MARSH

Liability Insurance Buyers Report
Europe 2005


Technology and telecommunications industry report

Data summary and findings

This report discusses liability data, trends and aspects of the technology, media and telecommunications industries that will be relevant to insurance buying and risk management strategies of companies in this sector. It is a component of Marsh's *Liability Insurance Buyers Report, Europe 2005*, which supplements Marsh's global *Limits of Liability Report 2005* – the largest report of its kind available:

visit: www.marsh.co.uk/insurancebuyersreport/

The data in this report is based on the prices paid for, and the volume bought of general and product liability for 128 companies in the technology, media and telecommunications industries across Europe.

- Dutch companies surveyed in this report purchased the highest average limits in 2005 (€63m) and also paid the highest price per thousand revenue (€). Swedish companies in our survey purchased the lowest average limits (€6m). The higher limits bought in Germany reflect the wider cover and lower deductibles on policies of German companies.

- Eastern European firms purchased the lowest volume of Limits (€3m) and the lowest average price paid per million was €1,770 in Sweden, according to our survey.

- The five companies in our survey with revenues in excess of €10billion purchased the highest average limits (though not the maximum for this industry sector) and paid the highest average price per million limits purchased. Despite paying the lowest average price per million limits, the smallest companies (by revenue) in our survey – those with revenues below €200million – paid the highest in terms of costs compared to revenue, at €0.46 per thousand, reflecting the impact of economies of scale.

Country	Minimum limits (€millions)	Maximum limits (€millions)	Average limits (€millions)	Average cost per €1,000 revenue
Sweden (5)	1.1	22	6	0.08
Eastern Europe (10)	0.3	20	7	0.07
Nordic (13)	1.1	40	10	0.08
Italy (13)	2.5	52	11	0.18
Germany (11)	1.0	225	35	0.13
UK (40)	1.4	283	47	0.15
France (20)	1.5	400	53	0.10
Netherlands (5)	2.3	110	63	0.34
Spain (3)	*	*	*	*
Belgium (4)	*	*	*	*

Figure 1

Total revenues (millions)	Minimum limits (€millions)	Maximum limits (€millions)	Average limits (€millions)	Average price per million	Average cost per €1,000 revenue
€0-€200 (67)	€0.3	€90	€12	€3,425	€0.46
€201-€500 (21)	€2	€134	€21	€4,065	€0.28
€501-€1,000 (12)	€3	€71	€25	€5,265	€0.19
€1,001-€5,000 (15)	€1	€550	€93	€7,434	€0.27
€5,001-€10,000 (8)	€10	€191	€67	€9,439	€0.09
10,000+ (5)	€100	€400	€262	€9,514	€0.10

Figure 2

*Numbers in brackets indicate total number of organisations surveyed. *Not enough data for analysis*

Sector liability exposures increasing

Technology companies are experiencing rising liability exposures in two major areas: intellectual property and professional indemnity.

In the first area, IPR (Intellectual Property Rights) infringement lawsuits are becoming more and more commonplace in the IT industry in both North America and Europe. Firms in industries such as telecommunications, software, consumer electronics and semiconductors face a growing risk that their technologies and products will be legally challenged and found to be guilty of infringing another party's intellectual property. As an example, a leading technology firm now defends around 40 patent infringement lawsuits at any one time, at an annual cost to the company of $100m. A company may think it owns a particular technology and product – yet it may have to think again if challenged in a patent infringement lawsuit.

An added risk is that the strength or weakness of a patent – the degree to which it protects a firm's invention and assigns ownership – often only becomes clear during the hearing of a case in court. Patent disputes are therefore highly uncertain and in the worst-case scenario, can cast doubt on a firm's future license to operate.

There is much room for improvement in how firms can manage such risks. Traditional risk management concepts of risk identification, assessment, control and transfer can provide clarification for managers. Not all technology firms, for instance, may carry out proper due diligence in verifying IP ownership rights. The effort required to analyse exposures around intangible assets can be considerable, requiring the co-operation of several different teams of people, such as senior managers, risk managers, legal, accounting and finance staff.

New business models introduce new risks

IT companies' expansion into new services such as consulting, systems integration, software development and outsourcing has increased their vulnerability to accusations of professional negligence. The trend to offer customised 'solutions' to individual clients rather than commodity products also increases risk. Implementation of bespoke software for an individual company, for example, carries more risk of a design fault than off-the-shelf software that has been tried and tested in a mass market.

