CRC Group
Wholesale & Specialty

Pandemic Accelerating D&O Market Changes

As a coverage line, directors and officers liability was already hardening before the coronavirus pandemic emerged in 2020. COVID-19 has accelerated tightening in the D&O marketplace, which has become much more challenging for both public companies as well as private organizations.

Rates for D&O coverage have shot up, while capacity for certain classes has dropped. Underwriters are demanding more details about organizations' financial health, while insisting on higher retentions as well as imposing exclusions. It's a difficult environment for retailers and their insureds.

Underwriters at the moment are overwhelmed with submissions. Everybody is marketing their D&O coverage because few believe how hard the marketplace has become.

This CRC Group State of the Market report explores what's changing in those segments and offers retailers insights on how to navigate the current conditions.

PRIVATE COMPANY D&O

D&O liability insurance for private companies is by nature broader than that for public companies, because private D&O policies generally include entity coverage as well as employment practices liability insurance (EPLI). As the coronavirus spread in 2020, some markets ceased writing new business because of the heightened EPL exposure as businesses faced furloughs and layoffs. On renewing accounts, D&O underwriters sought to more than double retentions in addition to imposing rate increases of 10% to 20% or more.

By the late summer and early fall, insurance markets began reconsidering new accounts, but underwriters issued new requirements. Insurers are taking a much stronger stance on companies' financial strength. For example, underwriters want information on organizations' relationships with debt holders and how COVID-19 is affecting their businesses. Heavily leveraged organizations will be asked to provide a lot more information. Supplemental applications about COVID-19 are increasingly common.

The key question for D&O underwriters right now is the financial condition of the company, its ability to survive the pandemic, and its emergency plans, such as whether employees can work from home. Complete information on quarterly and year-end financials is required for all submissions, and underwriters typically are asking accounts to demonstrate 12 to 18 months of liquidity. Absent these details, underwriters are likely to decline outright to quote an account.

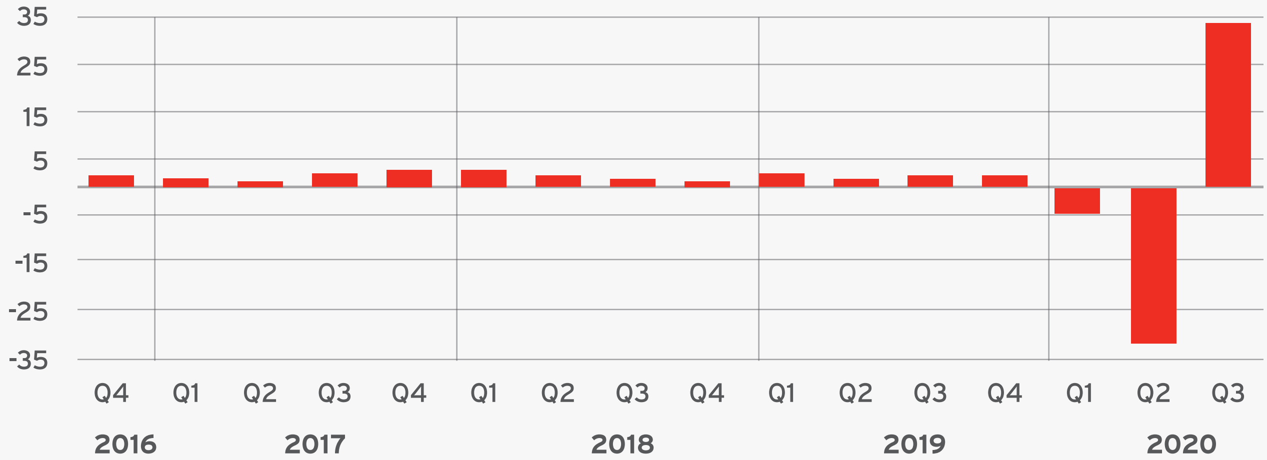
Managing expectations is needed in every part of the submission process. Retailers can start with the expectation that rates for private company D&O will increase by 10% to 25% at renewal, and retentions might double. They also should prepare clients for changes in terms and conditions. Common exclusions in private D&O policies include:

Bankruptcy. The pandemic has caused enormous financial stress to organizations in many industries, drying up liquid assets and pushing more than 600 into bankruptcy.[1] Because bankruptcy is a frequent trigger for litigation, and D&O insurers are even more cautious about their loss exposures, bankruptcy is a nearly universal exclusion.

Creditors. Next to bankruptcy, claims from creditors are a big source of loss, so insurers are excluding coverage for these.

