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Underwriters of D & O and Professional Liability Insurance

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In this issue … three items: TRIA returns to the legislative agenda, a large derivative settlement, and the elusive federal report on the U.S. insurance market.

TRIA: Back In The Limelight

The Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) does not expire until December 2014, but supporters and critics are already making their voices heard. It has been more than ten years since the original Terrorism Risk Insurance Act (TRIA) was passed in 2002, before some readers of this newsletter began their insurance careers. That original measure was extended in 2006, and then in 2007 it was "reauthorized" until 2014 by TRIPRA.

All current D&O insurance professionals, however, will be familiar with the recurring references to TRIA and TRIPRA in D&O coverage terms and policies, signifying its continued relevance.

TRIA Overview

Enacted as a response to the devastation of the September 2001 terrorist attacks, TRIA created a forced bargain between the federal government and private insurers. Insurers of most lines of property and casualty (P&C) insurance would henceforth have to offer insurance for terrorist acts, as defined by TRIA. In return, the federal government undertook to protect insurers from possible financial catastrophe by providing a federally funded backstop.

Directors & Officers liability was among those P&C lines that were required to offer terrorism coverage, although it soon became apparent that the greatest exposure was property damage to large, prominent buildings and structures.

At the extension of TRIA in 2006, certain P&C lines were relieved of the obligation to offer terrorism coverage. Professional liability was among those excepted lines, but D&O continued to fall under the coverage mandate. The enactment of TRIPRA in 2007 included a broadening of the definition of "terrorism" to include domestic acts, along with a reduction in the federal government's share of any losses.

Spring 2013: Maneuverings Begin

A bill introduced this month in the House of Representatives by Rep. Bennie G. Thompson seeks to extend TRIPRA by a further ten years; this followed a bipartisan measure proposed in February that sought a five-year extension.

Opposition to an extension of TRIPRA has come from the Consumer Federation of America (CFA). Pointing to the insurance industry's combined surplus of nearly $600 billion, CFA director of insurance J. Robert Hunter commented that: "…the industry can easily afford the losses of up to $100 billion that the current act would cover," arguing that TRIPRA should be left to expire.

The insurance industry meanwhile has welcomed the congressional initiatives to keep TRIPRA in force beyond 2014. Leigh Ann Pusey of the American Insurance Association (AIA) announced that: "AIA looks forward to working with [the] House Insurance Subcommittee…and the entire [Financial Services] Committee in the months ahead as AIA seeks to achieve a broadly-supported bipartisan TRIA reauthorization bill prior to the program's 2014 expiration."

Comment

If insurance for terrorist acts had not been mandated by TRIA in 2002, it is unlikely that many insurers would have willingly offered it. Evan G. Greenberg, CEO of Ace Limited probably spoke for many insurers when he recently commented that: “If it wasn’t for TRIA, you wouldn’t see much terrorism insurance sold.”

While the financial backstop provided by TRIA is substantial —in general up to $100 billion— there remains a significant cost to insurance companies. Before any TRIA payments are made to an insurer, that insurer must have already borne a deductible generally equal to 20 percent of that insurer’s direct-earned premium from the prior year. And even when a TRIA payment is finally made, the insurer is still responsible for 15 percent of that payment as a coinsurer.

It is hard to argue that TRIA is anything but a distant, though valuable, financial safety net, only to be used after the industry has made a meaningful contribution to a loss. If TRIPRA is not reauthorized, and terrorism insurance becomes available only at the insurer’s option, future availability will almost certainly be severely limited.

Derivative Lawsuits: Another Large Settlement

In April of this year, executives of News Corporation reportedly settled a shareholder derivative lawsuit for around $139 million. Being a derivative lawsuit, reimbursement of the defendants by the company was precluded, and so the money was reportedly paid by the D&O insurers, presumably under the Side A insuring agreement of the D&O policies, and if applicable, by an excess Side A-only program.

This newsletter has discussed derivative actions before, and a characteristic of such actions is that settlements are generally low in monetary value. A settlement of $139 million is not just high; it may be one of the highest derivative settlements ever. Large payments made by insurers usually get the attention of the market in general, and in this case the attention of Side A-only providers in particular. Will this payment cause an uptick in Side A premiums?

The answer would appear to be somewhere between “probably not” and “too soon to tell.” Certainly $139 million is substantial, but it is not the first nine-figure amount. As the *D&O Diary* points out, derivative actions in 2005 (Oracle), 2008 (AIG), 2009 (Broadcom), and 2012 (El Paso/Kinder Morgan) all settled for more than $100 million. If those cases had little discernible impact on Side A-only pricing, then the effect of the News Corp incident will probably be the same.

Insurers are generally good at separating anomalies from systematic patterns. A frequency of six substantial derivative settlements over the course of eight years would typically not indicate a series of events that could impact pricing. However, if that frequency increased to one every month it might be a different.

The Federal Insurance Office Report(s): The Wait May Soon Be Over

Readers may recall that the Dodd-Frank Wall Street Reform and Protection Act created a Federal Insurance Office (FIO). The office would be headed by a director, who was charged with undertaking a review of the U.S. insurance industry —with particular respect to its possible modernization— and reporting back to Congress.

That report was due at the end of January 2012, but has still not been delivered, making it some fifteen months overdue. There are, however, indications that the release of the report is in sight. Speaking at meeting in the District of Columbia in March, federal insurance director Michael T. McRaith said that the report (and also the overdue FIO report on U.S. and global reinsurance markets) should be made public before July of this year. ❖

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