Large suppliers of IT services that enter into high-value contracts with global corporations, perhaps worth hundreds of millions, worry about the breach of these contracts. One trend is that such suppliers would like single project insurance to cover the financial damage. Existing E&O limits that a company has may not be sufficient to cover such an eventuality.

Smaller and medium-size service providers in Europe are also experiencing rising Professional Indemnity claims as larger customers have become less tolerant of mistakes and poor levels of service. In the UK, the cost of claims for such companies has doubled in the last three years, according to IT specialist insurer Hiscox. Failure to deliver projects on time, on budget, and to their intended purpose are all typical reasons to file compensation claims. In a business climate where enterprise technology is more scrutinised due to the recent market downturn, corporate customers are also increasingly sceptical of supplier assertions regarding the return on investment from IT projects, leading to a greater tendency to litigate if errors occur.

Corporate customers are tending to insist on PI cover in their contracts with IT service providers, to ensure that compensation is available if negligence occurs. Many smaller service providers remain underinsured and, for their part, risk going out of business if they suffer claims.

An important issue is whether service companies' errors and emissions (E&O) exposures are covered under their General Liability cover. Companies that contract in the US are resorting to stand-alone E&O programmes. Our data shows that European companies with US operations typically purchase around twice as much limits on average as those without US interests. Either way, it is important for companies to realise the total potential impact of an E&O event.

This example illustrates the point. A major producer of business enterprise solutions software was retained by a leading food company to install and maintain software to interface with another manufacturer's software to coordinate orders and peak levels of inventory. Despite the software producer's certification of compatibility, the system failed, resulting in unprocessed orders, while warehouses maintained high levels of inventory. The value of the client's unprocessed orders were claimed to be in excess of $120m.

In contrast to E&O, technology firms are finding it relatively easy to obtain affordable D&O cover compared to the recent past. The finances of the tech industry are on the mend following the earlier market downturn and insurers are more comfortable with the risks they are assuming.

EU regulation, the environment and product design

Two new environmental regulations are already impacting the IT industry: the Waste of Electrical and Electronic Equipment (WEEE) directive, already implemented in some European nations but subject to delays in others, and the Reduction of Hazardous Waste (RoHS), coming into force July 2006.

WEEE requires that manufacturers, retailers and importers of IT equipment are newly responsible for recovering, treating and recycling that equipment when it becomes waste. The motives behind the directive are to reduce waste in landfill, prevent potentially harmful materials from entering the ground, increase resource efficiency through recycling and further the trend for eco-friendly product design.

RoHS requires that electronics products in the EU be free of lead and other hazardous materials such as mercury. Companies such as Dell have already launched 'green PCs' that reduce the use of harmful chemicals. Clearly there are a range of new liability issues for IT companies that fail to conform to these new standards.

Information for negotiation

In light of the new legislation, insurers are stepping up their efforts to understand product related risks. They are increasingly interested in more information relating to company culture and attitudes, the effectiveness of internal risk controls, and the nature of commercial and marketing pressures when new products or services are launched.

Those firms using risk management techniques to improve the quality of information provided to underwriters, and to demonstrate clear processes and strategies in place to mitigate risks and secure business continuity, are better placed to negotiate for and to achieve reduced premiums and deductibles with insurers.

Average Limits purchased in 2004 and 2005

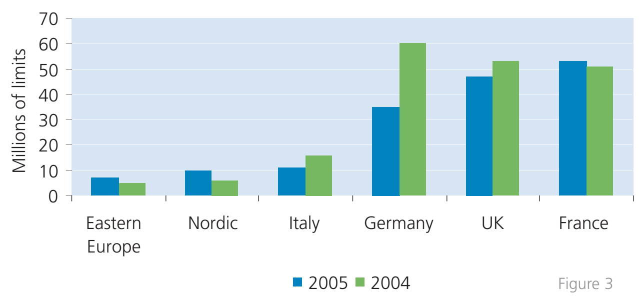


Figure 3

A comparison between 2004 and 2005 shows that there is no clear pan-European trend when it comes to limits bought and price. Limits have declined the most in Germany, with prices remaining static. Elsewhere, there have been either slight increases or decreases in limits bought. Prices have fallen the most in Eastern Europe and risen the greatest in Italy.

