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The Betterley Report

TECHNOLOGY ERRORS & OMISSIONS MARKET SURVEY—2018

Cyber Breaches and Tech Failures Continue as a Threat to Tech Providers and Their Insurers

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Highlights of this Issue

- Cyber-Related Exposures and Tech Failures Remain a Big Concern for Insurers
- Liberty and Ironshore Products Combined under the Ironshore Brand
- Axis, The Hartford, and Philadelphia Removed from Report

Next Issue

April 2018
Intellectual Property and Media Liability Market Survey

Editor's Note: *In this issue of The Betterley Report, we present our 18th annual evaluation of technology errors and omissions (E&O) insurance in which we review 23 of the leading insurers active in the market. For 2018, we removed Liberty International (following their purchase of Ironshore, their tech product is under that name). Axis, The Hartford, and Philadelphia were removed as they did not meet our survey deadline.*

Tech E&O is not immune from the continuing expansion of insurers into the specialty insurance segment, and insurers look to this expanding opportunity to help fuel their growth. Cyber exposures of tech companies make demand for this coverage stronger than in the past, and lawsuits by hacked clients will make the purchase even more compelling. Lawsuits such as that brought by Affinity Gaming (a breached casino) and its cyber-security provider Trustwave will become more common. This will increase demand but also increase pressure on rates.

While each insurer was contacted in order to obtain this information, we have tested their responses against our own experience and knowledge. Where they conflict, we have reviewed the inconsistencies with the insurers. However, the evaluation and conclusions are our own.

Rather than reproduce their exact policy wording (which can be voluminous), in many cases we have paraphrased their wording in the interest of space and simplicity. Of course, the insurance policies govern the coverage provided, and the insurers are not responsible for our interpretation of their policies or survey responses.

In the use of this material, the reader should understand that the information applies to the standard products of the insurers and that special arrangements of coverage, cost, and other variables may be available on a negotiated basis. Professional counsel should be sought before any action or decision is made in the use of this information.

For updated information on this and other Betterley Report coverage of specialty insurance products, please see our blog, **The Betterley Report Blog on Specialty Insurance Products**.

List of Tables

Introduction

Coverage for the liability arising out of the design and manufacturing of technology-related products, the creation and implementation of software, and the provision of related services is a growing business, with specialty coverages designed to cover the errors and omissions (E&O) liability that may not be covered under traditional liability policies. Tech E&O coverages can be purchased for technology consultants, systems integrators, application service providers, Internet service providers, Internet retailers, cloud services providers, network electronics manufacturers, medical technology manufacturers, and telecom companies. With a wide variety of coverages available, and each written on a nonstandard form, insureds and their advisers can be confused and bewildered by the choices.

The crush of data breaches affecting the clients of technology services providers is having an effect on the Tech E&O line. Applicants for coverage that provide data security and/or breach forensic services are increasingly being questioned about their activities and E&O controls relating to data security products and services. As more clients realize that a data breach is expensive and, at best, only partially insured by their own cyber policy, we expect that there will be more lawsuits like *Affinity Gaming v. Trustwave Holdings Inc.,* No. 2:15-cv-02464 (D. Nev. Dec. 24, 2015).

At this time, we are not aware of any new standard policy wordings related to data security services, but we would not be surprised to see them pop up.

Coverage for breach of data privacy continues to be the hot topic in Tech E&O product discussions, as both service providers and site owners grow increasingly anxious about loss of data. While most of the news has been about data breaches suffered by site owners, technology service providers have been—or ought to be—concerned about their own exposures. When we talk with our Tech E&O readers, many express worries about their exposures emanating from both their client work *and* from breaches of their own data security.

There is confusion in the marketplace about data privacy coverage for service providers. This coverage is generally referred to as Tech E&O and covers the professional liability exposure of the service provider. But what about the data breach that is not the fault of the service provider but that involves client data that it controls?

Our approach, adopted in 2012, makes the information presented more helpful to the readers. Our goal is to clarify the coverages for each of the three types of risk.

Companies in this Survey

The full report includes a list of 23 markets for this coverage, along with underwriter contact information, and gives you a detailed analysis of distinctive features of each carrier's offerings. For a sneak preview of the full report and all it has to offer, view the new 2018 Report Highlights.

A service provider's data breach risk can arise from any or all of the following.

