

CASUALTY · LOSS · RESERVE · SEMINAR

# CLRS

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# Meet the Speakers

## Peter Brinck, FCAS

Director, ICT, Willis Towers  
Watson

Peter works on a broad range  
of actuarial projects,  
specializing on D&O reserving.

Peter has over 15 years of  
actuarial experience covering  
lines of business in the US and  
the UK. Peter has had prior  
roles at Alterra at Lloyds and  
Equitas (now known as  
Resolute Management).

Peter holds a BSc (Hons)  
degree in Mathematics from  
Nottingham University in the  
UK.

## Rick Ramotar, FCAS

VP, Actuarial, QBE

Rick is a reinsurance actuary  
with expertise in Professional  
Lines insurance pricing.

Rick has more than 20 years  
of actuarial experience  
dealing with a variety of lines  
of businesses, having had  
prior roles at Swiss Re, Hiscox,  
the PMI Group, Aon, Trans Re,  
and Farmers.

Rick holds a BS in Statistics  
from UC Santa Barbara.

# Agenda

- D&O products & coverages
- Pre-2019: falling rates + declining results
- 2019: RATES!!!
- Trend in Security Class Actions (SCAs)
- 2020: COVID - year of uncertainty
- SPACS + de-SPACs
- 2021 & beyond

# Question #1

On a scale of 1-5, what is your experience level with D&O?

1 – none

2

3

4

5 – very experienced

# Question #2

What are your thoughts on D&O?

1. Great Opportunity – full speed ahead
2. Cautiously Optimistic
3. Wait and See
4. Still too risky

# Directors & Officers Liability – Coverages

- Not just one type of product
- Public D&O
  - Financial Institutions (FI) D&O
  - Non-FI D&O aka Commercial D&O
  - Side A
    - Covers D&O's for non-indemnifiable claims ie Bankruptcy or Derivative claims
- Private/Not-for-Profit D&O
- Ancillary covers: EPLI, Fiduciary, Crime

Over time these segments tend to move directionally in similar ways but magnitude and timing can differ

# Historical Rate Change (Pre-2019)

- Since the Financial Crisis ('07-'09), rates have generally been falling
- FI D&O rates fell but annual decrease tended to be single digits
- Non-FI D&O - Double digit decreases
- Rates challenges varied between excess and primary layers
- Side A rates have fallen but product has remained profitable due to healthy stock market and lack of bankruptcies
  - but uptick in large derivative claims
- Private/PNP – mixed bag but generally down

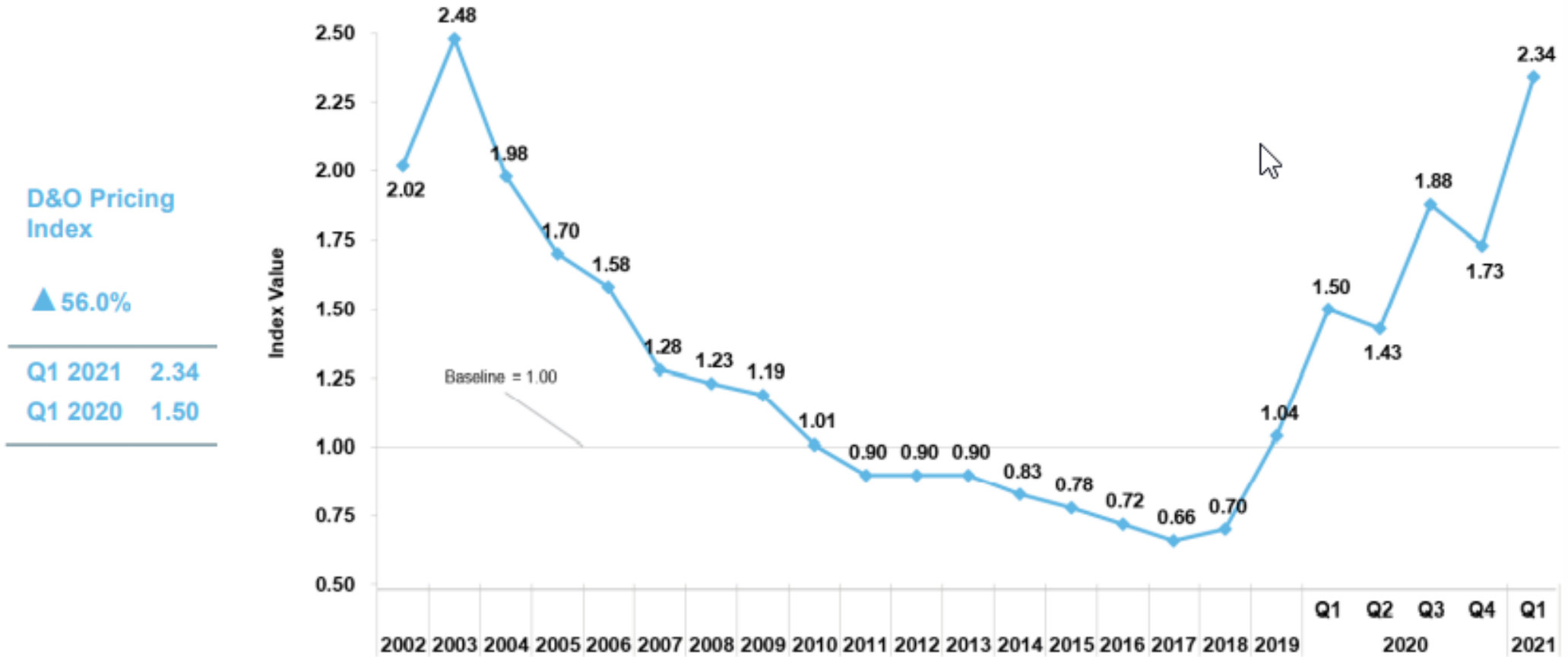


# 2019 and post – Is it all about the rates?

- 2019 Actual Rate Movements
  - Non-FI: 20-30%
    - Much higher for Excess Layers vs Primary Layers
  - FI: 5-15%
    - FI Rates > Non-FI Rates
    - Historical decreases not as great
  - Side A: 5-10%
  - Private/PNP: 2.5%-10%
- Rates during 2019 and 2020 generally trended upward during each year
- 2020 rate movements are ahead of 2019 rate movements, both showing strong positive movement especially on Non-FI public business

