Global FINEX - Directors & Officers (D&O)

GB D&O Market Update

May 2020

Current FINEX D&O London Market Conditions Q1 2020

Capacity

Reducing

- Significant reduction in appetite demonstrated by insurers reducing their 'per risk' capacity by up to 50%
- The London market in particular is exposed to global claims trends and is responding on a differentiated basis to various geographies and listing exposures. We are seeing:
  - **UK:** capacity reductions of 25% to 50%
  - **US securities exposure:** capacity reductions of 33% to 50%
  - **Australia:** extremely challenging
  - **Israel:** extremely challenging
  - **LATAM:** capacity reductions of 30% to 50%
- Mergers & Acquisitions between insurers has reduced the number of insurers in the D&O market while several other insurers are either in run-off or have withdrawn from writing D&O. Little sign of new capacity coming into the market to fill gaps.

Coverage

More Restrictive Conditions

- Insurers are narrowing the terms on which they are prepared to write and/or imposing new exclusions.
- Insurers more likely to offer terms on their own policy forms: growing reluctance to use other insurer forms or broker forms
- Pressure on sub-limits and bolt-on coverages
- The spate of recent corporate insolvencies, particularly from high street retailers, combined with the effects of the restrictions imposed as a reaction to the COVID-19 pandemic, insurers are increasingly seeking to exclude coverage in connection with insolvency.
  - Risk-specific retentions being imposed – e.g.
  - Bribery & Corruption
  - COVID-19
- Increased contractual subjectivities and inflexibility around timeframes for complying with these
- Significant COVID-19 related disclosures are being sought.

Claims and Losses

Significant

- Increasingly regulated global environment creating greater exposures and potential for regulatory and follow-on civil claims
- UK claims environment significantly increasing in terms of frequency & severity, driven by:
  - Insolvencies
  - Financial accounting issues
  - Regulatory investigations
  - Event driven litigation
- **2017:** third worst year since 2001 for US securities class actions (413)
- **2018:** second worst year since 2001 for US securities class actions (420)
- **2019:** worst year since 2001, with 428 filings for US securities class actions
- Australian market decimated by Side C Entity claims
- Combined ratios of insurers frequently significantly above 100%, and negative development of prior year matters

Premiums & Retentions

Increasing

- US listed companies seeing increases of 200% to 300% and can be significantly higher in extreme cases
- Average increase in the region of 50% for non-US traded insureds, subject to no claims
- Increasing trend to price in additional coverage: need to consider overall benefit cost/ risk
- **Side B & C retentions:** seeing significant upwards pressure
- **USA Side C retentions:** we are seeing insurers targeting minimum $2.5m ; however may be as high as $5m or $10m depending upon market cap
- **Sectors particularly affected by the hard market:**
  - Retail
  - Manufacturing
  - Real estate
  - Travel/Leisure/Hospitality
  - Oil & Gas
  - Healthcare
  - Mining

A Hard Market

- Since 2015, the number of claims against large international companies has increased significantly and this is not limited to US domiciled companies.
- Significant increase in investigation and defence costs and rising frequency and severity of settlements.
- Until relatively recently the Global D&O Price indexing has shown consistent prolonged decline with compound rate reduction.
- Increasing gap between claims and premium continues to widen even with price corrections over the last 18 months.
- A long period of suppressed premiums combined with increasing losses had led to London D&O insurers reducing capacity, increasing premiums and imposing stricter terms.
- The London market has been imposing even harsher renewal terms on some specific sectors including: Oil & Gas, Mining and Tobacco due to claims trends.

Claims and losses are increasing

A substantial proportion of the claims notified to the most recent years of D&O insurance will not be resolved for several years to come. Nonetheless, the market has taken the clear view that the picture is not a rosy one.

