Seminar on Reinsurance

Virtual Conference
June 13–14, 2022

D&O Liability

Market Update and Emerging Issues

Concurrent Session 7, June 14

2:15 - 3:30 PM ET

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Meet the Speakers

Marc Berner

SVP, FI, Allied World Ins Co

Marc Berner is SVP and Head of the U.S. Financial Institutions Division at Allied World where he has responsibility for all aspects of underwriting executive liability lines for financial services firms brokered in the U.S.

Marc has more than 24 years of insurance industry experience as an underwriter and broker. Prior to joining Allied World in 2016, he was Department Head for the Financial Institutions Practice at Hartford Financial Products.

Marc holds a BA in Political Science from Binghamton University and a JD from Albany Law School where he was Associate Editor of the Albany Law Review.

Rick Ramotar, FCAS

VP, QBE Re

Rick is a VP and Senior Actuary at QBE Re with expertise in Professional Lines insurance pricing.

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

Rick holds a BS in Statistics from UC Santa Barbara.

Brian Sabia, ARe, ASLI, RPLU

EVP CUO, TOA Re

Brian is a EVP and Chief Underwriting Officer at Toa Reinsurance Company of America.

Brian has over 20 years of experience in Professional lines underwriting, from positions within PartnerRe, Berkshire Hathaway, and Executive Risk.

Brian holds a MBA in Finance from Sacred Heart University and a BA in Economics from the University of Connecticut

Lon Chang, FCAS

VP, Ascot Group

Lon is the head of US Pricing at Ascot Group. He has 12 years of actuarial experience and has been with Ascot since Dec 2018.

Lon holds a BS in Finance from New York University.

Lon will be your Moderator for this session.

Before we begin…

Layout of Presentation

- Background information
- Increased rating environment (late 2018 – 2022(?))
- Current issues
- Potential future concerns

Speakers

- Since we're using Teams, speakers will aim to be more interactive with each others
- Please use chat function and we will try to answer questions either as they come up or at the end

What is Directors & Officers Liability Coverage?

- Definition
  - Provides protections for individuals from personal losses if they are sued as a result of serving as a director or an officer of a business
- Side A
  - Covers claims against Directors & Officers for *non-indemnifiable* claims i.e. Bankruptcy or Derivative claims
- Side B
  - Covers claims against Directors & Officers where company provides indemnification for them
- Side C
  - Provides coverage for actions brought against the entity

Directors & Officers Liability: Not just one product

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

These segments tend to move directionally in similar ways, but magnitude, timing and profitability can differ

Historical Rate Change (Pre-2019)

- Since Financial Crisis (’07-’09), rates generally fell each year
- Non-FI D&O - Double digit decreases
- FI D&O – flat to single digits decreases
- Side A rates – similar to FI
- Private/PNP – mixed bag but generally down