- Its failure to prevent a breach of its client's data, which is a third-party exposure and should be covered under an E&O form
- Its failure to prevent a breach of its client's data, which is a third-party exposure and should be covered under an E&O form
- A breach of its own data, which would not be covered under E&O and is a first-party cover just like data breach coverage is in a cyber policy
- A breach of client data while in its possession, perhaps through a network breach, theft of a laptop, or similar means

Some insurers and brokers seem to assume that a claim for any client data breach is a result of a professional error or omission and, therefore, covered by the basic Tech E&O policy. Our concern, though, is that coverage for breach of data that is not a result of an error or omission might also be needed.

Take, for example, a situation in which the tech provider finds that some of its client data have been breached. Would not the client expect the provider to arrange (or at least pay for) the response? Would not the provider want to step in and make the client whole? And would not that help reduce the chance of an E&O claim? We think the answer is "yes" to all of these questions.

For more on this topic, please see our discussion on data privacy beginning on page 8.

Tech E&O policy provisions should always be reviewed in connection with the insured's commercial general liability (CGL) policy provisions, especially with respect to new or emerging exposures of concern. Some insurer markets offer coordinated E&O and CGL coverage, whereas other markets may offer monoline E&O only. Coverage not provided or excluded by an E&O policy may well be addressed by the CGL. Given the complexity of the coverage choices, a good insurance broker can offer a lot of useful advice to prospective insureds, and their value in negotiating coverage is not to be underestimated.

State of the Market

The Tech E&O market is an attractive place for insurers, as economic growth is faster than in other areas. However, exposures are more difficult to evaluate, at least compared with more traditional risks.

Still, the technology sector is not exactly new. Some insurers have been writing this line for 30 or more years. Change comes fast, though, so sources of claims can appear suddenly and unpredictably.

Premium Volume and Growth Rates

Annual premium volume information provided about the Tech E&O market continued to be provided by most insurers. As in years past, we surveyed participating Tech E&O product managers, asking them for a range of gross written premiums for US-based insureds and for non-US-based insureds.

Several key insurers do not provide information about their own premium volume, so we remain concerned about the reliability of any premium estimates. Interest is clearly strong, though, as insureds and their business partners see the need for coverage in a world where litigation alleging technology errors and omissions or data breach is all too common. Unfortunately, rates remain somewhat weak, and that interest is being spread over more insurers.

When we asked the insurers for their estimates of the total gross written premium in the United States, the responses ranged up to $3 billion for US-based insureds, and $1.5 billion for non-US-based. This seems awfully high to us.

We suspect that the insurers themselves do not know. If the holdouts would share their information with us (confidentially), we would all be better off. We do respect their reluctance to share proprietary information, though.

Data on premium growth was well reported. Established insurers seemed to be experiencing premium growth in the range of 5–10 percent. Some of the growth is likely a result of the improved US economy, but we believe that growth is also coming from additional requirements for proof of insurance required by customer contracts.

It is also likely that there is additional premium written in the more traditional markets, but it is not being reported as Tech E&O. We continue to expect that there are many more potential insureds that need Tech E&O but either are not aware of its existence or underestimate its value. This is likely to be true for the smaller service firms. The Tech E&O monoline product is seeing continued competition from package/program products designed to wrap E&O and traditional coverages into a single product.

Thanks to relatively robust growth in sales and the formation of new tech firms, the Tech E&O market will continue to grow faster than the rest of the E&O market.

Despite unabated pressure on rates in general since 2014, the Tech E&O segment remains better positioned than the broader E&O market in terms of projected growth in written premiums through 2018, with Tech E&O projected to grow at nearly twice the rate of nontech, according to ISO MarketStance estimates.