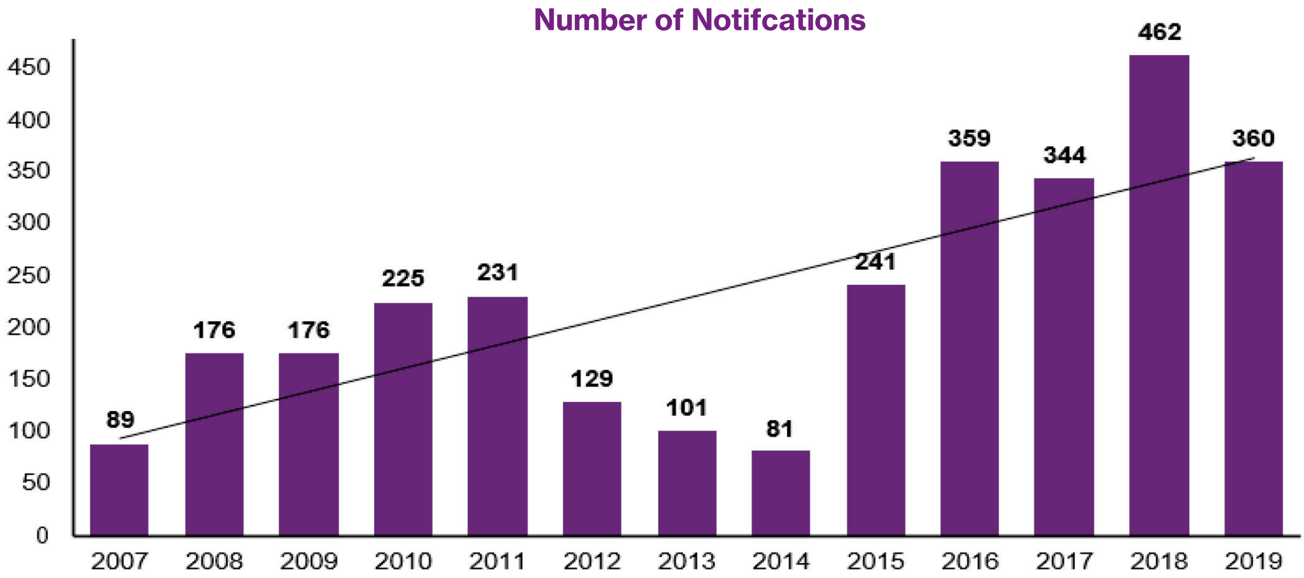


Figure 1

Source: Data based on D&O claims reported for insurance policies in the UK for clients of Willis Towers Watson.

The number of notifications over the last four years is approximately double the number of notifications between 2007-2010.

Leading loss driver – US Federal Securities Class Actions

As can be seen from the charts below, US securities class actions have more than doubled between 2012 to 2019.

Filings

(as of April 1, 2020)

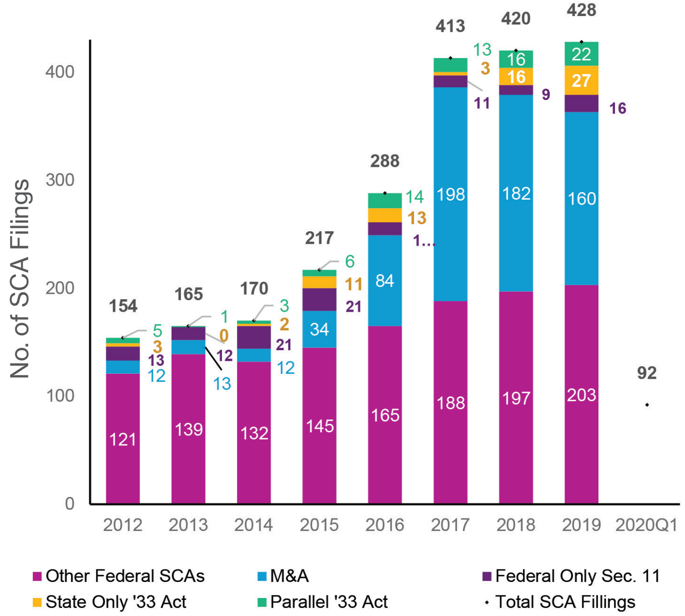


Figure 2

Notes: "Filings" is based on The Stanford Law School /Cornerstone's Securities Class Action Clearinghouse website information for the period ending March 31, 2020 as reported on April 17, 2020. http://securities.stanford.edu/list-mode.html?filter=2020

Settlements

(dollars in millions)

	1996-2018	2018	2019
Settlements	1,775	78	74
Total Amt.	$103,955.6	$5,154.8	$2,029.9
Minimum	$0.2	$0.4	$0.5
Median	$8.8	$11.5	$11.5
Average	$58.8	$66.1	$27.4
Maximum	$9,172.1	$3,054.4	$389.6

	No.	Median Settlement	Damages	Settlement as % of Damages
Sections. 11, 12(a)(2)	1,775	$7.2	$118.8	7.4%
Rule 10b-5 + Sections 11 & 12(a)(2)	115	$15.1	$390.0	5.8%
10b-5 Only	524	$8.5	$212.5	4.6%

Notes: "Settlements" is based on Cornerstone Research's Securities Class Action Settlements, 2019 Review and Analysis (the "Report"). "Damages" for Section 11 and/or Section 12(a)(2) claims reflects Cornerstone's "Median 'Simplified Statutory Damages'" and for all claims based in whole or in part on Rule 10b-5, Cornerstone's "Median 'Simplified Tiered Damages.'" (See the Report's Figure 6 for details). http://securities.stanford.edu/research-reports/1996-2019/Securities-Class-Action-Settlements-2019-Review-and-Analysis.pdf

