

D&O

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"THE GLOBAL SHOCKS OF THE PANDEMIC HAVE BROUGHT CORPORATE TURMOIL, FUELLING A HUGE SPIKE IN CORPORATE M&A AS THE WEAK ARE BOUGHT BY THE STRONG"

INTRODUCTION

Welcome to Global Insurance Law Connect's first review of international D&O insurance markets. We decided to write this report because of the scarcity of information on how D&O cover, pricing and availability compares across different global markets. In many countries D&O rates are rising, and in some places those increases are extreme, but this is not the case everywhere. In a few markets the green shoots of recovery are showing, as clients reach the limits of what they are prepared to pay, and prices look set to finally stabilise.

There are other tumultuous events impacting D&O too. The global shocks of the pandemic have brought corporate turmoil, fuelling a huge spike in corporate M&A as the weak are bought by the strong, and the well-positioned take advantage of changing markets to expand into new regions through acquisitions. This in itself brings great pressure to bear on directors and officers across the board meanwhile, alongside, many companies are also seeing exposure to new risks brought about by home-working and other pandemic impacts.

Finally, the increase in cyber attacks is driving growth in litigation by those affected, and in many cases the litigant will also name directors and officers within any class action, also increasing the perils for elected company officers. Regulation is a further factor in the mix.

Together, this all adds up to an increased need for protection for directors and officers, in a market which lacks capacity to supply it. The impact has been a notable growth in self-insuring for this class of cover, alongside the increased use of letters of indemnity for directors and officers.

In the following pages we have reviewed the global trends highlighted above; while the second half of our report gives you a snapshot of how D&O coverage shapes up country by country.

I would like to thank the talented lawyers of Global Insurance Law Connect who have taken time to discuss the complexities of their local D&O market, to analyse trends, and have brought their insight to bear on this report. As always, the specialist expertise of our global group of insurance lawyers sheds light on a complex and challenging topic.

Best wishes

Jim Sherwood
Chairman
Global Insurance Law Connect

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GLOBAL ISSUES IN D&O

BACKGROUND

In the majority of countries worldwide, the use of D&O insurance has been increasing for over a decade. The historic roots of this expansion lie in an increasing ability for those with a financial claim against a company to pursue that claim directly against its directors and officers. The concept of personal liability was introduced by the US in the Sarbanes-Oxley Act of 2002, which in itself resulted from the huge Enron corporate scandal – the world's largest company failure of its time.

In the years since 2002, legislators and regulators in many countries have followed the lead of the US in increasing the personal liabilities for company directors and officers. This in itself has brought about an increase in litigation, including a tendency for class action suits to be targeted at individuals as well as the company they work(ed) for.

For many years, D&O insurance was seen as a relatively stable class of cover, and discounting was common. It was popular, and its use also began to grow in countries where it had previously been unknown. Sakate Khaitan of Khaitan Legal Associates in India comments that "Over the last decade, the Indian insurance market has seen liability products like professional indemnity, D&O, cyber protection, etc. become more prevalent. ...The market is borrowing from the western world. As companies are becoming sophisticated, their risk and mitigation strategies need to catch up."

PRICING TRENDS

Stiff competition saw premia heavily discounted inevitably, some insurers began to take increasing punishment, as successful (and sometimes very large) claims were paid out.

Justus Könkkölä of Socrates in Finland reflects that: "Historically, the liability risks of D&O had been relatively modest, partly due to cultural reasons and features of the legal structure, such as a lack of opportunity for class actions. The tendency has moved towards a higher duty of care and expanding of liability risks for top management. This is among others because of technical development and cyber risks as well as the increased amount of financial regulation that the corporate entities must now follow."

As a result of all this, dark clouds gathered, and from 2018 onward, stress was obvious in D&O pricing. Wij Advocaten in the Netherlands reports that: "for many years, the Dutch D&O market was considered a soft market. This is no longer the case. In mid-2019 the market started to harden and the pandemic is considered to have been an accelerator further hardening the market."

