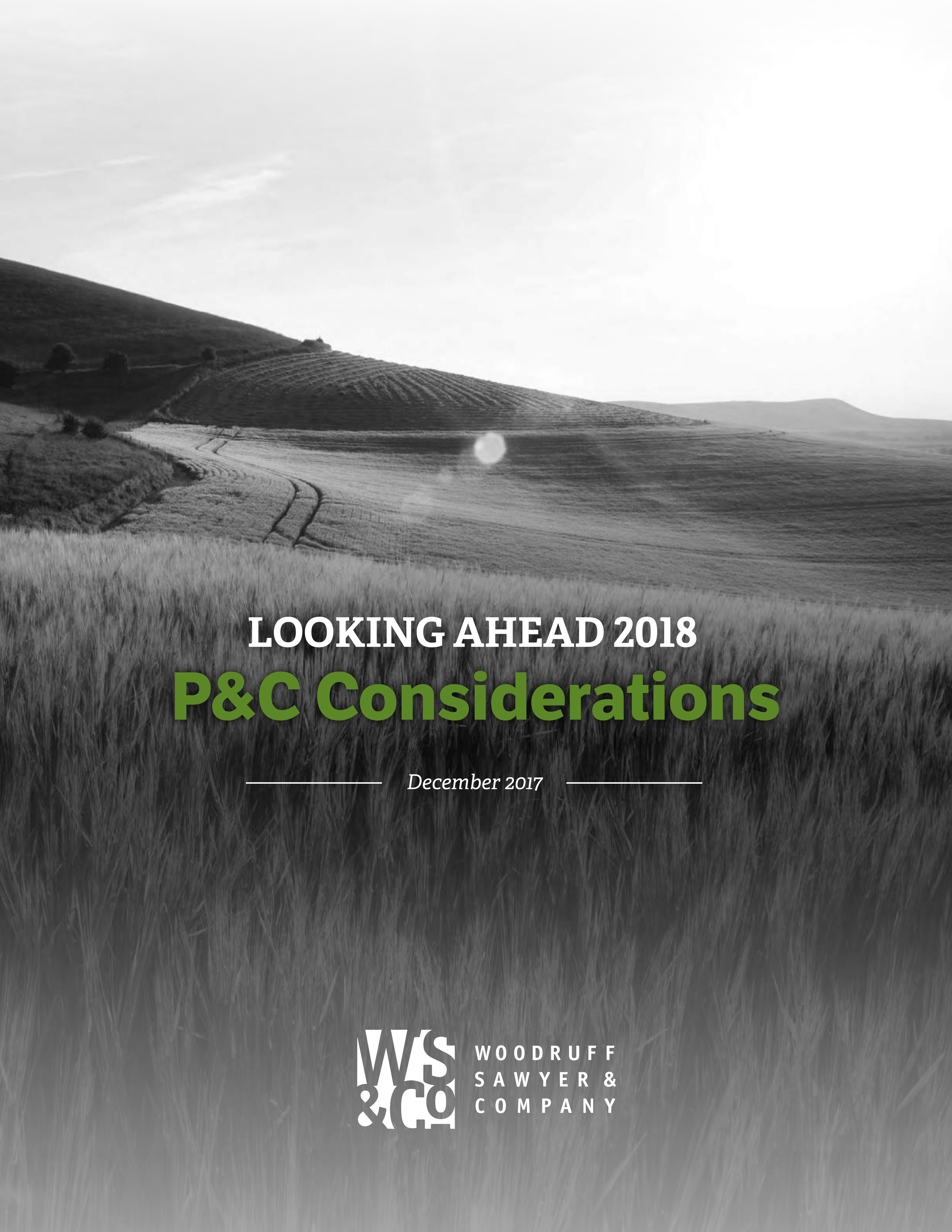

LOOKING AHEAD 2018
P&C Considerations

December 2017

WOODRUFF SAWYER & COMPANY

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Executive Summary

Welcome to the inaugural issue of Woodruff-Sawyer's annual P&C Looking Ahead Guide. As we "look ahead" to 2018, our goal with this guide is to lessen the mystery around property and casualty (P&C) insurance and risk management, so you can move confidently into the new year with the proper coverage and risk management strategies in mind.

In this guide, we'll cover:

- Strategic issues, like the state of the US insurance market
- Practical information, demystifying property and casual risk management
- Tactical guidance, such as adding additional insureds to errors & omissions policies

... and much more.

The State of the US Insurance Market

On the heels of highly catastrophic natural disasters in the US, it's important to understand the direction this and other events have had on the US insurance market, and the property and casualty segments in particular.

Commercial insurance buyers benefited from declining rates through most of 2017, but the downward trend is leveling off. Our forecast for 2018 is that there will be upward pressure on rates, but not uniformly across all property and casualty segments.

Technology is currently having an impact on the insurance sector as well. InsurTech is allowing insurers to look for correlations and trends in its data, which is the starting point for estimating losses. Once an insurer can do this, it can price the risk—which leads to the new product. This may positively affect what you pay for insurance in the future.

Demystifying P&C Risk Management

Understanding what's covered with P&C insurance is a mystery to many insurance buyers, and the industry has not been particularly good at lessening the ambiguity. In this guide, we'll provide some clarity around common questions we get from our clients, such as:

- When does an off-duty activity become a workers' compensation claim?
- Does a company's auto policy cover everything that happens with an employee's vehicle while he or she is on business?
- Is there a benefit in using a Freedom of Service policy to manage my international risks?
- Can insurance cover a cyber event and the resulting disruption to my business?
- Does adding a third-party to my E&O policy as an Additional Insured make sense?

We hope you find our guide useful.

Click/tap the contact information for any of our contributing authors on the following pages if you have a question or would like to learn more.

US P&C Insurance Market Update

Declining Casualty Insurance Rates Level Off

by

CAROLYN **POLIKOFF**

Senior Vice President, Partner and National P&C/Management Liability Practice Leader

415.402.6513

cpolikoff@wsandco.com

Learn more about Carolyn

Commercial insurance buyers benefited from declining rates through most of 2017. The downward trend is leveling off and the devastating catastrophic hurricane, earthquakes and wildfire events of Fall 2017 are top of mind for the insurance market.

