

Beyond the "4 Corners" ... Coverage Counsel as Strategic Counsel

2016 Primerus Defense Institute
Insurance Coverage/Bad Faith Seminar

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I. INTRODUCTION ... “Warm Up”

Notable Thoughts ...

“We’re not competitor obsessed, we’re customer obsessed. We start with what the customer needs and we work backwards.”

*Jeff Bezos, CEO
Amazon*

Notable Thoughts ...

“[A] topic that has been discussed in the past ... is the evolution as it relates to the relationship between capital and expertise. [I]t's expertise and intellectual capital that is increasingly the differentiator.”

*W. Robert Berkley, CEO
W. R. Berkley Corporation*

Notable Thoughts ...

“Predicting rain doesn’t count. Building arks does.”

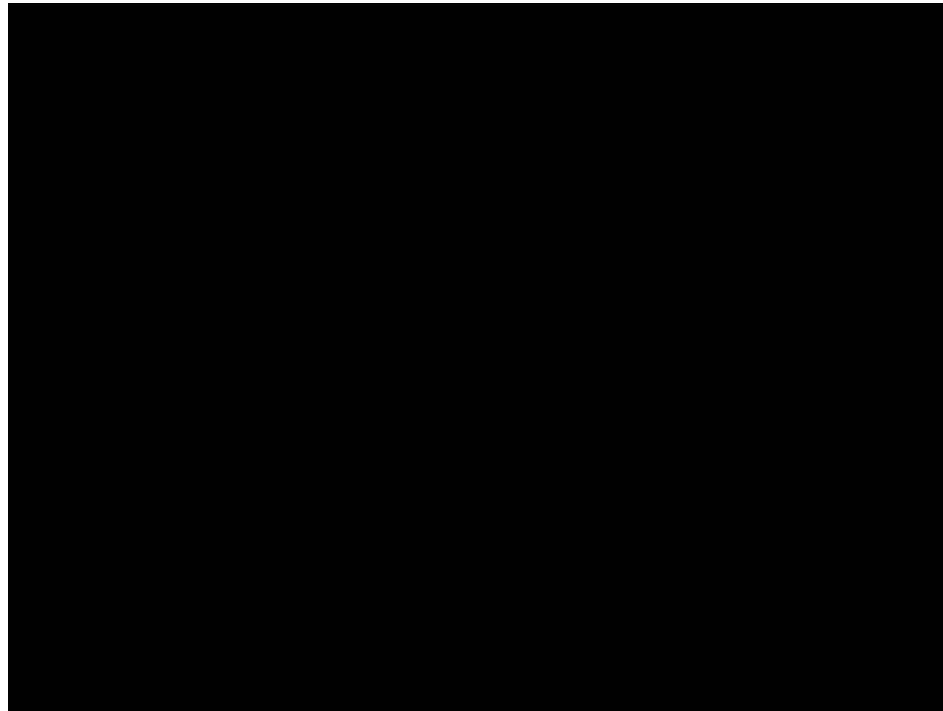
*Warren Buffet, CEO
Berkshire Hathaway*

What's on Your Client's Mind?

- Premium growth and expense reduction
- “Combined Ratio”
- Cost of capital/risk-based capital
- Emerging issues/concerns
- Predictability/risk avoidance/modeling/metrics
- Ratings/solvency (A.M. Best, S&P, regulators)
- Admitted market vs. surplus lines opportunities

What's on Your Client's Mind?

“I need new business.”



<https://www.youtube.com/watch?v=YHdb7t2wsDU>

And So Many Worries ...

- **Audit/disclosure**
- **Reinsurance/subrogation recoveries**
- **Reputation/“bad faith” risk**
- **Government investigation**
- **Public policy (legislative) changes**
- **Employee productivity/morale/succession**
- **Adverse development (losses)/unforeseen risks**
- **Financial (cash flow/investment) challenges**

Takeaway Thoughts ...

