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THE BETTERLEY REPORT

TECHNOLOGY ERRORS & OMISSIONS MARKET SURVEY—2017:

Cyber-Breaches, a Threat to Tech Providers

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Highlights of this Issue

- Arch Added to Our Report
- Chubb and Ace Products Combined under the Chubb Name
- Swiss Re Removed from Our Report

Next Issue

April 2017

Intellectual Property and Media Liability Market Survey 2017

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Editor's Note: *In this issue of The Betterley Report, we present our 17th annual evaluation of technology errors and omissions (E&O) insurance, in which we review 27 of the leading insurers active in the market. For 2017, we have added Arch, removed Swiss Re, and combined Chubb and Ace under the Chubb name.*

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](#).

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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.

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

Insurers in this Survey

The full report includes a list of 27 markets for this coverage, along with underwriter contact information, and gives you a detailed analysis of distinctive features of each carrier's offerings. [Learn more about *The Betterley Report*, and subscribe on IRMI.com.](#)

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- 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 6.

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.

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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.

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. When reporting on their own rates, less reduction was reported. 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?

Reinsurance Support

We asked insurers about the health and interest of the reinsurance market that supports Tech E&O products, and they generally reported that reinsurers still like the product. Stable or increasing interest in Tech E&O product support was reported by most of the responding insurers, although reinsurers are asking more probing questions about the risks accepted than in the past.

We note with some concern that one insurer reports that reinsurance support has retreated. The insurer reporting this is well-respected and successful, so the retreat is unlikely to be based on their individual circumstances.

Target Markets and Prohibited Insureds

Unlike most of our surveys, there are significant classes of business that some insurers indicate are prohibited. Problem classes seem to include financial transaction systems, Internet service providers, adult

content providers, security-focused risks, and higher-educational institutions.

Read the “Target Markets” table carefully as a guide to which insurers like (or do not like) certain classes of business, but also keep in mind these can change and are often subject to reconsideration.

Capacity and Retentions

Significant liability-limits capacity remains, and reasonable (account appropriate) retentions or deductibles are available. \$25 million can be provided by the insurers focused on the larger insureds, and even the smaller market offers limits of \$5 million–\$10 million. Higher limits can be arranged through excess markets.

Deductibles or retentions can be quite competitive; the “Deductibles, Distribution Channel, and Commissions” table shows minimums. Lower deductibles are generally available from the insurers offering lower limits, those that may best appeal to the smaller insureds that desire low deductibles.

Insurers are still reluctant to state commissions, but they typically are similar to those paid on other specialty lines products.

Data Privacy

To capture information about the coverages that might be available for any of the three types, we provide the following two simple tables to summarize the type of privacy coverage offered.

- Coverage Extensions and (sub) Limits Available for Tech E&O Insureds—Privacy Breach of Their Own Data

- Coverage Extensions and (sub) Limits Available for Tech E&O Insureds—Privacy Breach of Client Data

The first table presents information about coverage for a breach of the tech provider’s own data and limits available. The second provides information about a breach that involves the provider’s client’s data *while the data are within the provider’s control*. This is breach response (also known as remediation) coverage and would apply even if the provider’s liability is not involved (or not yet proven).

Insurers, brokers, and, most of all, insureds need to be clearer about the need to distinguish remediation coverage from E&O. Liability should not be necessary for a Tech E&O policy to respond to a breach that involves client data.

Media Liability

There is another type of coverage being made available on many Tech E&O policies, which is media liability coverage. Much as we noted in our “Cyber/Privacy Market Survey” (June issue), media liability coverage is no longer just for traditional media companies. The increasing use of social media, in particular, is generating a lot of interest in this coverage, and so we include a table to capture information about the coverage and possible limits. It follows the “Privacy Breach” tables and is titled “Coverage Extensions and (sub) Limits Available for Tech E&O Insureds—Media Liability.”

Tech companies are particularly active in social media, making this added coverage especially useful, although perhaps presenting more than a negligible risk to the insurer.

Policy Features

With the wide variance in coverages included in Tech E&O products, paying close attention to key features is important.

Coverage for liability arising out of the actions of subcontractors while working on behalf of the named insured is generally included in the basic policy form. However, most will not include coverage for the subcontractor itself, unless special arrangements are made.

The definition of products and services is critical for proper coverage; the policies define the products and/or services that are covered. There are two different ways this can be done: either the declarations page specifies the products and/or services covered (which comes from the application) or the policy definition itself defines the activities covered. Almost all of the insurers use policy definitions.

Either way, it is critical that the products and/or services of the insured be listed properly or defined as included in the policy. Wording is shown under “Products and/or Services Defined in Policy” included in the table “Definition of Products and Services.”

Claims Reporting, ERP Options, and Counsel

Each liability policy reviewed is a claims-made form, so extended reporting period (ERP) options are important. All insurers offer a supplemental extended reporting provision, but they range in length. Insurers will sometimes negotiate additional optional periods and/or cost.

Selection of counsel continues to be a delicate issue with insureds, but, as we frequently see in

other new lines of coverage, insurers typically reserve the right to select, or at least approve, counsel. In practice, insurers are generally willing to use legal counsel that is satisfactory to both the insured and the insurer.

Insurers offer varying levels of control (or, at least, influence) in the selection of counsel, ranging from selection exclusively by the insurer to the choice of counsel by the insured. As with all questions of counsel choice, we recommend that insureds discuss and agree with their insurer beforehand on the counsel they want to use; as an example, several insurers reserve the right to choose counsel but indicate that prenegotiated counsel will be considered on a case-by-case basis.