Upward Pressure on Rates, but Not Everywhere

We forecast an upward pressure on rates in 2018, but not uniformly across all property and casualty segments. Premium rates in some segments, such as cyber, are likely to be competitive or will at least remain flat. The decline in rates began to slow in the first half of 2017, indicating that rates may have reached a bottom prior to the natural disasters. Even if rates cease decreasing, they remain at historic lows.

By-Line Second Quarter 2017 Rate Changes Ranged From -3.6% to +6.1%

4 Key P&C Trends We're Watching

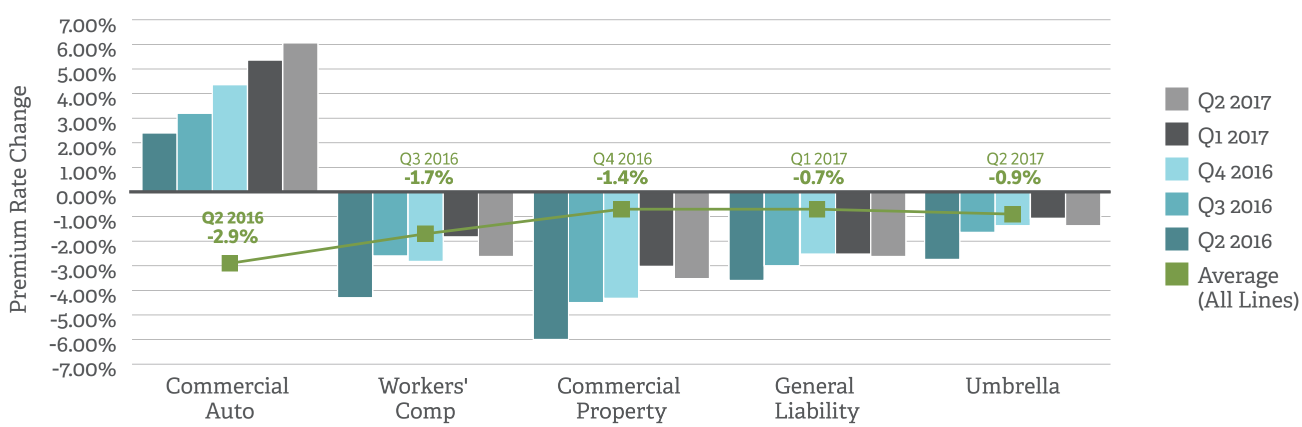
1. Supply and Demand

Insurance pricing cycles are governed by the principle of supply and demand. Currently, the supply of capital is abundant and demand for insurance is relatively stable due to weak economic growth. Additionally, catastrophic losses have been relatively low for the last few years. The result is declining rates.

Although the large catastrophes in 2017 will reduce capital in the market, insurance remains an attractive sector to investors because returns are relatively stable, and insurance stocks are not correlated to other movements in the financial markets.

Therefore, many investors, particularly hedge funds, will continue to hold insurance stocks as part of a balanced portfolio and supply of capital will remain robust.

On average, premium rates declined by just 0.2% from Q1 to Q2 2017



Source: The Council of Insurance Agents & Brokers, Press Release, "Premium Pricing Continues to Decline in Q2 2017, According To CIAB Market Survey," August 17, 2017.

The Takeaway:

Insurance is still a solid investment area for investors, so even if premium rates start to go up, there will be plenty of capital investment (supply) to meet the demand for insurance, so this will help temper price increases.

2. Brutal Competition

Competition typically drives prices down, but if it goes too far, it drives competitors out of the market. Supply then decreases and prices go back up.

Several top insurers have told us that the returns they earn on some product lines (property insurance is most often cited) do not meet their cost of capital. This was a factual statement prior to the events in Fall 2017, so recent catastrophes intensified an already weak situation by increasing the cost of capital.

If a majority of insurance product lines return less than the cost of capital, pricing is likely to be impacted as carriers are forced out of the market or become more selective in picking their risks. We've seen some signs of this as some carriers have pulled back from offering standalone auto coverage.

Check out our Property Market Update in the pages that follow.

However, the competitive environment has forced insurance carriers to find ways to compete in areas other than pricing. Many insurers are willing to expand coverage terms instead of lowering premiums and in many instances, there is great value to be gained by clients.

The Takeaway:

Insurers' rates are likely to go up if a majority of insurance lines return less than the cost of capital. But the environment is still competitive, so many insurers are willing to expand coverage terms and clients can gain value from this.

3. Recent Insurance Carrier M&A

Mergers among insurance carriers can impact market pricing as competition is consolidated and eliminated. Other than the massive Chubb-Ace acquisition, insurance company M&A in the US has been relatively stagnant.

The Chubb-Ace merger had no effect on commercial lines pricing, but that could change if the soft market (a market where premiums are decreasing) triggers other consolidations of US insurers. We believe this to be unlikely because it would require a significant consolidation to change the direction of the market.

The Takeaway:

It's not likely that rates will go up as a result of M&A, which has been stagnant in the US.

An additional factor is that foreign buyers have acquired some US insurers. These foreign buyers have large amounts of capital, but low growth opportunities in their home markets. These foreign acquisitions only increase the supply of capital in the US market.

4. InsurTech

One area of change in the industry comes from new software developed by "InsurTech" entrepreneurs (emerging technology that allows the insurance sector to discover more efficiency and ROI). Insurance isn't a particularly innovative industry, mainly because insurers need to know the "cost" of a product before they offer it.

"Costs" in this context refer to losses, and potential losses are not always easy to determine for new risks. Insurance companies have been sitting on massive amounts of loss data for years, but haven't had the tools to effectively analyze this data.

Correlations and trends are the starting point for estimating losses, and once an insurer can do this, it can price the risk—which leads to new products.

The Takeaway:

New software tools coming from InsurTech allow an insurer to look for correlations and trends in its massive data stores. This will ultimately lead to new insurance products as insurers can more accurately price risks.