- Educated/stronger-sustainable relationships
- Bad faith avoidance/creation
- “Management”/“exit” strategies
- Increase diversification
- More engagement (360⁰, “post-mortem”)
- Greater efficiency/expense savings/margin
- Marketing entrée

II. INSURANCE 101 ... “A Few Basics”

Key Insurance Financial Terms ...

- Expense Ratio
- Loss Ratio
- Combined Ratio
- Investment Return

They all matter in your client insurer's business!!!

Expense Ratio Components ...

- Salaries and benefits
- Insurance agent commissions
- Reinsurance costs
- Operating charges (e.g., leases, phones, etc.)
- “Boards, bureaus, and taxes”

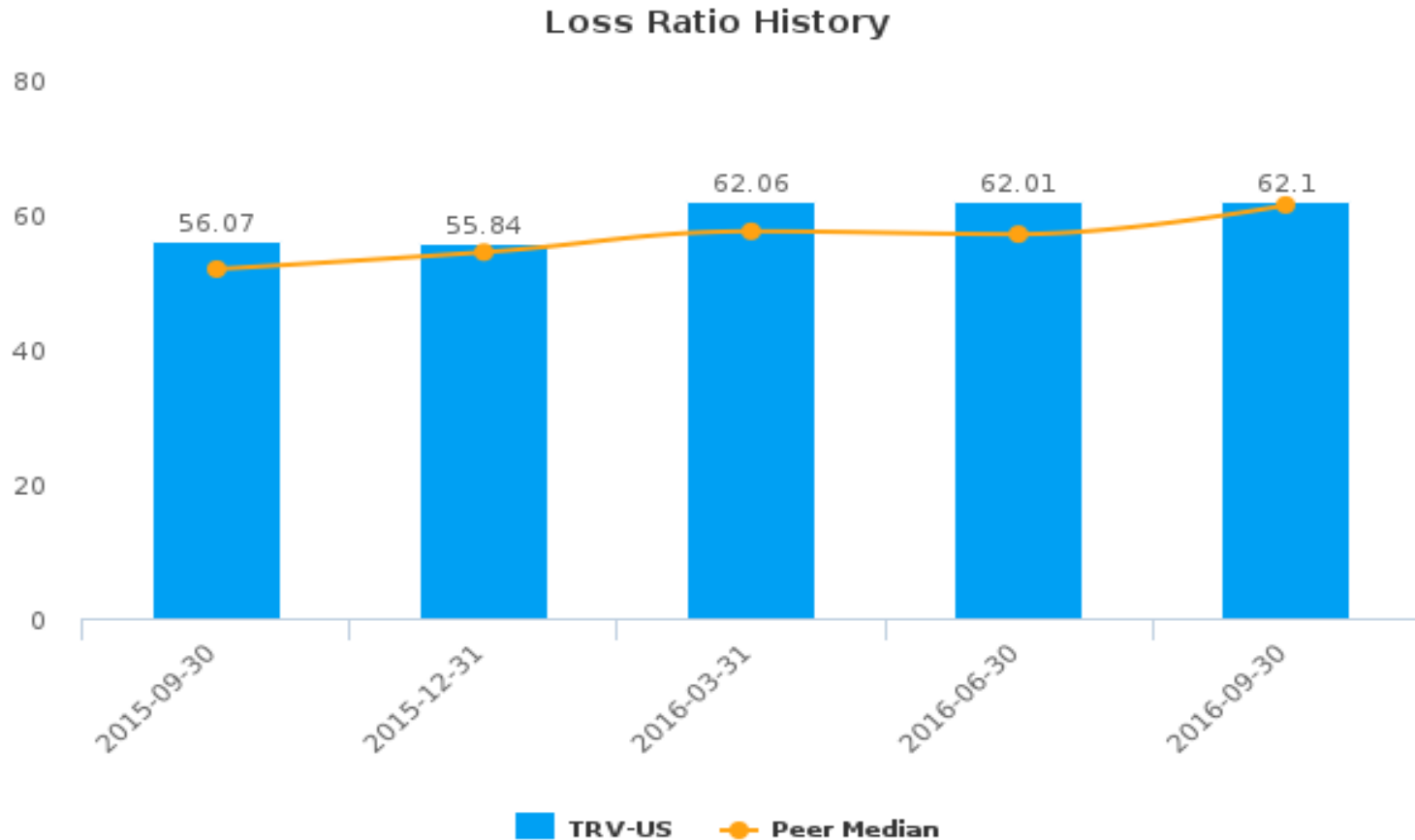
Expenses/Premiums = “Expense Ratio”
(“Typical” range 25% - 35%)

Loss Ratio Components ...