Infectious diseases. COVID-19 is the predominant worry, but underwriters aren't taking chances on other sorts of infections that might arise and trigger litigation, so these exclusions have become common in private D&O.

Real GDP: Percent Change from Preceding Quarter



U.S Bureau of Economic Analysis

Seasonally adjusted at annual rates

After stable growth in real gross domestic product (GDP) in the prior 13 quarters, the U.S. economy faltered in 2020 as the global pandemic spread. A recovery in third-quarter 2020 came largely due to easing restrictions and personal consumption, according to the U.S. Bureau of Economic Analysis.[2]

There are some new entrants in the marketplace, but they are deploying limited new capacity sparingly – mostly in excess layers. Retailers should understand that this new capacity might not be enough to move the needle on rates, terms and conditions.

In general, underwriters of private company D&O are writing to the risks each submission presents, or they are not touching accounts with losses. Classes of business that insurers are avoiding include those with nuanced risk profiles, such as cannabis-related accounts and cryptocurrency. Underwriters also are conservative in how they approach healthcare accounts and real estate-related businesses.

Loss drivers in private/non-profit accounts tend to be one-off issues and event-driven litigation, such as EPL lawsuits arising from the #MeToo movement, cyber events, environmental incidents, and the impact of COVID-19.

NONPROFIT D&O

Unlike the marketplace for private companies, nonprofit organizations are having a somewhat easier time obtaining D&O coverage. Insurers are still competing to write nonprofit accounts, though some markets are adding exclusions and raising self-insured retentions.

RECOMMENDATIONS FOR RETAILERS

Here are some do's and don'ts for retailers seeking private/non-profit D&O coverage for their insureds:

Don't be in a rush. The current marketplace is struggling to keep up with the volume of submissions, so it takes more time to complete renewals. Starting two months in advance is advised.

Don't sacrifice coverage for price. In the search for a lower price, it might be tempting to accept scaled-down coverage. That could be a mistake in the long run, however.

Don't skimp on details. Underwriters cannot issue terms on incomplete submissions or those lacking sufficient details. Transparency is especially important in this marketplace, during every phase of the renewal process.

Do be flexible. Brokers need to be prepared to seek alternatives, and part of that is staying open to other ways of achieving coverage goals.

Do talk to insureds. Find out what the insureds are worried about. If pricing is an issue for the insured, advise the client to take a higher retention or accept an exclusion.

Do share positives about insureds. To feel confident about writing coverage, underwriters need to hear, "We're not going to be a shock loss for your company." To instill confidence, retailers need to be ready and able to emphasize the positive elements of an insured's risk profile, from how well it operates, to its balance sheet strength, to the resumes of its board members.

PUBLIC COMPANY D&O

The marketplace for public company D&O is similarly challenging in the COVID-19 era. Public companies face a different set of market dynamics from private firms, as their financials are closely watched by investors, creditors and customers – all of whom are potential plaintiffs.

Loss drivers for public companies continue to include securities claims, bankruptcy, cyber events, issues around mergers and acquisitions, and now the impact of COVID-19. D&O underwriters have become stricter about reviewing audited financials, and virtually every market is asking accounts to complete a pandemic questionnaire.

One of the biggest changes in the current marketplace is reduced capacity for public company D&O risks, making it much more difficult to build coverage towers than in prior years. Insurers are no longer offering $10 million limits; more markets are offering $5 million layers or even $2.5 million.

Consider an Extended Reporting Period (ERP)

Difficult times require hard choices, and one potential option for insureds with hard-to-place D&O risks is an Extended Reporting Period (ERP). An ERP provides an extra one, two or more years to file claims under an expiring policy. Typically, an ERP is utilized to preserve broader coverage under the old policy, while the insured buys a new policy without prior-acts coverage to respond to future claims. This is usually an expensive option, as ERPs may cost 75% or more of the expiring premium without providing additional limits. It also carries risks that may not be suitable for all insureds. Retailers should discuss the ERP option, as well as its pros and cons, with a knowledgeable wholesale specialist.

Additional Resources

Extended Reporting Option Carries Risks

Pandemic Roiling D&O Market

Taking Another Look at Your
EPLI Coverage Needs

At the same time, self-insured retentions are $1 million at a minimum and can be far greater for large public companies. On top of reduced capacity and higher retentions, premiums for public company D&O are up 30% to 40% from last year.

