



THE BETTERLEY REPORT

TECHNOLOGY ERRORS & OMISSIONS MARKET SURVEY – 2006
CARRIERS CONTINUE TO INNOVATE, WHILE PREMIUM COMPETITION CONTINUES

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Editor's Note: We are pleased to present our sixth evaluation of Technology Errors & Omissions (Tech E&O) insurance, in which we review fifteen of the leading carriers active in the market. Markets new to our Report include NAS/Lloyds, OneBeacon, and SafeOnline.

Tech E&O is coverage for the liability of organizations and individuals that provide products and services utilizing technology. Depending upon the carrier, insureds can include manufacturers, software developers, consultants, service providers (such as systems integrators) and telecommunication companies.

While each insurance carrier was contacted in order to obtain this information, we have tested their responses against our own experience and knowledge. Where they conflict, we have reviewed the inconsistencies with the carriers. The evaluation and conclusions are our own however.

In most cases, we examined actual policy forms and endorsements provided by the carrier. Rather than reproduce their exact policy wording (which can be voluminous), we in many cases have paraphrased their wording, in the interest of space and simplicity. Of course, the insurance policies govern the coverage provided, and the carriers are not responsible for our interpretation of their policies or survey responses.

In the use of this material, the reader should understand that the information applies to the standard products of the carriers, and that special arrangements of coverage, cost and other variables may be available on a negotiated basis. Professional counsel should be sought before any action or decision is made in the use of this information.

INTRODUCTION

Coverage for the liability arising out of the design and manufacturing of technology-related products, the creation and implementation of software, and the provision of related services, is a growing business, with specialty coverages designed to cover the Errors and Omissions liability that may not be covered under traditional liability policies. Tech E&O coverages can be purchased for technology consultants, systems integrators, application service providers, Internet service providers, Internet retailers, network electronics manufacturers, medical technology manufactures, and telecom companies. With a wide variety of coverages available, and each written on a non-standard form, insureds and their advisors can be confused and bewildered at the choices.

One example is coverage for the cost to rectify perceived errors in a project in order to mitigate the likelihood of an E&O suit, or coverage for the return of project fees paid by the insured's client. It is a rare coverage, not widely advertised, but sometimes available for selected insureds that meet underwriting requirements. Chubb and St. Paul Travelers offer this coverage selectively; other carriers may also, but don't like to advertise it.

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Insureds looking for Tech E&O coverage are presented with a choice of buying individual policies that supplement their core General Liability policy, or a policy that includes both GL and E&O. In our experience, most insureds purchase separate policies, although carriers such as Beazley, Evanston, and St. Paul Travelers offer a combination of the two.

One item of note is the degree to which insureds are willing to investigate and purchase these coverages using online sources. Considering the comfort these insureds can be expected to have with online buying, this is no surprise, but may be a hint as to the future success of online insurance buying. Of course, given the complexity of the coverage choices, a good insurance broker can offer a lot of useful advice to prospective insureds, and their value in negotiating coverage is not to be underestimated.

STATE OF THE MARKET

Annual premium volume information about the U.S. Tech E&O market is hard to come by, but in asking several of the product managers, we have concluded that the annual gross written premium is now in the \$750 to 800 million range. It is likely that there is much more premium to be found in the more traditional markets, but that it is not being reported as Tech E&O. Also, we expect that there are many more potential insureds that need Tech E&O, but are either not aware of its existence, or underestimate its value. This is likely to be true for the smaller service firms.

Educating the technology community to the value of this coverage is important to the future growth of the line. As lawsuits become more common, we suspect that there will be better market penetration.

We asked carriers about the health and interest of the reinsurance market that supports Tech E&O products, and they generally reported that reinsurers still like the product. Stable or increasing interest in Tech E&O product support was reported by the responding carriers.

As for growth in premiums written, carriers are pretty reticent about responding. This can be a bit misleading, as Tech E&O coverages are often written as a part of other products, and not reported separately for premium purposes. Ten carriers responded to our question about their premium growth rates (2005 vs. 2004):

- Down 3
- 0 to 10 percent increase 3
- 11 to 25 percent 2
- 26 to 50 percent 1
- 51 to 100 percent 1

Premium volumes are similarly not widely reported; thirteen responded. As in 2004, we see one carrier writing a relatively large amount of business (over \$100 million), with other carriers also writing a significant book of business:

- Under \$1 million 1
- \$1 to 5 million premium 0
- \$6 to 10 million 2
- \$11 to 25 million 4
- \$26 to 50 million 3
- \$51 to 100 million 2

STATE OF THE MARKET — RATES

We asked the carriers whether, or not, they planned rate increases (or decreases) during the upcoming year, and whether, or not, they expected their competitors to. Most offered their thoughts.