For more on this, read our Insurance Technology Market Update.

Property Market Update

Catastrophic Losses Signal Uncertainty, Possible Hard Market Ahead

By

CASEY **SOARES**

Senior Vice President,
Partner and Property Specialist

415.399.6458

csoares@wsandco.com

Learn more about Casey

Since the end of August 2017, the property insurance market has seen a stark contrast to the prior historic lows in catastrophic (cat) insured losses. Insurers and reinsurers are citing this as reason to adjust rates upward in 2018.

What's a Reinsurer?

Reinsurers do business with primary insurers by taking on a portion of a customer's insurance risk, for a share of the insurance premium. Primary insurers purchase insurance policies from reinsurers to limit their total potential loss in the case of a disaster.

Let's take a closer look at the result of the recent cat losses.

2017 Catastrophes Reduce Insurance Market Capital by $100+ Billion

Hurricanes Harvey, Irma and Maria; the Chiapas and Central Mexico earthquakes; the California wildfires; and ongoing storm activity have the industry facing the prospect of a $100 billion reduction in capital. Insureds are asking whether this is enough to cause a reversal in the market cycle, from a soft market to a hard market, from low premium rates to high premium rates.

Year 2017 is the first since 2005 to have a Category 3 or higher hurricane make landfall in the US, and 2017 experienced three such hurricanes. Pressure from investors and financial rating agencies led insurers and reinsurers to estimate their total losses, while insureds were just beginning to quantify the damage that drives the insurers' ultimate losses.

We should therefore assume a fair amount of uncertainty in the overall industry loss estimate, as these estimates rely on modeled output, market share assumptions and early reports from underwriters.

See our recent blog post for notable carrier loss announcements to date (at the time of writing).

What We're Seeing:

In January, prior to the cat events, available insurance industry capital was understood to be at $600 billion, of which $80 billion was linked to alternative or third-party capital. This was a record high for the industry—multiple times higher than previous capitalization levels before historic loss events like 9/11 and Hurricane Katrina caused drastic turns to hard markets.

There will now be renewed pressure to ensure rates are actuarially sound (generating enough premium to cover expected losses over time) going forward.

Lower Insurance Carrier Reserves May Push Rates Upward

Through a decade of excess market capital, fierce competition, and declining premium rates and investment returns, historically low catastrophic losses perpetuated the soft market cycle.

Last year, Morgan Stanley[1] research estimated that approximately 30 percent of P&C insurance carriers' earnings over the prior five years were attributed to reserve harvesting (when funds that are set aside to pay future claims are reduced in order to boost profit). Even over the past three to four years, at the bottom of the soft market cycle, (re)insurers were making profits and adding to surplus, albeit at decreasing rates.

What We're Seeing:

The industry has known that the practice of harvesting reserves to meet earnings targets would be unsustainable once cat losses return to historical averages. Now that (re)insurers are paying cat claims well above historical averages, companies may be forced to raise rates or reduce the size of their book of business if reserves are deemed inadequate to meet future obligations. Added pressure will come from rating agencies, with some (re)insurers facing downgrades.

1 Morgan Stanley, "P&C Insurance, AIFA Conference Takeaways," 2016.

What's the Impact on Commercial Insureds? It Depends ...

While (re)insurers quantify their actual losses, assess financial strength and set strategy going forward, we all face the challenges of an industry in limbo. Immediately following the cat events, some large property underwriters had quasi-moratoriums, requiring higher level sign-off for quotes, leading underwriters to be less aggressive than usual.

There were some knee-jerk reactions: a few domestic carriers and excess and surplus (E&S) catastrophe underwriters started risk-swapping, whereby Insurer A would hike the price on a renewal and lose it to Insurer B, then on a different risk, the roles would reverse. For the most part, carriers have been thoughtful and clearer trends are emerging.

What We're Seeing:

For standard property placements, the quality of an insured's risk profile will trump all else and may allow for competition, protecting against significant premium rate increases.

For insureds, rate decreases from their incumbent insurance carriers will be scarce, and renewal outcomes will be driven by the number of carriers working toward a solution. Insureds will want to market to a large number of carriers (markets) in order to create rate competition and evaluate different program structure options. Insureds may also face difficult decisions if forced to monetize or justify maintaining their longstanding insurer relationships.

The Best Defense Against Rate Increases: Take the Offense

Insureds and their broker partners should get ahead of potential rate increases. Our advice is to start early, produce a robust renewal submission to carriers that showcases risk management and risk quality, and schedule in-person meetings with underwriters to set the tone of the renewal with a clear strategy and goals.

Our Advice: Get ahead of potential rate increases by starting the renewal early and getting in front of underwriters with a robust renewal submission and clear goals.

The longer term view is less clear. If enough reinsurers have no choice but to write risks at more profitable rates, and enough are willing to lose accounts and watch their book of business shrink in the meantime, we will see a turn to a hard market, where the demand is high, but the supply is low and premiums subsequently increase.

This would signal a momentous change in behavior for all sides of the transaction—underwriter, broker, risk management and finance team—after years of delivering only good news in terms of favorable rates and coverage.

Casualty Market Update

Auto Liability is Driving the Casualty Insurance Discussion

By

CHRIS **KAKEL**

Senior Vice President, Partner and Casualty Practice Leader, Colorado Office

720.593.5406

ckakel@wsandco.com

Learn more about Chris

Auto liability is driving the discussion in the casualty market. According to the CIAB[2], commercial auto rates increased by 6.1 percent in Q2 2017 after increasing by 5.4 percent in Q1. This is due to unprecedented claims severity and jury awards.