Rates changes varied between excess and primary layers

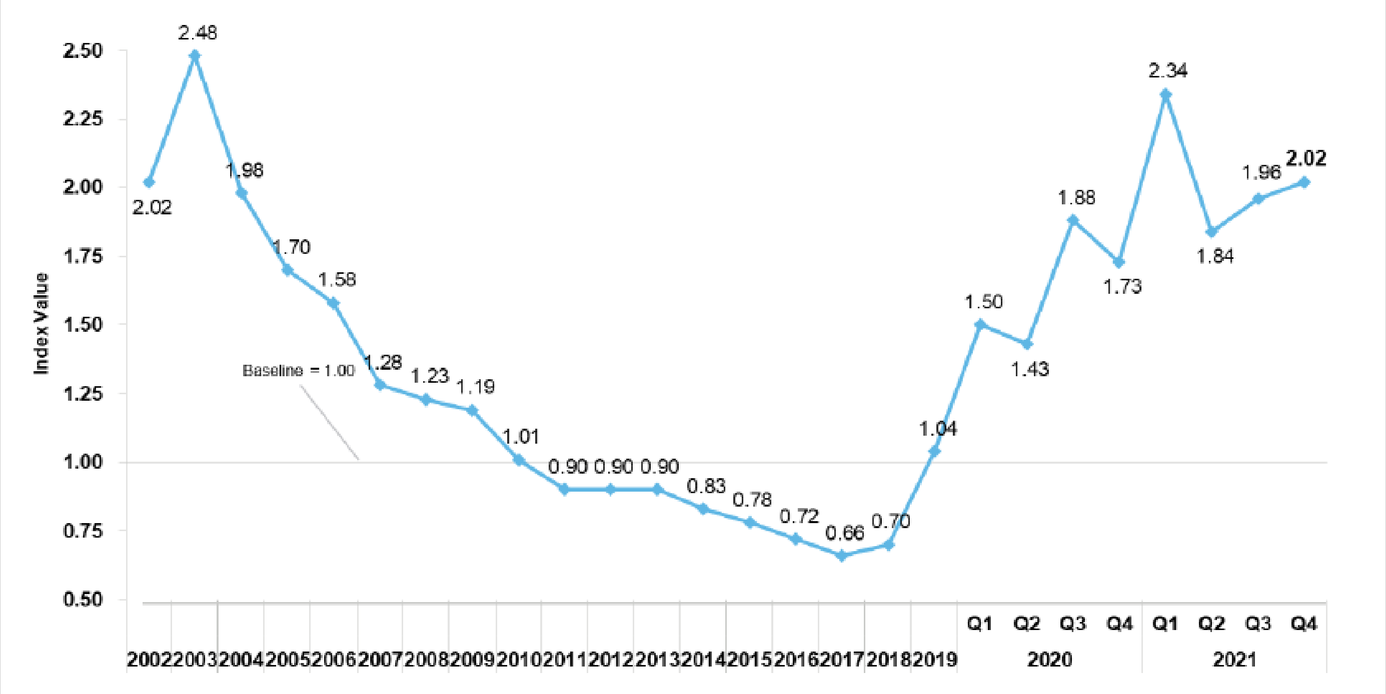
2019-2021 – Is it just a rate story?

- 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%
- 2020: Rate change intensified and became more widespread – still higher for excess layers
- 2021: Continued positive rate change throughout the year

Market Conditions

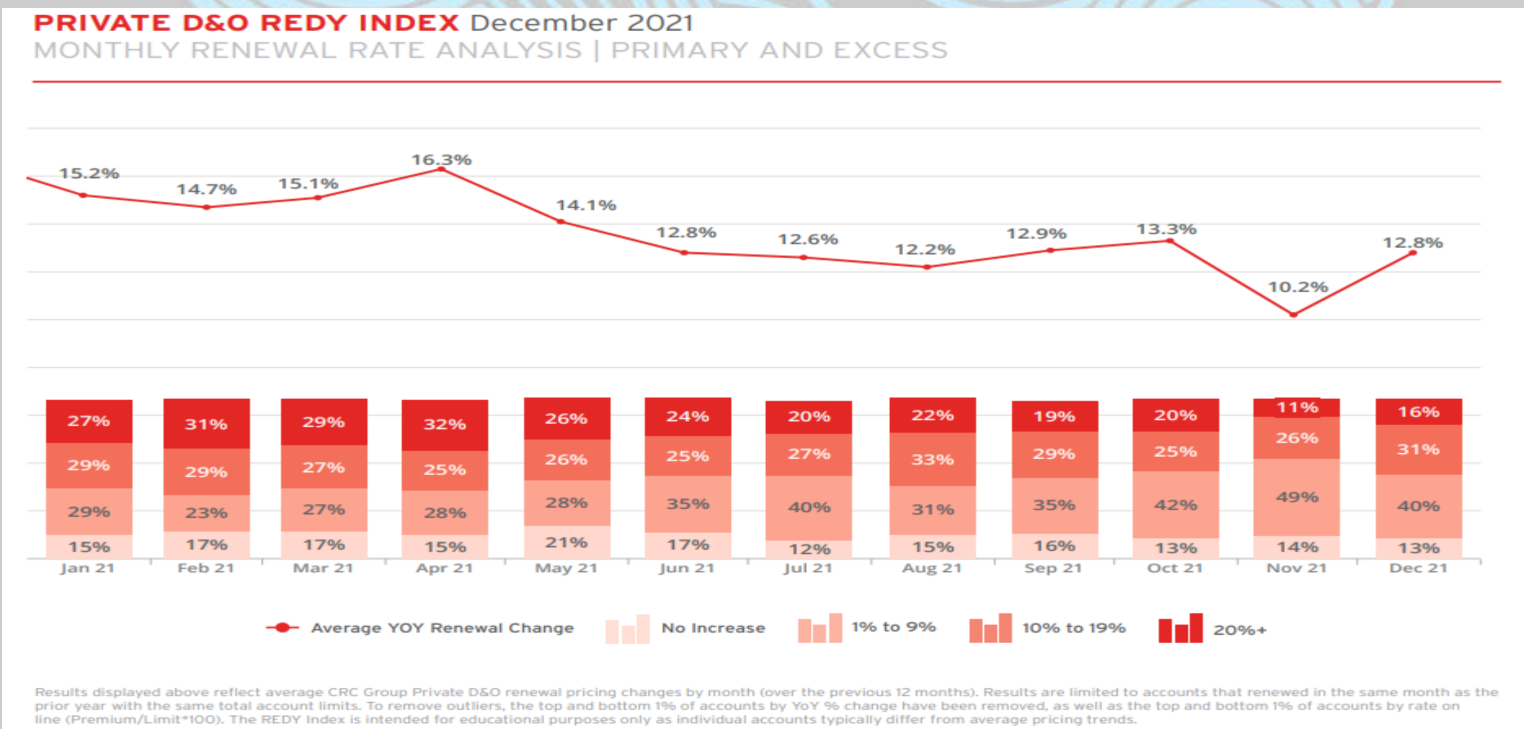
- Rate increases accelerated in March 2020 as Covid highlighted the following exposures:
  - Bankruptcy and Liquidity concerns
  - Supply chain issues
  - Layoffs, furloughs and employee safety
- Current conditions:
  - New capacity both traditional and new carriers/managing general agents entered market
  - Insurtech going after smaller insureds
  - Rates are holding between plus 5pts and 20pts, but are plateauing

