

# Directors and Officers Liability: 2005 Survey Executive Summary







## DIRECTORS AND OFFICERS LIABILITY:

## 2005 SURVEY EXECUTIVE SUMMARY

## EXECUTIVE SUMMARY

The Tillinghast business of Towers Perrin conducted its 28th study on directors and officers (D&O) liability claims and insurance purchasing trends during the second and third quarters of 2005. The primary objectives of our survey are to:

- help organizations improve awareness of potential sources of claims against their directors and officers
- provide information to organizations about the structure and cost of D&O insurance programs for various sizes and types of organizations.

Our 2005 survey results indicate that the market for D&O liability coverage has continued to soften, while claim frequency and severity have continued to increase. Tillinghast's D&O Premium Index decreased 9% in 2005, after a 10% decrease in 2004. Insurance capacity leveled off, and coverage restrictions continued to ease.

Claim frequency for 2005 survey for-profit participants is 0.34, compared to a frequency of 0.33 reported by 2004 survey for-profit participants. The 2005 survey nonprofit participants reported a frequency of 1.53 compared to a frequency of 1.34 reported by 2004 survey nonprofit participants. In addition, the overall average payment to claimants increased substantially for all participants from our 2004 survey to our current survey due to a large increase in the shareholders/investors claimant class.

Our 2005 D&O liability survey includes 2,645 U.S. and 49 Canadian participants. Of these, 1,800 U.S. participants responded to our 2004 survey, and 1,053 participated in both our 2003 and 2004 surveys. When the results are meaningful, we report on year-to-year changes in responses from repeat participants as a way to provide a look at trends for a consistent group.

### INQUIRIES FROM BOARD MEMBERS

This year, for the first time, we asked respondents whether potential directors inquired about D&O coverage. We also asked whether the level of D&O coverage has changed as a result of these inquiries. Approximately 50% of public and private respondents indicated that such inquiries about coverage had been made, while approximately 30% of nonprofit respondents indicated such inquiries. According to our survey, publicly held companies were most likely to change coverage as a result of inquiries. Nineteen percent of public respondents reported making changes as a result of inquiries, while only 5% of private and 2% of nonprofit respondents reported doing so.

## SECOND CONSECUTIVE YEAR OF PREMIUM DECREASES

In 1974, Tillinghast developed a standardized premium index for D&O coverage. The index was established at a value of 100 for the average D&O premium of a typical U.S. for-profit survey respondent in terms of policy limit, corporate reimbursement deductible and other coverage features. In subsequent surveys, we have compared the reported premium to this standard, thus generating a premium index. The historical values for this D&O Premium Index are shown in *Table 1*.

According to our 2005 index, D&O coverage costs decreased approximately 9% on average between 2004 and 2005 for U.S. for-profit participants. The median premium index reached the lowest point since our 2001 survey. The average premium index has decreased 18% from its high of 1,237 in 2003.

Thirty-seven percent of 2005 survey participants reported a premium increase, 37% reported a premium decrease and the remaining 26% reported no change. Among repeat participants, the average premium reported in the 2005 survey was 8% lower than the 2004 survey. The decrease was slightly more in the excess layer (10% decrease) than in the primary layer (8% decrease) (see *Table 2*).

Among the participants repeating from our 2004 survey, the durable goods, education, health services and nonbanking financial services business classes were the only business classes reporting an increase in average premium between 2004 and 2005.

**TABLE 1**  
**D&O Premium Index Trends — U.S., For-Profit Only**

Year	Index Median	Index Average
1974	90	100
1976	69	81
1978	77	103
1980	76	99
1982	55	71
1984	38	54
1986	415	682
1988	513	746
1990	481	704
1991	513	720
1992	515	720
1993	526	771
1994	548	806
1995	550	793
1996	498	726
1997	459	619
1998	402	539
1999	356	503
2000	349	560
2001	397	720
2002	496	931
2003	562	1,237
2004	433	1,113
2005	401	1,010

**TABLE 2**  
**Average Total Premium by Business Class — U.S.**

U.S.	
Banking	\$ 781,525
Biotechnology & Pharmaceuticals	262,989
Durable Goods	699,517
Education	102,232
Governmental & Other Nonprofit	12,602
Health Services	533,224
Merchandising	579,551
Nonbanking Financial Services	262,224
Nondurable Goods	427,614
Petroleum, Mining & Agriculture	682,759
Real Estate & Construction	194,715
Personal & Business Services	149,919
Technology	200,939
Transportation & Communications	362,139
Utilities	2,161,147
<b>All Size Groups</b>	<b>\$ 257,223</b>

### POLICY LIMITS INCREASE WHILE DEDUCTIBLE/RETENTIONS REMAIN UNCHANGED

The average policy limits for U.S. for-profit 2005 survey participants were \$14.3 million. In our 2004 survey, the average policy limits for this group were \$13.6 million (see *Table 3*).