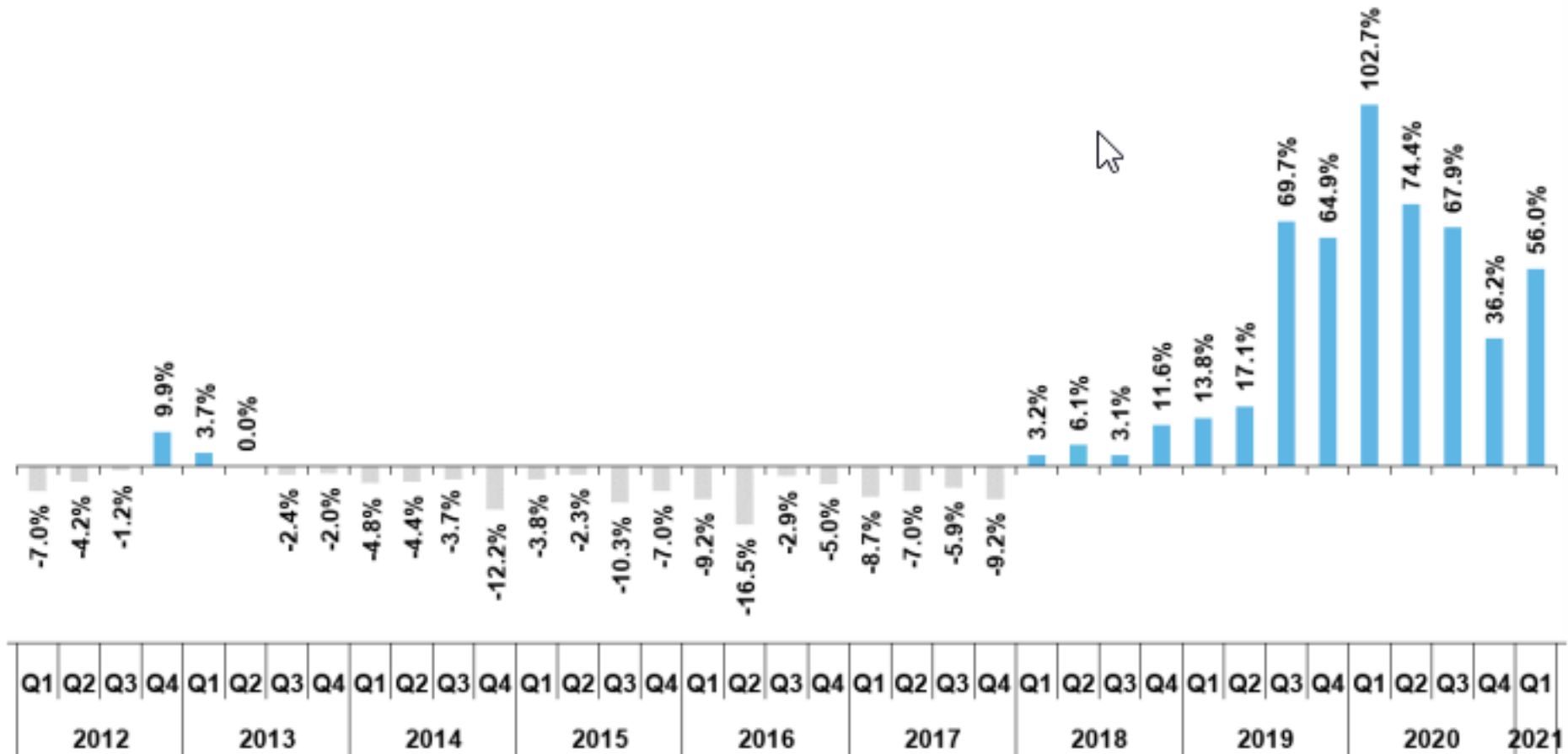
# QUARTERLY INDEX OF D&O PRICING

2002 through Q1-2021 | Base Year: 2001 = 1.00



# QUARTERLY “YEAR-OVER-YEAR” PRICE CHANGES

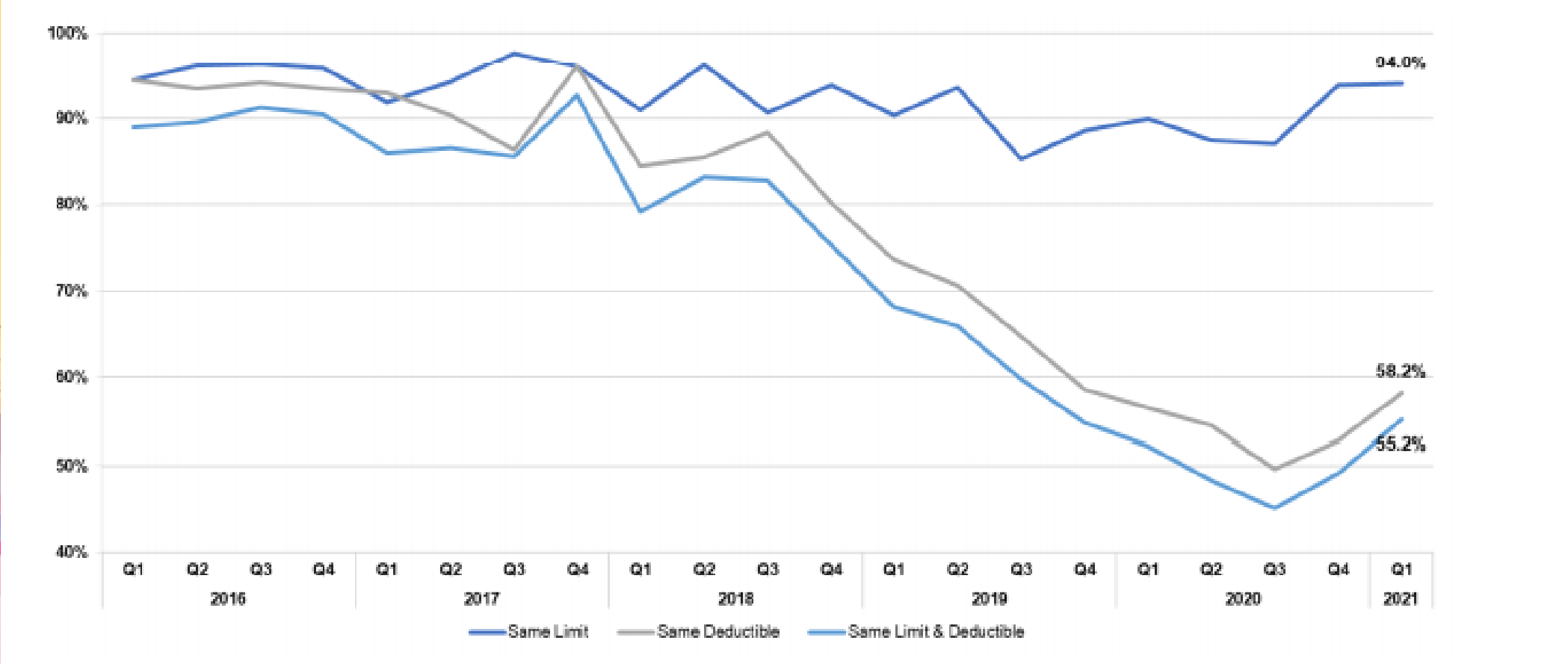
Q1-2012 through Q1-2021



# Nope, it's not just Rates

- Increasing Deductibles
- Limit retraction
  - Large towers are placed in D&O
  - Insurers pulled back from offering layers of 15m and above on excess layers
