INSIGHTS | FEBRUARY 2020

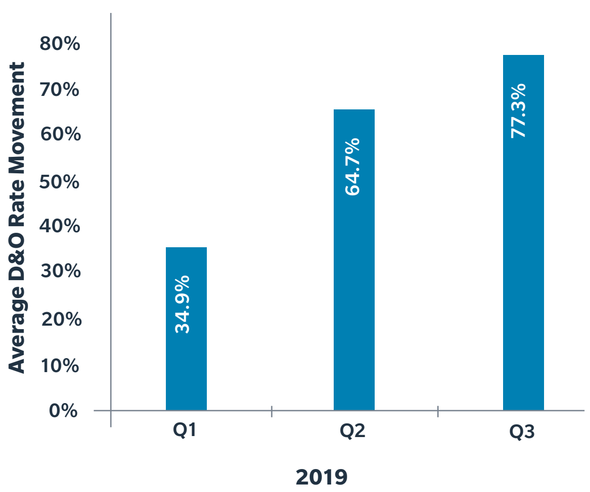
UK D&O Insurance Market Update

The UK directors and officers liability (D&O) insurance market has changed considerably in the last 18 to 24 months. This has continued into 2020, as capacity contracts and there are no new market entrants. Arguably, the change has been due for several years, due to a sharp rise in the overall frequency and severity of claims, and the deterioration of prior-year losses, which have led to a major shift in the global D&O market.

The D&O insurance market for FTSE 100 companies saw average rate increases in the first three quarters of 2019 of 35%, 65%, and 77%, respectively. The broader rate change for all UK companies is slightly higher at just over 80%.

FIGURE 1 D&O rate increases rose exponentially in 2019.

SOURCE: MARSH



Increased Volatility

The UK D&O landscape has been reshaped by increased class actions and a changing regulatory and legal environment globally, with a heightened emphasis on individual accountability of senior executives. Historically, many underwriters perceived US exposure as a key D&O risk, with non-US risk seen as relatively benign, but this is no longer the case.

The US has seen continued increases in securities class action filings, with a rapid rise in filings against foreign issuers. In 2006, there was one class action for every 45 US-listed companies; in 2018, the frequency was one in every 18 companies traded in the US.

Similarly, in Australia securities class action filings have continued to increase due to increased litigation funding and opt-out procedures. With the cost of some settlements amounting to AUS$50-75 million plus defence costs, large losses have been a huge drain on insurers' overall premium pool.

Meanwhile, Europe has seen increased regulatory activity and changing litigation processes, with class-actions-type litigation/ group litigation becoming far more common.

In the past, the UK D&O market rated companies with multinational exposure as if they were insulated from claims trends in other territories, despite having global exposure and purchasing multinational D&O programmes. This is no longer the case, with insurers underwriting UK and multinational accounts with an eye on global claims trends.

Changing Claims Landscape

The two most common types of D&O insurance claims Marsh D&O clients experienced in 2018 were:

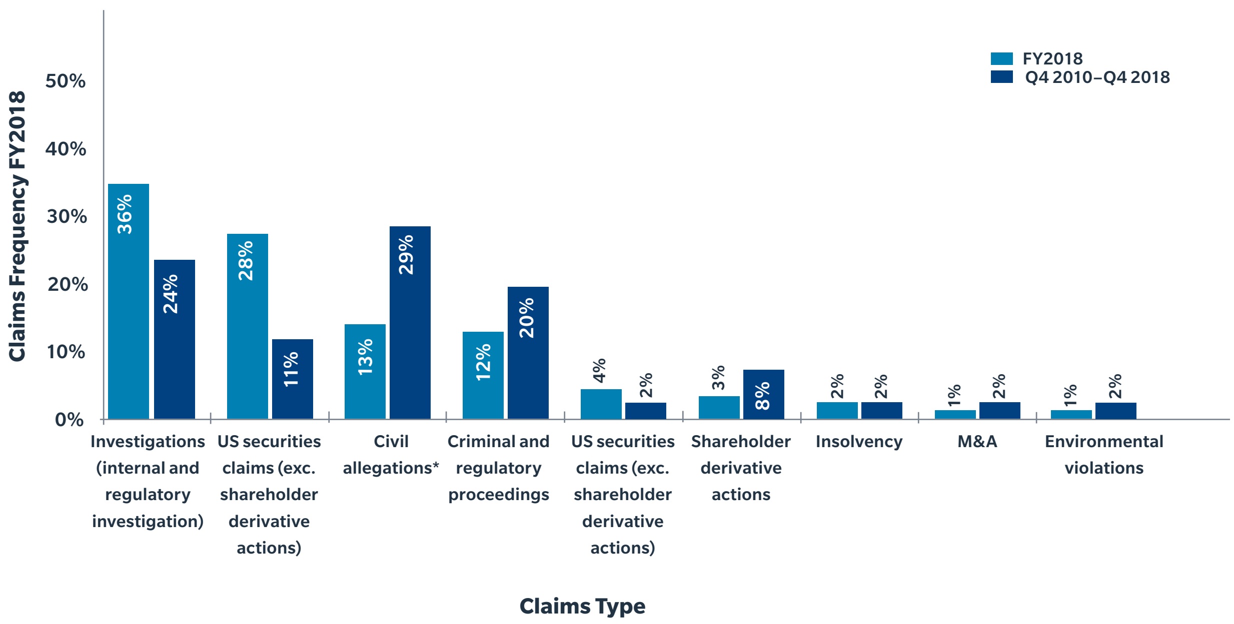
1. Investigations (internal and regulatory) – accounting for 36% of all claims.