D&O Rating Index from 2002



From AON Quarterly D&O Pricing Index Report, Fourth Quarter 2021

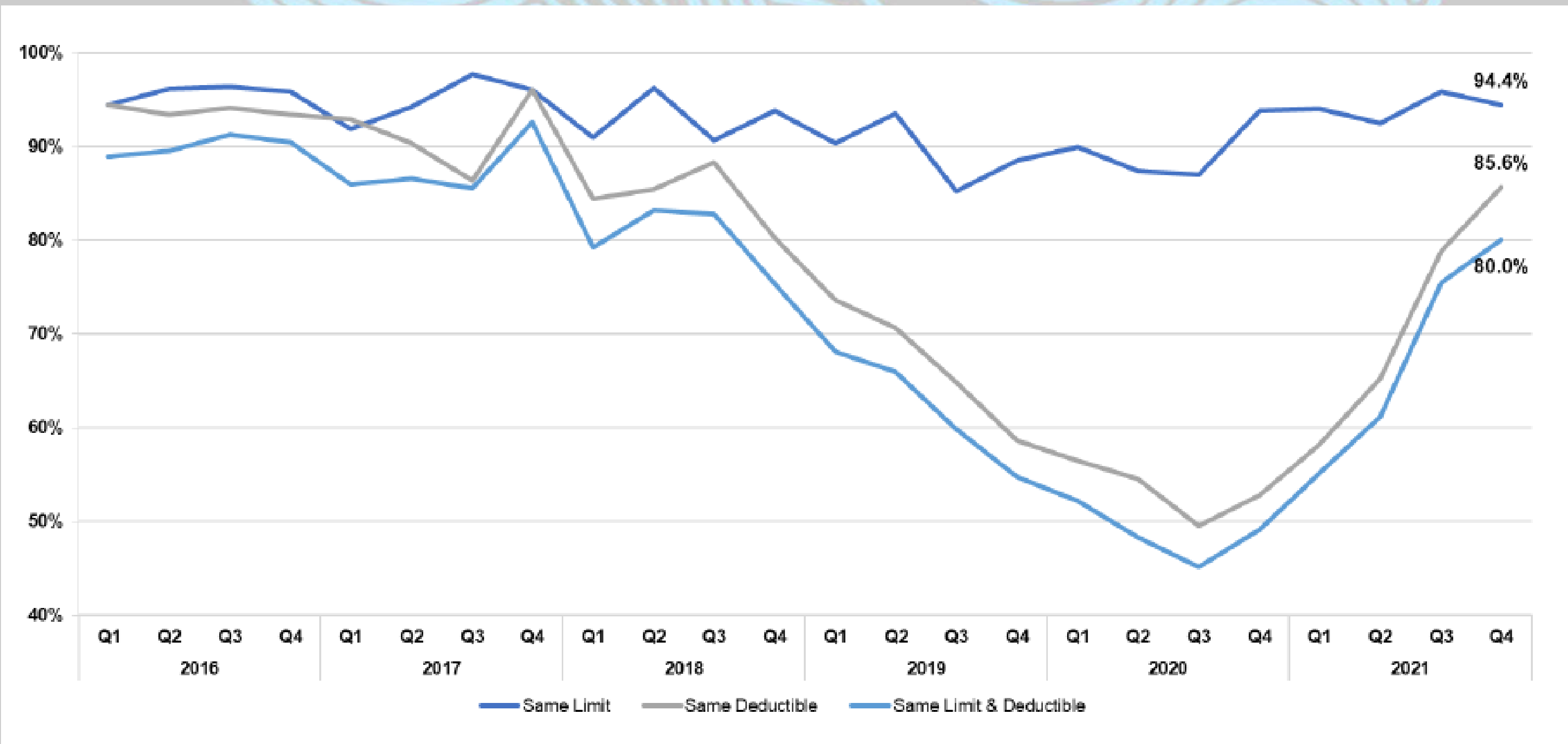
REDY Index (Private D&O rates 2021)



