The Assumption Of Unnecessary Risk And What To Do About It

The Danger of Treating Insurance as a Commodity

Even for an experienced insurance professional, arriving at the best insurance solution can be a daunting task due to the complexity, variety and sheer number of choices in risk transfer products. It is easy to see why some decision-makers opt to commoditize coverage by viewing the requirement for insurance as a simple box to be "checked" on a checklist rather than as a critical component of their business that demands attention. Ultimately, commoditization is a dangerous lowest common denominator approach, which can have serious implications that may put the investment, a company, reputations and jobs at unnecessary risk. Preferable to this approach is a more studious and involved one that requires working with a broker to modify insurance terms and conditions so they meet specific needs and address particular exposures. Perhaps one of the most effective approaches to obtaining the best coverage is choosing to implement a portfolio insurance program. This course requires venture capital firms (VCs) and their portfolio companies to spend time up front to establish the parameters for the program and the criteria for coverages. However, this initial investment of time will save many others from spending time later and will dramatically improve the consistency and quality of the portfolio's risk transfer objectives.

The Advantages of a Portfolio Insurance Program

There are a variety of compelling reasons for a venture firm and its portfolio companies to participate in a structured insurance program tailored specifically for the types of exposures that can put investments at risk within the portfolio. Typically, the primary goals of the venture or private equity firms that sponsor portfolio business insurance programs are two-fold. First, a program can provide the assurance of consistent insurance coverage terms and eliminate potential gaps that may exist with the unreliable approach of leaving the details of coverage to the individual portfolio member companies. Second, the leverage with insurance underwriters created by mandating

that the entire portfolio subscribe to a uniform program can yield significant savings to the overall cost of the risk transfer outlays of the portfolio as well as achieve coverage benefits that would not be available to many companies on a one-off basis. Additional sets of benefits are related to the significant reduction of time and effort portfolio company management would expend negotiating and obtaining quality insurance coverage as a single entity. In sum, a portfolio insurance program allows for more flexibility and greater creativity than a single entity program, which enables companies to better achieve their coverage and premium objectives for a group of risks. For the experienced, the most compelling aspect of a portfolio program is the ability to attain greater certainty about how insurance coverage will behave in the event of a variety of insured losses across the entire portfolio.

Portfolio Insurance Program Architecture

Portfolio program architecture can vary widely. Some programs will focus on a specific line of insurance coverage while others are far more comprehensive, including many lines of coverage. Approaches to managing the ultimate cost of coverage can be creative. For example, a common design is the creation of an “umbrella” of insurance capacity over multiple companies, multiple exposures or both.

There are a variety of insurance products that may be applied to a portfolio program. Management liability insurance coverages (directors & officers liability, employment practices liability and fiduciary liability), professional liability insurance coverages (professional errors & omissions), “business” insurance coverages (property, general liability, auto, workers’ compensation and excess liability), a myriad of employee benefits coverages, key-person life, financial transaction coverages and travel accident insurance coverages may all be incorporated into programs for portfolio investments.

Selection of the Insurers

When purchasing insurance for venture capital firm exposures and their portfolios, the financial wherewithal and experience of the insurance companies underwriting the

programs are critical. This is particularly significant when one considers the dynamics of the challenging insurance environment that exists in technology and other business segments. Many industry analysts predict that some insurance companies will fail. Others have already ceased independent underwriting operations or left the North American market. Therefore, in addition to comprehensive policy forms, it is important that VCs and their portfolios select an insurance carrier with the highest rankings for financial strength and claims-paying ability from the industry's principal rating agencies. Other considerations are the reputation the insurers have for paying claims and the level of involvement and support they dedicate to specialty underwriting and loss control services directed at emerging growth companies.

Selection of the Broker

Another key component of a successful portfolio insurance program is choosing to work with an insurance professional who is skilled in the process of selecting an insurer and negotiating with that insurer to secure favorable terms. The right insurance broker should have broad experience and a reputation for working with emerging growth companies in all of the coverage lines that are to be incorporated in the program. It is essential that the broker have demonstrated the ability to accomplish the following: effectively and consistently deliver the "package" of negotiated coverages quickly and efficiently to the portfolio; establish the trust of management, provide on-going services to a dynamic, growing enterprise; and advise and adjust coverages as the portfolio company changes over time.

Summary

Venture Capital firms that provide clear direction for managing risk transfer to their portfolio company investments are providing a valuable additional service to their portfolio as well as managing their own investment risk more effectively. The best portfolio insurance programs can streamline procurement costs and time as well as

provide greater security and certainty for a company's success and a profitable investment opportunity.