“The Market for Directors’ and Officers’ Insurance”
Stephen G. Fier and Andre P. Liebenberg
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Synopsis by Colin Reinhart

There are more than $5.4 billion in premiums written for Directors’ and officers’ (D&O) liability insurance each year. D&O insurance is used by companies to mitigate potentially catastrophic exposures they face from lawsuits brought against the company or officers of the company. D&O has several different types of coverage which indemnifies the directors and officers in case of judgments against them, the corporation for costs associated with suits against the directors or officers, and the corporation for suits brought against it; generally firms have each type of coverage.[1] Historically, it has been difficult to analyze the D&O market because firms have not had to disclose their D&O insurance held and insurance providers have not been required to disclose specific premium, loss, and expense data for D&O lines. The ambiguity in the D&O market lessened in 2011 when the National Association of Insurance Commissioners (NAIC) began requiring firms to complete the Director and Officer Insurance Coverage Supplement. Previous studies have analyzed why firms purchase D&O insurance as well as the pros and cons of the purchase decision. Fier and Liebenberg look at the supply side of the D&O market and find that a company’s size and geographical distribution are positively related to the decision to write and how much is written while product diversification is positively related only with the decision to write. A firm’s degree of leverage and if they are a part of a mutual are negatively related to the decision to write and how much is written while membership in an insurance group is negatively related only with the decision to write.

Fier and Liebenberg’s Hypothesis

To analyze firms that offer D&O insurance, Fier and Liebenberg look at why firms write D&O insurance and how much they write. The authors propose that the decision to write D&O insurance is related to seven main factors: organizational form, firm size, geographic diversification, product diversification, firm leverage, distribution system, and group membership.[2] Organizational form refers to whether the insurance company is a mutual or not. Fier and Liebenberg assume that a mutual insurer would be less likely to write D&O insurance because management has less control over the company, but there were no predictions offered on the extent of premiums written due to their mutual status. The authors hypothesize that the size of the company will positively impact the decision to write D&O insurance because larger insurers have better capabilities to write complex lines of insurance and therefore are more likely to offer D&O insurance and likely write more premiums. Geographic diversification refers to how spread out the company is geographically. Fier and Liebenberg assume that the more geographically diversified a company is, the more likely they are to write D&O. They suggest that a firm with the ability to be geographically diversified will have more resources to write D&O coverage, and that managers have more freedom to write more lines of

[1] Towers Watson, 2012
[2] Page 224

insurance. The authors predict that more geographically diversified companies would also write more coverage.

Fier and Liebenberg also look at how diverse a company is with the products it offered. D&O insurance is considered to be more complicated because there aren't a large amount of claims for a firm to analyze and claims are often much larger. Insurance companies must be confident in their analysis which means they must be experts on the risks that directors and officers face. Fier and Liebenberg predict that a more diverse company will indicate a lower likelihood to write and will write less D&O insurance because D&O is a highly specialized line of insurance; therefore, a company with many lines will have difficulty specializing in such a unique product.

The degree of leverage of the firm is also analyzed because the authors assume that more leverage is likely associated with more restrictions from debtors which would create an inability to write such complex lines of insurance like D&O. The type of distribution system is also analyzed measure the impact the use of agents has on a firm's sale of D&O policies. The study predicts that insurance companies using agents would be more likely to offer D&O because corporations seeking insurance generally use brokers to purchase it. For more complex lines of insurance, brokers offer expertise about markets and levels of coverage. Finally, whether or not a firm is affiliated with an insurance group is treated as a control variable and Fier and Liebenberg made no predictions about the direction of this variable. Table 1 summarizes Fier and Lebenberg's hypothesis on each variable.

Table 1

The hypothesized relationship of the variables to the decision to write and the extent of D&O written

Variables:	Relationship to the Decision to Write	Relationship to the Extent of Business Written
Size	Positive	Positive
Leverage	Negative	Negative
Geographic Distribution	Positive	Positive
Product Diversification	Negative	Negative
Agency	Positive	Positive
Mutual	Negative	No Prediction
Group	No Prediction	No Prediction

Results

Fier and Liebenberg found that only 12% of insurers actually write D&O insurance, the premiums from D&O account for less than 1% of total property-casualty liability insurance, and that D&O lines are the 11th largest contributor to overall insurance premiums written. When the top twenty writers of D&O were examined, they found that four of the twenty receive over 40% of their premiums from D&O, three receive between 20-40%, and the rest received under 10%. This shows that while some companies seem to specialize in D&O, most offer it along with other lines of insurance. Table 2 provides a summary of the top ten insurers by volume in the D&O market.[3]

[3]This is also a portion of the authors Table 2, p. 222.

Table 2

1. Federal Insurance Company	**10.11%**
2. National Union Fire Ins Co. of Pittsburgh	**9.65%**
3. XL Specialty Insurance Company	**9.28%**
4. US Specialty Insurance Company	**5.46%**
5. Travelers Casualty & Surety Co. of America	**4.45%**
6. Ace American Insurance Company	**3.87%**
7. Philadelphia Indemnity Insurance Company	**3.84%**
8. Illinois National Insurance Company	**3.76%**
9. Zurich American Insurance Company	**3.75%**
10. Continental Casualty Company	**3.69%**

Many of Fier and Liebenberg's hypothesized relationships in Table 1 about the decision to offer D&O insurance were supported statistically. Table 3 summarizes the statistically significant results from Fier and Liebenberg's regression analysis and how each variable is correlated with the decision to write and to the extent of D&O insurance written. The red text indicates results that differed from Fier and Liebenberg's predictions.

Table 3

The empirical relationship of the variables to the decision to write and the extent of D&O written		
Variables:	Relationship to the Decision to Write	Relationship to the Extent of Business Written
Size	Positive	Positive
Leverage	Negative	Negative
Geographic Distribution	Positive	Positive
Product Diversification	Positive	N/A
Agency	N/A	N/A
Mutual	Negative	Negative
Group	N/A	Negative

Mutual insurers are less likely to offer D&O insurance, large insurers are more likely to offer it, the more geographically dispersed firms and ones that offered more products sell significantly more D&O coverage, less levered firms are more likely write D&O, and three quarters of firms selling D&O insurance use agents.

Fier and Liebenberg find support for nearly all of the estimated relationships between the variables, the decision to write D&O insurance, and the extent of D&O policies written. The main exceptions being the distribution system used and product diversification in relation to their impact on how much D&O insurance a firm writes. The authors find that for firms that used agents there was no significant relationship between the use of an agent and the choice to offer D&O insurance or the amount of insurance written. Fier and Liebenberg also found that although companies with more product diversification were more likely to write D&O coverage, out of the firms that do, ones which are less diversified are more likely to have a higher volume. This is likely explained by the fact that the firms that are more specialized, geographically and product-wise, are able to more accurately underwrite D&O insurance at a higher volume.

References

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