The majority (82%) of 2005 survey participants reported experiencing no change in policy limits during their last renewal. Among participants that did report a change, increases in policy limits were reported more frequently than decreases.

For those respondents that participated in the 2003, 2004 and 2005 (03-05 repeats) surveys, the average total policy limits increased 9% between 2004 and 2005. The increase in average primary limits and average excess limits between 2004 and 2005 for this group was 2% and 11%, respectively (see *Table 4*).

For respondents that participated in 2004 and 2005 (04-05 repeats), the increase in average total policy limits from the 2004 survey to the 2005 survey was also 9%. The increase in average primary limits and average excess limits from the 2004 survey to the 2005 survey for this group was 3% and 10%, respectively.

As expected, the largest increase in limits was in the excess layer. However, there were comparable premium decreases in both the primary and excess layers. It seems counterintuitive that there is a decrease in the excess layer premium given the increase in excess limits and increasing claim severity.

**TABLE 3**  
**Historical Average Coverage Limits by Asset Size (in millions) — U.S., For-Profit Only**

	2001	2002	2003	2004	2005
Up to \$100 million	\$ 6.0	\$ 5.2	\$ 4.5	\$ 4.7	\$ 5.5
\$100 million - \$400 million	18.3	17.0	16.2	16.3	16.5
\$400 million - \$1 billion	31.6	30.0	27.6	25.4	24.6
\$1 billion - \$2 billion	40.7	40.9	39.5	34.3	34.8
\$2 billion - \$5 billion	65.2	62.3	56.5	58.6	66.3
Over \$5 billion	109.0	117.3	108.3	122.9	104.8

**TABLE 4**  
**Repeat Participants: Change in Average Policy Limits From 2004 to 2005 by Layer**

Repeat Group	Layer	2004 Average Policy Limit (millions)	2005 Average Policy Limit (millions)	% Change From 2004 to 2005
03-05	Primary	\$ 4.99	\$ 5.09	2%
	Excess	20.60	22.85	11%
	Total	11.57	12.56	9%
04-05	Primary	\$ 4.36	\$ 4.51	3%
	Excess	22.17	24.41	10%
	Total	9.86	10.75	9%

Among participants repeating from our 2004 survey or 2003 survey, there were no business classes reporting decreases in total policy limits for both groups of repeat participants.