It's not just Rates

- Increasing Deductibles
- Limit retraction
  - Large towers are placed in Public 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
  - Higher risk or Insureds with claims are seeing higher rate increases
- 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 D&O Policies



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

Importance of Limit Retraction

- D&O has large towers with many insurers taking different tranches throughout the tower
  - In the past, tranches could be 20m or 50m
- As insurers pulled back on the limit they were putting out, layers had to be broken in smaller tranches and 1 + 1 ≠ 2
  - In other words, the cost of a 20m layer tranche broken into four 5m limit pieces is much greater than the original single layer
  - In order to place towers with layers cut into smaller piece, ILF curves flattened and increased on some segments. Insurers demanded more for capacity.
- Trend persisted even with new carriers entering the D&O space, and limit retraction allowed more players to sit on a tower

D&O didn't have a capacity issue, it had a capacity evolution

Claim Concern

- Frequency of class action claims was trending up pre-Covid
  - Fewer listed companies today but higher level of claims
  - Shift of merger objection claims from state to Federal Court (Trulia) drove frequency
    - Excluding merger objection claims, frequency is still up

- Expense cost increasing
  - Legal fees to defend cases are going up – this was true even before recent surge in inflation

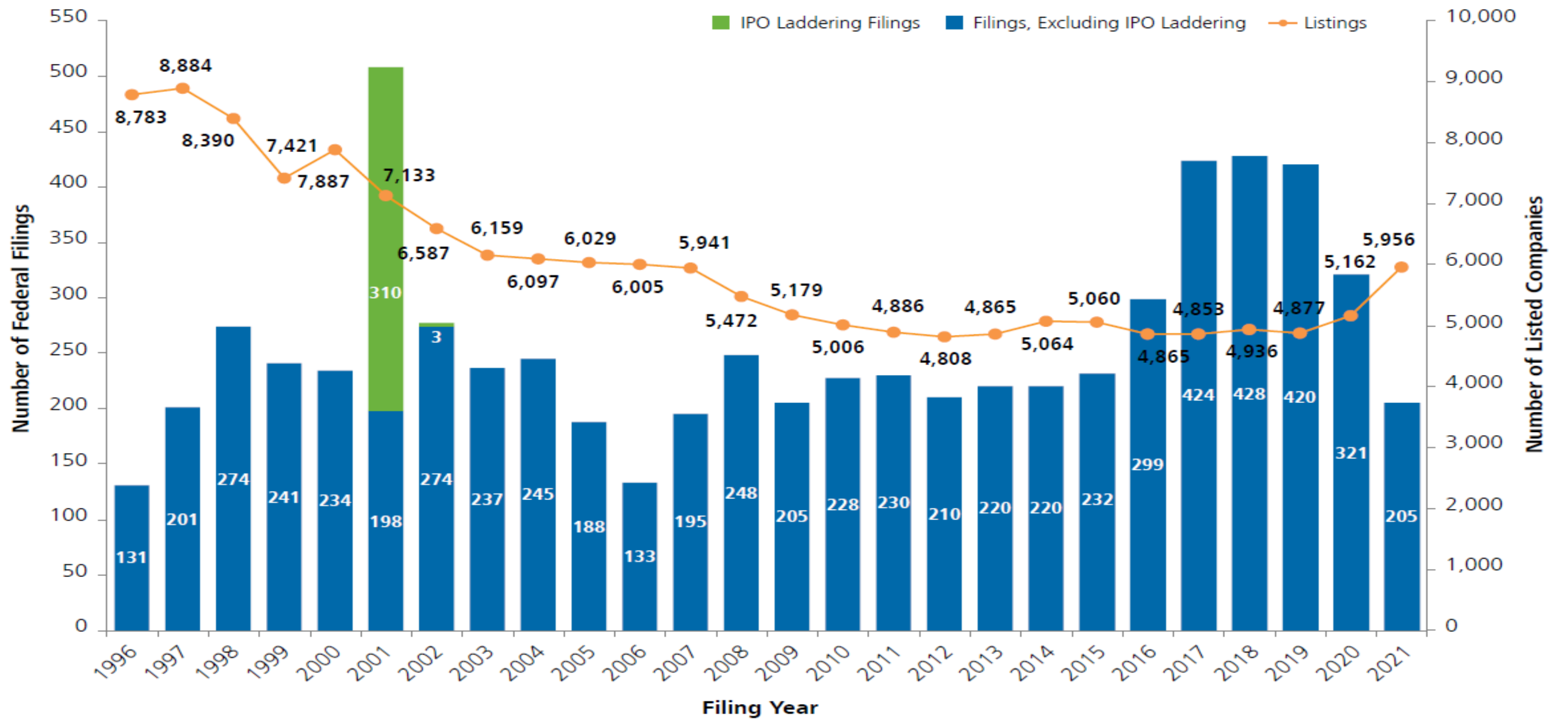
- Cyan decision allows for parallel filing in state and federal
  - At the very least, there will be higher ALAE cost
  - Recent cases may make this less of a concern

