Commercial Lines: Specialty and Financial Lines (Cyber, D&O, Professional Indemnity)

Interview preparation summary · IN track

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INT.NT.1.a · Directors' and officers' liability (D&O)

Explain directors' and officers' liability (D&O) insurance: Side A, B and C, the claims-made trigger, run-off and change of control, securities claims and the main pricing drivers.

Directors' and officers' liability (D&O) insurance protects the people who run a company, and the company itself, against claims alleging wrongful acts in managing it. Side A pays directors and officers directly when the company cannot or will not indemnify them, for example on insolvency; Side B reimburses the company when it has indemnified them; Side C covers the company itself, and for listed companies it is typically limited to securities claims. The policy is claims-made: it responds to claims first made and reported during the policy period, with a retroactive date for earlier acts. When a company is taken over, cover usually becomes run-off for acts before the deal, often for several years, bought for a premium. Securities claims allege that investors were misled and lost money when the share price fell, and are the main severity driver, especially with a US listing. Pricing looks at size, sector, financial strength, listing venue, claims history, recent share price falls, IPO or deal activity, and limits; excess layers cost a fraction of the layer below. Wordings vary.

WORKED EXAMPLE: PRICING A D&O TOWER AND TESTING A SECURITIES CLAIM

Orsmere Plc, an invented listed company, buys a 30m D&O tower. The primary 10m costs 240,000. The first excess, 10m excess of 10m, is priced at 60% of the primary. The second excess, 10m excess of 20m, is priced at 70% of the first excess. A securities class action then settles for 17m with defence costs of 3m. The entity retention is 0.5m, the limits sit above the retention and defence costs erode the limits. Work out the premiums, the rate on line of each layer and what each layer pays.

Answer: The tower costs 484,800, with rates on line of 2.40%, 1.44% and 1.01%. Of the 20m loss the insurers pay 19.5m, the primary 10.0m and the first excess 9.5m, and the second excess is untouched.

> **Interview tip:** Say which side responds, then lay out the tower from the bottom: retention, primary, excess layers, and why each higher layer is cheaper.

INT.NT.1.b · Professional indemnity and errors and omissions

Explain professional indemnity and errors and omissions insurance, including the claims-made basis, retention, defence costs inside or outside limits, notification of circumstances, and how financial institutions differ from other professionals.

Professional indemnity (PI), called errors and omissions (E&O) in some markets, covers a professional firm's legal liability to clients for financial loss caused by negligent advice or services. It is claims-made, so it responds to claims first made and reported in the policy period, with a retroactive date; a firm that stops practising needs run-off cover. A retention is the insured's first share of each loss, often including defence costs. Defence costs may sit inside the limit, so they erode it, or outside, so they are paid in addition; inside is cheaper for the insurer and leaves the insured more exposed on a big claim. Notification of circumstances lets the insured report facts that may lead to a claim during the policy, so that a later claim is treated as made under that policy. Small professionals such as surveyors or architects are rated mainly on fee income, discipline and record; financial institutions such as asset managers and banks buy much larger limits on bespoke wordings, face investor claims after market falls, and need a view on regulatory exposure. Terms vary by country and wording.

WORKED EXAMPLE: HOW DEFENCE COSTS INSIDE OR OUTSIDE THE LIMIT CHANGE THE RESULT

Greymoor Surveyors, an invented firm, has a PI policy with a limit of 5m and a retention of 100,000 that applies to the total of damages and defence costs. A client claims; damages are 4.2m and defence costs are 1.5m. Compare what the insurer pays and what the firm bears if defence costs are inside the limit and if they are outside the limit. Convention: the retention is taken first, then the limit applies.

Answer: Inside the limit the insurer pays 5.0m and the firm bears 0.7m. Outside, the insurer pays 5.6m and the firm bears 0.1m, so the structure moves 0.6m of the loss.

> **Interview tip:** State the two structures, give both numbers, then say who bears the difference and that the choice is a price against protection trade-off.