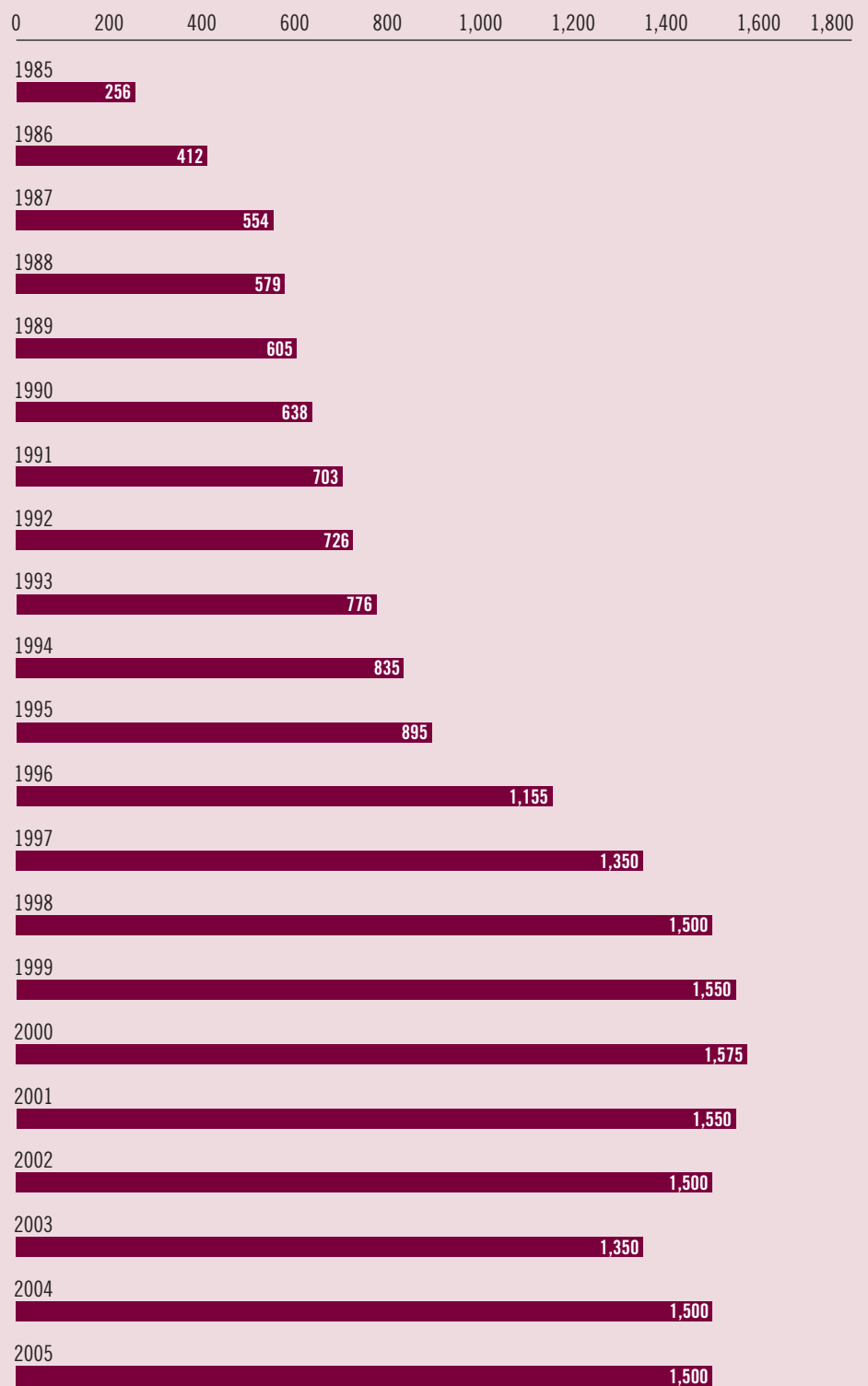
Only 29% of our U.S. respondents with renewals since the second half of 2004 reported increases in their deductibles/retentions. Overall, 63% of U.S. participants reported no change in their deductibles/retentions, which compares with 65% in our 2004 survey.

#### COVERAGE RESTRICTIONS CONTINUE TO EASE

Enhancements increased and exclusions continued to ease, building on a trend observed in our 2004 survey. In 2003, we noted that the percentage of U.S. participants reporting coverage expansions (i.e., decreases in exclusions and increases in enhancements) had been declining since 1998. In our two most recent surveys, these provisions have been increasing. In 2005, 25% of U.S. participants reported increased enhancements (up from 13% and 5% in 2004 and 2003, respectively) and, for the second year in a row, 10% reported decreasing exclusions (up from 2% in 2003 and 3% in 2002).

For the second consecutive year, D&O insurance carriers provided approximately \$1.5 billion in full limits capacity (see *Table 5*).

**TABLE 5**  
**Full Limits Capacity (in millions) — U.S., For-Profit Only**



### FREQUENCY AND SHAREHOLDER CLAIMS COST INCREASING

Claim frequency for 2005 for-profit participants was 0.34 compared to a frequency of 0.33 reported by 2004 survey for-profit participants. The 2005 nonprofit participants reported a frequency of 1.53, compared to a frequency of 1.34 reported by 2004 nonprofit participants. Susceptibility was 19% and 6% for 2005 for-profit and nonprofit participants, respectively. In our 2004 survey, susceptibility was 15% and 5% for for-profit and nonprofit participants, respectively.

An increase in susceptibility and frequency is also seen when we look at 03-05 and 04-05 repeat participants. The 03-05 repeats reported a susceptibility of 20% and a frequency of 0.38 in the 2004 survey and a susceptibility of 26% and a frequency of 0.49 in the 2005 survey. This is an increase of six percentage points in susceptibility and 30% in frequency. The 04-05 repeats reported a susceptibility of 15% and a frequency of 0.28 in 2004 and a susceptibility of 22% and a frequency of 0.40 in 2005. This is an increase of seven percentage points in susceptibility and 43% in frequency.