    - Typical excess Layers max Limits offered in 2019 in 5-10m range, now 5m is norm
- Concerns about Profitability
- Concerns about trend and emerging risk
  - Increase in Security Class Actions
  - D&O is claims-made business with expenses within the limit so can react to concerns before seeing emerging losses

# Deductibles on Primary Policies are changing



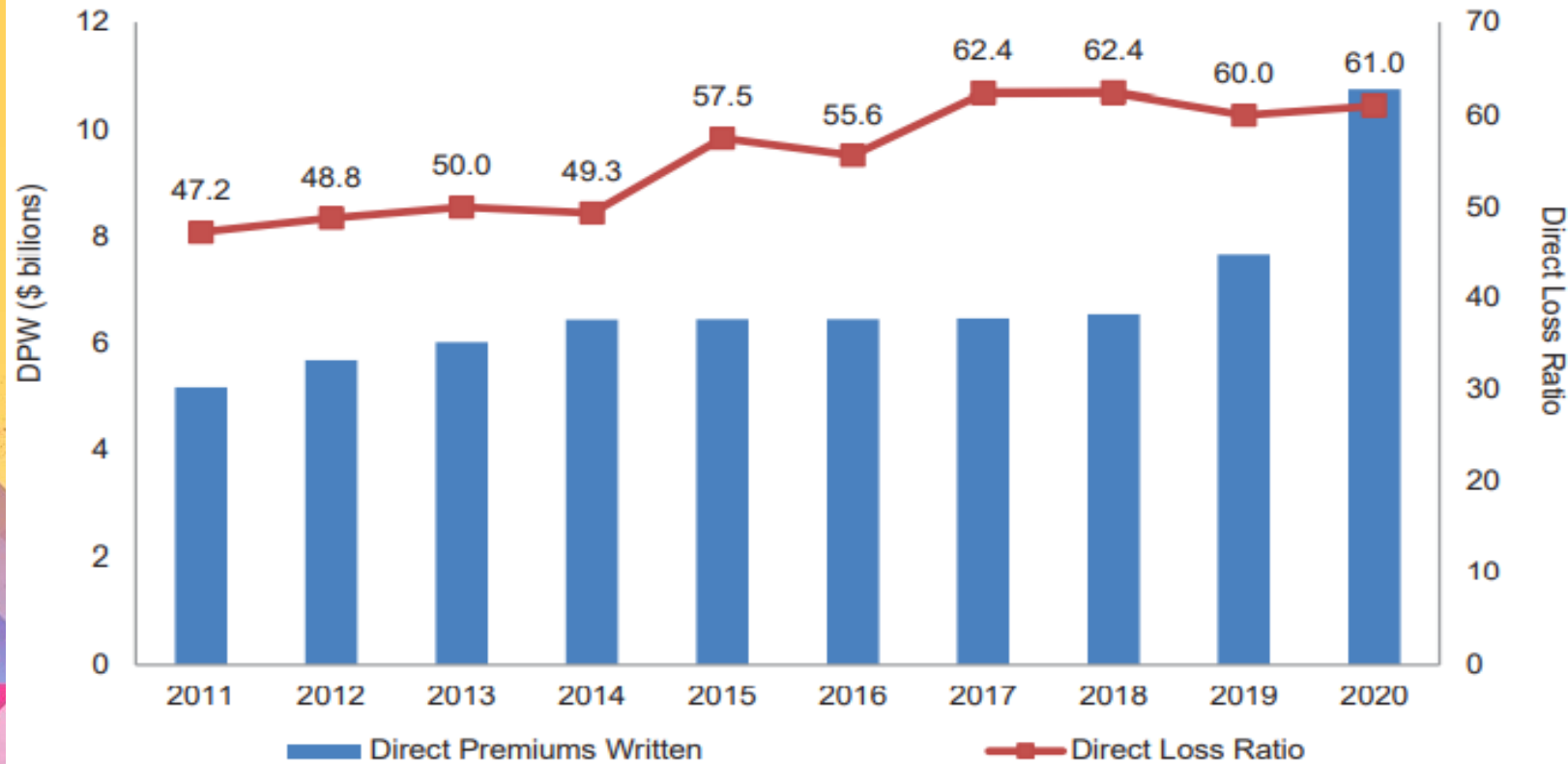
Aon Quarterly Index of D&O Pricing, First Quarter 2021