Some markets took off first, with Australia witnessing a spectacular shortage of capacity and price increases to match in 2019 – as did Spain. However, the misery soon spread, and 2019-2020 became notorious for the increases in cost for D&O premia around the world. In Europe, Robert Byrd of Byrd & Associates in Paris relates that "whilst neighbouring markets such as Italy, Germany and Spain reportedly saw premia increase as early as 2019, the French market escaped this increase in premia until the first quarter of 2020."

The smaller markets of Latin America suffered just as badly as the USA and Europe.

João Marcelo dos Santos of Santos Bevilacqua in Brazil reflects on the many causes that led to this: "Rising D&O claims in the last five years link to corruption charges, environmental damages, administrative liability around securities operations, mergers and acquisitions impacts on tax, labour and anti-competition faults. Particularly in the last year, the trend in claims relates to tax, labour and consumer issues, in addition to financial mismanagement, some of these questions linked with the pandemic situation and its impacts."

Meanwhile in Asia, markets such as China, which were growing, have also seen increased securities-related litigation. Buren's Li Jiao recounts that "As investors' awareness and means of defending their rights continue to increase, the risk of securities-related litigation faced by A-share listed companies has skyrocketed in China." In India, the basis for D&O claims widened exponentially: "The market has seen an increase in "event-driven litigation". Claims which normally were related principally to financial reports can now be driven by product problems, man-made disasters, environmental disasters, corruption, or cyber-attacks."

Prices rose (anecdotally) between 30% and 100% in different territories, and the pandemic brought a global hardening of insurance rates that drove D&O rates up further, along with most other classes of commercial insurance. The pandemic also put further stress on the category itself – see the section below for an exploration of this particular issue.

COVID has been linked to D&O price rises, but, as reported by BLM, "COVID has been an accelerant but not the main cause for the hardening market with rising premiums in the D&O space. The real reason for rising premiums was that there was a gradual appreciation that there was a greater D&O risk in the realms of corporate mismanagement and financial misrepresentation together with a widening exposure of new risks in particular like cyber but also environmental and gender pay/employment issues."



"COVID HAS BEEN AN ACCELERANT BUT NOT THE MAIN CAUSE FOR THE HARDENING MARKET WITH RISING PREMIUMS IN THE D&O SPACE."

THE IMPACT ON RENEWALS AND COVERAGE

The impacts of all this have been felt by some very large firms. In New Zealand, Duncan Cotterill report that "listed companies, and in particular dual-listed companies (shares quoted on both the NZX and ASX), have experienced increased difficulty and cost when renewing their D&O insurance."

Elsewhere, price rises were less significant, but the impact on wordings and what was included in the policy became an issue. Dr Quirin Verghe of ASD in Germany explains that in Germany "D&O insurance premiums have been rising at double-digit rates across the market in recent years, and significantly more in some market segments. However, due to the comparatively low premium level, this is less serious for customers than the simultaneous shortage of limits."

ASD has found that "coverage under German D&O contracts ... has been put to the test by the hardening of recent years."

A good example of how this can impact real-life scenarios comes from New Zealand, where Duncan Cotterill's Aaron Sherriff says: "D&O wordings often exclude claims arising out of insolvency, which can be a principal area of risk for which cover is sought. Cover for this particular risk therefore often requires additional premium as well as satisfactory supporting financial data when cover is being placed."

In Germany too, insolvency is a major cause of claims but may not always be covered. ASD advise that in future "policyholders should pay particular attention to risks associated with corporate insolvency."

The increased use of D&O also impacts courts. Giorgio Grasso of BTG in Italy reports that "Italian Courts are becoming more confident with D&O policies (and coverage rules), so is less hard to explain the correct application of coverage criteria (and renewals). The tendency is now to ask insurers to open settlement discussions during the litigation phase – even if there is not much space to confirm the coverage - so it is now absolutely critical to insurers to be assisted by specialized insurance litigators who have the skills to handle bankruptcy counsels."