Claims Environment: London Market Loss Events

(WTW client portfolio data)

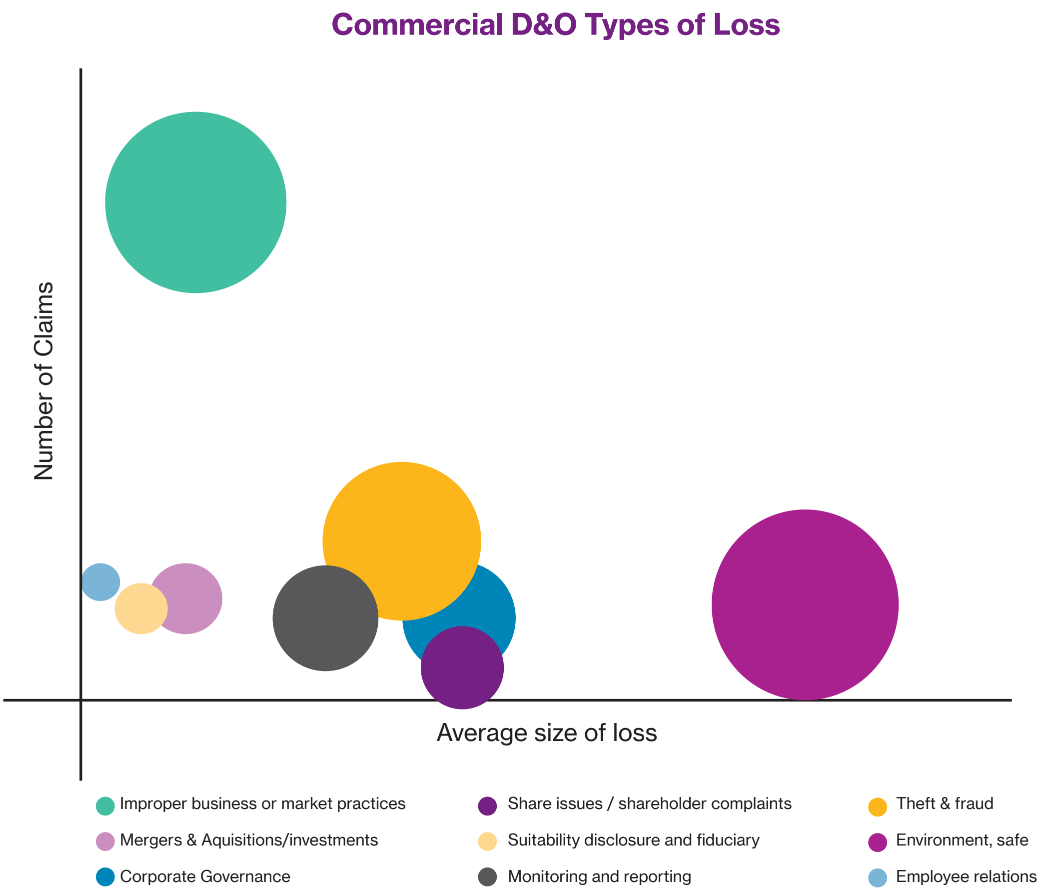


Figure 3

Source: Willis Towers Watson Claims Analysis Report – Commercial D&O, 2019

Claims Environment: London Market Action Types

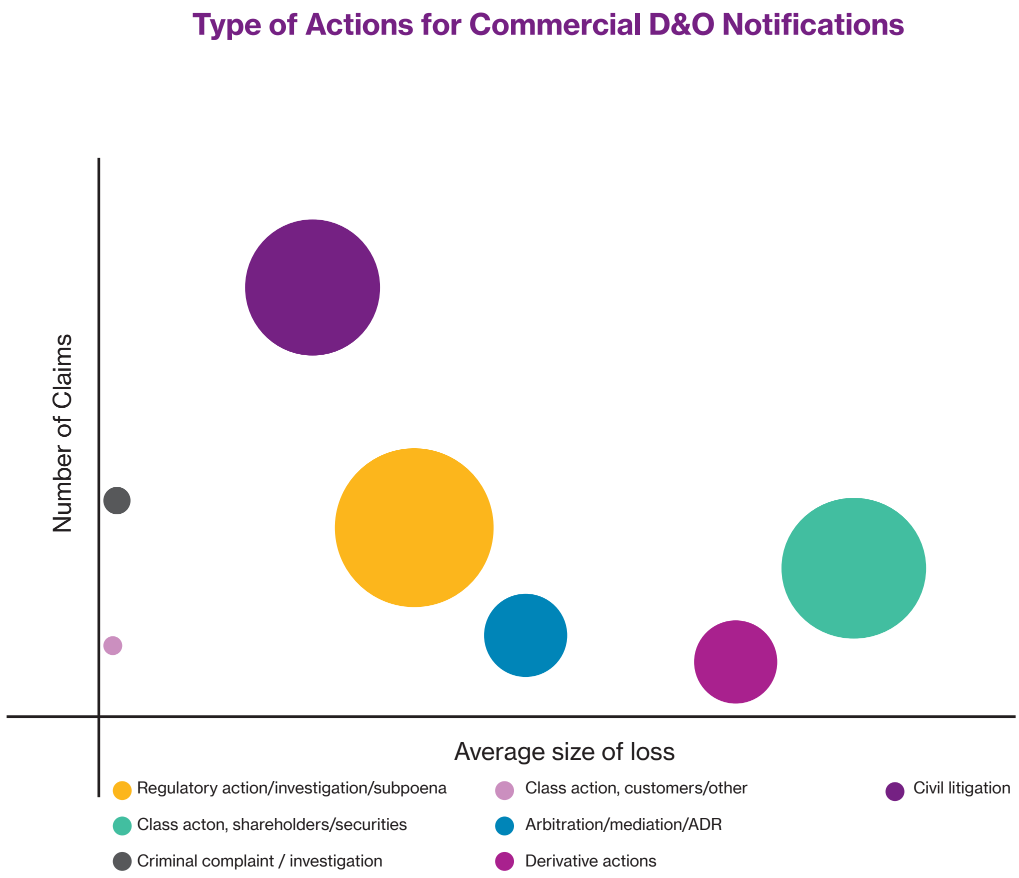


Figure 4
Source: Willis Towers Watson Claims Analysis Report – Commercial D&O, 2019