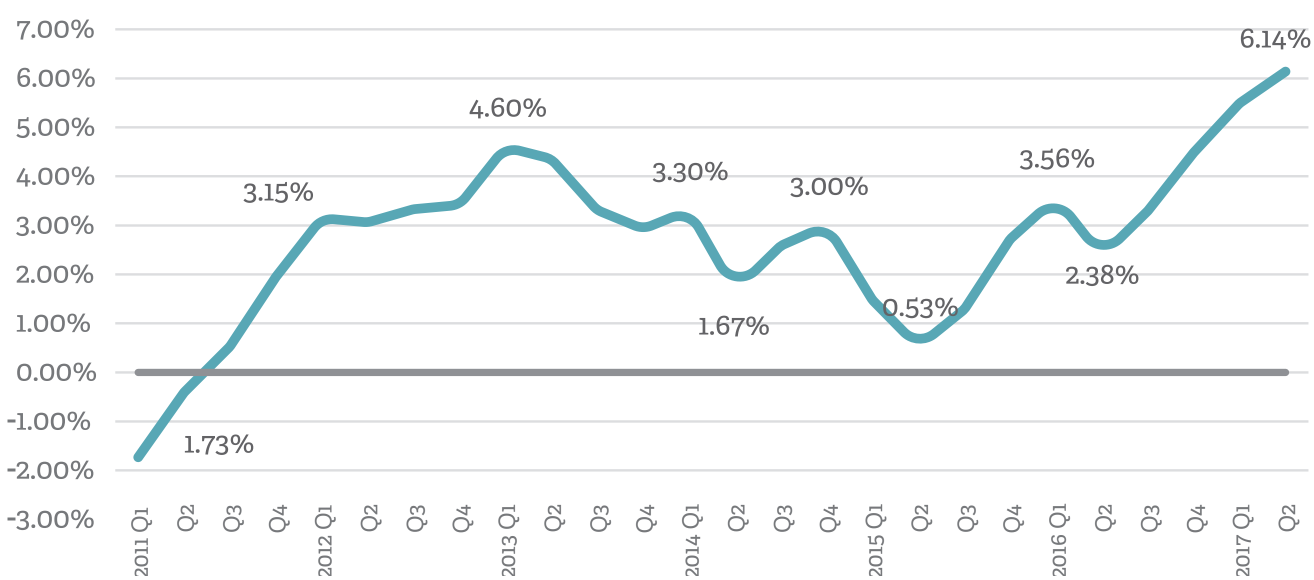
Commercial Auto Rates Are Going Up

Insurance Companies Are Losing Money on Commercial Auto Policies

Since 2011, the commercial auto combined ratio (measure of profitability of an insurance company) has been in the neighborhood of 110 percent, more than 10 points higher than other insurance lines. A combined ratio of more than 100 percent means that an insurance company had more losses plus expenses than earned premiums, and lost money on its operations.

From 2006 to 2015, the estimated average claim size rose by 39.1 percent, during which time commercial auto rates fell by 18 percent. Insurers and their pricing and actuarial models (equations that determine probability of events covered by policies, and the costs these events present) are trying to play catch up to account for these trends, and have since started raising their rates.

Premium Change for Auto Commercial, 2011 -2017
Commercial auto rates increased by 6.1% in Q2 2017 after increasing by 5.4% in Q1



2 The Council of Insurance Agents & Brokers, Press Release, "Premium Pricing Continues to Decline in Q2 2017, According To CIAB Market Survey," August 17, 2017.

Vehicles Are Purportedly Safer, So Why Are Auto Rates Increasing?

Distracted driving is a major contributor. According to the National Highway Traffic Safety Administration[3], 3,477 people were killed as a result of distracted driving in 2015. Another 391,000 were injured. And, according to transportation safety analysts, this trend is offsetting the increased safety features in vehicles.

Although vehicles are safer, people involved in serious crashes have higher chances of survival, but this leads to higher claims costs.

Other Casualty Lines Remain Price-Competitive

Outside of auto, workers' compensation, general/products liability and umbrella/excess liability lines are the most competitive segments of the casualty market, with renewals ranging from flat to double-digit rate reductions.

Program structures have generally remained consistent with respect to retention levels (i.e., how much risk a business retains versus transferring it with insurance); for insureds, the soft market tends not to justify the decision to assume higher levels of risk.

While retention amounts have remained consistent, we have seen variations in terms of how insurance limits are most economically purchased.

Our Advice:

With insurers being sensitive to rising claims severity and the abundance of higher and inexpensive liability capacity to bear those claims, it's important to explore options from insurers at various attachment points (additional coverage on top of the primary coverage, which kicks in when a specified claim amount is reached) and capacity amounts, so as to find the most cost-effective way to piece together the overall limits purchased.

For example, an insured purchasing $26 million in total insurance limits could compare the costs of purchasing a $25 million excess limit above a $1 million primary, versus breaking that $25 million layer into a lead $5 million and $20 million excess from a different insurer. The latter program structure could be a more cost-effective way to achieve the same amount of coverage.

3 National Highway Traffic Safety Administration. n.d. "Distracted Driving." Accessed November 28, 2017. https://www.nhtsa.gov/risky-driving/distracted-driving.

Insurance Technology Market

Making the Old New Again

By

GORDON **ZELLERS**

Senior Vice President,
Partner and Colorado Practice Leader

720.593.5405

gzellers@wsandco.com

Learn more about Gordon

Technology is changing every aspect of client service, and the insurance industry is no exception. Historically, insurance has not been considered a hotbed of innovation, but the abundance of capital in the industry, which has led to decreasing premiums, is forcing insurers to look for new ways to increase market share, and these insurers are looking to technology to find solutions.

Insurers Starting to Mine Big Data

Massive amounts of data ("big data") have been available for years, but insurers have been slow to develop the tools to effectively analyze and use this data.

Today, new software tools and increased computing power are allowing insurers to find correlations in data that were not previously evident, or too expensive, to determine.

Once an insurer can find correlations between risk factors and losses, it can model them. Once losses can be modeled, premiums and subsequent new products can be developed and offered to the general market. Risks that in the past may have been deemed "uninsurable" may become insurable.

Future Impact on Commercial Insurance Buyers

Easier application processes, lower premiums and more innovative and customized products are all on the horizon, given the way technology is impacting the industry. InsurTech companies and some insurers are experimenting with tools that mine data from the internet to find risk factors.

Easier application processes, lower premiums and more innovative and customized products are all on the horizon.