Claim susceptibility is low for private and nonprofit companies (10% and 6%, respectively) compared with public companies (35%, up from 27% in our 2004 survey). This is likely due to the larger size of publicly held companies, in general, and to the number of shareholder claims brought against public companies.

Once again, our survey indicates some correlation between a participant's asset size and its susceptibility and frequency results. In particular, entities with asset value below \$100 million report much lower susceptibility and frequency than larger entities.

The average claim payment decreased for four of the five claimant classes reviewed in our 2005 survey. Despite this fact, the overall average payment to claimants increased substantially for all participants from our 2004 survey to our current survey due to a very large increase in the shareholders/investors class.

The claimant distribution continues to be heavily dependent on the ownership structure of our U.S. participants. For example, 52% of the claims against public participants were brought by shareholders and 23% by other third parties. In contrast, 92% of the claims brought against nonprofit participants and 25% of the claims brought against private participants were brought by employees and 64% were brought by shareholders or other third parties.

## PARTICIPANTS

The D&O Liability Survey is a self-selecting, non-probability sample of insurance purchasing and claim patterns. There were 2,694 companies and organizations operating in the U.S. and Canada that provided usable responses to the 2005 survey questionnaire. Some participants did not answer all of the survey questions. In these situations, we used the answers that were provided. Data are in U.S. dollars for U.S. participants and in Canadian dollars for Canadian participants.

The 2,645 U.S. participants and 49 Canadian participants are profiled on the basis of several exposure characteristics, including:

- size, as represented by total assets, revenue and market capitalization
- principal business class
- ownership structure
- number of full-time employees
- number of years of operation
- occurrence of an aftertax loss during the past five years (for-profit only)
- merger, acquisition or divestiture activity during the past five years (for-profit only)
- involvement in an initial public offering sometime in the past five years (for-profit only).

The distribution of participants by assets and revenues has remained consistent with our 2004 survey, with more than 70% of the participants in each survey reporting assets of less than \$50 million.

**TABLE 6**  
**Participants by Business Class and Ownership — U.S.**

Principal Business Class	Ownership		
	Public	Private	Nonprofit
Banking	22	8	—
Biotechnology & Pharmaceuticals	156	219	2
Durable Goods	39	21	—
Education	3	3	16
Governmental & Other Nonprofit	3	30	449
Health Services	9	17	18
Merchandising	39	41	1
Nonbanking Financial Services	31	140	6
Nondurable Goods	51	45	2
Personal & Business Services	52	151	8
Petroleum, Mining & Agriculture	18	16	4
Real Estate & Construction	14	30	7
Technology	254	577	3
Transportation & Communications	45	51	3
Utilities	28	8	5
<b>All Business Classes</b>	<b>764</b>	<b>1,357</b>	<b>524</b>

**TABLE 7**  
**Participants by Business Class and Ownership — Canada**

Principal Business Class	Ownership		
	Public	Private	Nonprofit
Durable Goods	5	2	0
Financial Services	2	4	1
Nondurable Goods	5	2	0
Petroleum, Mining & Agriculture	9	0	0
Transportation & Communications	2	0	2
Utilities	2	3	2
Other	2	2	4
<b>All Business Classes</b>	<b>27</b>	<b>13</b>	<b>9</b>

Participants in the three largest classes (technology, governmental & other nonprofit, and biotechnology & pharmaceuticals) represent 64% of the U.S. participants (see *Table 6*). The education, health services, and governmental & other nonprofit classes contain a significant portion (88%) of responses from nonprofit organizations.



#### REPEAT PARTICIPANTS

Of the 2,645 U.S. participants, 1,800 respondents (68%) also responded to the 2004 survey; of these 1,800 participants, 1,053 respondents (40%) also participated in our 2003 survey. We did not include Canadian participants as repeat participants due to the small number of Canadian participants and limited statistical information.

The large percentage of repeat participants allows us to closely examine insurance purchasing and claim trends for a consistent group of organizations.

In general, the repeat participants are slightly smaller by revenue and asset size than the 2005 new participants.

There does not appear to be any significant difference between the distribution of total participants and repeat participants by business class.