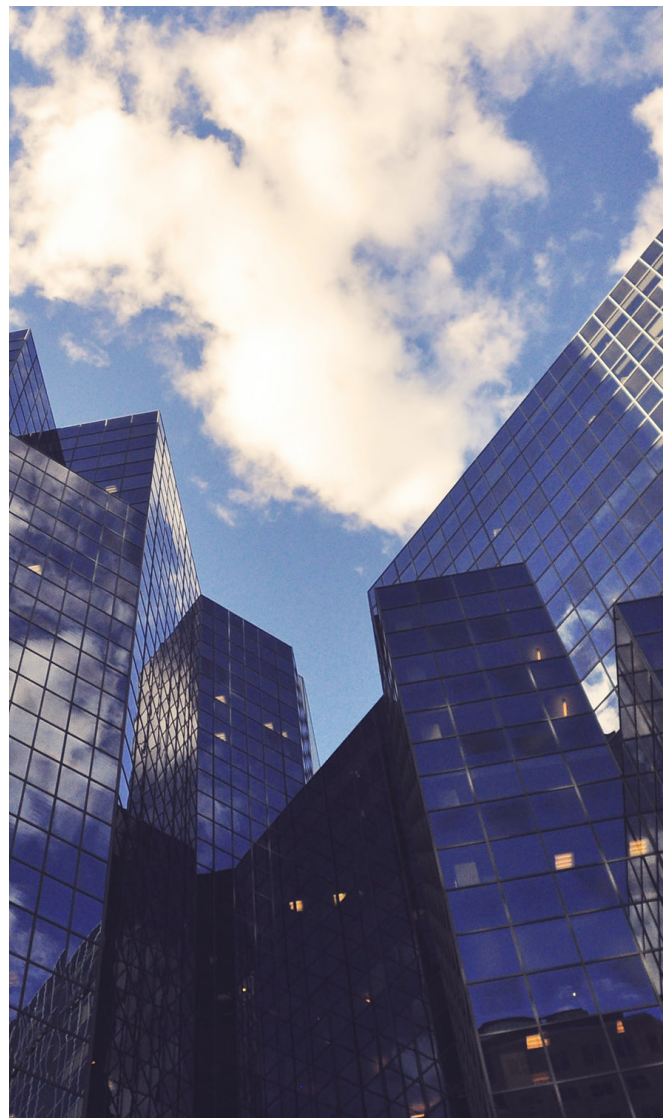
WHAT NEXT?

Many of our lawyers from around the world report that the ceiling in pricing has been reached. Corporates cannot, or will not, pay any more for D&O cover, and as a result, some interesting trends have begun to bubble along in this class. As Dino Liistro of Sparke Helmore in Australia comments: "The recent experience of underwriters is that whilst insureds had been prepared to increase their spend, the limit appears to have been reached. Over the last year, insureds began maintaining the same legal spend in the face of rising premiums by increasing excesses or reducing limits of cover and in some cases looking to other risk management solutions to bridge the gap."

One alternative is the trend towards self-insuring. First seen in the attention-grabbing shape of Elon Musk, who in 2019 was unable to insure his Tesla directors and officers, and who, as a result, personally funded his company's corporate D&O cover, self-insurance is a trend that is gaining traction in multiple countries.

In Denmark Jesper Ravn of Ark Law says that: "a number of publicly listed companies, including Danske Bank, Tryg and Novo Nordisk, have retreated from purchasing D&O insurance policies with full liability coverage. Instead, the companies self-insure D&O risks through a letter of indemnity in favour of the directors and officers."

Other options are also being examined. In Switzerland, Clemens von Zedwitz of GBF says "we have had conversations with large corporations who are interested in trying to set up captive insurance companies. They have seen the price trends and are trying to plan for alternatives."



SPECIFIC ISSUES FOR D&O

Alongside the generalised price stress discussed above, there are several specific (and major) issues that are impacting D&O risk. In this section, we consider each in turn.