# Limit Retraction

- D&O has large towers with many insurers taking different tranches throughout the tower
  - Some of these tranches can be 20m or even 50m
- As insurers pulled back on the limit they were putting out, layers had to be broken in smaller tranches and  $1 + 1 \neq 2$ 
  - In other words, the cost of a 20m layer tranche broken into four 5m limit pieces is being priced much greater than the original single layer
  - In other to place towers with layers cut into smaller piece, ILF curves flattened and increased on some segments. Insurers demand more for capacity.
- For now, there is still ample capacity, but it has evolved

# Profitability

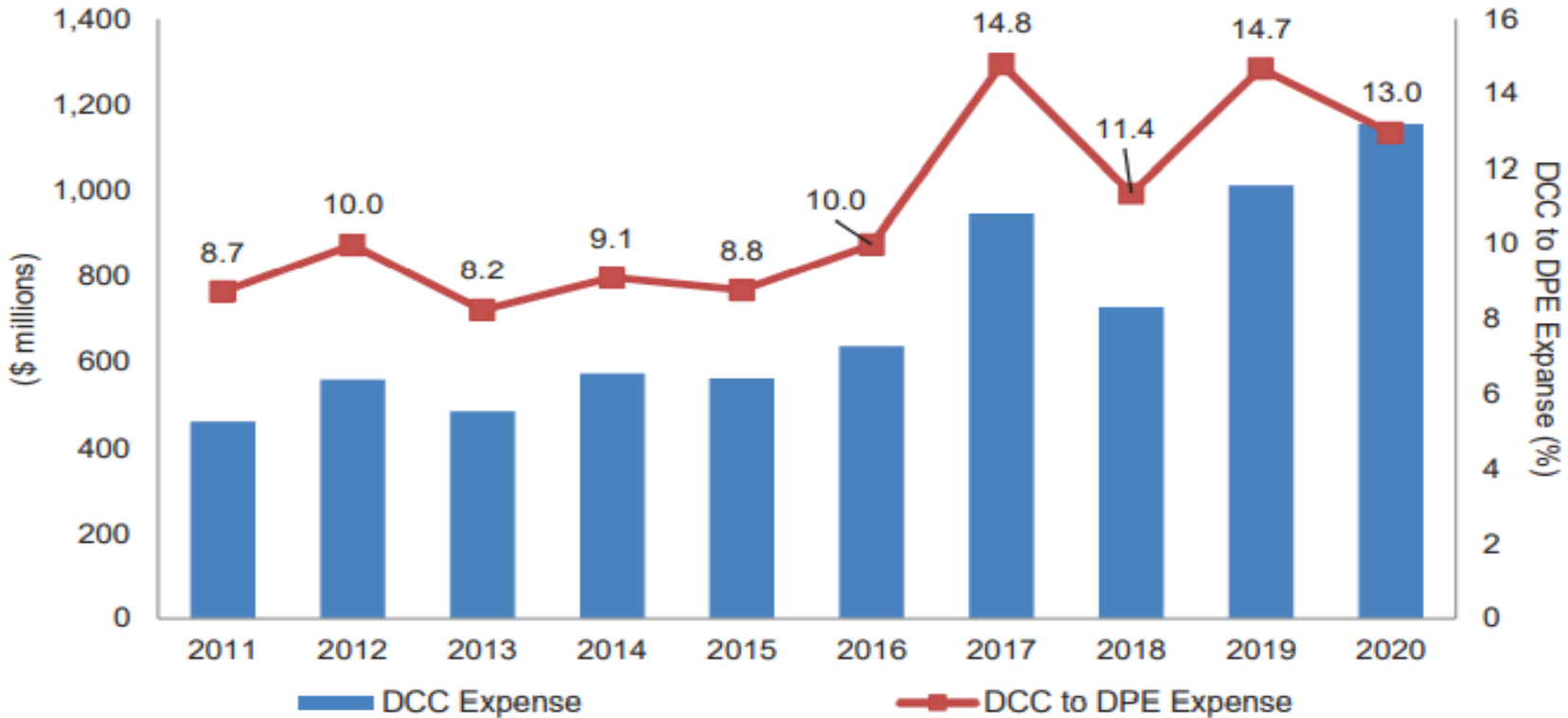
**US D&O Liability – Direct Premiums Written and Direct Calendar Year Loss Ratio**