- “Losses” (e.g., monetary damages, awards, interest, etc.)
- “Allocated Loss Adjustment Expenses” (e.g., outside adjuster expenses, legal costs, investigator charges, etc.)

$(\text{Loss} + \text{ALAE}) / \text{Premium} = \text{“Loss Ratio”}$
 (“Typical” range 50% - 70%)

Loss Ratio Example ... Trends (Overall)



www.capitalcube.com

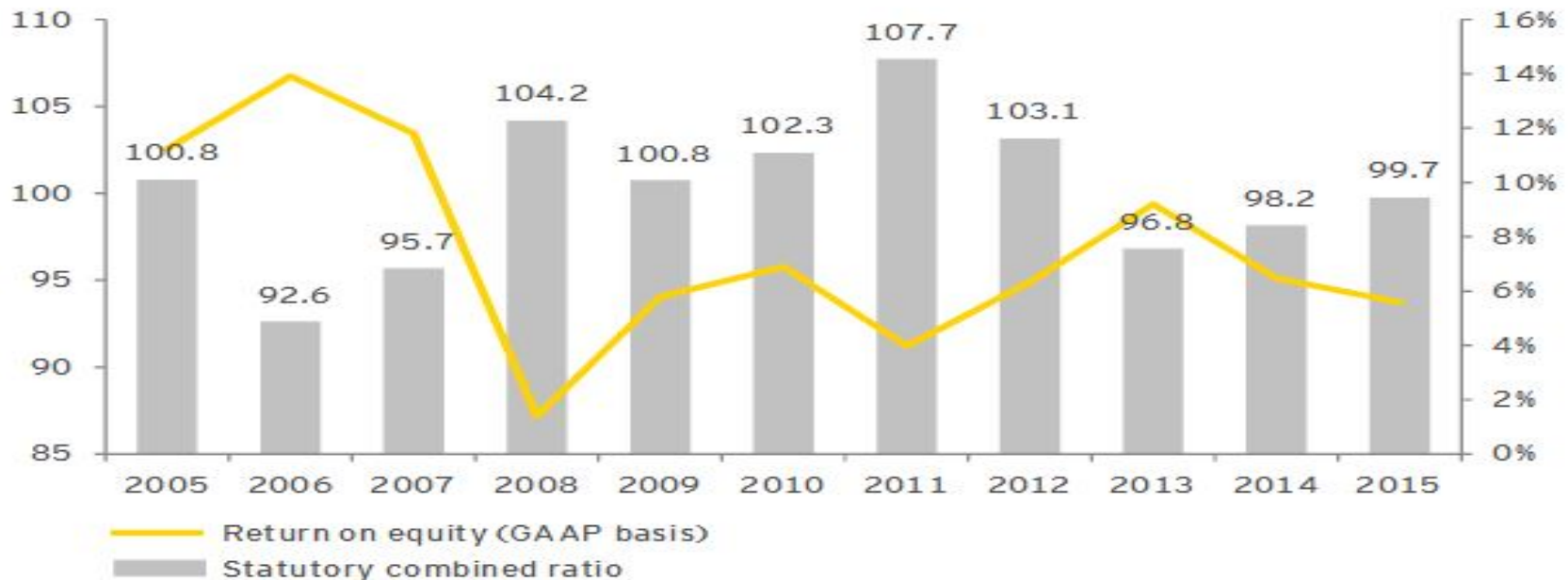
Combined Ratio ... What is It?

