Are private companies walking a high wire of risk?

Highlights from the Chubb 2007 Private Company Survey

Companies make financial decisions every day and are increasingly looking for ways to conserve costs. In a tough economic climate, however, that can be especially perilous if it means cutting back or doing without insurance coverage. Managing a business can be like walking a high wire—extremely challenging with a safety net, and potentially suicidal without one. Yet, according to findings from the *Chubb 2007 Private Company Survey*, many private companies are operating with no safety net when it comes to important management liability, professional liability, and other types of exposures.

Chubb's survey found that only about one-third of private companies purchase management liability, professional liability, and crime insurance policies, despite the fact that the types of situations covered by these policies are increasingly common—nearly two-thirds of the companies reported experiencing at least one of these loss events in the past five years—and they can be costly. The three most common types of loss revealed in the survey:

- Employee crime (also known as fidelity)
- Directors and officers (D&O) liability
- Employment practices liability (EPL)

Why These Risks Are Even Greater *Right Now*

When economic conditions are tight, employees may be more inclined to steal from their company, a company may be more likely to lay off employees (possibly leading to EPL lawsuits), and investors may be more likely to sue a company and its senior management team for allegedly poor financial performance.

In addition, in an uncertain economy, such losses can spell double jeopardy. A thinning profit margin can be threatened further by a costly, noninsured loss event. Also, companies experiencing a D&O liability or EPL lawsuit may find that tight credit makes it difficult to obtain funds to pay for such a loss or even to continue business operations. Consider that when the survey was fielded in late 2007, when the economy was only beginning to show signs of trouble, one-third of the executives surveyed said they expected tighter access to capital in the coming 12 months. Today, one could reasonably expect that number to be higher.

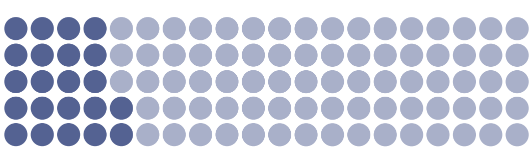
This report offers some of the major findings from the Chubb survey.

Key findings tell the story

Directors and officers (D&O) liability

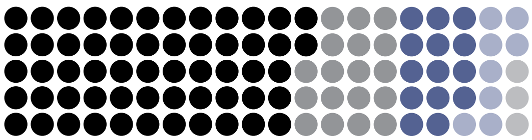
Are private company executives underestimating their D&O liability risk?

- **Not unlike public companies, private companies and their directors and officers are vulnerable to lawsuits.** In fact, about **1 in 5** companies **(22%)** experienced a D&O liability lawsuit in the past five years:



22% / Companies experiencing a D&O lawsuit in the past five years

- **Who is suing?** D&O liability lawsuits can have many sources, but customers are more likely to sue private companies and their directors and officers than are all other groups combined:



Twenty-six percent of company executives believe it is likely their company will experience some type of D&O-related loss event in the coming year.

- **A D&O lawsuit can be costly.** Among the companies in the Chubb survey that experienced a D&O liability lawsuit in the past five years, the average loss (settlement, judgment, and legal costs) was:

$393,017

Interestingly, for smaller companies (25-49 employees) the average cost was **$538,463**.
For larger companies (250 or more employees) the average cost was **$924,103**.

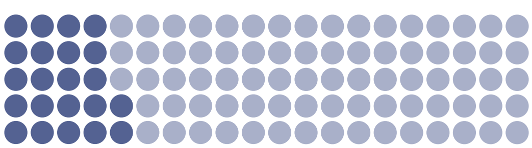
- **Most companies forgo coverage.** Despite the relative frequency of D&O lawsuits and their potential cost, more than 60% of private companies do not purchase D&O liability insurance:

Size of company:	Does not purchase D&O liability insurance:
25-49 employees	67%
50-249 employees	62%
250 or more employees	46%

Employment practices liability (EPL)

Most executives are well aware of their EPL risks, but many still opt to go without insurance.