Average price paid per million limits in 2004 and 2005

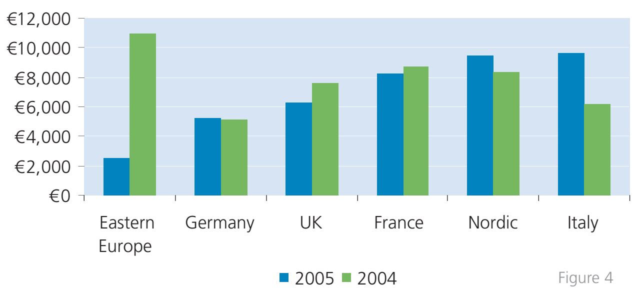


Figure 4

Average limits purchased with price paid per million, 2005

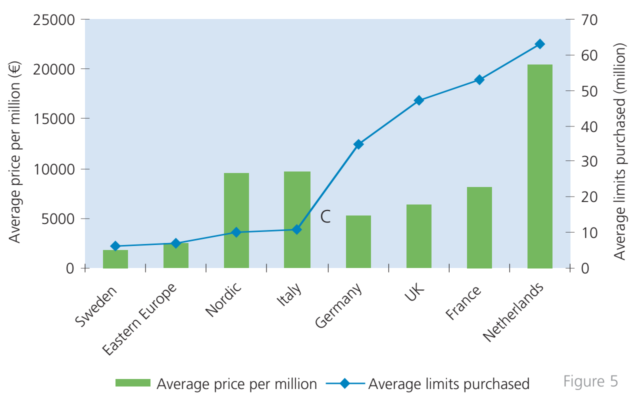


Figure 5

The underwriting environment

- Few primary stand alone underwriters on a technology E&O basis.
- Capacity is approximately 150-200 million USD on a primary level.
- Underwriters can be quite restrictive in what extensions they will provide however, it can be possible to obtain retroactive coverage depending upon the circumstances.
- There are markets that can provide both third party (tech E&O) and first party coverage (non material property and business interruption coverage).
- Markets may require security audit/legal review of the clients business and processes.

The data for Figure 6, showing market capacity for insurers actively underwriting risk in the tech, media and telecommunication sector, was compiled in September 2005. Many underwriters impose conditions on writing new business, such as a preference for companies domiciled in their own country, a preferred position in the programme, or on condition of additional lines being placed (such as property) at the same time.

Market capacity – tech, media and telco industries (London/European markets)

Market	Have	Use
ACE	$5M	$5M
Beazley	$20M	$10M
Hiscox	$20M	$20M
Lexington	$10M	$10M
Swiss Re	$50M	$25M
Zurich	$10M	$5M
Additional capacity from other London Insurers	$80M	$25M

Figure 6

The next 12 months

Liability may increase for technology firms because of the greater social value placed on product safety and in particular, the implementation of the 'precautionary principle' into law. With the introduction of such a principle, industry is expected to play it safe with the introduction of new products and any breach of the principle may invite accusations of negligence.

- Contract sizes are expected to continue to increase, creating the need for additional limits (as well as supporting insurance market capacity) for a number of companies.

- Intellectual property and patent disputes are likely to continue to worsen, as companies become even more aggressive in trying to protect the cornerstone of their business.

- Consolidation across the technology and telecommunication sectors, as well as the emergence of new technologies in combination with existing ones, such as Voice-over-Internet-Protocol (VoIP), and data, video and music available via mobile phones, will continue to create entities and solutions that represent new and partly untested liability exposures.

- Concerns around privacy, and data security related to the Internet, are likely to remain on the front pages.

Using risk management to improve insurance buying

Companies that retain a focus on managing risk achieve significant discounts on premiums, and better negotiation on deductibles. In general terms, insurance market pricing operates around three interconnected concepts:

- what is the available data, and what does it mean;

- that the claim event was unpredictable, and was not caused deliberately by the insured, and

- economic efficiency.

Good risk management can help organisations provide insurers with greater awareness, not just in terms of data, but around the process in place and efforts to mitigate risk.

1. Risk Management focus on providing information for insurers

Detailed, quantifiable risk information and loss estimates do impact insurance terms and conditions. Property surveys and business interruption reviews enhance the quality of underwriting information and provide maximum loss estimates to help the underwriter fix capacity and rating levels. They also audit the existing insurance programme, and subject to more detailed analysis can help to create an understanding of an organisation's supply chain risk and single point of failure dependencies.