#### INSURANCE CARRIERS AND BROKERS

Chubb and AIG continue to underwrite the largest shares of U.S. D&O primary insurance business. Chubb leads in policy count (21%) and AIG leads in premium volume (36%). Admiral and ACE share third place by policy count with approximately 10% of policies each. Chubb is still in first position in the Canadian D&O insurance market, with approximately 49% of policies and 52% of premiums. These results represent substantial increases in market share for Chubb in 2005.

According to our survey sample, Chubb and XL share the largest excess layer market share among insured U.S. participants by policy count and premium volume. Among Canadian participants, Liberty International and ACE are the largest excess insurers by policy count, while AIG, Lloyd's and ACE are at the top when ranked by premium volume.

ABD Insurance and Financial Services, Woodruff Sawyer & Company, Armfield, Harrison & Thomas, and William Gallagher Associates were the leading D&O brokers, among our survey population, with approximately 80% market share by policy count. Marsh and AON were equally represented among our Canadian respondents, with a combined market share of approximately 60%.

## DIRECTORS AND OFFICERS LIABILITY PEER GROUP REPORTS

Our customized Peer Group Reports are designed to help risk managers and other D&O professionals efficiently and effectively compare their D&O program to a peer group with similar exposure characteristics. A Peer Group Report typically contains detailed information on about 20 to 30 organizations, drawn from participants in the 2005 D&O Liability Survey. Experience has shown that this sample size is large enough to be statistically credible, but small enough to be tailored to the situation of the organization ordering the report.

The 16-page report includes the following data:

- number of participants carrying/not carrying D&O insurance
- main reason for no insurance
- renewal policy changes in limits, premiums, exclusions and deductibles
- distribution and average of total limits purchased
- distribution and average of premiums
- distribution and average of premiums for most common coverage limits
- leading insurers' primary layer market share (policy count and premium)
- leading insurers' excess layer market share (policy count and premium)
- participants with no personal coverage deductible
- distribution and average of nonzero personal deductible amounts
- distribution and average of nonzero aggregate deductible amounts
- personal coverage percentage retention amounts
- distribution and average of corporate reimbursement deductibles
- number of participants reporting claims and number of claims
- extent of coverage of claims by insurance
- extent of coverage of claims by corporate indemnification
- leading claim sources
- leading claim issues
- number of derivative suits
- disposition of claims
- number of closed claims with zero-dollar indemnity payment
- distribution and average of reported nonzero indemnity payments
- distribution and average of legal expense costs.

The distributions provided in the report allow you to determine where your organization ranks within the peer group with respect to D&O liability insurance coverage limits, premiums and deductibles. The distributions of indemnity payments to claimants and legal expense costs provide insight into actual loss magnitudes. We also include tips on interpreting and applying the data as an integral part of the risk management process.

For more information about Directors and Officers Liability Peer Group Reports, please contact:

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To order a Peer Group Report or the complete 2005 Directors and Officers Liability Survey Report, simply fill out the form on the following page.

## 2005 Directors and Officers Liability Survey



The Tillinghast business of Towers Perrin is pleased to offer the most in-depth study available on the subject of D&O liability claims and insurance purchasing patterns. Our 2005 report includes data from 2,645 U.S. and 49 Canadian survey participants. Order your copy today.

We also offer customized Peer Group Reports, which are designed to help risk managers and other D&O professionals efficiently and effectively compare their D&O program to a peer group with similar exposure characteristics.

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### ORDER FORM

- I would like to purchase the *2005 Directors and Officers Liability Survey Report*  
Regular price: \$750 Survey participant price: \$375
- I would like to purchase a *D&O Liability Peer Group Report* compiled from 2005 survey data  
Regular price: \$600 Survey participant price: \$400
- I would like to purchase both the full report and a peer group report  
Regular price: \$1,010 for both (save \$340)  
Survey participant price: \$580 (save \$195)

Company name	Company type or SIC code
Ownership (public, private or nonprofit)	Asset size
Revenue size	Market cap

### PAYMENT INFORMATION

- Please charge \$\_\_\_\_\_ to my  
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Credit card number

Expiration date Security code\*

- A check payable to Towers Perrin is enclosed for \$\_\_\_\_\_

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The firm has served large organizations in both the private and public sectors for 70 years. Our clients include three-quarters of the world's 500 largest companies and three-quarters of the *Fortune* 1000 U.S. companies.

Towers Perrin has offices in 25 countries. Our businesses include HR Services, Reinsurance and Tillinghast.

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