- **EPL lawsuits are among the biggest and most common risks faced by private companies.** In fact, more than **1 in 5** companies **(22%)** experienced an EPL charge or lawsuit in the past five years:

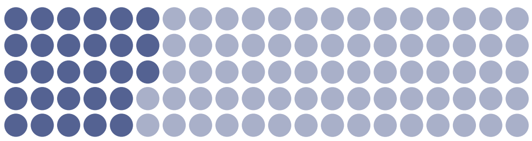


- **Even a mere charge of employment practices misconduct can seriously damage the bottom line.** Among the companies in the Chubb study that experienced an EPL charge or lawsuit in the past five years, the average cost was:

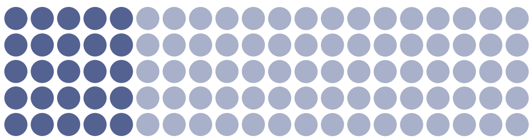
$63,114

*Of these companies, 35% reported costs to the company ranging between **$45,000** and **$600,000**.*

- **Many companies are planning RIFs or ways to outsource jobs.** About **1 in 4** executives say it is likely their company will reduce its work force **(28%)** or outsource functions or operations **(25%)** in the year ahead. Because both of these activities can have a negative impact on employees, they can result in EPL lawsuits alleging wrongful termination or discrimination:



28% / Executives saying it's likely they will reduce work force in year ahead



25% / Executives saying it's likely they will outsource functions/ operations in year ahead

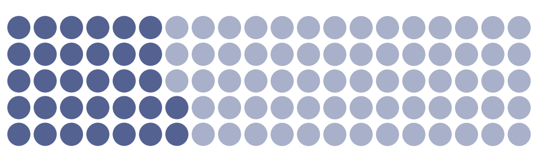
- **Are companies taking care to reduce their chances of suffering an EPL loss?** The good news is that most companies recognize an EPL risk and attempt to counter it by employing good EPL risk mitigation practices, such as having written policies banning discrimination and harassment **(87%)** and having HR policies, procedures, and training programs to help prevent losses **(81%)**.

  The bad news is that another mitigation practice—purchasing EPLI—lags far behind:

Workplace crime

Curiously, private companies don't seem too concerned about workplace fraud.

- **Employee theft is a fact of business life even in the best-managed companies. One in three** companies **(32%)** experienced at least one incident of employee theft—such as stolen funds, equipment, inventory, or merchandise—during the past five years:



32% / Companies experiencing employee theft in the past five years

Do smaller companies face a bigger EPL risk?

The cost of an EPL event reported by small (25-49 employees) and midsize (50-249 employees) companies is almost the same—close to $55,000. This means that an EPL charge or lawsuit may be more difficult for a small firm to handle financially than for a larger firm. However, survey findings suggest that small companies may not realize this:

- Only 18% of small-company executives are concerned about an EPL lawsuit, compared to 25% of midsize-company executives and 45% of large-company (250 or more employees) executives.
- Only 30% of small companies purchase employment practices liability insurance (EPLI), compared to 37% of midsize companies and 51% of larger companies.

- **Employee theft can be costly.** For the companies in the Chubb study that experienced some kind of employee theft in the past five years, the average reported loss was:

  $42,058

  *Of these companies, **30%** reported losses ranging between **$10,000** and **$200,000**.*

- **Do the companies buy fidelity/crime insurance?** Most don't, despite the widespread nature of employee theft. However, more than half of larger companies do buy this insurance coverage:

Size of company:	Does not purchase fidelity/crime insurance:
25-49 employees	68%
50-249 employees	66%
250 or more employees	45%

Cyber liability (electronic security breaches)

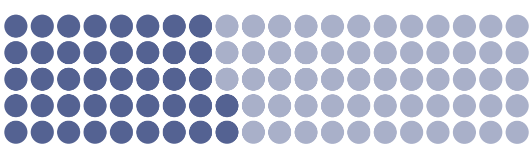
An emerging and dangerous risk is becoming commonplace.