INT.NT.1.c · Cyber insurance

Explain cyber insurance: first-party and third-party covers, ransomware and business interruption, aggregation and systemic risk, war exclusions in outline, and the underwriting controls and pricing trends.

Cyber insurance pays for the cost of a data or network incident. First-party cover pays the insured's own losses: forensic and incident response costs, legal and notification costs, data restoration, business interruption after an outage, and often cyber extortion. Third-party cover pays liability to others for privacy breaches, network security failures and media claims, and regulatory costs where the law allows insurance of them. Ransomware is the main frequency driver, and business interruption, usually after a waiting period of some hours, is often the biggest part. The central problem is aggregation: one cloud outage or widely used software flaw can hit many insureds at once, so insurers measure scenarios, use sublimits and limit systemic cover. Wordings typically exclude war and state-backed attacks, and the exact definition matters. Underwriters look at controls: multi-factor authentication, tested offline backups, patching, endpoint detection, access management and incident plans. Prices rose sharply after the ransomware wave and have since moved with the market, often with ransomware sublimits and coinsurance. Check current practice.

WORKED EXAMPLE: A RANSOMWARE CLAIM WITH A WAITING PERIOD AND COINSURANCE

Wadlow Retail, an invented chain, has annual insured gross profit of 36m and is hit by ransomware that stops trading for 6 days. The policy has a 12-hour waiting period, a retention of 250,000, a ransomware coinsurance of 20% (the insured bears 20% of covered loss) and a ransomware sublimit of 1,000,000. Costs: incident response 450,000, data restoration 220,000. Convention: gross profit accrues evenly over 365 days; the retention is taken before coinsurance.

Answer: Covered costs are 1,212,466, and the insurer pays 769,973 after the retention and 20% coinsurance. Wadlow bears about 442,493.

> **Interview tip:** Walk through waiting period, then retention, then coinsurance, then sublimit, in that order, and say that waiting periods and sublimits are what the buyer should read first.

INT.NT.2.a · Crime and fidelity insurance

Explain crime and fidelity insurance: what it covers, including employee dishonesty, forgery, computer and funds transfer fraud and social engineering, how it differs from cyber and D&O, and how discovery, single-loss treatment, limits and controls shape the cover.

Crime and fidelity insurance covers a firm's own financial loss from theft and fraud. Fidelity cover responds to dishonest acts by employees; the wider crime policy adds forgery, theft of money or securities on premises and in transit, computer fraud, funds transfer fraud and social engineering, where staff are deceived into sending money voluntarily. Social engineering is often sublimited and conditional on controls such as call-back verification. It differs from cyber, which responds to data and network incidents, and from D&O, which responds to claims against the people who run the company; the gaps and overlaps between crime and cyber for payment fraud need care. Most policies work on a discovery basis: the loss must be discovered in the policy period, or a discovery period, whenever the acts happened. A series of dishonest acts by one person is usually one loss, so one limit applies. Banks and other financial institutions buy their own bond forms. Underwriters look at segregation of duties, dual authorisation, vetting, audit and verification, and wordings vary.

WORKED EXAMPLE: A LONG-RUNNING FRAUD AND A PAYMENT FRAUD ON ONE CRIME POLICY

Selbourne Distribution, an invented firm, has a crime policy with a single-loss limit of 1,000,000 and a retention of 50,000, and treats all acts of one person as one loss. A clerk diverted 90,000 a month for 14 months before discovery in the policy period. Separately, a fraudster impersonating the chief executive tricked staff into paying 400,000; the social engineering sublimit is 250,000 with a retention of 25,000. Convention: retention first, then the limit; ignore any controls conditions.

Answer: On the clerk's fraud the insurer pays 1,000,000 and Selbourne bears 260,000; on the impersonation the insurer pays 250,000 and Selbourne bears 150,000.

> **Interview tip:** Say what is being covered, show that the single-loss rule and sublimits cap the result, and finish with the control that would have stopped it.

