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CORPORATE HEADQUARTERS • NEW YORK, NY • TEL 212 432 1234
EASTERN REGIONAL OFFICE • MELVILLE, NY • TEL 516 228 1234
PERSONAL LINES CENTER • VALHALLA, NY • TEL 914 773 4321

THE INSURANCE NEWSLETTER

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Cyber Risk and Privacy Liability

It seems not a week goes by without a fresh news report about a loss or theft of personal information from some company or organization. Financial institutions, retailers and healthcare operations seem to get the most publicity when they suffer privacy breaches, but organizations of all types and sizes are experiencing the same losses and incurring the same expenses to clean up after breaches, most without much publicity.

In earlier days (say, ten or fifteen years ago) cyber risk concerns were primarily focused on potential legal liability exposures to third parties arising from use of technology, digital communications and the internet. These risks still exist, but liability risk concerns largely failed to materialize to the extent originally anticipated or feared. What has developed, though, is a new range of first and third party exposures arising from privacy breaches and lapses of security that lead to private, personally identifiable information falling into unauthorized hands.

We are now in the digital age, and vast amounts of sensitive personal and private information about almost everyone resides in databases and on computers and servers all across the world. This information has value; cybercriminals have long since figured out how to profit from purloined personal information, and a huge underground black market for buying and selling it has developed.

The days when isolated hackers, stereotypically depicted as socially awkward misfits hunched in front of computer screens in bedrooms or dorms,

made sport of hacking into private computer systems and databases are long gone. These days highly sophisticated criminal enterprises, armed with high tech equipment and plenty of time, are continually probing for security breaches that might yield private information they can then convert to illicit financial gain. The stakes are high, and the bad guys are smarter, more sophisticated, more persistent and more numerous than ever before.

In response, forty six states and numerous departments and regulatory authorities of the federal government have enacted regulations or legislation imposing obligations and penalties on any business or organization who suffers a security breach and loses personally identifiable information held in their possession. Some states have gone beyond just mandates for notice to affected parties, and have established strict liability or mandated data security requirements. These trends can only be expected to continue. By way of one example, Massachusetts recently enacted one of the most stringent regulations in the country, which other states are reported to be taking as a model as they review their own statutes.

What most of these laws and regulations have in common is that they impose specific obligations on an organization that suffers from a privacy breach. These obligations have measurable, identifiable costs associated with them; this in turn has prompted a change in the types of insurance policies available to cover these exposures. Where in the past cyber policies focused on liability exposures (that is, coverage for threats of lawsuits from third parties) privacy liability policies now contain significant first

party coverage. Put another way, you can now buy insurance that will pay the direct, out of pocket costs that you'll incur if you suffer a privacy breach.

This is where the most significant and meaningful developments in coverage in these policies have taken place. Under the terms of many state and federal laws and regulations, the costs that you must pay because of loss of personal information from privacy breaches can be enormous. According to a recent surveys conducted by industry sources the average organizational cost of a data breach in 2010 was several million dollars and cost companies an average of \$214 per compromised record. Worse, the meter starts running the moment you discover a breach; don't think you'll have the time for a measured, thoughtfully considered and deliberately executed response to a breach. Many applicable rules have strict timelines for response built in, often with significant penalties for failure to comply. Privacy breaches are serious, and require an "all hands on deck" response.

There are three things you should look for when considering a privacy insurance policy: 1) generous internal sublimits to cover the direct out of pocket costs you must incur to comply with privacy breach laws; 2) a liability section to protect you against liability claims arising from such breaches, and 3) a crisis management resource, a phone number to call when a breach occurs where you can reach someone who can advise you quickly on what you must do to respond; costs for these services should be covered by the policy. Given the maze of state and federal rules that may apply to any privacy breach, this last feature alone makes purchase of privacy insurance worthwhile for many organizations.

Risks from privacy breaches and loss of personal information in your possession are not just theoretical; businesses and organizations are suffering real financial losses from them every day. Sources in the law enforcement and insurance communities compile information on data breaches and associated costs; the numbers are big, and getting bigger. This, along with the first party costs imposed by legislation and statute, make insurance for privacy risk something every organization has to look at.

One last caution, as with so many important types of insurance these days these are not standardized policies; every insurance company has their own form, which can vary widely in the scope of coverage offered. We'll be happy to discuss available options with you.

Information You Should Report to Us

Businesses routinely undergo changes and development in the normal course of events. It's not uncommon for insurance to be the last thing you think about as you contemplate even routine changes, but it's important that you tell us about any changes that may have a bearing on your insurance.

Here is a summary listing of some (but not all, of course) of the changes we should know about in advance:

1. Changes in any operation such as expansion to new locations, operations in other states or introduction of new products or operations.
2. Mergers and/or acquisition of new companies or operations, or divestiture of existing operations or divisions.
3. Any newly assumed contractual liability, granting of indemnities, or hold harmless agreements.
4. Any new circumstances which may require increased liability insurance limits.
5. Any changes in fire or theft protection, such as the installation of, or disabling or disconnection of sprinkler systems, burglar alarms, etc.
6. Any equipment you may acquire that should be scheduled on your policies, such as vehicles, contractors equipment, electronic data processing equipment, mobile or portable property and equipment, and so forth.
7. Property of yours that is in transit, unless we have already previously arranged for insurance coverage on it.
8. Any changes in existing premises including vacancy (whether temporary or permanent), renovations, alterations, demolition, etc.; any new premises either purchased, leased, rented, constructed, or occupied.