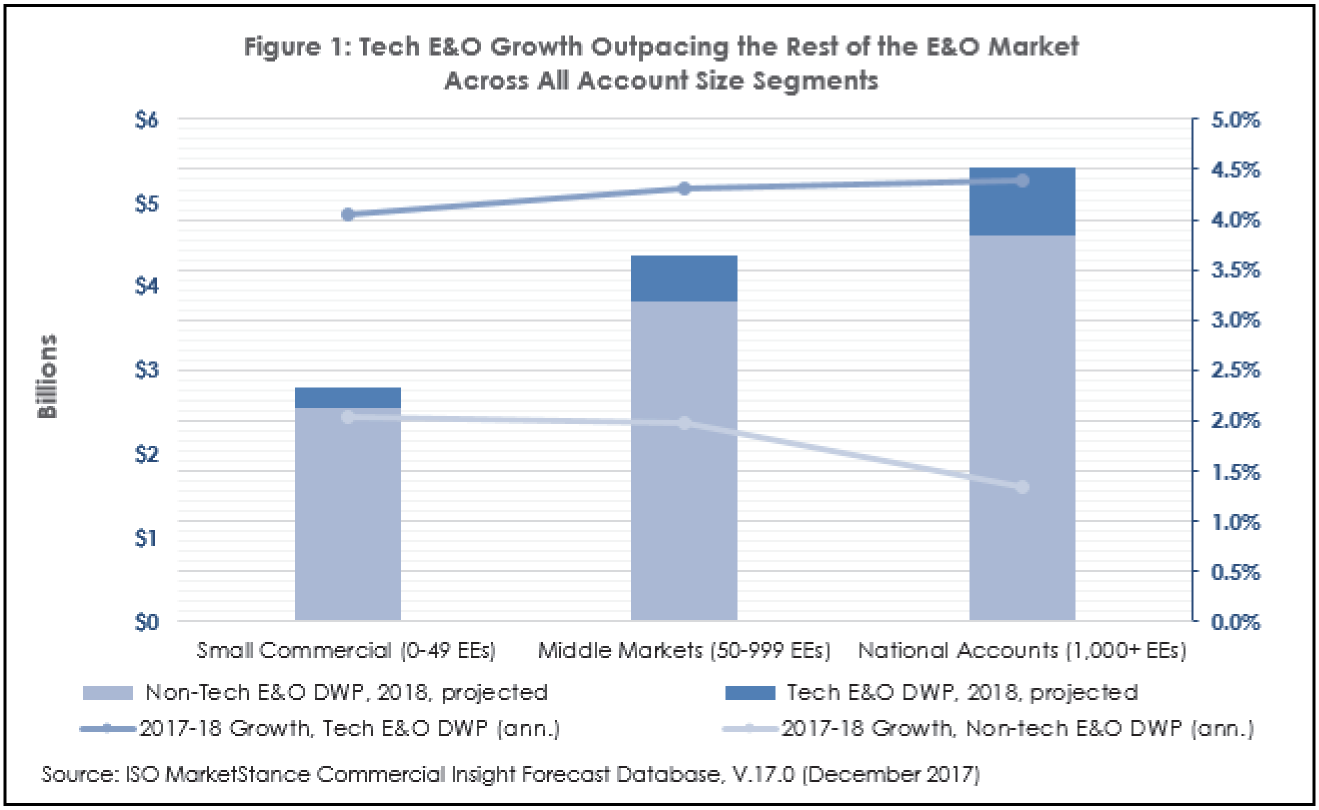
By year-end, ISO MarketStance forecasts tech's market share will grow to nearly 15 percent of the E&O market—up from 14 percent in 2016—or $1.6 billion of direct written premium (DWP). As Figure 1 indicates, ISO MarketStance expects tech accounts of all sizes to enjoy this modest growth advantage.

Though tech's growth advantage spans the leading business classes, all of which are growing at a 3-4 percent rate or more, Internet media and data processing accounts growth is forecast to continue at 10 percent or more this year.

The seven leading Tech E&O business classes account for about $1 billion of the Tech E&O DWP—or about two-thirds of the $1.5 billion premium that will be written in tech this year. See Figure 2 for more details.

Rates and Retentions

We asked the insurers whether or not they planned rate decreases (or increases) during the upcoming year and what they expected of their competitors. Many offered their thoughts.