2. Risk Management activities directed at improving the risk quality

An organisation can demonstrate its commitment to manage major exposures, such as fire protection, business continuity management and employers' liability. Clearly defined plans and procedures provide underwriters with evidence that the organisation is taking risk management seriously. They reduce the maximum loss potential to underwriters by ensuring that properly worked out recovery strategies are in place.

Our case studies demonstrate real benefits achieved by firms that understand how risk management can improve their organisation's performance, profitability and growth:

Marshalling global resources

A global semiconductor firm sustained a pollution-related loss at one of its major subcontractors in Asia. The insurer was going to deny the claim due to a pollution exclusion in the policy. Marsh immediately pulled together a claims team, including the branch manager and claims consultant in Marsh's local office. The team participated in the initial investigation of the loss, provided the Marsh team with a full description – including photos of the damage – and coordinated subsequent visits by claims adjusters to the loss site. Marsh successfully argued on behalf of the client, resulting in an insurance payment in excess of €1million.

Covering all the basis

A semiconductor firm experienced rapid growth and expansion in overseas markets. Feeling that its broker was not keeping pace with its changing profile, the company turned to Marsh to review how its indigenous exposures were being placed and handled, whether it was complying with local laws, and if it had adequate coverage. Among Marsh's findings were that the company's property values were underinsured by €20million, there were no locally admitted policies in place, and loss-control surveys had not been done. Marsh identified the programme deficiencies and quickly reported the correct information. The client gained a clearer picture of the issues and available solutions with its foreign subsidiaries – issues of which it had previously been unaware.

About Marsh

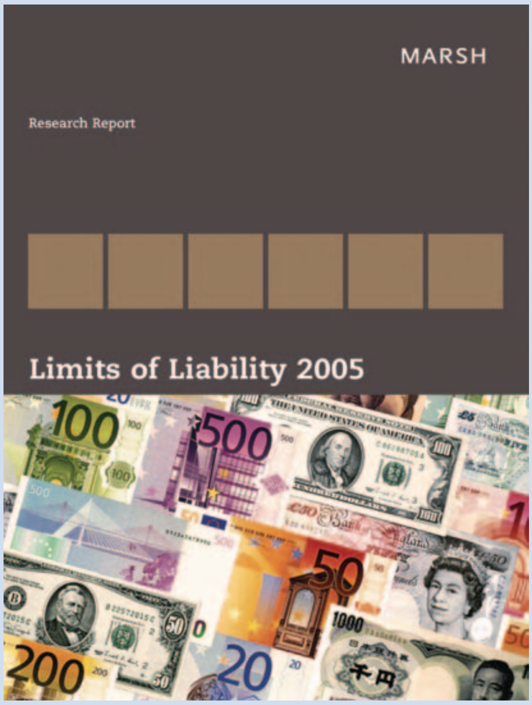
The Technology, Media and Telecommunications (TMT) Practice within Marsh is the world's leading provider of technology and telecommunications risk management solutions. Our experts deliver proactive, consultative risk management tools and techniques designed to help anticipate emerging trends and pre-empt potential risks before they become costly problems – or tomorrow's headlines. As well as understanding and mitigating risks, we help clients to better "market" their risks to the underwriting community, helping them with reduced pricing and stronger negotiating power at renewal.

The Practice serves over 2,500 clients worldwide, and has more than 150 specialists operating around Europe and the Middle East who collaborate in real time with another 500 TMT industry experts worldwide.

Technology	Telecommunications
software	equipment manufacturers
hardware and peripherals	wireless service providers
internet and new media	competitive local exchange carriers
semiconductor and capital equipment	incumbent local exchange carriers,
data networking and infrastructure	rural local exchange carriers
technology services segments	cable television operators

Solutions	Solutions
directors' and officers' liability;	market alternatives;
intellectual property exposures;	business interruption;
internet risks;	corporate governance and directors' and officers' liability;
tech E&O and contractual liability;	errors and omissions;
management of technology-related litigation;	cyber liability;
alternate funding options	crisis management
workforce strategies	telecom-specific benchmarking data.

Figure 7



This technology and telecommunications industry report, a component of the *Liability Insurance Buyers Report – Europe 2005*, supplements Marsh's *Global Limits of Liability 2005 report*. Limits of Liability contains data and analysis of over 300 companies operating in the technology and telecommunications industry around the world.

www.marsh.co.uk/insurancebuyersreport/

For further information about this report, or about risk and insurance challenges in the technology and telecommunications sector, please email practice leader: fredrik.motzfeldt@marsh.com

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