Don't assume your policies will automatically pick up and cover changes like these. A quick phone call

or email is all it takes to make sure we are aware of developments and can do what it takes to get you covered properly.

Tough Times for Workers Compensation

The NCCI (National Council on Compensation Insurance) is a national insurance industry rate making organization for workers compensation. NCCI monitors WC results in the thirty four states that use their services, and tracks developments in other jurisdictions. While workers compensation experience countrywide has been influenced by general economic conditions in measurable ways, NCCI recently reported that conditions in the workers compensation industry continue to deteriorate.

Some of the significant problems noted:

- Poor underwriting results: the underwriting ratio for the most recent year continued to decline, from 110 to 115; in other words, WC insurers paid out \$1.15 for every dollar collected in premium, which was the worst result since 2001. Investment and other income was not enough to offset this underwriting loss, resulting in an overall pre-tax operating loss, the first since 2002. This is obviously not a sustainable trend.
- Premiums have declined: This is obviously good news for buyers of WC insurance, although it's debatable how much of the decline is attributable to the soft insurance market, and how much is due to the poor economy, higher unemployment and smaller payroll totals. Premiums have declined over 20% in just the past three years, another unsustainable trend.
- Claims frequency has risen: Perhaps most worrisome, lost time claims frequency had declined for 12 years until 2010; the streak ended with a 3% increase in claims frequency in that year. It's not the size of the increase in claims frequency that matters, it's the fact it happened at all that causes concern.
- External factors: Medical costs continue to increase faster than the rate of general inflation, as they have for many years; The impact of the Dodd-Frank financial reform bill has not

yet been felt; there are 24 new state insurance commissioners in the past year, on top of the political shift from the 2010 elections; and the possibility of inflation remains a looming concern.

Together, these developments suggest that if the soft insurance market is going to end, it may well be workers compensation where buyers see the first effects.

More Wild Weather

As this issue was being compiled the news was full of reports of hurricane Irene, bringing substantial wind and flood damage to the eastern seaboard as far north as Vermont; some sixty wildfires in Texas, where over eighty percent of the state labors under a prolonged and very severe drought; and a recent earthquake in Virginia that affected much of the east coast. These all followed a Spring that saw severe flooding in many parts of the country, and tornadoes, including one that wiped out large parts of Joplin, MO. Add it all up, and for the 2011 year to date disasters have been declared in all but two states.

It's worth remembering (or learning) an important but little known fact: no other country in the world suffers from so many, and so many different and diverse, natural catastrophes. Floods and earthquakes, tornados and hurricanes, wildfires and mudslides, blizzards and ice storms, we have them all. Increasingly of late it seems like they are not always confined to the same geographic regions or areas that typically suffer from them.

Bottom line, prudence would suggest taking another look at your property insurance program from time to time, including contingent loss exposures such as business income or extra expense. No one is really immune to natural catastrophes, and you want to be sure your insurance will respond properly if the need arises.

NFIP Reauthorization

And just following on the preceding topic, the National Flood Insurance Program (NFIP) is due to expire on September 30 unless it is reauthorized by Congress. Some readers may recall we have written about this before. As we have reported here in past issues, the recent history of the NFIP has been

characterized by a series of short term extensions, sometime occurring weeks or months after the program had already expired. This put a serious crimp in real estate lending activity, both commercial and personal, as lenders proved reluctant to close on loans for properties in flood zones with flood insurance unavailable.

Floods are a unique peril and a major risk. Some critics have questioned whether the federal government should be involved in flood insurance in the first place, but adverse selection (most who buy flood insurance do so because they are located in flood prone areas) and the concentration of catastrophic losses in flood events combine to make the risk of flood in flood prone areas essentially uninsurable by standard, for-profit insurance companies. The federal government was forced to step in and created the NFIP in 1968 to make flood insurance available and affordable. For structures located in known flood zones, the NFIP is the only

practical and affordable means of obtaining flood insurance protection.

The House of Representatives has already passed an extension bill that would reauthorize the NFIP for five years, rather than once again subjecting taxpayers and policyholders to the uncertainties of the short-term extensions like those passed in recent years. The bill also contains reforms needed to move the current financially ailing NFIP towards fiscal health, including graduated increases in annual premiums, new mapping standards to accurately reflect flood risks and methods to increase program participation.

The Senate now needs to act and a conference must then reconcile some significant differences between the House and Senate versions of the bill. Time is running out; we may well be facing another round of temporary extensions, with all the uncertainties that go with them, while congress tries to get their act together.

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68 South Service Road
Melville, NY 11747-2357

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