- New law firms entering class action arena

- #MeToo claims / Event claims

Security Class Action Claims

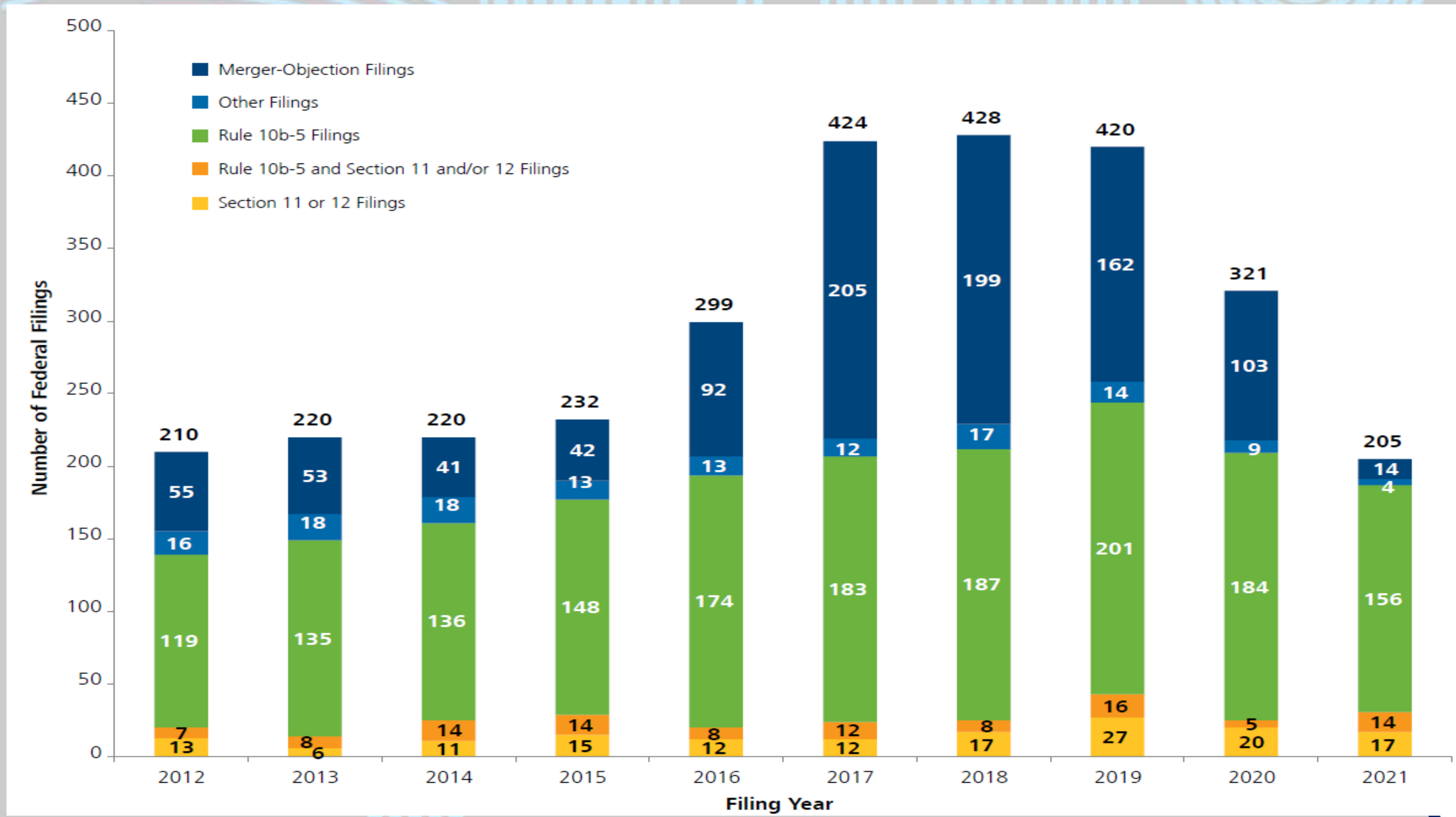
Figure 1. **Federal Filings and Number of Companies Listed in the United States**
January 1996–December 2021