ENVIRONMENTAL AND ESG ISSUES

One additional problematic trend that is almost universally reported is the impact of climate change on D&O insurance. Many countries are seeing increasing attempts to hold directors and officers liable through the courts for poor environmental practices. This is also pushing D&O rates. "There is a trend of growth in D&O liability for environmental damage, especially given international regulations and market trends opposed to greenwash." In the UK, BLM's Alex Traill reports that "there is a gathering momentum seen in ESG issues in the US, which is beginning to be felt in the UK."

This is also true elsewhere, including Italy, where, according to Giorgio Grasso of BTG "climate change is one of the issues rising to the top of boards' risk registers; and failure to disclose climate change risks may drive litigation in the coming years."

THE PANDEMIC AND D&O COVER

When preparing this report, GILC asked all its members about the impact of the pandemic on D&O insurance. The response was universal: all countries agreed that the pandemic has worsened the risks of claims on D&O policies, and as such, is also contributing to price increases. Sakate Khaitan of Khaitan Legal Associates explains: "Ever since the outbreak of the pandemic, organisations have faced numerous challenges. COVID-19 brought financial and operational hardships to organisations which they will take time to recover from. The potential risks due to the ongoing pandemic could affect the directors and officers of an organisation and this risk has been lingering over their head ever since the outbreak. The uncertainty with regulatory compliance due to multiple changes and amendments, mismanagement of disclosures by the company, operational adjustments leading to unanticipated risks are few of the D&O claims which may arise due to the pandemic."

THE COVID 19 CRISIS HAS SERVED TO SPOTLIGHT CIRCUMSTANCES THAT HAVE SURROUNDED THE MARKET FOR A LONG TIME. ONE OF THE BASIC FUNDAMENTALS WAS THAT D&O POLICY PORTFOLIOS WERE NOT PRICED CORRECTLY.

FERNANDO BLANCO, B&A, BLANCO Y ASOCIADOS ABOGADOS

In Brazil, Santos Bevilaqua records that "The economic impacts caused by pandemic created a huge sense of economic uncertainty, leading to an expansion on the search for coverage. As a result of it, coverages had their premia updated and many policies had their wordings changed, to adapt to new economic circumstances. Claims, in turn, continued an uptrend."

Covid will continue to be a factor in D&O pricing for some time to come. One of the principal issues is that it takes time for insolvencies to bottom out, and particularly given the fact that many governments have run schemes to support struggling businesses, some of which are only just winding down. Wij Advocaten in the Netherlands recognise this: "Businesses that were able to stay out of an insolvency scenario due to the government's financial support scheme during the pandemic, might not survive long-term without that financial support." Delayed insolvencies are a real risk, as are long-term claims arising from risk taking and mismanagement during a stressful fast-changing economic scene. In almost every territory, there is concern about this over the longer term.

CYBER

Cyber is another dominating issue for D&O insurers, and also for insureds. On the insured side, there is more and more demand for cyber cover – litigants are increasing seeing directors and officers as a legitimate target after data loss or cyber attacks. Sakate Khaitan of Khaitan Legal Associates in India states "Cybersecurity is a top D&O liability concern for organisations. The work-from-home culture has been a boon and bane for organisations. The virtual world brings with it vulnerability to the large scale threat of data breaches. The laws governing data privacy in India are at a nascent stage and thus cannot provide adequate safeguard to organisations. This makes organisations feel the need to synchronise cyber insurance and D&O insurance in India."

On the insurer side, however, the opposite tendency is working. As reported by Blanco y Asociados in Spain "Some time ago it was difficult to find in our market specific exclusions in D&O contracts that excluded the negligence committed by administrators or directors related to cyber risks. However, from 2019 to today, it has become increasingly common to find exclusions to differentiate the two types of coverages."

In France, Byrd & Associates has noticed that: "Directors and officers have been held accountable for the adverse impacts of their failures to put in place appropriate corporate policies to mitigate the risks of cyber security." There is an increasing trend worldwide for litigation relating to cyber breaches, and for these to target individuals within a company. No wonder insurers are beginning to set cyber aside from the 'core' D&O risks, although such an exclusion will rarely be popular with insureds.