- Expense Ratio + Loss Ratio = “Combined Ratio”
- CR > 100% ... “not good”
- CR “desired” ... 90% or less (most LOBs)
- Will vary (by time period, “cat” events, etc.)

Investment income (return) not included.

Combined Ratio Insights

Combined Ratio v. Return on Equity



Source: Conning, Inc., "Life-Annuity Forecast & Analysis, Midyear 2014"

Investment Returns ...

- Insurers invest their “claim reserves”, “surplus”, and premium “float”
- Investments “regulated” by statutes, rating agencies, “policyholders”, and “investors”
- Generally “conservative” portfolios (e.g., match duration to claim payout patterns, etc.)

Investment Return = 5%+ (“desired”)
(Typical range 1% - 4%)

Other Insurance Insights ...

- 1st Half Financial Highlights (2016) (\$ billions)

Net Earned Premiums	257.07
Incurred Losses (Including loss adjustment expenses)	183.7
Expenses	73.8
Policyholder Dividends	1.0
Net Underwriting Gain (Loss)	-1.5
Investment Income	22.1
Other Items	2.2
Pre-Tax Operating Gain	21.4
Realized Capital Gains (Losses)	4.4
Pre-Tax Income	25.8
Taxes	4.1
Net After-Tax Income	21.69
Surplus (End of Period)	680.64
Combined Ratio	99.8**

** Includes mortgage and guaranty insurers

SOURCE: Insurance Information Institute (October, 2106)
Dr. Steven N. Weisbart, CLU

<http://www.iii.org/article/2016-commentary-on-first-half-results>

III. COVERAGE DISTINCTIONS ...

“Making You Think”

“Run of the Mill” v. “Large Exposure”

- “Run of the Mill” Claims:
 - Typically “smaller dollar” amounts
 - Apply facts to policy language in light of law
 - Often “commoditized” in character (low value, low volatility, low management, low expertise, Low billable rate)

But, beware ... avoid complacency/repetitive error!

“Run of the Mill” v. “Large Exposure”

- “Large Exposure” Claims:
 - Coverage itself often involves large \$ amount
 - For example ...
 - * “Catastrophic” Property
 - * “Mass Tort”
 - * Individual (“Egg Shell Plaintiff”)
 - * Precedent-Setting/1st Impression/Other

“Large Exposure” Claims ...

- **“Catastrophic”/Property**
 - Wind, fire, water, earthquake, equipment, fidelity, surety, cyber/data breach
- **“Mass Tort”**
 - Asbestos, pollution, EMF, shareholder-derivative, construction/product defect

“Large Exposure” Claims ...

- **Individual (“Egg Shell Plaintiff”)**
 - Civil rights, auto, sexual misconduct, shootings/violence, employee benefits
- **Precedent-Setting/1st Impression/Other**
 - Precedential, shareholder derivative, “White collar” (antitrust), M&A failure/warranty

“Run of the Mill” v. “Large Exposure” ...

- “Large Exposure” Claims:
 - Higher potential of negligent claim handling/purported “Bad Faith” (Breach of Implied Covenant); “Extra Contractual”/ “Excess of Policy Limits” exposure:
 - * Failure to Settle within Limits (individual or multiple claimants)
 - * “Set Up” Settlements

IV. “LARGE EXPOSURE” CLAIMS ... “Commonalities Ripe for Coverage Disputes and Bad Faith”

“Large Exposure” Claim Commonalities ...

- **Issue Complexity**
 - Legal, factual, jurisdictional, timing, resource, “human” challenges
- **Interest Divergence**
 - Among insureds/insurers/reinsurers (duty to defend; shared/wasting limits; consent to settle)

“Large Exposure” Claim Commonalities ...

- **General “Discomfort”**
 - “Need to know” (real time), risk aversion, slowed decision-making
- **“Non-standardized” (Irrational) Thinking**
 - Second guessing, criticism, finger-pointing, “sunk costs”, “anchoring”, “analysis paralysis”

“Large Exposure” Claim Commonalities ...