Note: Listed companies include those listed on the NYSE and Nasdaq. Listings data obtained from World Federation of Exchanges (WFE). The 2021 listings data is as of September 2021.

**NERA Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review*

Federal Filings By Type – January 2010 – December 2021



**NERA Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review*

Covid

- Initial expectations from those outside the D&O world
  - D&O is doomed.
  - Companies will go out of business or be sued, and it will all end up as D&O claims
- People within the D&O world
  - Concerned but not sure it would be doom and gloom – fear was more around wave of bankruptcies
    - Government stimulus stemmed a lot of that risk
  - Stock price drop can lead to an initial D&O claim, but the D&O has a dual trigger and unless the company did something improper, the claim would likely get dismissed

Covid Claims to date

- 33 claims filed in 2020; 20 claims filed in 2021
  - Number would be less if definition of Covid wasn't purposely broad as some "Covid" claims may be more in line with traditional claims
- So far, it has not been a major loss event for D&O

Current Concerns

- SPACs/De-SPACs
- Cyber related D&O claims
- Litigation funding
  - Big driver in Australia… has it come to America?
- ESG / Derivative claims
  - Bought by shareholders on behalf of company against D&O
  - More activist shareholders
- ECONOMY– Inflation / Recession

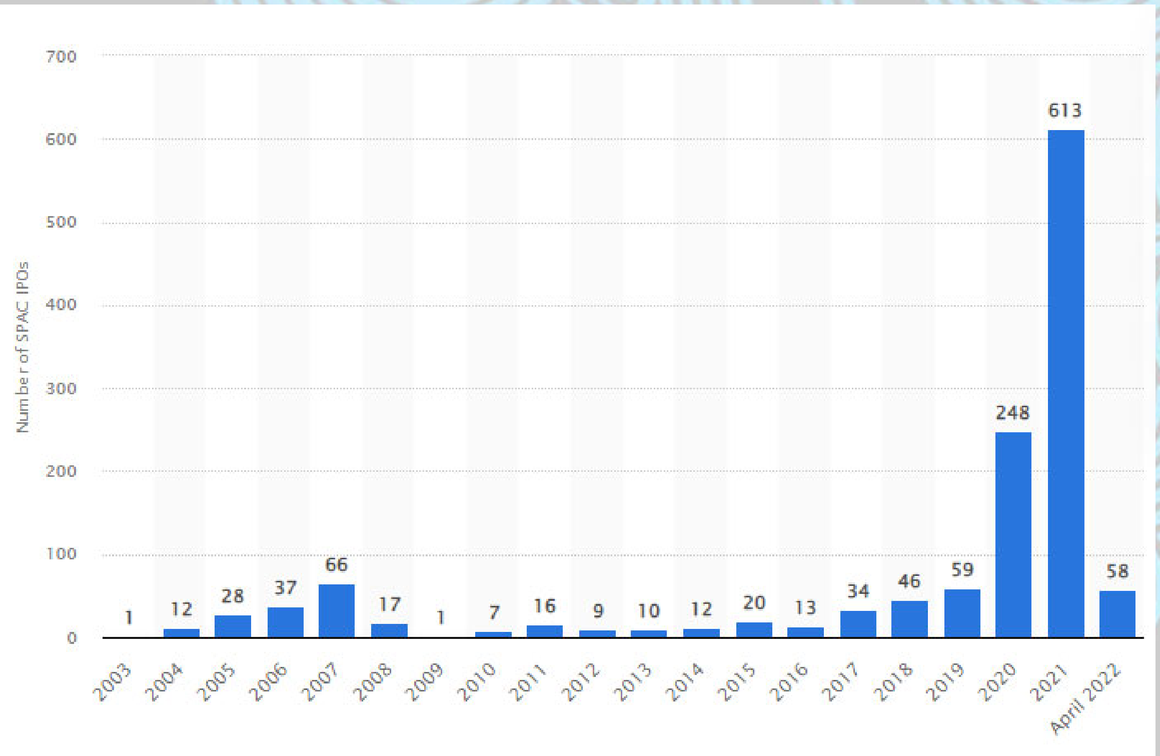
SPACs / de-Spacs

- 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)

SPAC/deSPAC Basics

- Special Purpose Acquisition Vehicle (SPAC): vehicle for taking a company public, alternative to IPO, often referred to as “blank check company” i.e. a shell company with no physical assets
- SPAC (blank check company) raises money in an IPO to be merged with private company, usually 2-year deadline for SPAC to invest. Combination referred to as **de-SPAC transaction**
- SPAC sponsors granted significant consideration, usually 20% of the SPAC’s equity in the merged company
- SPAC IPO investors have the choice of redeeming shares or investing in the now public company. Private Capital in form of Private Investment in Public Equity (PIPE) can be raised to supplement company’s capitalization.
  - Redemptions have increased and PIPE financing have dried up
- SPACs have been in existence for decades but increased exponentially in 2020-21 with 248 in 2020 and 613 in 2021, 2022 has slowed 65 (through May). Average of 20 per year from (2009-19)
- 92 de-SPACs closed in 2020, 213 in 2021 and 16 in thru March of 22; over 500 SPACs looking for partners