# Defense costs are increasing

## US D&O Liability – DCC Expense

As a % of Direct Premiums Earned (DPE)



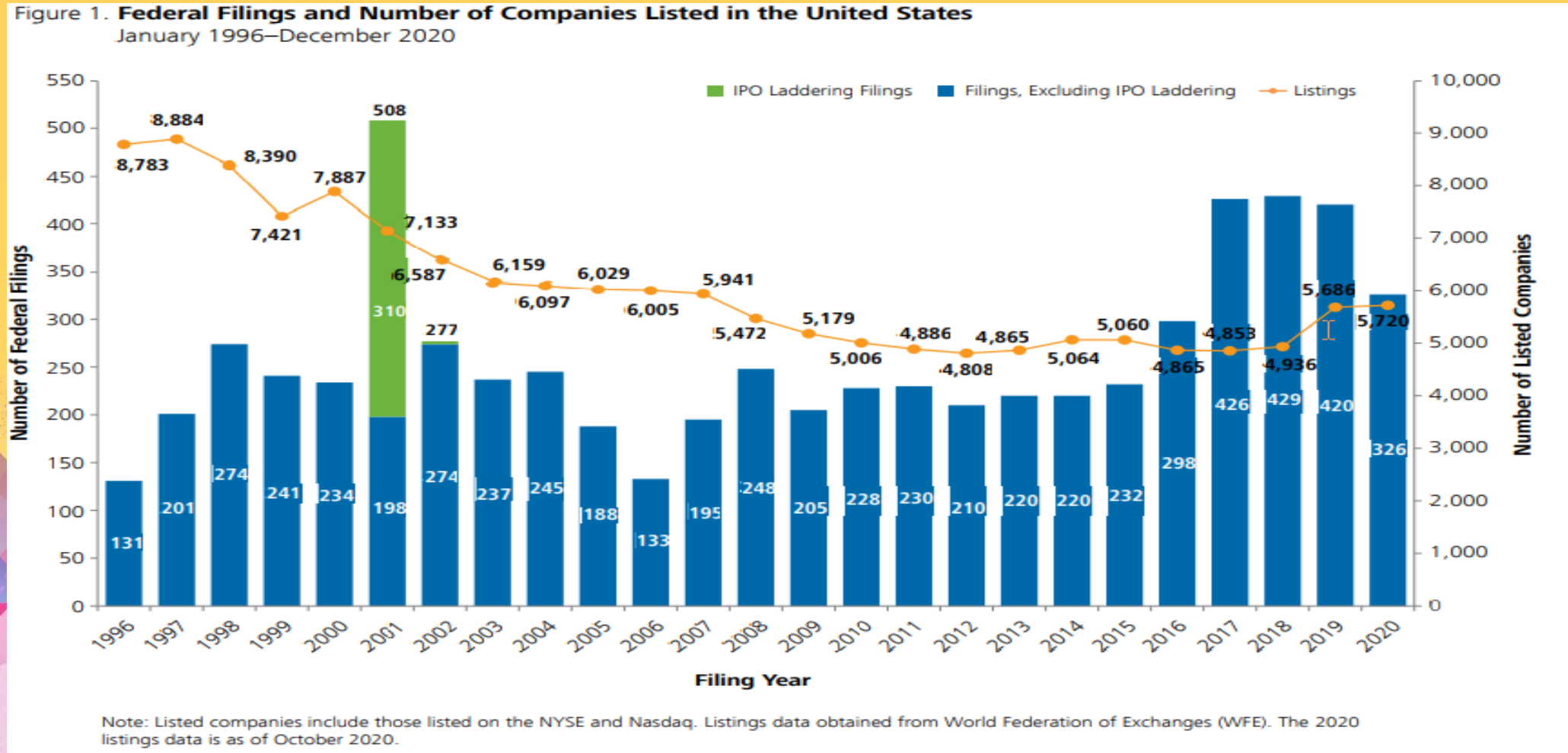


# Concerns

- Frequency of class action claims are up through 2019 calendar year – where 2020 (and 2021) are showing signs of reducing
  - Fewer listed companies today and higher level of claims
  - Some of recent increase driven by shift of merger objection claims from state to Federal Court (Trulia)
    - Excluding merger objection claims, frequency is still up
- Expense cost are increasing significantly
  - Legal fees are going up
- Cyan decision allows for parallel filing in state and federal
  - At the very least, there will be higher ALAE cost
- New law firms entering class action arena
- More public disclosures from certain sectors regarding climate change regarding how they reduce their carbon footprint
- #MeToo claims / Event claims

# Security Class Actions Claims

*Following increases in filings in recent years, 2020 shows a decrease in filing activity.*

