Protecting your Reputation

How to protect the balance sheet when your reputation is impacted by a cyber incident.

Forty years ago, intangible assets represented about 17% of the value of the largest listed American businesses in the S&P 500 index. Calculate that figure today and you will find that intangibles, including reputation, account for nearer 84%, a fivefold increase in a little over a generation.

Law firms remain reliant on their reputations, investing both time and money in building and improving them with clients, regulators, employees, lateral hires, the media, and other parties. As important as reputations are, they are fragile, and the emergence of an ever-increasing danger from cyber incidents adds a new threat to law firms' reputations. So, what can law firms do to protect the balance sheet should cyber incidents impact their reputation?

Before considering what insurance solutions are available, bear in mind this is not a fictitious debate; cyber incidents have occurred at law firms (either through employee negligence, fraud, or external hacks). Some have been reported in the press – think 'Panama Papers' and DLA Piper as a couple of high-profile examples.

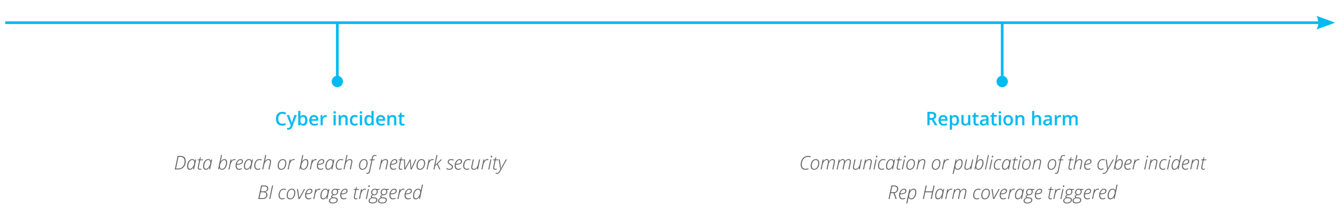
Cyber policies, at a minimum, should include Business Interruption (BI) coverage where the insurer agrees to indemnify the law firm for lost income and interruption expenses (e.g. additional rent or salaries) arising from a cyber incident. Some insurers go further and offer cover for lost income and increased costs due to reputation damage.

This coverage is called Reputational Harm. Unlike BI coverage which is triggered by a cyber incident, 'Rep Harm' coverage is triggered on the communication or publication of the cyber incident, which thereby causes harm to the insured's reputation and loss of income. The publication may occur at the same time as the cyber incident, although it is more likely to follow later, sometimes as much as several months later.

The triggers for calculating any Rep Harm loss under a policy should be carefully reviewed and, where appropriate, discussed with the insurers. All parties to the contract need to appreciate the importance of this coverage.

Calculating Rep Harm loss is not an exact science; a loss of income (net profit) claim will result in a number of factors being considered when adjusting the claim. In the event of a claim, insurers appoint an independent professional loss adjuster or forensic accountant to work with the CFO of the firm, to assess the loss. The objective of the Rep Harm coverage is to put the law firm in the same financial position it would have been in if the cyber incident and associated media coverage had not occurred. The loss adjuster or forensic accountant will adjust for other factors unconnected with the cyber incident. For example, the overall income of the firm may be static, yet the firm may still have lost income if it was forecasting an increase following the opening of a new office and/or several lateral hires.

Timeline of Events and Insurance Triggers



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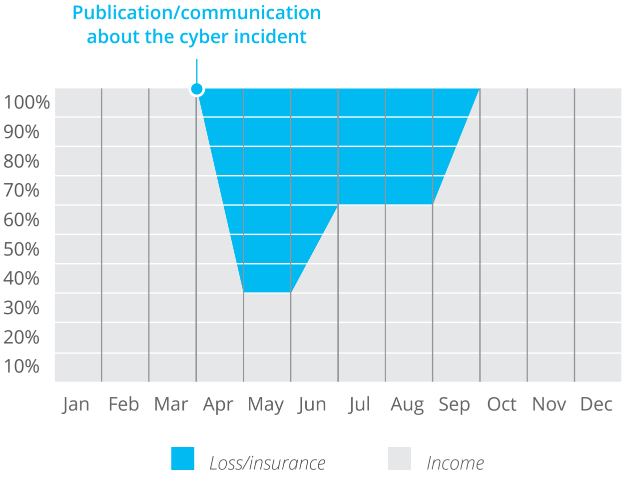
Drop of income (net profit) of the insured following the publication of a cyber incident



Crucially, this coverage not only indemnifies the law firm for lost business from clients who were impacted by the data breach, but also from other clients who were not impacted but cancel engagements or cease to provide further work to the firm. Some policies go even further and cover accrued amounts for fees billed but not paid.

The above image depicts a drop of income (net profit) of the insured following the publication of a cyber incident. Reputational Harm insuring coverage would compensate the insured.

The length of time that insurers will compensate law firms for loss of income varies, with a maximum of up to 12 months' coverage available from some markets. A further element to Rep Harm insurance is insurers will cover appropriate costs for PR professionals to work with the law firm to re-establish its reputation and public image due to the cyber incident. Brokers, insurers and breach response counsel can also help to suggest PR firms with appropriate cyber expertise.

How much does Rep Harm coverage cost? Some insurers include this coverage in their standard cyber coverage whereas others add an additional premium in the region of 10-15%. Some markets offer a sub-limit for Rep Harm coverage, while others offer full limits.

The reputation of a law firm remains fundamental to its success, and protecting it is now more difficult than ever. The insurance market can offer solutions and is currently seeing an increasing demand for cyber coverage, including Rep Harm, from law firms.

In his biennial 2014 letter to Berkshire Hathaway Managers and Directors, Warren Buffett wrote:

"We can afford to lose money – even a lot of money. But we can't afford to lose reputation – even a shred of reputation."

If you would like to talk about protecting your business and your reputation please contact your local broker.

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