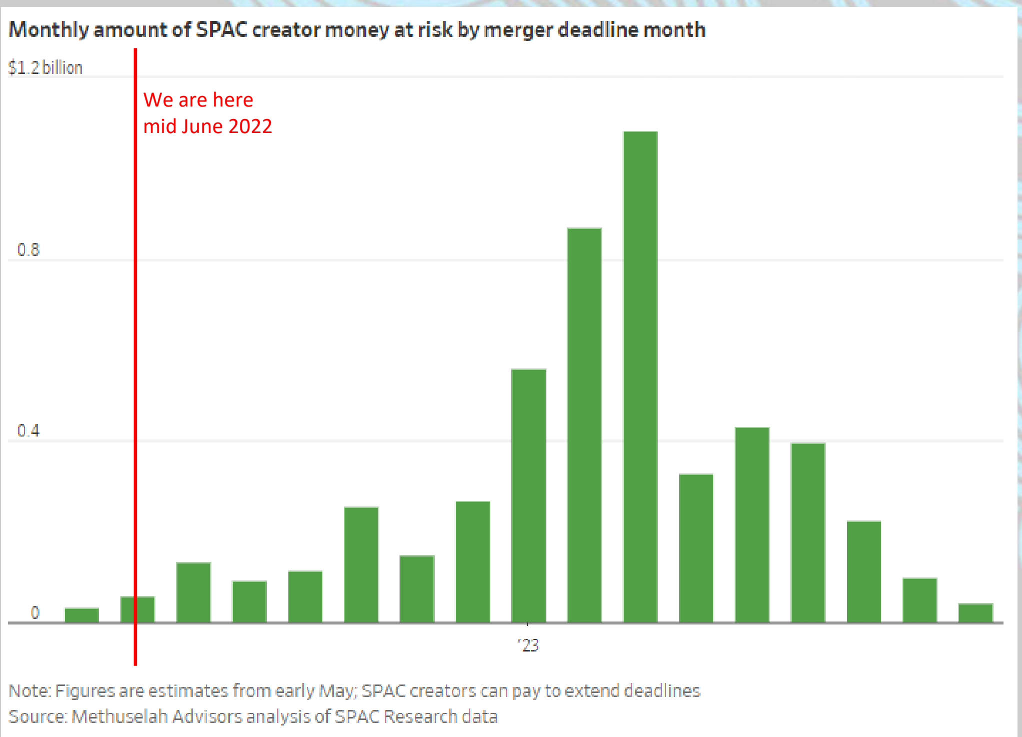
Why are SPACs important



Src: Statista 2022

- Massive increase in SPACs
- Viewed as an easier and cheaper alternative to IPO Process
- Not as heavily regulated
- Has always been a fringe vehicle but its use exploded in 2020
- Assuming claims will lag a SPAC transaction, expect future claims to come

More SPACs in the pipeline



Src: Wall Street Journal 2022

- SPACs have a finite time horizon to complete a merger or else funds are returned to the investors
- About 280 SPACs have merger deadlines during Q1 2023
- Market conditions now are not favorable to IPOs and SPACs
- Will de-SPACs offer a strong value proposition for investors or will they be completed to enrich the SPAC sponsors?

The Fall Out

- Wave of SPAC related litigation: 62 Securities Class Action Cases filed between January of 2019 and May of 2022. 16 in first 4 months of ’22
- Claims differ from traditional core SCA suits because in addition to being brought against the surviving public company, also brought against the SPAC, and its sponsor and principals. **Multiple Insurance policies in play**
- SEC Vigilance:
  - Proposed rule changes that **may add significant D&O exposure**; i.e., (1) required disclosures; (2) private company subject to liability under Section 11 of the Securities Act of 1933; (3) elimination of safe harbor for forward looking statements under the PLSRA
  - Enforcement Division activity for misleading statements
- **Industry is prepared** by making rate adjustments for these exposures; e.g., Primary pricing for de-Spac companies typically exceed $200k/mil since 2020, prior to any SEC rulemaking
- To Be Continued…

Market view on SPACs / de-SPACs

- No Consensus view
  - Pro SPAC & anti de-SPAC
  - Anti SPAC & pro de-SPAC
  - Support both
  - Support neither

- All sides may good points to participate or avoid
  - The truth is no one knows what will happen

Cyber related D&O claims

- D&O claims as a result of Cyber incidence or failure to disclose
- Failing to meet business plan due to impact of Cyber events
- Claims related to cyber related penalties
  - Loss of reputation
  - Losses due to fines
  - Restriction of future business
  - Restatement of results

Litigation Funding

- Third party funding claims to reap bigger rewards
- At the very least, higher defense costs
- Higher settlement costs
- Longer time to settle

ESG claims

- Environmental, social, and governance (ESG)
  - Set of standards for a company's behavior used by socially conscious investors to screen potential investments. Environmental criteria consider how a company safeguards the environment, including corporate policies addressing climate change, for example. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls and shareholder rights. (Investopedia)
- Covers a lot… hot topic issues in society
- Will these lead to large claims?
  - Are these claims to force behavioral changes or will they result in paid losses
  - At very least, there will be defense cost incurred

Emerging issues and trends for Private D&O

- EPLI exposures remain at the forefront for underwriters
  - #MeToo, Higher retentions and separate retentions for California risks.
  - Covid-19 layoffs causing rise in discrimination, harassment and ADA claims
  - Diversity and Inclusion policies and actions are important underwriting concerns
- Antitrust litigation
  - Merger and consolidation activity increasing, causing underwriters to review potential anticompetitive behavior
  - FTC's renewed focus on enforcing the Sherman Act (anti trust laws)
- Merger and Acquisition risk
  - SPACs buying private companies causing extra scrutiny on Directors and Officers
- Bankruptcy
  - Covid-19 increased bankruptcy filings especially for Private Companies
  - Underwriters focusing on debt, which exposure is increasing not only as a result of Covid-19 pressures, but Inflation and interest rates

Future concerns

- New markets
- Inflation / Recession / Interest Rates
- Lack of Employees / Great Resignation / Wage Inflation
- Supply Chain disruption
- Gas Prices
- The Government

A lot of questions and no real answers right now but will this affect D&O…. And when?