If this technology follows the current trajectory, commercial insurance buyers can expect a much smaller application or no application at all. Your broker will merely provide addresses to the underwriter and the data mining tools will be able to identify key underwriting variables such as the construction and the presence of sprinklers at a location.

Innovative devices will also transform the human-safety landscape. Wearables offer the promise of lower workers' compensation costs and increased productivity. For example, some wearable technology can detect fatigue, leading to loss prevention. Telematic solutions, which monitor automobile speed, acceleration and overall driving safety, can revolutionize the way we monitor and/or mitigate risk profiles.

This ERM Telematics device monitors driving quality and safety.

Woodruff-Sawyer's New Tech Portal for Clients: Woodruff360

As brokers, our highly customized and personal service offering to clients is something technology can't replace, but it can enhance our offering. Here at Woodruff-Sawyer, we've spent several years ramping up our infrastructure to lay the groundwork for delivering meaningful tools and resources to clients in a digital environment.

Over the next year, we're rolling out our enhanced offering to clients on the web, Woodruff360. The interactive program management website allows clients access to their information on a 24/7 basis and integrates claims reporting, certificate management and other core functions.

Expert Insights

Since When is Running a Marathon a Workers' Compensation Claim?

By

DARREN **CARTWRIGHT**

Senior Vice President,
Partner and Claims Practice Leader

415.402.6542

dcartwright@wsandco.com

Learn more about Darren

When does an injury sustained while participating in a voluntary, off-duty activity become work-related? Ordinarily, employees' recreational activities are personal matters and would *not* be the basis for a workers' compensation claim if injuries were to occur.

How Off-Duty Recreational Activities Become Work-Related

This general rule is embodied in California Labor Code § 3600(a)(9), which states that an injury is not eligible for compensation if it arises out of the "voluntary participation in any off-duty recreational, social, or athletic activity not constituting part of the employee's work-related duties." Other state labor codes have similar variations and should be reviewed carefully.

However, case law has established that any time an employee subjectively believes that participation was an expectation of employment, and that subjective belief is objectively reasonable, an exception to this rule may apply.

Furthermore, the court of appeals has noted that the question of whether an employee was on-duty or off-duty at the time of injury is not the ultimate test for whether the injury arose out of, and in the course of, employment.

When an employee files a claim that he or she was injured while engaged in an off-duty activity, it is on the employee to show that the activity was "expressly" or "impliedly" required by the employer, or that the activity was "a reasonable expectancy of the employment."

So, what are some examples that would meet this threshold? To understand this, let's review the facts of a few key cases.

A “Reasonable Expectation” Case Study

Ezzy v. Workers’ Comp. Appeals Board

Was Softball Game Participation Expected as Part of Employment?

Marilyn Ezzy, a female law clerk for a law firm, was injured during a softball game that the law firm sponsored. Here are some facts of the case:

- The games were played regularly, and a certain number of females were necessary for each game. Female employees were therefore asked to participate and Ezzy testified that she thought she was expected to participate.
- The employer gave her a softball jersey and a team schedule, and told her that they would see her at the game.
- The law firm paid for all equipment and t-shirts, as well as post-game refreshments.
- The firm sponsored an awards banquet where team members and other employees were invited.
- A substantial benefit to the firm was generated by participation in the softball team by virtue of improved office cooperation, spirit, morale and camaraderie.

The Verdict

A two-part test was used to determine if the activity was deemed to be a “reasonable expectancy” of her employment:

1. Did the employee subjectively believe participation was expected?
2. Was the belief, viewed objectively, reasonable?

While initially ruled as not a work-related injury, Ezzy’s case ultimately went to the courts of appeals. The appellate court considered specific factors to determine the reasonableness of Ezzy’s belief that the law firm expected her to participate in softball games.

The appellate court evaluated:

- *Level of employer involvement*
- *Benefit to the employer through the activity*
- *Job-related pressure to participate*

Relying on the test noted above, the court of appeals in *Ezzy* ultimately concluded that the petitioner’s subjective belief that her employer expected her to participate in the company-sponsored baseball activities *was objectively reasonable*, and, therefore, her injury arose out of and in the course of her employment.

The second key factor is whether an activity may be expressly or impliedly required by the employment.

“Expressly Required by the Employment” Case Studies

Here, we’ll take a look at two key cases. First is Hermann v. Workers’ Comp. Appeals Board.

Was Cumulative Injury Caused by Fitness Work Requirement?

Fredric Hermann was a California Highway Patrol (CHP) officer from 1968 to 1996 and the CHP implemented physical fitness evaluations, which he failed at first.

To pass the evaluations, he engaged in a CHP-approved fitness program. The program included running, which was limited to 40 minutes per day. After engaging in this, he passed the evaluations with ease.

He then went on to participate in 5K and 10K runs, marathons and even “ultra” marathons of up to 100 miles. For this he would train by running 50 to 60 hours per week. In 1990, his right foot and right big toe became painful, and in early 1995 he sought treatment, which would include two surgeries.

Later, Hermann filed a cumulative trauma (CT) claim alleging that his mandatory running for the CHP caused problems with his right foot and right big toe.

The Verdict

There was no dispute over the fact that his running aggravated his condition, but the judge issued a ruling stating he did not sustain cumulative injury arising out of and in the course of employment.

The judge noted that Hermann’s running activities, which he engaged in for 50-60 hours per week, were well in excess of the 40-minute per-day maximum imposed by the CHP.

Hermann sought a writ of review, essentially contending his running program was a reasonable expectancy of his employment and was required as part of employer’s physical fitness program, but this was ultimately denied.

Contrast this case with Kidwell v. Workers' Comp. Appeals Board …

Is There a Reasonable Expectation to Exercise While Off Duty?

California Highway Patrol (CHP) officer, Linda Kidwell, who was injured while practicing a standing long jump in her home during off-duty hours. As a "tier 1 employee" with the CHP, she was required to take an annual fitness test that included the standing long jump as one of the fitness test protocols.