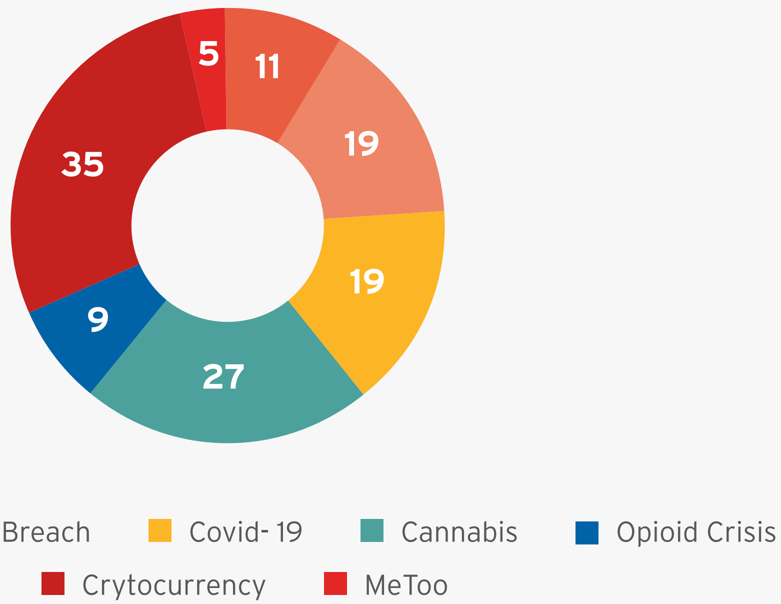
A lot of insurers are pulling back on coverage for claims alleging antitrust, insisting on higher retentions or sublimiting coverage. Other markets are imposing antitrust exclusions, while some policies have broadened these exclusions to apply to lawsuits alleging any anticompetitive behavior, not just violation of federal antitrust laws.

One of the trends in public company D&O claims is lawsuits against special-purpose acquisition companies, or SPACs. These non-operating entities, also known as "blank check" companies, raise capital before pursuing mergers or acquisitions of operating firms. During 2020, the number of SPAC offerings skyrocketed as they became an alternative to initial public offerings.

Securities class-action litigation remains a risk for public companies and their D&O insurers. According to the Securities Class Action Clearinghouse, maintained by Stanford Law School and Cornerstone Research, in 2020 there were 324 federal filings – down from 2019 but still the fifth-highest year since the SCAC began tracking the data in 1996.[3]

As of January 2021, the current topics accounting for the greatest number of securities class-action filings, according to the SCAC, were: cryptocurrency, cannabis, data breach, COVID-19, and SPACs.[4]

Number of Securities Class-Action Filings by Topic[3]



BOTTOM LINE

Insureds, especially if they are new purchasers of D&O coverage, might have sticker shock in the current marketplace. For the foreseeable future, rates for both private and public company D&O are up sharply, with underwriters imposing tighter terms and conditions, and usually requiring higher self-insured retentions. To a degree, the hardening is a market correction. After years of fierce competition among insurers led to underpricing the risk, and a steep increase in claims frequency and severity, D&O became unsustainable. While rate increases may temper in 2021, they are unlikely to return to pre-2019 levels.

Retailers therefore should seek help from a wholesale specialist with experience in the nuances of D&O coverage and strong market relationships. Involving a wholesale partner earlier in the renewal process is strongly advised, even when a retailer has strong relationships with standard markets. Excess and surplus lines markets continue to offer meaningful options in D&O coverage. By working with a CRC Group producer, clients can benefit from market leverage and expertise based on over $1.8 billion in management and professional liability premium and clients' submissions will receive greater attention in the marketplace. In addition, CRC is able to offer data driven insights that enhance the services retail brokers deliver in the placement process. Contact your CRC Group producer for more information.

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ENDNOTES

1. "US bankruptcies surpass 600 in 2020 as coronavirus-era filings keep climbing," S&P Global Market Intelligence, December 13, 2020; https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-bankruptcies-surpass-600-in-2020-as-coronavirus-era-filings-keep-climbing-61734090

2. "Real GDP: Percent change from preceding quarter, 2016-2020," U.S. Bureau of Economic Analysis; https://www.bea.gov/index.php/news/2020/gross-domestic-product-third-estimate-corporate-profits-revised-and-gdp-industry-third

3. "Federal Securities Class Action Litigation 1996 – YTD," Securities Class Action Clearinghouse; http://securities.stanford.edu/charts.html

4. "Current Topics in Securities Class Action Filings," Securities Class Action Clearinghouse; http://securities.stanford.edu/current-topics.html