Unstable Combined Ratios

Many insurers are making a net loss despite recent premium increases

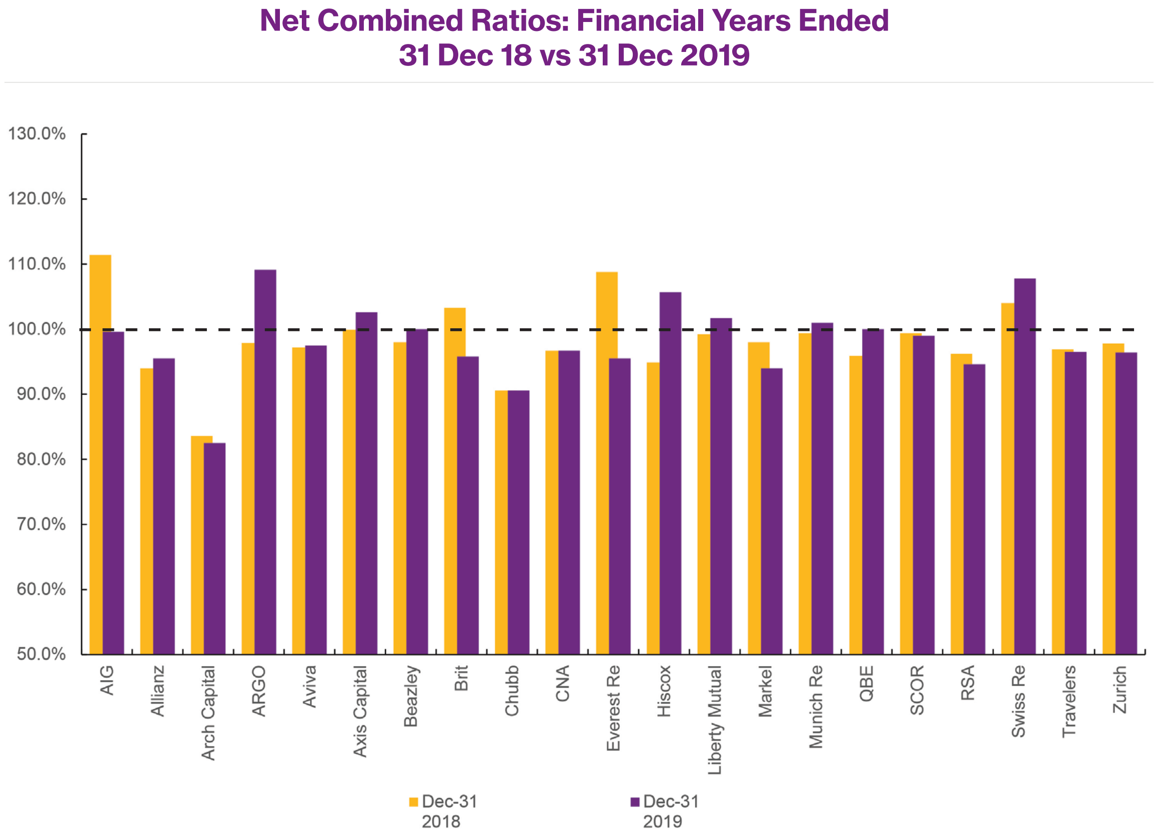


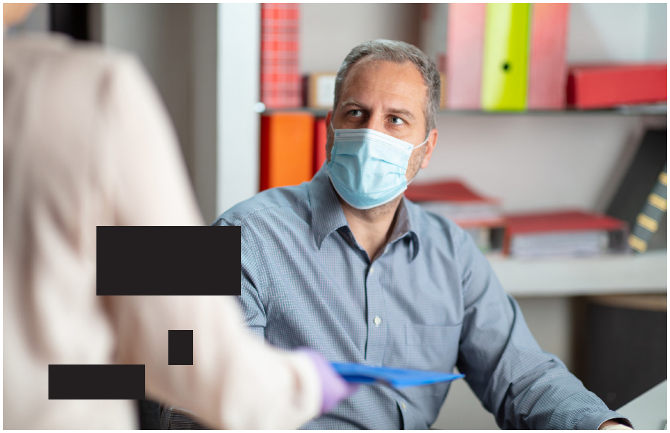
Figure 5

Source: The information compiled in this chart by Willis Towers Watson is compiled from third party sources we consider to be reliable. However, we do not guarantee and are not responsible for its accuracy or completeness and no warranty or representation of accuracy or completeness is given.

N.B. AVIVA 2019 combined ratio restated to include amortisation and impairment of internally generated intangible assets. Munich Re & Swiss Re combined ratios are for P&C reinsurance only.

COVID-19 Impact on D&O

- Organizations around the world have been dealing with a myriad of COVID-19-related issues and resulting financial and operational hardships. Risks associated with directors and officers (D&O) liability are among the many risks that are top of mind. In the context of this pandemic, the risks may include:
  - The adequacy and accuracy of disclosures in a financial/business environment with so much in flux, including many businesses trying to cope with shutdowns and other unprecedented pressures.
  - Fiduciary and other duties owed. Changes are occurring quickly and there is no real precedent for many of today's tough decisions.
  - Complications and challenges in balancing the needs and priorities of today's diverse and complex interests among key stakeholders.
  - Regulatory and compliance uncertainty in facing unparalleled events and responses by authorities.
  - Workforce and operational adjustments bring new, potentially unanticipated risks.
  - Legal, financial and other external advisors may be overtaxed or unavailable as many others are wrestling with COVID-19 related issues.
  - Reputation risk arising from perceptions, well-founded or not, of how management has responded to the pandemic.