These fitness tests were considered "job-related" but not "minimum job standards" for tier 1 employees. Thus, failing the test would not affect her employment security. However, CHP policy mandated that failure of the annual fitness test by a tier 1 officer would result in a loss of "eligibility for salary differential, voluntary initial assignment to special duty, promotion and voluntary special overtime programs."

In addition to losing these administrative benefits, officers who fail the annual fitness test are issued a "fitness plan" in accordance with CHP guidelines and can begin the "retest cycle" as outlined in the CHP policy manual. Failure of the fitness test would also appear on an officer's performance evaluation.

The Verdict

Upon review, the court of appeals found the petitioner's belief that practicing the long jump for the employer's fitness test at home was job-related and to be an objectively reasonable belief, and thus her injury was compensable.

The court said: "It is patently unreasonable to determine that the CHP did not expect applicant to practice. Additionally, it is unreasonable to assume that applicant should not have practiced in her home."

An "Impliedly Required by the Employment" Case Study

Now, let's look at a case that involves an implied requirement to participate: Smith v. Workers' Comp. Appeals Board

Was There a Causal Connection Between Employee's Death and His Employment Expectations?

The *Smith* case involves the death of a temporary high school math teacher (Ronald Smith) due to a wind surfing accident during a school math club picnic. Attendance at the picnic was an implied requirement of the teacher's employment.

In addition, Smith coached the girls' baseball and basketball teams. His employment contract stated that he "may be required to devote a reasonable amount of time to other duties" in addition to instructional duties.

The teachers in the school system were evaluated once a year regarding both instructional duties and non-instructional duties, including the "sponsorship or supervision of out-of-classroom student activities."

The accident was the result of the teacher's participation in the recreational activities, which were part and parcel of the picnic's "entertainment" and were causally connected to his employment.

The Verdict

Because attendance at the picnic was an implied requirement of the deceased's employment, the court of appeals held that the deceased's accident was causally connected to his employment for purposes of awarding workers' compensation benefits to his heirs.

An injury is deemed to have arisen out of one's employment if there is an incidental or causal connection between the employment and the accident.

Know the Risks with Offsite Activities, and Document Yourself

Workers' comp incidents that arise in the normal course of business can transpire from activities that include casual team outings and official offsite events. And, in most of these scenarios, they have one common purpose: to improve office cooperation, spirit, morale and camaraderie.

When evaluating an activity or recreational program, take a second to ask yourself: *Do the benefits outweigh the risk?* Oftentimes, they do. Just make sure you or someone within your organization is ready and able to document the "who, what, when, where and how" questions, if an injury occurs.

With that, keep in mind Labor Code § 3600(a)(9) states that liability shall exist for an injury sustained by an employee during off-duty recreational, social, or athletic activity that is either a reasonable expectancy of the employment, where the employee subjectively believes his or her participation is expected and that belief is objectively reasonable. Or, the activity is expressly or impliedly required by the employment.

Busting Myths About Employees Using Personal Auto on Business

By

MATT **GAUEN**

Senior Vice President,
Partner and P&C Specialist
Southern California Region

949.435.7357

mgauen@wsandco.com

Learn more about Matt

There is a common belief among employees that "anything" that happens while they're driving their personal vehicle on company business is covered by their employer's auto liability coverage. This is a myth that needs to be dispelled.

Just Because You're on Company Business, Doesn't Mean Your Employer's Insurance Pays

State laws dictate insurance follows the car, which means that the registered owner (the employee) is required to place insurance on the vehicle. Full coverage would include physical damage (property damage to the vehicle itself) and liability (bodily injury and property damage caused by the vehicle to others). The employer's auto coverage is for liability only, and is triggered only after the employee's insurance limit has been exhausted in an at-fault accident while on company business.

Let's illustrate this concept with a story …

Joe's Job Requires Him to Drive to Customers for Meetings

Joe is a sales representative for a pharmaceutical company. A condition of his employment is that he maintain a valid driver's license and must use his own personal vehicle to make calls on customers for his employer. Here are some ways Joe might use the vehicle, and some scenarios he may find himself in …

Scenario 1 – Joe's Personal Auto Limits Are Sufficient for the Total Loss

Joe is driving to a customer appointment when he makes an illegal left turn in front of oncoming traffic and another vehicle broadsides him. It's determined Joe is at fault in this accident. The damage to the other vehicle, its driver and passenger is $160,000.

- Joe maintains physical damage protection on his vehicle with a $500 deductible and $300,000 combined single limit liability.
- Joe's insurance responds to the physical damage to Joe's vehicle and to the liability to the other vehicle and its driver and occupant.
- Joe's insurance pays the entire loss to his vehicle (less $500 deductible) and the liability to the other party ($160,000).

The Takeway:

In Scenario 1, if the employee is at-fault in the accident, the employee's personal auto policy covers all physical damage to his own vehicle in addition to the liability to the other vehicle and its occupants.

Scenario 2 – Joe's Personal Auto Limits Are Insufficient for the Total Loss

This scenario is the same as above with the difference being that the other party was speeding when a new father was taking his expectant wife to the hospital. It's determined Joe is at fault in the accident. The damage to the other vehicle, its driver and the passenger is $500,000 due to complications with the pregnancy. In this scenario:

- Joe's personal auto insurance responds to the physical damage to Joe's vehicle and will pay the full liability on his personal policy, to the maximum policy limit of $300,000.
- Joe's employer's auto insurance is triggered to cover the rest of the damages. Assuming the employer's auto policy includes hired/non-owned auto coverage, the additional $200,000 is paid by the employer's policy. And since Joe's personal auto policy has paid out to the maximum, the employer's insurer won't subrogate or pursue Joe's policy for its insurance loss.

The Takeway:

In Scenario 2, if the at-fault employee's personal auto policy pays its maximum and there are still damages to pay, the employer's auto policy kicks in to cover the remaining damages. In essence, the employee's personal policy is triggered first.