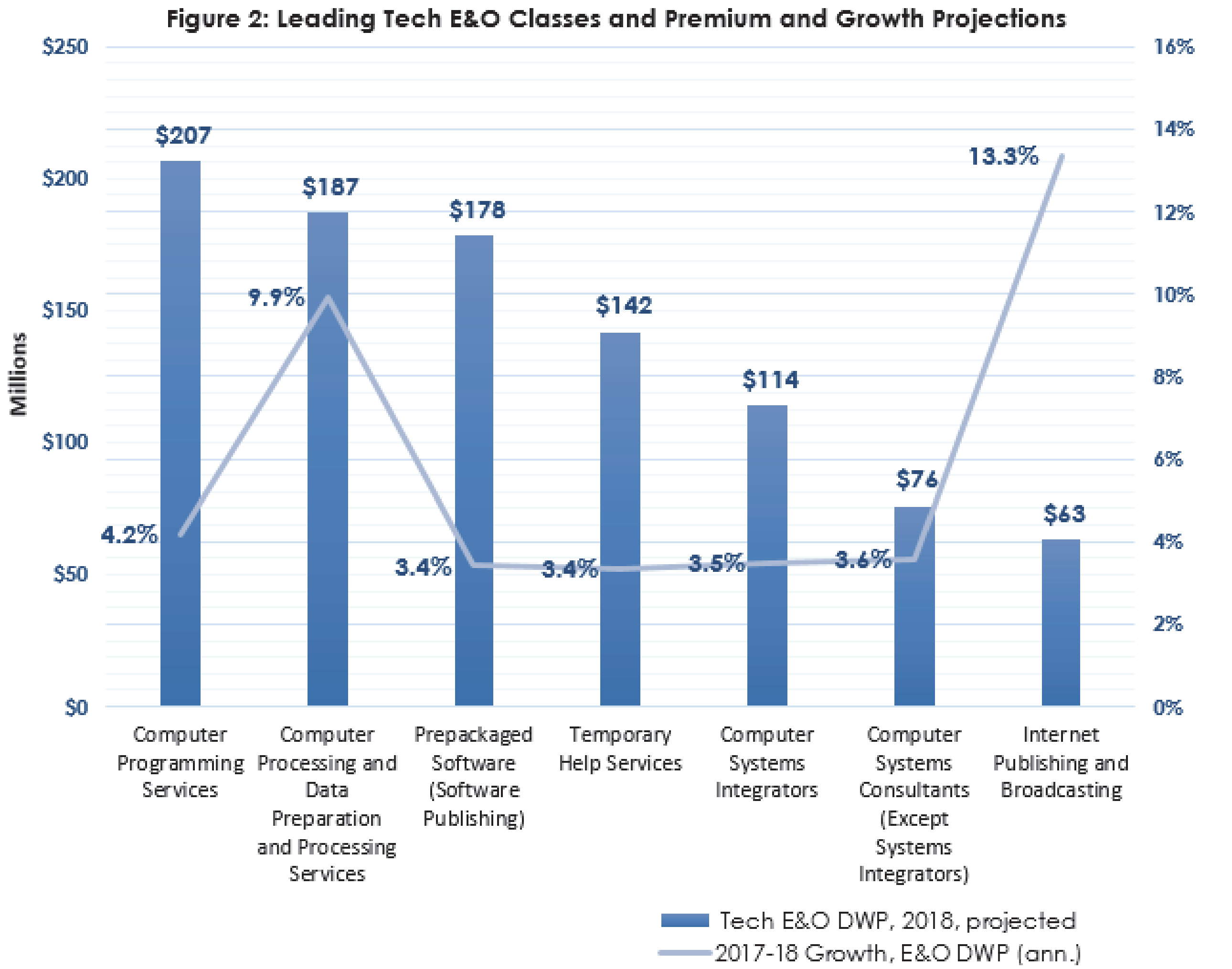


It seems that the general commercial market trend to softening rates is somewhat stronger in the Tech E&O market, especially in the small- to-midsized (SME) market. In that market segment, many insurers expect their competitors' rates to decrease as much as 5–10 percent (just like last year). When reporting on their own rates, less reduction was reported (also just like last year). There was very limited expectation of increases in rates, except of course for insureds with claims histories.

The larger insured segment was different from the SME segment, with insurers generally expecting stiffening rates and 10 percent being a common estimate.

The level of retentions or deductibles that insurers are willing to write continues to be flat. Isolated prospective insureds may be able to achieve lower retentions, but we do not believe that it represents any type of trend.

However, there is one very large concern that we have: as the continuing attacks on data show, even well-run organizations are vulnerable to data breaches. This will undoubtedly lead to increased Tech E&O claims, increasing retentions, and, perhaps, constrictions in the market. Will data security risk become a large source of E&O claims, and if so, what will that mean for the Tech E&O market?



Source: ISO MarketStance Commercial Insight V.17.0 (December 2017)

Like what you see in this executive summary?

By purchasing the full report, you can learn more about how 23 different insurers address the changing technology market.

For a sneak preview of the full report and all it has to offer, view the new 2018 Report Highlights.