- **Transactional Morass**
 - Documents, e-discovery, reporting (SOX, auditors, regulators), coordination, experts
- **Underlying Severity Exposure**
 - \$1M+, \$10M+, \$100M+ (or more) loss potential (e.g., damages, expenses, ECO/XPL)

“Large Exposure” Claim Commonalities ...

- **Expense-driven**
 - Loss (and ALAE) ratio impact, resource drain (internal and external), “higher cost” advice
- **Unpredictability/Volatility**
 - Defy “metrics”, accurate-data-impaired, low frequency, multi-variate in character

V. WHY IT MATTERS ... “Insurer Think”

Insurer Bad Faith Statistics ... Real Fears?

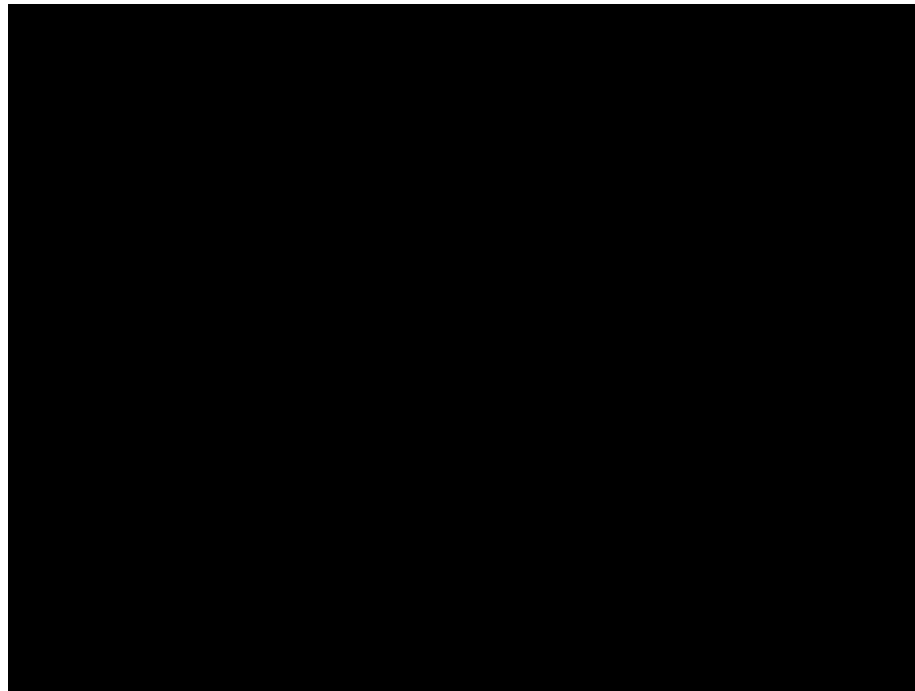
- Bad Faith verdict study (California, 1991 – 1999)
- Punitives constituted 77% of damages imposed
- Punitives were awarded in 42% of the cases (compared to a 4-6% rate in all civil litigation)
- Mean punitive award = \$16,655,895,
- Median punitive award = \$2,816,000.

Cause for concern????

Source: Jury Verdicts in Insurance Bad Faith Cases, Kelso & Kelso McGeorge School of Law (Institute for Legislative Practice) <http://www.mcgeorge.edu/documents/publications/ccglpbadfaithcases.pdf>

What's on Your Client's Mind?

“How the Insurance Claims Process Really Works.”



<https://www.youtube.com/watch?v=kch7DzdvjKE>

Emerging/Cost Issues ...

- Legal expenses (containment)
- Technology (“big data” capture/analysis/metrics)
- Increased specialization
- Retention/alignment of resources/experts
- Attorney fee awards
- Confession of judgment risks
- Treble/punitive damages
- Negligence per se, private cause of action statutes

VI. COVERAGE COUNSEL ... “Retention Models”

“Traditional” and “Emerging” Models ...

- The “Traditional” Model:
 - “We Provide Peace of Mind”
 - Ethereal differentiation
 - Reputations and relationships
 - “Results” history
 - Limited “quantification” (measurement)

“Traditional” and “Emerging” Models ...

