, more mature competitors to small, small insurers with a very small capital base and a few hundred millions dollars of surplus and no real track record, no experience, no book. I think the only real objective way to measure how much exposure you should have to a particular carrier is to look at the key metric of a carrier's strength

which is its surplus. Surplus being the difference between assets and liabilities and really being the fundamental measure of a carrier's strength. So I would counsel brokers and risk managers to allocate their exposure to a particular carrier based on that carrier's surplus and look at the ratio between the limits you have in the carrier and that carrier's surplus.

**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:** We've had two clients ask us to do across the board coverage comparisons among six or seven different forms of the same type. For example, umbrella. 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?

**GUNN:** Well, the form can be a major factor. Say you have eight policies and one in the middle form – as Neal was talking about – 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?

**GLAZER:** Optimally, if policyholders and brokers lived in a dream world, all the way up the tower you would have consistency and uniformity of forms, terms and conditions. But the larger the tower, the less likely it is to happen because there are some insurers that simply insist upon using their form for their layer. They're convinced it's superior and so what happens is, within a tower, you can have insurers with different coverage terms and conditions and, therefore with different coverage positions and it makes claims handling very, very difficult without regard to liability of damages just for a policyholder to figure out what kind of coverage he has.

**MCDONALD:** What does our panel see as some of the

differentiating strategies for building a property versus a liability tower? How do they differ?

**JOHNSON:** Property is built generally with big blocks of quota share plays. This is where you're putting together large property programs. We do have that dynamic in casualty as well – it's not as common. And I think in both cases, whether it's property or liability when you have those quota share blocks you have the same fundamental problem that we've been talking about – which is it's going to be difficult to get anything done. So you're bringing more players to the table, especially when it's in a quota share. So it's one vertical limit, there'll be lots of horizontal chunks that you will have to try to deal with. It makes it very difficult. It makes it very difficult to adjust.

**BRESNAHAN:** My contribution to this issue is that you have fundamentally very different risks with fundamentally different time horizons on when the loss needs to be paid. So, while you may accept a little more variability in a property tower your risks with that may be much, much less than making similar decisions on a large casualty tower that has to be called upon seven, eight, nine years down the road. Who knows what that panel of insurers is going to look like that far down the road.

**GLAZER:** With most property losses is what I call a "boom." Whether it's a hurricane loss or an explosion, it's a single event, identifiable in time and place whereas in the larger casualty losses sometimes you have ongoing injury and damages for years, sometimes decades and so property claims are, I think by their nature, simpler to handle. I'm not saying they're simple to handle. If anyone has had to handle a business interruption claim they are far from simple. But in terms of the nature of the claims in property, the cause is usually a single event. The claims handling is generally more straight forward than on the casualty side.

**MCDONALD:** The difference between short-tails and Long-tails, whether it's liability or property. I imagine in liability it's mostly going to be Long-tail? Among liability, though, is there long and longer? If you're in any particular sectors do you have to think longer term than in others?

**JOHNSON:** Any claim can take an awful long time to resolve, whether it's a bang, a big pop, something blowing up, or products. Certainly, products is going to take longer. I know claims folks that are working on claims from 30 years ago. Those are generally going to be products claims. But even on a big pop – an explosion – that can take many years to a result. You've got to try to figure out what caused the explosion, who's at fault, you're going to have subrogation issues. You're going to have valuation issues and you're going to have a lot of strife just trying to figure out what goes where in terms of who's responsible for what part and what sum in the total cost to rebuild on the explosion side. So I say that there are very few of our claims that are short-tailed. It's all going to be Long-tail.

**BRESNAHAN:** The one thing that I would add is auto liability in a broad, catch-all of casualties is the shorter tail line. You usually feel more confident about your book, whether it's an auto or trucking book, is performing in a shorter

period of time than you might . . . it might take a lot longer to conclude you're making money in product liability and some of these other areas.

**GLAZER:** I'd just like to make the distinction between coverages that lend themselves to long term exposures and long-tail claims, which may take many years to develop. An occurrence-based coverage, which afford coverage for bodily injuries during a policy period, is a long-tail coverage because an insurer might not find out about the occurrence for years. On the other hand a claims made or integrated occurrence type policy in Bermuda . . . they're going to find out about the claim pretty soon. However, it will still take the same number of years for the claim to resolve itself. So, we have to keep in mind the two aspects of long-tail - the long-tail coverages and the long-tail claims.

**JOHNSON:** I think with both those dynamics you have to look at the impact of inflation. So you build a tower today but you're not valuing the claim today. You could be valuing the claim six, 10 or plus years down the road where inflation has elevated the value of that claim. So when you put a tower together you have to try to predict what is going to be the inflated value of a claim, based on the length of the tail. It could be six, 10 or more years. You also have to try to figure out what's going to be the impact of tort claims in that same period and how changes in tort are going to influence the value of that claim.

**MCDONALD:** When brokers are involved in helping to create liability towers, we've talked about some of the issues that may emerge in the tower itself, are there any issues that may come back to brokers? Do they have any exposure or liability in this process?

**GLAZER:** There are probably a fair number of brokers watching this webcast so it's a sensitive subject but one need only harken back, for example, to the litigation between Silverstein and the World Trade Center insurers after 9/11. Where, for whatever reason, the policy had 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.

**MCDONALD:** What do people need to keep in mind as they become involved in towers? What do you want them to know?

**GUNN:** I think the potential insured needs to be dealing with sophisticated brokers who are dealing with sophisticated insurers. Trying to do it inexpensively can be enormously expensive in the long run. You get what you pay for just like in anything else.

**MCDONALD:** Jeremy, what's the message here?

**JOHNSON:** Pretty much the same - focus on the back end as much as you focus on the front end. It's not just about having a piece of paper that says I have insurance, it's about how is that insurance going to actually work in that remote possibility that you have that 100, 200 million dollar claim.

**MCDONALD:** Neal, what do you see?

**GLAZER:** My advice to brokers and policyholders would be go with the pros. The companies who have been doing it for a while, and if it's a new company, are the underwriters and claims people, people of experience? Have they been in the industry for years? Have they seen friends come and go? Have they seen soft markets? Have they seen hard markets? So when you ask who are these people, you know who these people are.

**MCDONALD:** David?

**BRESNAHAN:** I think pricing and underwriting decisions are at a crossroads in 2010. I think the stakes are very high because you could have a disconnect between what pricing level will support a tried and true long term partner and you could have a disconnect with the supply side of all these new entrants and you could be, as we've said, if you make the wrong decision and end up getting what you paid for it could be a real problem.