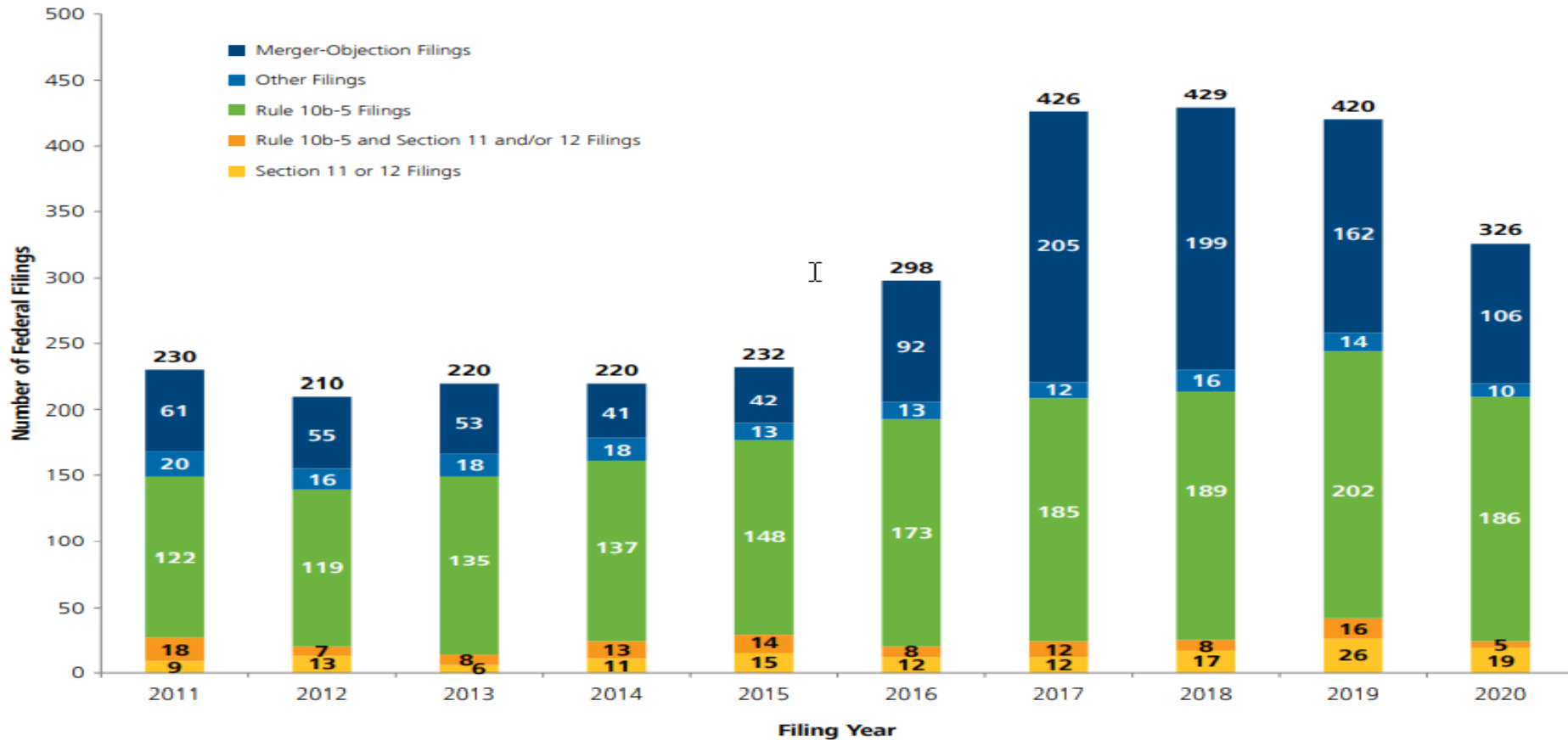


# Federal Filings By Type – January 2010 – December 2020

***Filings are driven by 'Rule 10b-5 Filings' and Merger-Objection Filings.***

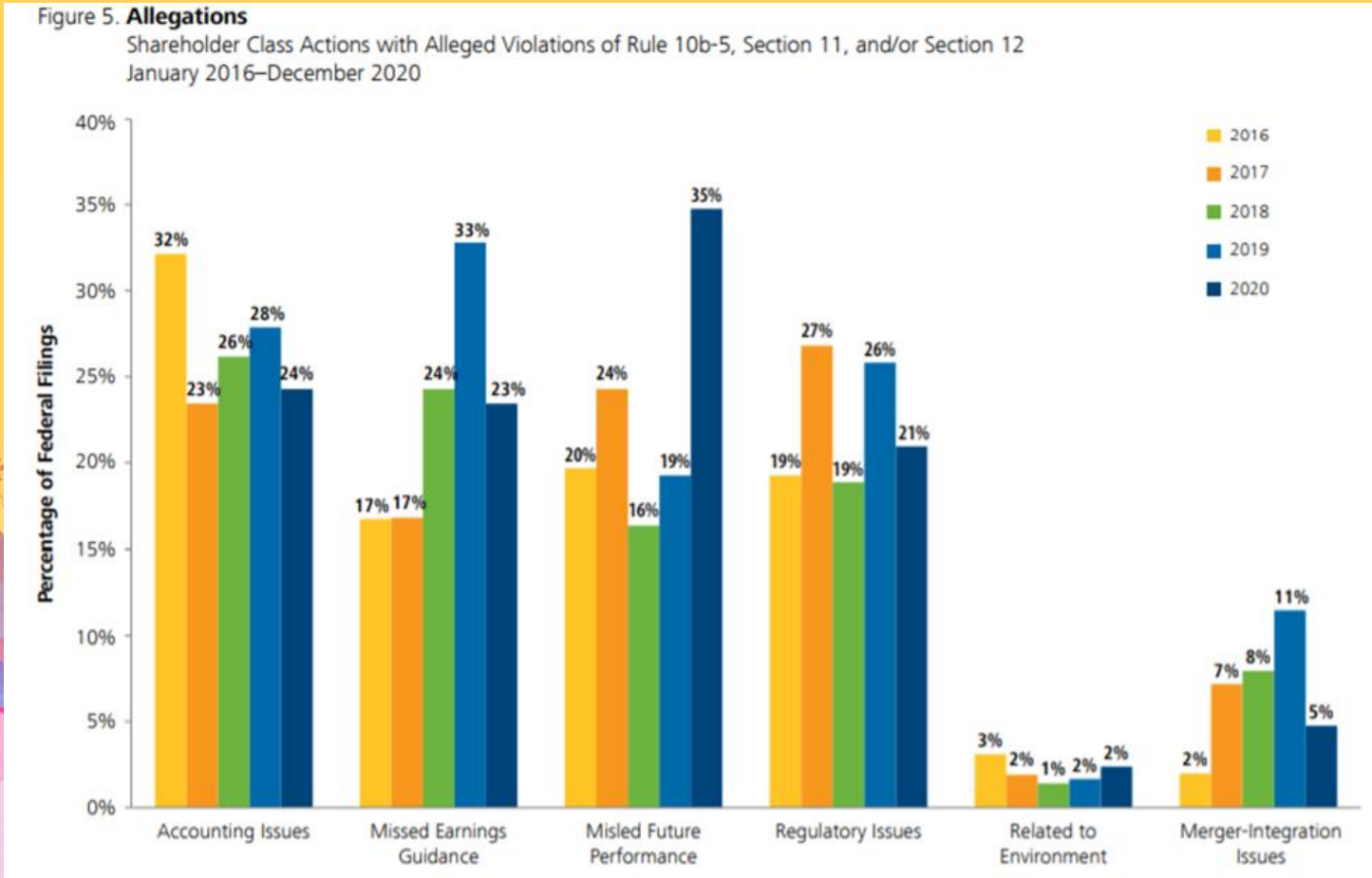
***Reduction in 2020 filings driven by decrease in Merger Objection filings, as a consequence of lower M&A activity in 2020.***