- **Cyber insurance is a rare purchase.** For the companies that reported experiencing an electronic security breach in the past five years, the average loss was **$50,457**. Despite this, not to mention increasingly common media reports of costly computer breaches and data theft, **9 in 10** companies do not purchase cyber liability insurance, with **half** of the executives **(51%)** citing "low risk/no exposure" as the reason:

Reason for not purchasing cyber liability coverage:	Companies citing:
Low risk/no exposure	51%
Not relevant to industry	18%
Have not needed in past	12%

  Cyber liability insurance is a relatively new type of insurance product, which also helps explain why the purchase rate is low.

- **Retail firms are the exception.** Not surprisingly, because they are especially vulnerable to cyber exposures, retail firms are the most likely industry segment to purchase cyber liability coverage—**2 in 5** do so:



42% / Retail firms that purchase cyber liability insurance

Other Crime Topics:

Kidnapping? Extortion? Workplace violence? Not to worry…

The Chubb survey also looked at other criminal activities that many companies face but that few seem to worry much about. Are they being shortsighted? A few highlights:

Kidnapping and extortion

According to the *2008 Chubb Multinational Risk Survey*, more than 2 in 3 companies (about half of which are private) plan to increase employee travel outside the U.S. to overseas locations in the coming year. Yet, despite increasing globalization of business operations, only a handful of companies purchase kidnap/ransom and extortion insurance—although the buying rate (14%) increases among larger companies (250 or more employees), which are more likely to have international business dealings.

Workplace violence

When you consider that:

- Fully 10% of the companies experienced an incident of workplace violence in the past five years;
- 13% of executives said they are concerned about workplace violence, and 9% said that such an incident is likely to occur in the year ahead; and that
- 28% of executives said a RIF is likely and 25% said their company is likely to outsource functions/operations in the year ahead—actions that can have an unsettling effect on employees…

…does it make sense that:

- Only 4% of private companies purchase workplace violence expense insurance?

Errors and omissions (E&O) liability

Nobody's perfect (even if you are, you can still be sued).

- **E&O lawsuits can be expensive.** For the companies in the Chubb study that experienced an E&O lawsuit in the past five years, the average loss was:

  $65,343

  Nearly all of these companies ***(98%)*** *reported E&O liability lawsuit costs of as much as* ***$300,000****.*

- **Still, two-thirds of companies do not purchase coverage** even though most **(70%)** routinely use contracts when engaging with third parties, clients, and customers, and nearly half **(47%)** plan to broaden their product offering in the year ahead:

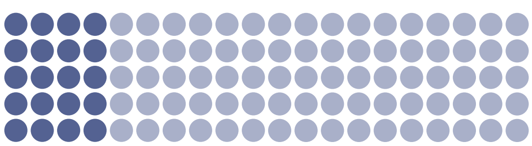
Size of company:	Does not buy E&O/professional liability insurance:
25-49 employees	75%
50-249 employees	64%
250 or more employees	64%

Of these nonbuyers, ***1 in 3 (33%)*** *say "low risk/no exposure" is the reason.*

Fiduciary liability

Do signs point to increased future risk?

- **Regardless of size, 1 in 5 executives say it's likely their companies will reduce or eliminate some employee benefits in the year ahead**—a possible source of fiduciary liability lawsuits by employees and/or retirees:



20% / Executives saying their companies likely will reduce or eliminate some employee benefits in the year ahead

- **Most companies do not purchase fiduciary liability insurance,** although larger companies are more likely to purchase this coverage than are smaller companies:

