



nerej

The subprime lending meltdown and its impact on the global D&O insurance market

May 27, 2008 - Spotlights

Much has been written and experienced as a result of the subprime lending meltdown. Many great banking institutions, investment banks and hedge funds have failed or been irrevocably impacted due to the enormous losses incurred. Ironically, the insurance marketplace continues to have significant capacity. Commercial insurance continued to be competitive through the first half of 2008, however with the investment outlook deteriorating and an unknown future regarding catastrophic loss, the soft market of 2007 and 2008 could change dramatically.

Recent news from the marketplace does not bode well for the executive risk underwriting. According to Ironshore Insurance's president Greg Flood, losses in the global Directors and Officers Liability Insurance (D&O) market directly resulting from the sub prime exposures could exceed \$4 billion, and that is the low end estimate! Flood told Best Week Europe "the entire subprime-related financial crisis looks to him like one of the slowest-moving train wrecks he'd ever seen." Litigation related to subprime exposures is being referred to as analogous to a Category 5 hurricane hitting the gulf coast. In the first quarter of 2008 D&O litigation resulting from the subprime meltdown s said to be up over 400%.

Recent negotiations for a medium venture capital fund D&O renewal resulted in flat premium and similar terms and conditions. However at the outset of the negotiation, the underwriters were seeking a rate and retention increase of over 10%. These recent negotiations are the tip of the iceberg for the potential hardening of the D&O marketplace resulting from the subprime exposures. We had spoken in earlier articles about the marketplace being at best uncertain. If a catastrophic loss event occurs the pillars holding up the soft market could crumble rapidly. It is possible that the exposures to the insurance industry as a result of the subprime meltdown could be the catalyst turning the insurance marketplace from soft to hard in a very short timeframe.

D&O insurance for public companies with little or no financial sector exposure continues to show competitive signs. However, we continue to watch this segment closely. Although frequency of claims is down; severity trends of the class action suits continue to increase. Companies with global operations or expansion plans should consult with their broker regarding the evolution of corporate laws expanding the duties of directors and officers and shareholders rights in many foreign jurisdictions. Coverage voids may exist for foreign D's and O's at subsidiaries of U.S. parent companies. Purchasing local D&O policies in countries that do not recognize non-admitted U.S. D&O policies might be a prudent option.

The subprime crisis could be the catastrophic shock that will manifest a hardening in the

professional liability markets worldwide. It is extremely important for management to build strong relationships with their underwriters so they are able to limit the impact of a hardening marketplace. Comprehensive renewal presentations combined with strong corporate governance protocols are increasingly important, presenting the best possible risk to the underwriters. Building strong risk management relationships with your broker and underwriters creating strategic risk partnerships will assure stable renewals for years to come.

Spencer Macalaster is a senior vice president with Risk Strategies Company, Boston, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540