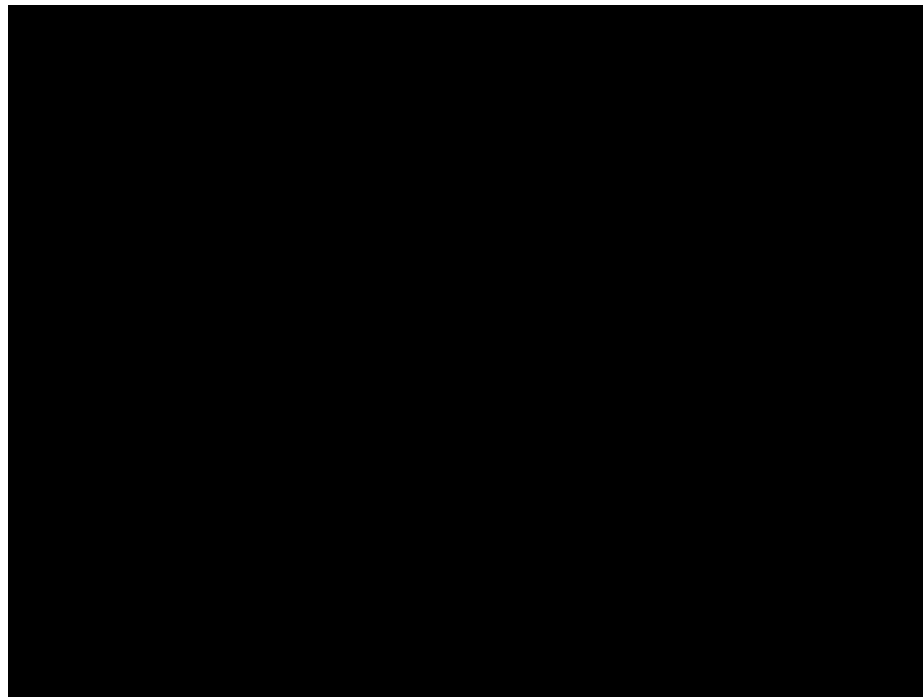
- “Emerging” Model:
 - Not only “results”, but
 - Controlled and established counsel costs ...
 - * Accurate and adhered to budgets
 - * File cycle consistency
 - * Audit guideline compliance/precision
 - * Comparisons to “competition”

“Traditional” and “Emerging” Models ...

- **Emerging Model, cont’d.:**
 - **Unconvinced what’s “emerging”? Consider ...**
 - * **2015 CLM Litigation Management Study**
 - * **Alternative/Value-Based Billing**
 - * **Bottomline Technologies; Legal Cost Control; LSG; Legal Tracker (f/k/a Serengeti); Litigation Management Counsel; et al.**

What's on Your Client's Mind ...

“Lawyer vs. Adjuster”



<https://www.youtube.com/watch?v=x1IyVpBk1EY>

Metrics (“Objective”) ...

- **Cycle Time/Duration of Litigation**
 - **Average Age of Open, & Closed Files**
 - **Surrogate for:**
 - * **Counsel Efficiency**
 - * **Claims Handling Efficiency**
 - * **Early Case Resolution Identification**
 - * **Timing to Bring Reserve to Full Value Evaluation**

Metrics (“Objective”) ...

- Legal Expense per Case:
 - Average Costs/Case Type; Mean/Median;
- Budget Conformance;
- Invoice Review/Billing Guidelines Compliance;
- Costs/Files per Year;
- Rate Structure;
- Average Billing Rate/Hour by Claim Type;

Metrics (“Objective”) ...

- Loss per Litigated Case;
- ALAE as a % of Loss Ratio (ALLAE);
 - (Does More Defense = Less Indemnity?)
- Number of Timekeepers/Staffing Mix;
- Litigation Inventory/Pending Matters;
- L Code Component Comparisons/Staffing;
- In House/Out-of-House Counsel Ratios;
- Alternative Fee Arrangements (AFA);

Metrics (“Results”) ...