Scenario 3 – Auto Break-In and Theft of Personal and Employer Property

Joe takes a customer golfing. They finish their round of golf and Joe puts his company laptop in the trunk along with his new set of clubs. While they are in the club house having lunch, the vehicle is broken into and the laptop and clubs are stolen. In this scenario:

- Joe's auto insurance would respond for the physical damage done to his vehicle (broken window, punched trunk lock, scratches to the paint) less his deductible.
- Joe's homeowner's policy would respond for the stolen clubs.
- Joe's employer's property policy would respond for the stolen laptop.

The Takeway:

In Scenario 3, if personal property is stolen from the vehicle, the employee's personal insurance (homeowner's or renter's) is triggered for the vehicle damage and stolen personal property. The employer's policy is triggered to cover the stolen company property.

Final Piece of Advice: If Medical Care is Involved, File a Workers' Comp Claim

Apart from auto insurance, employers should keep in mind that when an employee is involved in an accident while on the job, and an injury is sustained, a claim for workers' compensation may need to be filed. The best way to determine this is if the employee requires any form of medical care. If so, medical attention should be sought and a claim should be reported to the workers' compensation carrier for further handling.

Global Insurance Strategies: Tackling the Complexity of International Risk

By

KRISTY **FURRER**

Vice Chair, Partner and International Risk Specialist

415.399.6347

kfurrer@wsandco.com

Learn more about Kristy

Building a business in a global economy comes with complications as well as opportunities. Most of our clients will sooner or later grapple with covering their risks abroad. They are not alone; insurers, too, have had to address the complexity of effectively managing risks across a complex multinational landscape.

Controlled Master Programs is One Strategy

A logical solution for many of our clients' complex risks is to develop a controlled master program. For many US buyers, they want to ensure they are in control of their global insurance spend and this program provides just that, through:

- Consistent coverage worldwide
- Compliance with local regulations, laws and insurance premium taxes (IPTs)
- Centralized claims handing
- Centralized communication
- Proven cost savings

Along with control, this type of program also brings the burden of significant administration that comes with placing and issuing polices in each country. Increasingly, local regulators are requiring anti-money laundering and KYC (know your client) declarations along with the standard applications, acknowledgements, payment requirements, broker commission rules, and the list goes on.

Freedom of Service Policy – A Good Alternative within the EEA

Within the European Economic Area (EEA), there are options other than the controlled master program. One product that has emerged and has been embraced by insurers is the Freedom of Service (FOS) policy.

An FOS policy covers risks on a cross-border basis within EEA. These policies allow insurers to streamline communication and allow the policy to be administered by one European broker, usually in the UK.

Controlled Master Program vs Freedom of Service Policy

Having one European broker, and one who speaks English, is a clear advantage. A key difference from a controlled master program is that the insured loses the cultural and technical benefit of having a local broker in each country.

As insurers have found success with the FOS product, many are offering this as a sole solution within the EEA. They like the administrative ease and control of FOS policies and encourage clients to make the leap.

For many of our clients, shifting strategies was a concern. For that reason, we at Woodruff-Sawyer have engaged our network of local brokers in those European countries where broader local services and attention is needed. In doing so, we can customize and enhance the FOS product to maximize its effectiveness, making this transition easier and more viable for clients.

Woodruff-Sawyer can customize and enhance the FOS product to maximize its effectiveness, making the transition from a controlled master program to an FOS policy easier and more viable for clients.

Brexit Poses Additional Challenges for FOS Policy Holders

As the FOS tool has become the choice of insurers in the EEA, a new challenge is emerging that must be watched: Brexit.

As the UK exits the EU, will a UK broker still be able to be the lead broker on FOS policies? If not England, who? Belgium, Luxembourg and Germany have all been mentioned. Many brokers and insurers in these countries speak English, but English is not the official language in any of these countries, removing the primary benefit of FOS policies being administered out of the UK.

Time will tell if FOS policies remain popular with insurers. We think they will. The administrative ease of an FOS saves money and time for insurers, and a skilled insurance broker can fill the service gaps that may arise from these policies. Woodruff-Sawyer has developed dedicated resources to managing international risks in placing property, liability and D&O insurance in over 60 countries.

Rethinking Business Interruption in a Cyber Age

By

DAN **MCMULLEN**

Senior Vice President, Partner and New England Property & Casualty Practice Leader

617.658.7103

dmcmullen@wsandco.com

Learn more about Dan

Cyber Events Are Rapidly Evolving, Leaving Property Insurers Scrambling

Historically, business interruption coverage has resided within a property policy, but as business moves more and more to a digital environment, business interruption is now more likely to arise in cyber space; both in frequency of events and magnitude of exposure.

For example, this past summer, shortly after the WannaCry attacks sent shockwaves around the world, a breed of ransomware known as NotPetya stepped onto the scene. Corporations large and small were affected regardless of how many state-of-the-art security measures they had in place, ultimately causing huge earning losses for companies around the world.

Read our recent blog post on the impact NotPetya had on companies like FedEx, and how your organization can prepare for cyber attacks.

Property insurers are accustomed to pricing business interruption for perils like fire, but electronic security breaches and other cyber interruptions are new and uncharted territories. Cyber events have left property insurers scrambling to quantify exposure in this rapidly evolving space. The result has been reduced or excluded coverage on property policies.

In Comes Cyber Business Interruption Coverage

Seeing this gap in the market, a new breed of insurers has stepped in to provide business interruption coverage specific to cyber exposures. Once uninsurable, today there exists many evolving products that effectively protect your balance sheet for perils, like:

- Cyber security events that cause a system outage. A well-designed policy will also cover system outages/degradations and other system failure triggers outside of a pure security failure.
- Denial-of-service or DoS attacks and hacking (both internal and external).
- Cyber extortion events, where a policy can cover ransom payments if data is held hostage.
- Exposure that occurs due to your dependency on a supplier's computer networks and/or services that can cause an interruption. This constitutes dependent or contingent business interruption. Most insurers will offer this, subject to a typical sublimit of $100,000 to $250,000.

What's Contingent Business Interruption Insurance?

Contingent business interruption insurance (CBI) is designed to reimburse you for lost profits and extra expenses resulting from an event (such as a natural disaster), that prevents you from engaging in normal business operations. The event could have taken place either at your premises or that of a customer or supplier.