Figure 2. **Federal Filings by Type**  
January 2011–December 2020



# Changing focus of allegations over time

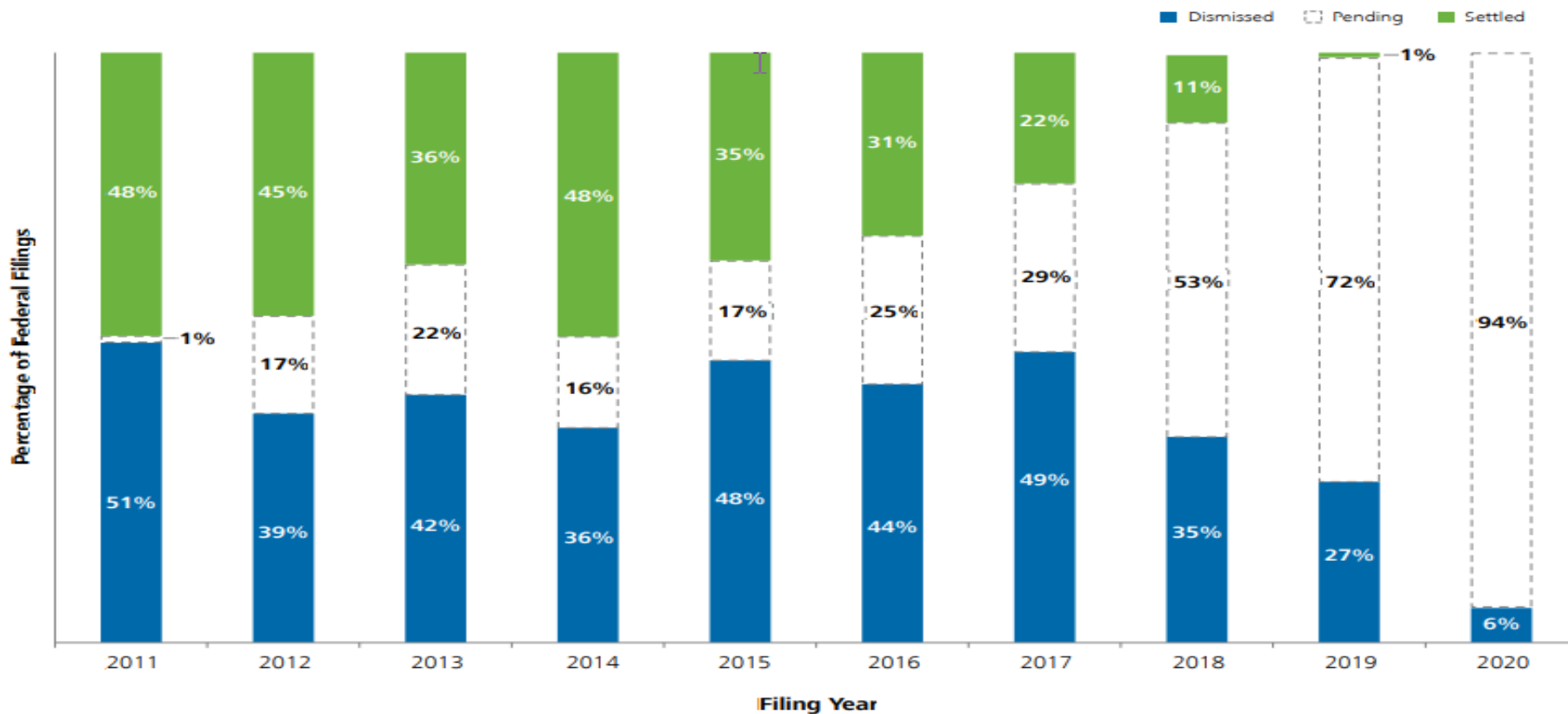
***2020 shows an increased proportion of allegations relating to 'Misled Future Performance'***



# Dismissal rates are trending higher

*Increasing trend in dismissal rates, but too early to tell on filing years 2018 and post*

Figure 11. **Status of Cases as Percentage of Federal Filings by Filing Year**  
Excludes Merger Objections and Verdicts  
January 2011–December 2020



# 2021 overview

- Rates continue to increase by double digits, however end of the year expected to be more challenging
- SCA claims continue to decline in first half of 2021, mostly driven by decrease in M&A filings, despite increase in merger deal activity
- SPAC related cases on the increase