Rates for Tech E&O insurance, like most commercial insurance, are softening, but less so than the core lines. Carriers report plans to reduce rates 5 to 10 percent, or so as needed, but we wonder if this market will allow them to avoid deeper discounts. Troubled insureds will undoubtedly face significant increases, but for the insured with very good claims experience and effective risk management controls, no increase—or perhaps a slight decrease—is more likely.

One substantial carrier reported a plan to slightly increase its rates (less than 5%).

STATE OF THE MARKET — RETENTIONS

The level of retentions or deductibles that carriers are willing to write continues flat. No carrier reported a plan to increase retentions, and that was mostly to bring them into line with their competitors.

TARGET MARKETS AND PROHIBITED INSUREDS

Unlike most of our surveys, there are significant classes of business that some carriers indicate are prohibited. Problem classes seem to include process control and robotics, automated manufacturing systems, Internet service providers, and security-focused risks.

Read the *Target Markets* table carefully as a guide to which carriers like (or don't like) certain classes of business, but also keep in mind that these can change, and are often subject to reconsideration.

CAPACITY AND RETENTIONS

Significant liability limits capacity remains, and reasonable (account appropriate) retentions or deductibles are available. Carriers with stated capacity of \$25 million include ACE, AIG, Chubb, OneBeacon, and St. Paul Travelers. Up to \$20 million is available from Beazley, while \$15 million can be bought from CNA, and \$10 million from The Hartford, Media/Pro, Philadelphia, and SafeOnline.

Lower limits can be arranged with Euclid and Evanston (\$5 million), and Indian Harbor and NAS (\$2 million).

Most carriers can secure limits above those indicated when necessary, noting in particular Euclid's interest in writing excess limits.

Deductibles or retentions can be quite competitive; the *Limits and Deductibles* table shows minimums, of course. Lower deductibles are generally available from the carriers offering lower limits, those that may best appeal to the smaller insureds desiring low deductibles. Deductibles are, however, pretty reasonable, considering the low frequency nature of the coverage.

Carriers are still reluctant to state commissions, but they typically are similar to those paid on traditional commercial lines products.

POLICY FEATURES

With the wide variance in coverages included in Tech E&O products, paying close attention to key features is important.

For example, in the table *Policy Type*, note that several carriers are willing to offer General Liability coverage to their Tech E&O insureds, either as a separate policy (ACE, AIG, Chubb, CNA, Evanston, Hartford, and OneBeacon) or as an optional endorsement (Beazley, and St. Paul Travelers). Only Euclid, Indian Harbor, Media/Pro, NAS, and SafeOnline do not offer a GL coverage option. Note that Beazley's GL option is on a claims-made basis only.

Coverage for liability arising out of the actions of subcontractors while working on behalf of the named insured is generally included in the basic policy form. However, most will not include coverage for the subcontractor itself, unless special arrangements are made.

The definition of "Products and Services" is critical for proper coverage.

The policies define the products and/or services that are covered. There are two different ways this can be done: either the declarations page specifies the products and/or services covered (which comes from the application) or the policy definition itself defines the activities covered. For example, Evanston, Media/Pro, NAS, and Philadelphia specify the covered activities on the declarations page. The other carriers use policy definitions instead.

Either way, it is critical that the products and/or services of the insured be listed or defined as included in the policy. Wording is shown under "Definition of Products" and/or "Services Defined in Policy" included in the table *Definition of Products and Services*.

We are often asked whether, or not, coverage in a Tech E&O policy includes losses arising out of:

- Identity theft
- Credit and/or debit card fraud
- Theft of trade secrets
- Invasion of privacy

These concerns are prevalent because of the publicity around hackers breaking into Websites and stealing information. Is there coverage in a Tech E&O policy for the Web designer or site host that fails (or is alleged to have failed) in its duty to prevent such theft?

Tech E&O policies do not typically address these causes of loss directly. Instead, the insured or its advisor needs to review whether the alleged failure is a result of E&O under the policy language, and then see if the exclusions eliminate coverage for the type of loss (such as identity theft). In reviewing the *Exclusions* table section “Security Breach/Unauthorized Access,” it is clear that some carriers grant coverage when the breach occurs to a customer’s system, but not to the insured’s own system.

Tech E&O policy provisions should always be reviewed in connection with the insured’s GL policy provisions, especially with respect to new or emerging exposures of concern. Some carrier markets offer coordinated E&O and GL coverage, whereas other markets may offer monoline E&O only. Coverage not provided or excluded by an E&O policy may well be addressed by the GL.

**CLAIMS REPORTING,
ERP OPTIONS,
AND COUNSEL**

Each liability policy reviewed is a claims-made form so Extended Reporting Period (ERP) options are important. All carriers include a Supplemental Extended Reporting Provision, but they range in length. Carriers that offer up to a one year SERP include Beazley, Indian Harbor, NAS, and Philadelphia. Up to two years is available from Media/Pro, while up to three years is offered by ACE, AIG, and Evanston. CNA and Euclid offer up to five years, while Chubb, OneBeacon, and St. Paul Travelers offer an unlimited period.