Generally, insurers can impose the infamous “hammer clause” on lawsuits that an insured may not want to settle. The “softened hammer clause” is making inroads in this market.

Insurers tell us that hammer clauses are rarely wielded (we love that image), but a soft hammer could be a valuable tool for an insured facing a tough E&O claim.

Prior Acts Coverage and Territory

All insurers offer prior acts coverage, with previous coverage usually required by all insurers, although many may require previous coverage based upon underwriting criteria.

All insurers offer worldwide coverage if a suit is brought in the United States, Canada, or possessions. True worldwide coverage (suit brought anywhere) is available from each of the insurers reviewed. Technology is a worldwide business, and one of the liability problems is that the legal standards of many countries differ from those of the United States.

Exclusions

Rather than try to recite them here, the information for each insurer is found in the “Exclusions” tables. Exclusions are many and varied, as would be expected; please read those tables carefully.

Unlike our other reports, we have categorized the exclusions into the following.

- General insurance exclusions (bankruptcy, dishonesty, intentional acts, expected or intended damages, Securities and Exchange Commission, unfair competition, piracy, and punitive damages)
- Product-related (product recall, cessation of support, direct property damage, direct bodily injury, loss of property, contingent bodily injury/property damage, prior to customer’s acceptance of your work, breach of warranty, and hardware)
- Service and security-related (contractual liability, cost estimates exceeded, performance delay, security breach, failure to prevent virus passing, or data theft)
- Cyber-risk-related (personal injury, advertising injury, intellectual property, and public key infrastructure)

The following are a few comments on some of the exclusions that are specific to Tech E&O.

- Cost estimates exceeded—This refers to exclusions for claims by customers that the cost of a project exceeded the estimate or proposed fee. Insurers do not want to pay claims for poor pricing decisions of their insureds.
- Performance delay—This arises out of the insured’s failure to meet project time deadlines

and is included in policies to protect insurers against an insured’s overly optimistic promises.

- Security breach or unauthorized access—This is a very important set of exclusions for any insured that offers services related to secure data, including e-commerce. Some insurers will provide coverage if the insured is providing services related to security, while others will include coverage as long as the breach is on the system of others (i.e., not the insured), which is, after all, the intent of E&O coverage.
- Intellectual property—Infringement of patents, copyrights, or trademarks is a source of much litigation, and coverage is rarely available when an insured is sued. Each insurer handles this very differently; read this portion of the “Exclusions” table carefully.
- Public key infrastructure—The term used to describe technology that enables secure online transactions.

Risk Management Services

Supplemental loss avoidance and control services are now much more prevalent in Tech E&O, of which we approve, considering the ability of such services to reduce or eliminate losses for the benefit of both insureds and insurers. Please see our “Risk Management Services” table for a description of the many services that insurers are including in their offerings to insureds.

Generally, the range of cyber-related risk management services offered is increasing, a trend we welcome. Insureds and their brokers should look carefully at the services offered and make use of them to help improve their exposure.

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Summary

Tech E&O is an important coverage line, supporting the risk strategies of a key component of the US (and world) economy. Marketing (smaller tech companies may not buy E&O, large tech companies may not think they need it) and product design (exploding privacy risk the most important) present challenges, as does rate adequacy. Sharp underwriting skills are needed in this line of coverage, as numerous types of business segments seek coverage.

We continue to see signs that the middle market is getting serious about this coverage; insurers continue to move down market and are encountering smaller competitors. This presents a real opportunity for significant growth in premium, as well as a way for middle market insureds to economically obtain expertise on how to handle a breach.

Privacy risk is now well recognized, and insurance should be seriously considered. While

some form of self-insurance or self-retention might make sense for large organizations, especially those with existing captives, the high costs of a breach and the unpredictability of data loss may make risk transfer appealing. Combined with increasing pressure by business partners to show evidence of real coverage, the days of self-funding this risk may be about over.

And looming on the horizon, if it hasn't already arrived, are claims alleging failure to protect against or investigate data breaches. This threat will increase interest in Tech E&O but also cause underwriters to more carefully consider what type of insured they want and what type of cover they are willing to offer.

We always encourage readers and their advisers to carefully consider the type of coverage that they need and whether or not the policy they are considering is really the right answer to their needs. The large insurer offering may not be the best one for them, but then again, the smaller insurers may not offer enough capacity.



About the Author

Richard S. Betterley, CMC, is the president of Betterley Risk Consultants (BRC), an independent insurance and alternative risk management consulting firm. BRC, founded in 1932, provides independent advice and counsel on insurable risk, coverage, alternatives to traditional insurance, and related services to corporations, educational institutions, and other organizations throughout the United States. It does not sell insurance or related services.

Mr. Betterley is a frequent speaker, author, and expert witness on specialty insurance products and related services. He is a member of the Professional Liability Underwriting Society. He joined the firm in 1975.

Mr. Betterley created *The Betterley Report* in 1994 to be the objective source of information about specialty insurance products. Now published six times annually, *The Betterley Report* is known for its in-depth coverage of management liability, cyber-risk, privacy, intellectual property, and media insurance products.

More recently, Mr. Betterley created [*The Betterley Report Blog on Specialty Insurance Products*](#), which offers readers updates on and insight into insurance products such as those covered in *The Betterley Report*. It provides him with a platform to more frequently and informally comment on product updates and newly announced products, as well as trends in the specialty insurance industry.

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- Side A D & O Liability
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