# Quick recap pre-Covid

- Rates moving up significantly (mid +20% Q1 '20)
  - But this is just fixing sins of the past
  - Not there yet, still need to continue increasing for the past sins
- Losses
  - Legal expenses are trending upward
  - Increasing SCA claims
  - Parallel actions in State and Federal courts increasing
  - New types of claims (Cyber / Event driven)

# COVID / Pandemic

- Still on-going but going forward companies will have to disclose pandemic risk
- Potential Impacts
  - Rates
  - Losses
  - Capacity
  - Terms & Conditions

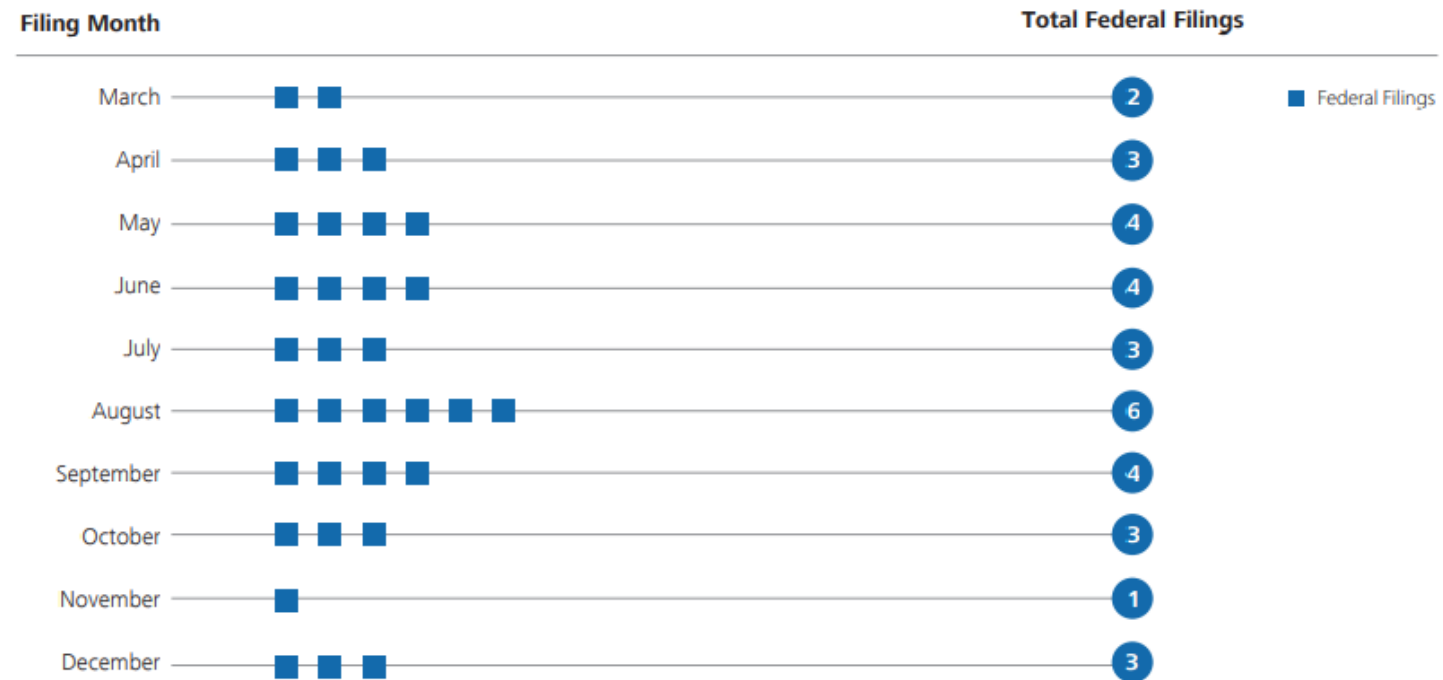
Biggest issue may not be Covid but what follows

→ Recession, Inflation, ???



# Covid Claims

Figure 6. Number of 2020 COVID-19-Related Federal Filings by Month  
March 2020–December 2020



# SPACs / de-Spacs

- SPAC

- A special purpose acquisition company, also known as a "blank check company", is a shell corporation listed on a stock exchange with the purpose of acquiring a private company, thus making it public without going through the traditional initial public offering process. (Wikipedia)

- De-SPAC transaction

- When a SPAC identifies a potential match, they'll begin the acquisition process through a formal letter of intent, which is followed by a due diligence phase and the execution of a merger agreement. (Donnelly Financial)

# Why are SPACs important

- Potential for Claims
- Growth in SPACs
- Insurance exposure

# De-SPAC transactions

- Are these better risks?



# Other Potential Claims

- Cyber related D&O claims
  - Board being sued because it didn't do enough to prevent a cyber loss or didn't disclose
- Litigation funding
  - Big driver in Australia... has it come to America
- Derivative claims
  - Bought by shareholders on behalf of company against D&O
  - More activist shareholders
  - Impacts Side A – 3 of top 5 derivative claims are within the last 2 years
  - Weather related claims, Board Diversity, Institutional Racism
- Social Inflation – do we see it in D&O?

Seeing impact on overall Frequency and Severity for Primary layers. Not seeing big claims yet so muted impact on higher layers but can't rule it out

# Reserving – Things to Consider

- Known unknowns (IBNR)
  - SPACs/De-SPACs
  - Covid
  - Cyber
- Unknown knowns (reserving)
  - Impact of COVID on development patterns
  - Strength of case reserves
  - Social Inflation Impact
  - Expenses

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? ? *QUESTIONS* ? ? ? ?

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