- The London D&O insurance market was already experiencing considerable upheaval and the COVID-19 pandemic has made the market even more challenging.
- The fear of a systemic impact across D&O portfolio's appears to be driving steep increases in rate and reduction or in some cases removal of capacity.
- Insurers are reacting to this in a number of ways, which varies from insurer to insurer. At the least, in advance of renewal, especially those in the nearer term, insureds should expect heightened underwriter focus on COVID-19 impact, plans and disclosures.
- So far, top D&O underwriting areas of focus are liquidity and industry. Inquiries may be tailored to company-specific concerns or they be limited to a consistent COVID-19 questionnaire that asks the same questions of all insureds.
- Inquiries may also drill down on COVID-19-related risk disclosures, the impact on financial results, operations, product/services shortages, industry-wide concerns, liquidity/solvency, and cyber security. For some companies, insurers may attempt to modify terms that were, several weeks back, formally or informally quoted or conveyed.



Conclusions

- Directors and officers are the subject of increasing exposure; from the **'#MeToo'** movement to climate change to increased regulatory scrutiny, there is no doubt that D&O insurance is increasingly important.
- Over the last 12-18 months, insurers have been reducing the size of lines they will write, increasing premiums, tightening terms and, in some cases, withdrawing from this market entirely.
- COVID-19 has only made this position worse.
- With few new entrants into the D&O insurance market to take up the capacity of those who have pulled out, it can be difficult to find a replacement for an insurer who, somewhere on a large programme, is seeking to impose unpalatable terms.
- A lot more time may be required to place a risk than has been needed in previous years and clients are likely to face additional disclosure requirements.

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