

Enforce

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Entanglements: Brokers Say Rate Increases Driven by Costs of Regulations and Investigations

Policyholders might not like it, but they get used to the pricing cycles of insurance markets. Current market increases, however, are being driven by a new factor — the cost of what new regulations and investigations might do to the cost of insurance, and the fear of what they might do in the future.

Enforce took the pulse of three major brokers who appeared at Anderson Kill's 10th annual D&O conference — and talked to one independent broker — and the consensus is clear: government regulation and the fear of dealing with extensive red tape and potential civil and criminal investigations is one of the factors that is hardening a market that has been soft for a decade.

“It is the fear of the unknown,” said Fred Podolsky, executive vice president for Alliant Insurance Services. Insurance companies “want it correct for the new regulatory environment.”

What's driving this new environment is shareholder and government demands that all major transactions be thoroughly scrutinized and squeaky clean. If not, any hint that something is amiss can set off an investigation by the Justice Department or the Securities and Exchange Commission or both, and, if the company is involved in a global market, might also involve law enforcement agencies in foreign lands. This is the price companies

are paying for decades of Enron scandals, dot-com bubbles bursting and venerated institutions crumbling before their eyes, our panelists said.

Allison Hollern, senior vice president at Lockton Companies in London, said, “We are beginning to see regulators over here [who] either, 1) look to mimic the U.S. regulators and how they operate, or 2) see the U.K. or European regulators work with U.S. regulators.” She cited one U.K. company with operations in Malaysia and markets in the United States that potentially could be under investigation on three continents simultaneously. That would be very expensive for the company to defend and “incredibly complex” as an insurance coverage matter. “For insurers, the policy can be eroded [beginning] from dollar-one defending a multi-jurisdictional investigation,” she said.

Andy Doherty, senior vice president and Atlantic region leader for Willis' FINEX North America, said that the Foreign Corrupt Practices Act has become prominent and “a lot of the time, corporate investigation expenses are not covered under the D&O policy. These investigations can be very expensive and the costs might not be covered at all depending on how the policy [is] structured.”

Hollern noted that policies have been amended heavily to ensure coverage of

investigations. “The policy has to be global and it needs to respond to any official regulator or body that has the authority to regulate. And you have to look closely at your retentions, depending on the class, because the policy is now triggering a lot earlier.”

It has also made the policy underwriting process even more slow and tedious. According to Doherty, “We get a lot more questions on interactions with regulatory bodies . . . have all the policies and procedures been updated with respect to anti-bribery efforts?” He added that, fortunately, “most companies have thorough policies and procedures in place. Most responsible companies will reevaluate them in light of what is happening.”

The number of microscopes on companies is “one of a number of points driving rate increases,” said Doherty, adding, “I think if the rate increases for primary coverage are in the high single digits that the regulatory landscape is contributing probably a third of that. The other two-thirds being M and A objection claims, anticipated settlements from the credit crisis claims and a low interest environment.”

Hollern suggested the long-term effect is the “gradual pushing-up of rate of the primary policy. Long term we might see a two-tiered policy in which the bottom tier is a lot more price sensitive than we’ve seen historically, and excess layers become much more of a commodity placement.”

Even mid- to small-market companies are paying the price for increased government regulation. Doherty noted the Consumer Financial Protection Bureau “obviously puts a lot of focus on how companies act in dealing with their customers. That type of oversight is not quite a direct D&O issue, but a bad

customer-related issue can quickly turn into a D&O issue.”

James N. Scanlon, CEO of SGB-NIA Insurance Brokers, a large independent broker in the Los Angeles area, deals with small- to mid-market companies feeling the weight of regulation.

Small- to mid-market business owners are dealing with increased pressure from the Labor Department over compliance with wage and hour laws and the Employee Retirement Income Security Act, known more commonly as ERISA. “It is expanding with the new health care laws and up until now, enforcement has not been a priority for the Department of Labor,” said Scanlon. He guessed that more than 50 percent of his clients are trying to comply with Labor Department regulations and wondering what happens if they fail. “Certainly, this is going to affect the cost of their EPLI [employment practices liability insurance]; the size of the retentions.”

“We are seeing some clients — especially in the construction area — who can no longer get the amount of coverage they used to.” Scanlon added that self-insured retentions are doubling and prices are increasing up to 25 percent, “sometimes doubling if you had claims activity.”

His company’s answer for its clients is to assist with a client audit to ensure compliance. “The new regulations are so complex that you can read them and still not know where you are.” But you will get hit with higher rates.

On the large-market companies, Hollern suggests, “Stress test your policy.”

In answer to the same question, Podolsky said, “Lay out a half-dozen scenarios with your brokers to determine if there is coverage.”▲

About Anderson Kill

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