- Case Disposition Statistics
 - Loss/Litigated Case
 - Loss & Legal Costs/Litigated Case
 - Number of Cases Resolved
 - Timing of Cases Resolved
 - Trial Results
 - Dispositive Motion Results
 - Disposition Compared to Initial Evaluation

Metrics (“Subjective”) ...

- Understanding Client Needs
- “Wins” to “Losses
- Feedback
- Expertise (Human; Technology)
- Perception of “Creating Value”
- “Go-To” Firms/Lawyers
 - “Within Limits,” Other Perceptions Not as “Valuable;”

VII. STRATEGIC COUNSEL ...

“Adding Value in the Representation”

What's on Your Client's Mind ...

“Across several insurance lines, many buyers renewed their [2016 – 2017 insurance] programs with rate decreases in the first half of the year, continuing soft market trends seen in recent years.”

US Insurance Markets 2016: Midyear Update
Marsh & McLennan Companies

<https://www.marsh.com/us/insights/research/>

What's on Your Client's Mind ...

“Cost reduction is no longer just an operational issue; it is now a competitive necessity. ... Maintaining good profit margins requires insurers to focus on cost, efficiency and more refined segmentation and pricing strategies.”

2015 US Property-Casualty Insurance Outlook
EY (Ernst & Young)

<http://www.ey.com/Publication/vwLUAssets/>

Insurer Representation (Adding Value) ...

- Value Proposition:
 - Early Engagement of Coverage Counsel as a Strategic Counsel on a “Large Exposure” claim ...
 - * Fulfills general and specific insurer purposes
 - * Can “quarterback” and “coordinate”
 - * Enhances insurer resources in the adjudication (acts as “Knowledge Partner”)

Insurer Representation (Adding Value) ...

- **Proving Value:**
 - **Coverage counsel can support retention as a strategic counsel if counsel ...**
 - * **Stays focused on insurer interests**
 - * **Delivers coverage and “big picture” advice**
 - * **Conveys unique, correct, relevant, timely, and measurable information to client**

Insurer Representation (Adding Value) ...

- Engagement Execution (“Trust”):
 - Lay groundwork for the execution through demonstrated learning of the insurer’s ...
 - * Markets, program, lines of business
 - * Value system (claims/business philosophy)
 - * Human talent to “quarterback” with or to complement

Insurer Representation (Adding Value) ...

- Engagement Execution (“Trust”), cont’d.:
 - Develop metrics/analytics/“systems” that are meaningful to the insurer ...
 - * Learn/improve insurer’s metrics/analytics
 - * Acknowledge data/credibility challenges
 - * Remain willing to frequently assess (re-assess) assumptions with new information

Insurer Representation (Adding Value) ...

- Engagement Execution (“Trust”), cont’d.:
 - Develop further knowledge of emerging claim issues/costs of the insurer ...
 - * Expand geographic sphere
 - * Understand underlying defense/counsel
 - * Anticipate and communicate potential issues/claims before they occur

Insurer Representation (Adding Value) ...

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Insurer Representation (Adding Value) ...

- Other “Value-Adds”/“Tools”:
 - Industry-tailored communications/leadership
 - “Crisis Response” protocol/network/team
 - Defense lawyer referral
 - Coverage/product drafting (timely)
 - Access to defense /litigation “capital” (hedge)
 - Custom solutions to design/implement metrics
 - Primerus expertise

VIII. VALUE TO YOU ... “Being Creative”

Creative and Strategic Value to Counsel ...

- **Differentiation**
 - “Result-centric”, “disruptive”, “innovative”
- **Diversification**
 - Cyclical industry, “leveraging” expertise, broadening
- **“It’s (not) about the money ...”**
 - Better rates (less commoditized), more rewarding

A Word of Caution ...