Consideration should also be given to the definition of "computer network," as some policies will limit coverage only to your network(s), not those of an outsourced services provider.

Like most commercial coverage, there will be deductibles on these types of policies, in the form of an hourly waiting time, mostly in the eight to 12-hour range. This means the policy won't pay an interruption loss until after the applicable waiting period has lapsed. As many outages are corrected fairly quickly, thoughtful consideration should be given to a reasonable waiting period.

Learn more about the basics of cyber insurance here.

In addition to protecting your income stream, cyber business interruption policies can also be endorsed to address other "post outage" expenses, such as forensic investigation costs to determine the source of loss, and data restoration expenses to research/replace corrupted data.

This additional coverage is usually part of a broader cyber insurance policy, adding coverage for security/privacy liability and other "first-party" expenses, such as notification costs, credit monitoring where applicable, call center services and public relations costs.

Additional Insureds on Your E&O Policy: It's More Complicated Than You Might Think

By

KRISTIN **BEAULIEU**

Vice President and P&C Specialist
Pacific Northwest Region

206-455-2971

kbeaulieu@wsandco.com

Learn more about Kristin

For those familiar with general liability (GL) policies, adding a third party such as a customer or landlord as an additional insured (AI) on one's GL policy is common. The third party may either be specifically scheduled on the policy via a variety of endorsements, or the extension may be made through a broad form blanket contractual liability insurance provision in the policy.

Additional Insureds on GL Policies are More Straightforward

In this case, the AI would be covered for liability risks already covered by the policy, including claims for bodily injury and property damage arising out of premises, operations, products, completed operations, advertising and personal injury caused by the named insured's operations or in connection with their business premises.

What's an Additional Insured?

A person or organization receiving the benefits of insurance under an insurance policy for the activities of the Named Insured. (A Named Insured is specifically designated by name as an insured in an insurance policy.)

Adding Insureds on an E&O Policy Can Create Problems

In contrast, professional liability insurance, or errors & omissions (E&O), responds to demands for financial damages arising out of the provision or failure to provide "professional services" to a client or customer. Examples of "professional services" include design services, business consulting, architects, engineers, technical consulting and so on.

When a client or other third party of an insured seeks to be included as an AI on an insured's E&O policy, it can create problems such as these:

1. A Claim Naming the AI Might Not Trigger Coverage

Coverage under an E&O policy is triggered by allegation of financial loss arising from the failure to render, or negligence in rendering a defined professional service. As the AI is not rendering the professional service, it's possible a claim naming them would not result in coverage payout.

2. Getting an Underwriter to Agree to Add an AI Can Be Difficult

Insurers offer terms based on an analysis of the insured's exposure (services, revenue and other measures). Adding an AI potentially broadens the scope of liability, and is difficult to underwrite. Many E&O insurers also have reinsurance treaties that prohibit them from adding unrelated third parties as an AI.

3. If the AI Sues the Insured, Coverage Will Be Excluded

Most E&O policies contain "insured-versus-insured" exclusions that preclude coverage when one insured sues another insured under the same policy. The coverage is intended to compensate injured parties on behalf of an insured for which the insured is legally liable. The intent of excluding claims brought by one insured against another insured is to avoid covering internal disputes between co-insureds.

4. Covering the AI's Defense Costs Could Erode Coverage Limits

Defense costs for most E&O policies are included within the limit of liability. Therefore, covering the defense of AIs can rapidly erode one's policy limit, potentially leaving the insured exposed. Also, if the carrier is tendering a defense for both the insured and the AI, then a potential conflict of interest could arise.

What's Driving the Need?

When asked to name a third party as an AI on an E&O policy, it's helpful to understand why the third party is making the request. In most cases, the third party is looking to back up the indemnity language in the service contract. While you can understand why an AI would want to do this, E&O policies contain contractual liability exclusions that remove coverage for any assumed liability via contract that would not be attached to the insured in absence of a contract.

Our Advice:

> Some friendly coaching with your third party can often highlight the fact that not only would adding that third party as an AI <u>not</u> achieve the desired protection, but it can also actually *reduce or completely eliminate* the desired coverage.

While including broader language in the policy around true vicarious liability might seem appropriate in order to extend coverage to third parties and their assumed liabilities, the “insured-versus-insured” exclusion described above could be problematic for getting a claim paid.

Meet Your Mutual Needs Without an AI Provision

Rather than include third parties as AI on E&O policies, we recommend you consider amending the E&O insurance requirement in the contract to state that the third party is protected for their vicarious liability arising out of the wrongful acts of the insured. This removes the requirement for them being actually listed on the policy as an “additional insured,” but provides meaningful coverage to the third party.

Furthermore, if the third party also provides professional services as part of the service agreement, the insured would want this language to apply to them as well. As the third party’s own E&O policy would only cover their own wrongful acts, this extension on both sides fills a potential gap.

In reality, there could be allegations against both parties, leading to an allocation discussion regarding the relative liability of each party. Most service agreements contain mutual indemnity agreements and mutual hold harmless agreements, so extending vicarious coverage for third parties for errors, omissions and negligence of the insured is about the extent of what can be appropriately extended for this exposure.

Our Advice:

Amend your service contract’s E&O insurance requirement to state that the third party is protected for their vicarious liability arising out of the wrongful acts of the insured and vice-versa.

In summary, while it may be beneficial and common for a third party to request being included as an AI under a firm’s GL insurance, we don’t recommend naming AIs on an E&O policy without appropriate consideration and full understanding of what is actually insurable, and the potential unintended consequences that come with such a blanket request.

Woodruff-Sawyer is one of the largest independent insurance brokerage firms in the nation, and an active partner of Assurex Global and International Benefits Network. For nearly 100 years, we've been partnering with clients to deliver effective insurance, employee benefits and risk management solutions, both nationally and abroad. Headquartered in San Francisco, Woodruff-Sawyer has offices throughout California and in Oregon, Washington, Colorado, Hawaii and New England.

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