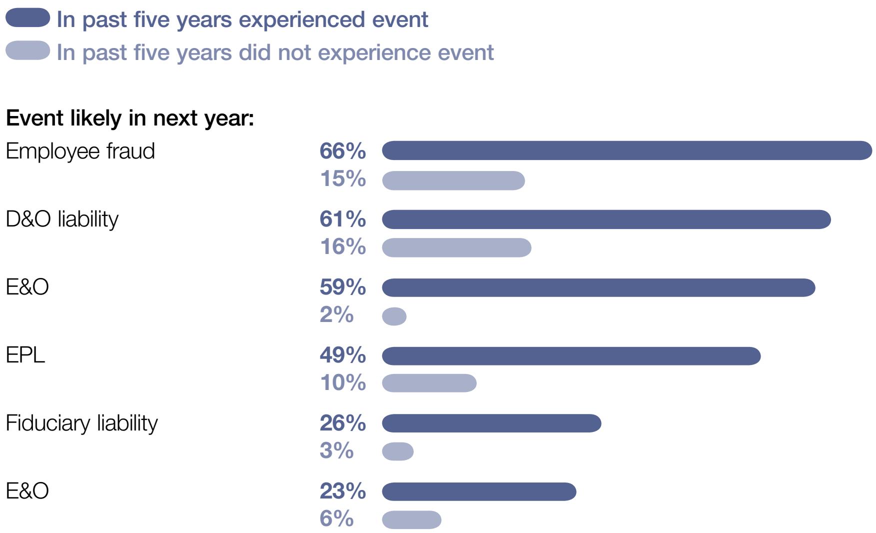
Size of company:	Does not buy fiduciary liability insurance:
25-49 employees	66%
50-249 employees	56%
250 or more employees	35%

Will High Court decision motivate executives to purchase fiduciary liability insurance?

In its *LaRue v. DeWolf* decision (February 22, 2008), the U.S. Supreme Court cleared the way for individuals to sue their 401(k) plan administrators for money damages under ERISA on behalf of themselves rather than the plan as a whole. Although the impact of the High Court's ruling remains to be seen, some experts believe it will increase companies' fiduciary liability risk.

Companies bitten once are more likely to believe they'll be bitten again.

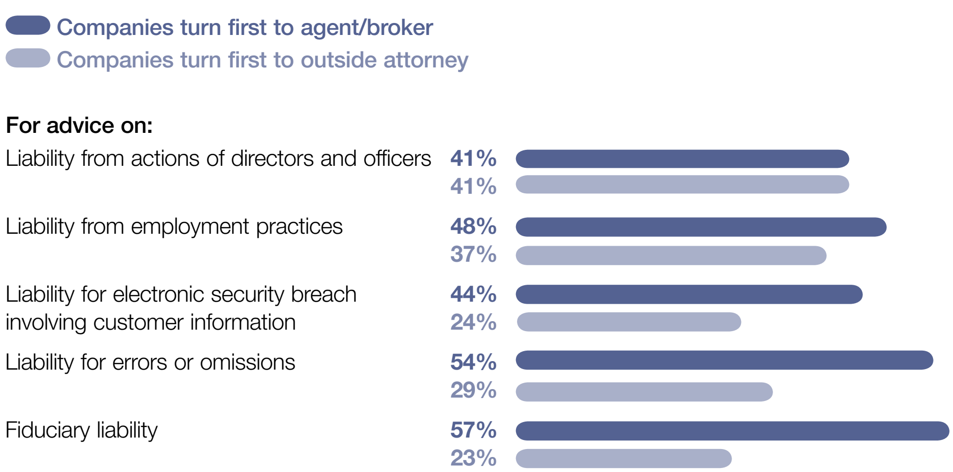
- **Some things have to be seen to be believed.** Companies that had experienced a loss event were much more likely than other companies to expect another similar loss in the coming year:



Where do executives turn for advice?

Companies depend on agents and brokers as their trusted advisers.

- **Executives usually look first to insurance agents or brokers** for information, a referral, or advice about the management/professional liability and crime-related risks in the survey:



About the survey

Between November 6 and December 3, 2007, Chubb interviewed 469 decision-makers in the United States and 300 in Canada by telephone in order to gain a better understanding of their needs. The purpose of the study was to learn:

- The level of concern about and perceived impact of management liability and professional liability exposures.
- Measures the companies have taken to mitigate potential risks.
- The incidence of events that could trigger litigation.
- The actual financial impact of litigation and other risk events.

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Form 14-01-0987 (Ed. 8/08)