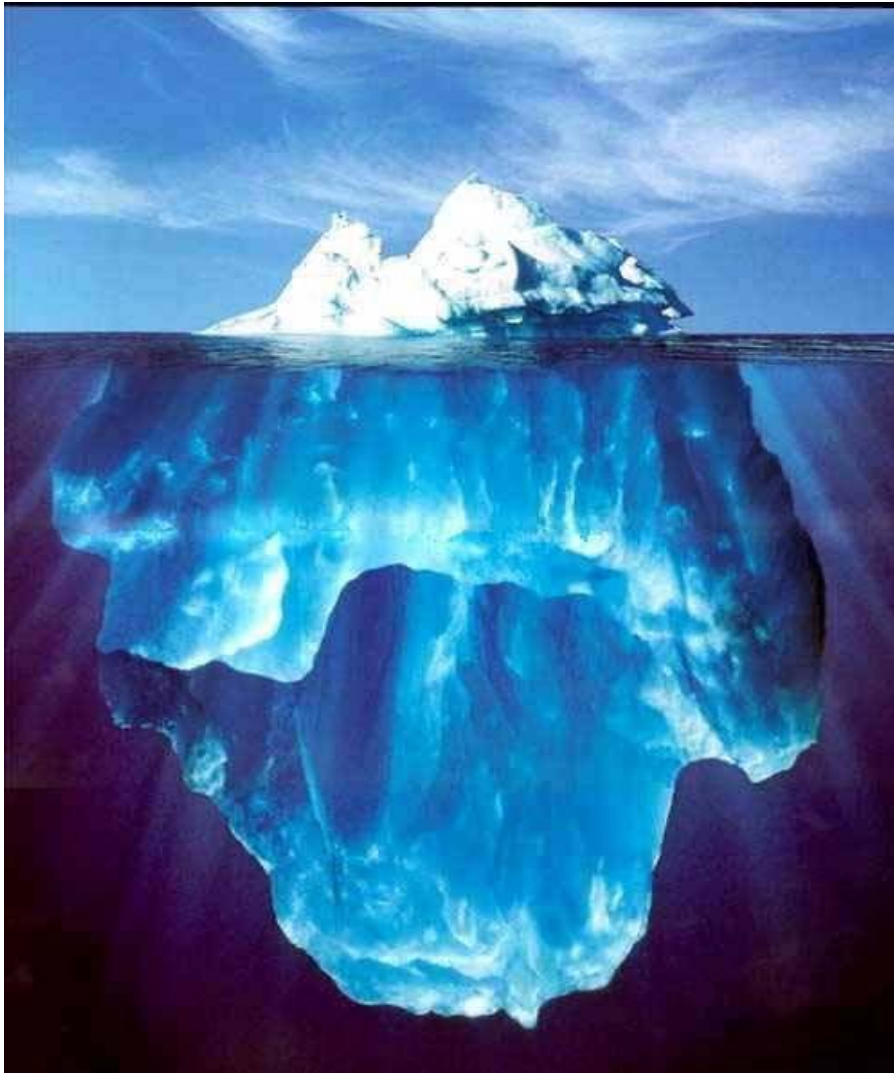
*Gallup Survey - “Honesty/Ethics in Professions”
December, 2015*

<http://www.gallup.com/poll/1654/Honesty-Ethics-Professions.aspx>

- Lawyers rated for honesty and ethical standards
- Ranked “very high or high” -- 21%
- Ranked “average, low, or very low” -- 79%

A lesson? Go slowly, sincerely, convincingly!

IX. CONCLUSION ... “Tip of the Iceberg”



CONCLUSION:

**Tip of the
Iceberg!**

About Kylo Consulting

David Kylo, Esq., is the principal and founder of Kylo Consulting. He is a licensed attorney in MN and CO; an adjunct Assistant Professor in the graduate programs division of St. Mary's University of Minnesota; and a member of the board of directors of the Nonprofit Risk Management Center.

Prior to founding Kylo Consulting in January, 2016, Mr. Kylo spent nearly 30 years in the insurance and construction industries in a variety of operational, claims, legal, research, product development, sales and marketing, and executive roles.

Kylo Consulting offers select clients a broad range of experience-driven advice, perspective, and strategy related to insurance program development, risk administration, and dispute resolution.

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