REGULATORY PRESSURES

There has been a global increase in regulatory pressure for the last decade – a fall-out from the 2008 market crash - with the trend spreading from the UK and North America. This impacts numerous countries, as reported by our lawyers.

D&O claims arising from corruption and bribery as well as price fixing or harassment have also considerably increased in recent years, and this sort of behaviour naturally attracts regulatory attention. In France, “both regulatory and legal actions are driving claims. This increased severity reflects the aggressive enforcement recently adopted by both French and overseas regulators. French regulators are now actively communicating with regulators abroad and currently have a variety of tools to hold company directors accountable for their acts.”

Stakeholders, trade unions and non-profit organisations are also now more active in holding the insured accountable for their actions and omissions. Insured-against-insured claims are growing as companies show no hesitation to pursue previous directors for their actions.

In Australia, Sparke Helmore mentions that “investigation costs cover in relation to regulatory and occupational health and safety (OHS) investigations have also been prominent. Some of these investigations have resulted in claims. Claims against individual directors have increased following OHS investigations, whilst regulatory investigations have more commonly resulted in claims against entities.”

Robert Byrd also reports an additional Covid-related factor: “the Covid-19 pandemic gave rise to numerous new regulations that had to be applied in a brief time span. These new regulations generated added risk for directors and officers who were expected to apply these new rules quickly, correctly and efficiently.” This is true across many countries, and in some, such as France, directors and officers may be held criminally liable in the case where these rules and regulations were not applied correctly and contributed to the loss.

THE IMPACT OF THE GLOBAL SURGE IN M&A

The second half of 2020 saw the biggest growth in M&A on record. Demand, held back by the pandemic for six months, surged, and was further propelled by concerns around the US Presidential election and a wave of Covid-related takeovers, buyouts, recapitalisations and expansions.

The market saw some strong Covid winners – companies that had repositioned themselves smartly (or were simply perfectly designed for lockdown), saw huge sales, and new segments came into the spotlight, from video conference facilities to home deliveries of every type. There were, of course, some significant losers, with restaurants, cinemas, airlines and holiday companies all needing to be propped up by government, recapitalise or sell parts of their offering.

This set off a wave of buying and selling, in which COVID played a further role. Due diligence became harder to achieve without international travel. Meanwhile, some companies became more dependent on future contracts and some were tempted to overstep the mark. M&A insurers, such as Liberty GTS¹ report an increase in ‘founder fraud’, as well as increased levels of claims relating to customer or supplier contracts that turned out not to be quite as stated once the transaction was completed. In some cases, companies were simply unable to validate stock levels, and this sort of error has become magnified by on-screen only due diligence by buyers.

The result is already showing through in increased M&A insurance claims, but we predict that in years to come, some of these issues will play down into litigation against directors and officers involved in the transactions. The size of the issue is yet to be quantified but could be significant – and is reported globally as a concern for insurers and their advisers in many countries globally.

1. Source: Liberty GTS 2021 Claims Briefing

GROWTH MARKETS

The picture for D&O is further complicated by the fact that many markets are, or were, growing. In some markets, the current restrictions on capacity for D&O are causing a temporary pause on what were about to become rapidly growing markets. Khaitan Legal Associates recounts that pre-pandemic “The demand for liability insurance surged in India.”

In China, Buren explains that “D&O insurance has snowballed in China in recent years, though it remains a somewhat niche liability insurance product, with only a handful of foreign insurers and insurance brokers engaged in it. As recently as 2019, only 38 listed companies purchased D&O insurance. But two events last year, the new revised Chinese Security Law and the scandal of Luckin Coffee, were both beneficial for D&O insurance. 2020 saw a leap forward; in the first half of 2020, 57 listed companies publicly disclosed the purchase of D&O insurance, which is far more than the full year 2019 figure. The trajectory of growth looks set to continue.”