INT.NT.2.b · Political risk and trade credit insurance

Explain political risk insurance and trade credit insurance: what each covers, how they differ, and how aggregation and sovereign risk are managed in outline.

Trade credit insurance protects a seller against non-payment by its buyers, usually through insolvency or long delay. It is typically written on a whole-turnover basis: the insurer sets a credit limit for each buyer, the insured pays a small premium, often well under 1% of insured turnover, and recovers a stated indemnity percentage of covered losses after a waiting period. It is short term, high volume and monitored buyer by buyer. Political risk insurance protects investors, lenders and exporters against government actions: expropriation, currency inconvertibility and transfer restrictions, political violence and sovereign non-payment or contract breach. It is long tenor, low frequency and high severity, and depends on government behaviour, so it is priced by country. Aggregation matters in both: trade credit by buyer, sector and country, because defaults cluster in recessions; political risk by country and sovereign counterparty, with country limits and reinsurance, and sometimes public or multilateral support. Wordings and availability vary.

WORKED EXAMPLE: A TRADE CREDIT PORTFOLIO COMPARED WITH A POLITICAL RISK POLICY

Crossgill Components, an invented exporter, has insured turnover of 200m with an average payment period of 73 days, a premium rate of 0.20% of turnover and an indemnity of 90%. Illustrative assumptions: buyers default each year with a probability of 1.2% and the loss after recoveries is 55% of the amount owed. A 4m buyer defaults. For comparison, a lender buys 95% cover on a 50m loan to a state utility for 0.90% a year. Convention: expected loss is average amount outstanding x default probability x loss rate x indemnity.

Answer: Expected loss is about 237,600, a 59.4% loss ratio on 400,000 of premium. One 4m default costs 3.6m; a sovereign event on the loan costs 47.5m, about 106 years of its premium.

> **Interview tip:** Contrast the two: trade credit is frequent, small and monitored by buyer; political risk is rare, huge and managed by country limits.

INT.NT.2.c · Transactional liability insurance

Explain transactional liability insurance, mainly warranty and indemnity (W&I) insurance in M&A: how it is placed, what it excludes, how the retention works and how a deal team uses it.

Transactional liability insurance covers risks that arise in a company sale. Warranty and indemnity (W&I) insurance is the main form: the buyer, usually, claims from the insurer for loss from a breach of the seller's warranties in the sale agreement, instead of, or beyond, claiming from the seller. A broker obtains non-binding indications from several insurers, the buyer picks one, and the insurer underwrites by reading the buyer's due diligence reports and holding a call with the deal team; what was not diligenced is often excluded. Typical exclusions are matters known to the deal team, disclosed matters, forward-looking statements, purchase price adjustments and some areas such as underfunded pensions. The limit is often around 10% of enterprise value, the retention a fraction of a percent of value, and the premium a few percent of the limit; all are illustrative here. A seller, such as a private equity fund, may limit its liability to a small amount and exit cleanly, and a buyer gets a creditworthy counterparty. Tax and contingent-risk covers also exist. Check current practice.

WORKED EXAMPLE: COST AND RECOVERY UNDER A BUY-SIDE W&I POLICY

Ashenfold Capital, an invented buyer, acquires a company for an enterprise value of 120m. It buys a W&I policy with a limit of 10% of enterprise value at a rate of 2.5% of the limit, premium tax of 12% (illustrative) and an underwriting fee of 35,000. The retention is 0.5% of enterprise value, of which the seller bears the first half. Eight months after completion a warranty breach causes a loss of 2.1m. Convention: the retention is taken from the loss first; ignore the later drop in retention.

Answer: The policy costs about 371,000. On a 2.1m breach the insurer pays 1,500,000, the seller 300,000 and the buyer bears 300,000.

Interview tip: Say who the insured is, what the retention and limit are, and that the policy covers only what diligence and exclusions leave in.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.