

# Capital and Financing: “That pig has moved through the python”

Bloomberg reports: “Securities suits drop as credit-crunch cases dry up, study says”. With significant rate softening, especially in peak zone risks, this means that D&O and E&O rates will be under significant pressure.

## Digested

“That pig has moved through the python,” Stanford Law Professor Joseph Grundfest said. “All of the major cases that were profitable have already been filed,” he said. “The pool is in effect fished out.”

## Great expectations

Rewind nine to twelve months and D&O and E&O rates were expected to spike. Three major carriers were on the brink of extinction, claims were expected to sky rocket and demand was anticipated to rise. Leading underwriters salivated at the anticipation of naming their price and, most importantly, their terms. Opportunistic investors began to line up to participate. There was an air of expectation and excitement around the market.

The previous credit crisis around 2000 to 2002 had seen a number of high profile businesses fail: Enron, WorldCom, Global Crossing – together with Tyco going to the brink and Parmalat collapsing just to show that Europe can play too. The professional liability claims that ensued were vast and the remnants still ripple around the Lloyds market. Syndicate 1241 is a memorial to bold underwriting in this market.

## Listen to a successful underwriter

As BRAVE Partners sought to develop ideas for clients on the E&O and D&O market, the firm met with some of the most successful underwriters in that market. The message came back loud and clear: “We all thought that it would happen, but it isn’t”. As the title of a previous BRAVE Partners’ commentary puts it, the E&O and D&O market is: “The dog that didn’t bark”. There was also clearly a fear of naïve capacity entering the market.

## A change of policy

A part of the confidence arises from a change in the type of liability policy. Insurers, and Lloyds in particular, learned their lesson from the asbestos claims. Liability insurance was once written on an incurred basis. This means that if an insurer provided a policy today for 2010 it was responsible for all losses that resulted from events

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that occurred in 2010. In the case of asbestos it took tens of years for the cancer to develop, so the claims only emerged 20 years later. Adding on a decade or so for litigation and the liabilities are only settled 30 to 50 years after the policy. This is a long tailed risk.

Liability policies are now written on a claims made basis. This means that an insurer is only liable for losses due to claims that are made during the year of the policy. In the case of asbestos, a claims made policy written at the time of the exposure would not be liable for claims. An insured could only claim against a claims made policy if it is in effect over the year in which the claim is made. In the case of asbestos this would mean that the policy that took the loss would be the one written decades later when the claims are actually made. This might sound impractical, but in fact it allows the insurer more time to gather information on potential risks.

### Robust policies – low claims

So, the D&O and E&O market have emerged from the credit crisis pretty much unscathed. Reduced commercial activity had reduced demand. Supply has persisted – in fact even increased. Insurance Insider is reporting that 2010 capacity at Lloyds is at a record £22bn+. It would seem that not everyone listened to the wise underwriters in the market.

### So what for investors

Investors need to look to markets in which there is a demand-supply imbalance. BRAVE Partners believes that this is the financial risks market. Insurance Insider reports that sovereign risk rates are rising. BRAVE Partners is in touch with demand for credit insurance and residual value insurance.

### Away from Lloyds

Most interestingly, although Lloyds capacity is at a record, the Franchise Board at Lloyds does not like financial risks business. Therefore there is little financial risks business underwritten at Lloyds. The capacity increase at Lloyds therefore does not bring capacity to the most constrained insurance markets.

### The need for diversification

Given the recent experience of monoline credit insurers, the capital need for establishing a monoline, or concentrated, financial risk insurance business will be prohibitive. However, a diversified business will bring capital benefits and efficiencies.

“The current opportunity in insurance lies in establishing a diversified financial risks insurance business away from Lloyds.”

Christopher Cloke-Browne  
Managing Partner  
BRAVE Partners LLP

### The opportunity

BRAVE Partners believes that the current opportunity in insurance lies in establishing a diversified financial risks insurance business away from Lloyds.

The python needs another pig to swallow. BRAVE Partners believes that the financial risks markets are squealing.

### BRAVE Partners services

BRAVE Partners advise management teams and investors to establish insurance businesses. Services include: strategy and business planning, financing plans and introductions to and management of legal, regulatory and actuarial processes.

### Interaction

If you enjoyed this commentary and would like to receive a weekly update by E-Mail, then please contact BRAVE Partners on [commentary@bravepartners.com](mailto:commentary@bravepartners.com)

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- A recent study by Stanford Law School suggests that D&O and E&O insurance is not only the dog that did not bark, but now also the dog that will not bark. Filings for stock fraud claims from the financial crisis are diminishing rapidly.
- BRAVE Partners believes that investors should look to the financial risks insurance markets to pick up superior returns.

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