This growth is mirrored in Latin America, where demand for D&O insurance is strong, and capacity is desperately short because of the small number of insurers operating in the region.

There also remain European markets which have capacity for growth. Joachim Skjelsbæk of Riisa tells us that “the Norwegian market for D&O is still relatively new and has been growing steadily with increased publicity around D&O claims. Some high-profile cases with large claims have given many people an eye opener about the need for D&O insurance.” In the smaller European economies, D&O demand is trending upwards.

It is worth bearing in mind, however, that the appetite for D&O cover does have some significant local aspects. In Taiwan, for example, CT Chang at Lee & Li reports that “the overall number of D&O claim filings as well as the claims associated therewith remain rather low compared to other advanced markets, such as the United States and Singapore, as the local market remains unfamiliar with this insurance policy. Further, there have been certain reservations on D&O insurance in Taiwan due to the known high barriers to bring a lawsuit against directors and supervisors, which is proved to be time-consuming and inefficient. As a result, the market demand for D&O insurance is not strong, despite the enforcement of compulsory purchase under the amendments of 2019. We are of the view that in Taiwan’s market, there is still ample room for further development of D&O insurance.” Local regulations and judicial conditions are a significant factor in take-up on this class of insurance.

“D&O INSURANCE HAS SNOWBALLED IN CHINA IN RECENT YEARS. THOUGH IT REMAINS A SOMEWHAT NICHE LIABILITY INSURANCE PRODUCT. WITH ONLY A HANDFUL OF FOREIGN INSURERS AND INSURANCE BROKERS ENGAGED IN IT.”



BRIGHTER TIMES AHEAD?

There is certainly no short-term fix on the horizon for D&O insurance, and currently the market remains dysfunctional. Wij Advocaten in the Netherlands see the toll this is taking on insurers and brokers: "It appears that these developments have put pressure on the relationships between insurers, brokers and Dutch businesses. The market seems to be gearing up for another tough renewal season at the end of 2021."

However, if we look further ahead, there are a few bright sparks beginning to appear on the far horizon. In Brazil, Santos Bevilaqua says that "in the next two years, we expect to see a stabilization of the rise of claims, due to a better economic situation, and a better adaptation of D&O cover to the new risks. In addition, we expect a better market response, with more coverages offered and new players entering this business." If this prediction is correct, some easing of prices should follow.

In Spain, Blancos y Asociados Abogados also expects that the shortages are likely to bring new entrants into the market, alongside creative adaptations to the product. Fernanda Blanco Gamella says that "All the issues will lead to a gradual adaptation of the market with a transformation of price, the coverage on offer and bringing new proposals and new products."

BLM in the UK remains convinced that there is still space for growth in parts of this market. They point out that "awareness of D&O as a product is perhaps heightened amongst publicly-listed and large privately-owned companies, as they tend to possess sophisticated in-house financial, legal and compliance functions. However, in contrast, amongst SMEs, there are still a significant minority who consider that D&O liability insurance does not apply to them at all on the basis that their board's exposure emanates from shareholders alone and is, therefore, negligible." Here is a group of companies who may now begin to see more reason to purchase D&O cover.