Selection of counsel continues to be a delicate issue with insureds, but as we frequently see in other new lines of coverage, carriers typically reserve the right to select, or at least approve, counsel. In practice, carriers are generally willing to use legal counsel that is satisfactory to both the insured and the insurer.

Carriers that offer specific control (or at least, influence) to the insured include AIG and CNA, which both offer an optional Choice of Counsel form (insured chooses counsel). Chubb, Evanston, and St. Paul Travelers allow the insured to select counsel, subject to carrier’s approval, which will not be unreasonably withheld. As with all questions of counsel choice, we recommend that insureds discuss and agree with

their carrier beforehand on the counsel they want to use; as an example, The Hartford reserves the right to choose counsel, but indicates pre-negotiated counsel will be considered on a case-by-case basis.

Generally, carriers can impose the infamous “hammer clause” on lawsuits that an insured may not want to settle. The use of “soft” hammer clauses has not penetrated this product as it has in Employment Practices and Management Liability products.

PRIOR ACTS COVERAGE

All carriers offer Prior Acts coverage, with previous coverage usually required by all carriers except Chubb (although Chubb may require previous coverage based upon underwriting criteria).

TERRITORY

Technology is a worldwide business, and one of the liability problems is that the legal standards of many countries differ from those of the U.S. For example, a well-known legal case in Germany was brought against a U.S. e-commerce portal, was based on German legal standards, and was brought in Germany. True worldwide coverage is important!

All carriers offer worldwide coverage if a suit is brought in the U.S., Canada, or possessions. True worldwide coverage (suit brought anywhere) is available from each of the carriers reviewed except Indian Harbor.

EXCLUSIONS

Exclusions are many and varied, as would be expected. Please read those tables carefully.

Rather than try to recite them here, the information for each carrier is found in the *Exclusions* tables. Unlike our other reports, we have categorized the exclusions into:

- General Insurance (bankruptcy, dishonesty, intentional acts, expected or intended damages, SEC, unfair competition, piracy, and punitive damages)
- Product related (product recall, cessation of support, direct property damage, direct bodily injury, loss of property, contingent bodily injury/property damage, prior to customer’s acceptance of your work, breach of warranty, and hardware)

- Service and security related (contractual liability, cost estimates exceeded, performance delay, security breach, failure to prevent virus passing or data theft)

- CyberRisk related (personal injury, advertising injury, intellectual property, and public key infrastructure)

A few comments on some of the exclusions that are specific to Tech E&O:

- “Cost estimates exceeded” refers to exclusions for claims by customers that the cost of a project exceeded the estimate or proposed fee. Carriers do not want to pay claims for poor pricing decisions of their insureds.

- “Performance delay” arises out of the insured’s failure to meet project time deadlines, and is included in policies to protect carriers against an insured’s overly optimistic promises.

- “Security breach or unauthorized access” is a very important set of exclusions for any insured that offers services related to secure data, including ecommerce. Some carriers will provide coverage if the insured is providing services related to security, while others will include coverage as long as the breach is on the system of others (i. e., not the insured), which is after all the intent of E&O coverage.

- “Intellectual property” infringement of patents, copyrights, or trademarks is a source of much litigation, and coverage is rarely available when an insured is sued. Each carrier handles this very differently; read this portion of the *Cyberisk Related Exclusions* table carefully.

- “Public Key Infrastructure (PKI)” the term used to describe technology that enables secure online transactions. Only ACE has a standard exclusion for PKI, but the insured can expect that the PKI risk, if existent in its business, will be examined carefully before coverage is offered.

RISK MANAGEMENT SERVICES

Supplemental loss avoidance and control services are not prevalent in Technology E&O, which is odd, considering the ability of such services to reduce or eliminate losses, for the benefit of both insureds and insurers.

We note and applaud the several carriers that do offer risk management services, including:

- AIG—Network security assessments
- Beazley—Professional risk assessments
- Chubb—Data network security tools and an E&O risk management guide and checklist
- OneBeacon—various loss control services
- Philadelphia—loss assistance hotline with two free hours of confidential consultation per occurrence
- SafeOnline—Online risk assessment by security experts (NetDiligence)
- St. Paul Travelers—Various loss control services.

It is good to see these services being made available to insureds, and we look forward to their expansion to more carriers.

SUMMARY

We are glad to see that the Technology E&O market is strongly supported by a variety of carriers, both large and small. The market is growing as the technology products and services industries expand, and as companies within those industries see the need for E&O coverage.

Product offerings vary widely from carrier to carrier, with some good and innovative coverage features available from the smaller insurers—innovation that may expand the products of the larger carriers. Still, insureds should look to the stability and related products (such as General Liability) of the more established carriers, as well as the newer, innovative products on the market.



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Annual subscription: \$347. US
Single issues are available for \$65. each (\$95. for the EPLI Report).
ISSN 1089-0513

On-line version: \$159. US or \$50. US for 30-days
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