2. US securities claims – accounting for 28%.

FIGURE 2

Investigations and US securities claims accounted for more than half of D&O claims in 2018.

SOURCE: MARSH



*CIVIL ALLEGATIONS INCLUDE:
- EMPLOYMENT PRACTICE VIOLATIONS COVERED UNDER D&O POLICIES.
- CLAIMS FOR BODILY INJURY/OR PROPERTY DAMAGE.
- MISLEADING STATEMENTS.

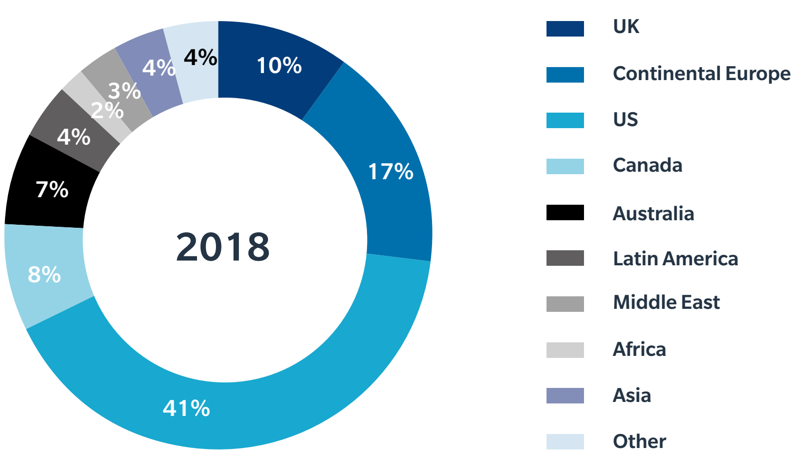
The largest increase was in the volume of investigations notified (36% of all notifications in 2018, compared with just 22% in the previous seven years).

Conversely, civil allegations, previously the single biggest source of claims (accounting for 31% of all claims notified in the period 2010–2017), accounted for just 13% in 2018, as the volume of both securities claims and investigations increased.

Claims are seen in every jurisdiction and sector (see figure 3). More than half (59%) of class actions now occur outside the US, with 27% in Europe. All sectors are seeing big losses, with many of them Side A claims.

FIGURE 3

More than half of D&O class actions occurred outside the US in 2018.



Insurers with significant D&O portfolios have unprofitable combined ratios for D&O insurance, with losses since 2015 particularly affecting results. Several insurers have tried three times to set appropriate reserves; a fourth attempt might not be far off.

Markets have tried to increase rates over the last few years, but this proved difficult due to insurer competition. However, arguably the market has been fundamentally changed by two factors: 1) One large insurer revised its D&O insurance strategy, including more economical capacity deployment; and 2) The Lloyd's of London review, which scrutinised non-performing lines of business within Lloyd's, particularly focusing on the bottom performing 10% of each syndicate's portfolio. While D&O was not in scope for the review's first phase, the review's timing has catalysed wider change, leading to market volatility.

In recent months some insurers have closed D&O portfolios, and this trend may continue if insurers cannot see a path to profitability in the short term.

Managing a Transitioning Market

Insurers are reviewing how they rate D&O exposures. With the volume of claims and value of costs incurred showing no signs of reducing, it will be increasingly necessary for buyers to prepare themselves for a progressively challenging D&O market as they approach their next renewal.

Providing upfront, granular information on areas that may particularly concern insurers can make a difference. When assessing D&O risks, insurers will principally consider five factors:

- Jurisdiction – Where are your listings? Where do you have operational exposures? For example, if your company has operations in South America, providing information demonstrating your focus on anti-bribery and governance controls may help to mitigate insurers' concerns.
- Industry sector – Although all sectors experienced claims, some are perceived as higher-risk, such as life science, mining, technology, and financial services.
- Claims activity – How has the company performed from a claims perspective?
- Financial stability – Has there been stock price variation?
- Mergers and acquisitions activity – If your company has recently been acquisitive, it may help to outline the company's integration plans and governance controls.

We recommend that companies proactively evaluate their existing limits (are they still achievable and, if not, what is appropriate?); their structure (do you have the right mix of Side A, Side B, and Side C?); and their Side B and Side C retentions (could the company retain more risk?).

C-suite engagement and representation at insurer meetings is increasingly important and we recommend companies include board-level representation at market presentations.

In order to obtain the best possible terms at renewal, start discussions with your advisers early, and be prepared for greater underwriting scrutiny over your business.

CONTACTS

STEPHANIE MANSON
Management liability chief client officer and head of D&O product
Marsh JLT Specialty
stephanie.mason@marsh.com
020 7178 2067

CLARISSA FRANKS
Placement leader, Risk Management Practice
Marsh Ltd
clarissa.s.franks@marsh.com
020 7357 3309