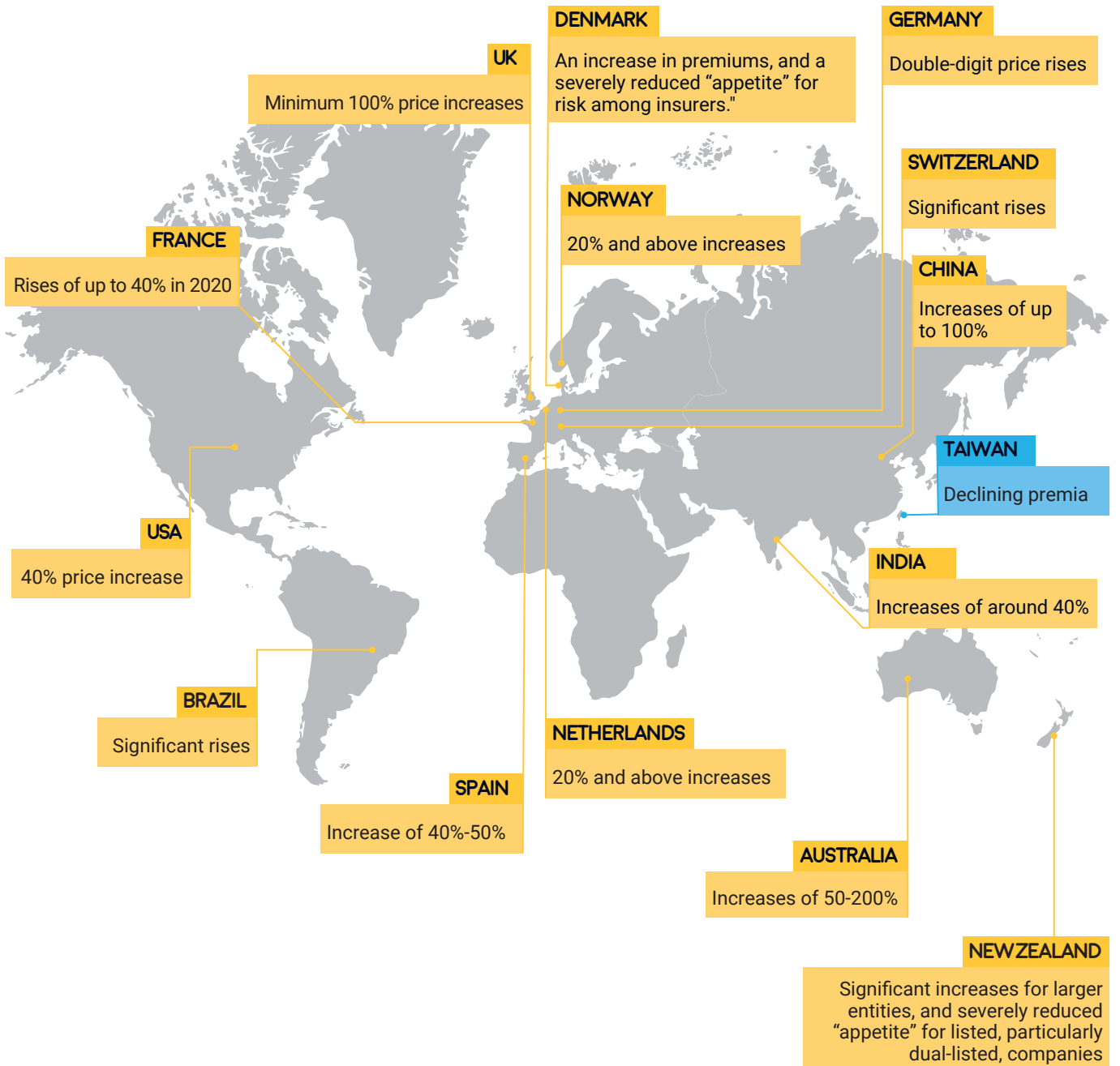
New entrants are also shaking up the market to the benefit of buyers. BLM's Alex Trill reports that in the UK "there are early, tentative signs that market conditions may be beginning to soften gradually, as a number of insurers unburdened by historic claims losses have spotted an opportunity to enter the D&O marketplace, drawn to the level of premiums that they can currently command."

If this is true and new capacity does come onstream, it may be that prices stabilise and correct in the coming eighteen months. However, without any prospect of major issues, such as environmental and cyber concerns, going away, it still seems likely that many corporates will need to consider reducing the breadth of their cover, insuring cyber risk separately, or even undertaking an element of self-insuring to get the protection that their directors and officers need.



"IN THE NEXT TWO YEARS, WE EXPECT TO SEE A STABILIZATION OF THE RISE OF CLAIMS, DUE TO A BETTER ECONOMIC SITUATION, AND A BETTER ADAPTATION OF D&O COVER TO THE NEW RISKS."

D&O PRICING TRENDS



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