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IFoA Covid-19 Action Taskforce (ICAT) for General Insurance Pricing Actuaries

Case Study: Impact on Directors & Officers

October 2020

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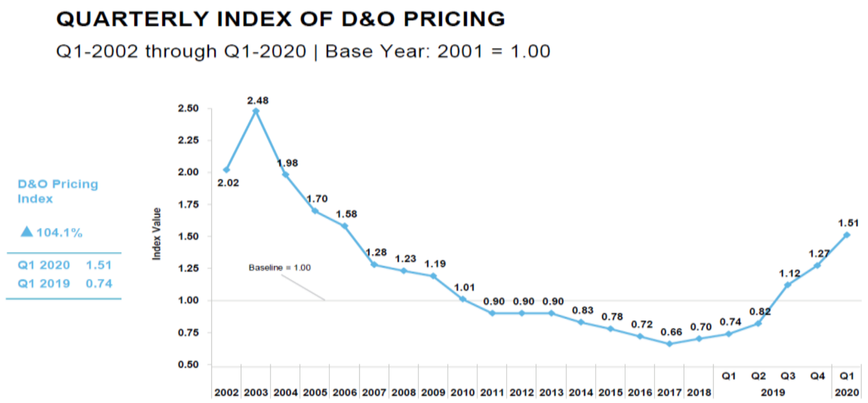
If you have any questions please reach out on our LinkedIn Page: https://www.linkedin.com/company/ifoa-covid-19-action-taskforce-impact-on-gi-pricing

What is D&O and what is the current outlook?

D&O insurance policies offer liability cover for company directors to protect them from claims which may arise from the decisions and actions taken within the scope of their regular duties.

Types of coverage

- Side A: Indemnifies directors from claims arising from their corporate role
- Side B: Corporate reimbursement for organisations from expenses arising in defending management (legal expense and claims settlements)
- Side C: Entity securities coverage – used by PLCs as protection for the company itself against shareholder disputes
- Side D: Derivative Investigation Coverage – indemnifies against costs arising through shareholder derivative claims



Current Pricing Environment

D&O has experienced over nine consecutive quarters of year on year rate increases. This has continued into Q2 2020 and has meant that even pre-COVID policyholders were finding it harder to get coverage without significant price hikes.

Price increases have only been further escalated due to the pandemic, as D&O coverage is becoming increasingly difficult to find due to reduced appetite for insurers to provide capacity in the midst of increased demand from companies wanting the coverage.

Source of chart: AON Q1 2020 D&O Pricing Index
https://www.aon.com/risk-services/thought-leadership/d_o_report/default.jsp

D&O in the news

There's been significant coverage of D&O in the international media over the last few months.

- Demand outstripped supply even before COVID-19 hit due to general increase in activism eg #metoo. For example Tesla set up a captive insurer solely to self-insure D&O risks given the market rate increases makes it unaffordable to purchase.
- COVID-19 has amplified this even further as insurers are less willing to underwrite large limits without significant rate increases.
- This is a global issue, see the following from Marsh 2020: *"Corporate Australia could face a future in which D&O insurance is no longer available or affordable or provides the coverage expected or required"*
- Return to work and recessionary pressures will escalate claims as management decisions will be heavily scrutinised.

Source of Marsh quote (made in a parliamentary submission):
https://www.insurancenews.com.au/daily/covid-worsens-do-crisis-marsh

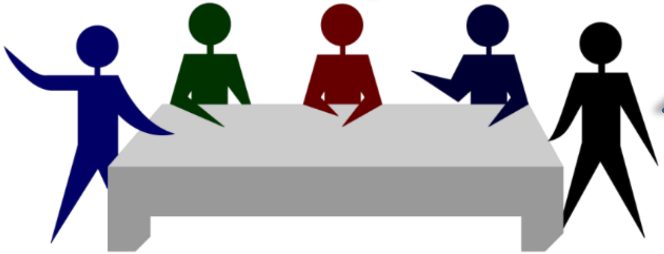
How has D&O been affected by COVID-19?

Impending global recession means no/very little shareholder returns. In turn shareholders might sue management regarding their actions in protecting the financial health of the company during and after lockdown.

COVID-19 vaccine related companies
Difficult for these companies to get D&O coverage due to risk of derivative litigation about improper marketing of their products or if management allows a faulty product to be launched

Reduced underwriting appetite
Underwriters are already worried about lawsuits and claims from COVID-19 (from bankruptcies to return to work). Means many insurers are only willing to write small layers or with significant price hikes.

COVID-19 regulation
Return to work policies and office safety will have a significant impact on the pricing considerations for D&O (which traditionally focused on financial health of the insureds).



Employment Practices Liability Insurance (ELPI)
If cover includes ELPI as an add-on, claims might increase given the likely recession meaning staff layoffs become more common.

Regulatory pressures
For some insurers, D&O has been loss making for years, leading to many pulling out of it. Remedial actions taken to turn the remaining book around might mean appetite for new risks will be minimal.

Crime / Fraud
Similar to the 2008 recession it is expected that work crime and fraud will increase due to COVID-19. This is typically an add-on for D&O cover so claims activity might increase.

Run-off add-on
D&O cover is on a claims made basis but usually if the company stops trading it can take up Run-off cover as an extension. However, insurers may not want to offer this due to the pandemic.

How will the D&O landscape change for policyholders

Smaller companies typically have standard wordings.

Was that enough for COVID-19?

Will policyholders be priced out at renewals?

In which case will management be comfortable in making decisions without insurance in place?

D&O excludes BI to avoid double insurance.
But if staff get ill from return to work being inadequate and this causes financial losses to the share holders – is it a BI claim or is it a D&O claim? Where does the claim sit?

D&O tends to be on a claims-made basis.
If the company shuts down there could still be late claims – will the policyholder be able to affordably purchase tail coverage (Extended Reporting Period)?

Exclusions might be put in place to exclude COVID-19 claims and/or restrict coverage for pandemic exposure and/or creditor/insolvency
Are policyholders aware of this?

Willingness to share commercially sensitive information including business forecasts, COVID-19 stress testing, risk controls will need to be shared as likely to be reviewed before coverage provided

Rating Factors and changes due to COVID-19

Rating Factor	Post COVID-19 change?
Domicile	There will be a greater emphasis on each countries government performance / decisions as that will have a direct impact on COVID-19 related D&O claims
Financial performance	COVID-19 is presumed to cause a global recession meaning previous financial ratings and profits will be vital. If the company was already struggling pre lockdown it is unlikely cover will be provided in the current climate
Revenue or assets held	Risk of a second wave or future pandemics means there will be greater scrutiny on revenue incurred during lockdown. Did revenue halt/ get boosted / no change?
Industry	This will be vital as industries have fared differently due to COVID-19. E.g. online retailers or supermarkets may find it easier to get insured than hotels or schools
Experience of Board	Eg those who worked through 2008 recession or SARs would increase insurer confidence in the challenge of management occurring at the company
Staff: turnover, redundancies and severance packages	Due to pending recession and financial pressures it is almost certain that employee disputes will spike and so this data before and after will be needed before coverage is considered
Add-on's	Lack of desire for insurers to offer this during COVID-19 and so any extensions or additional coverage is likely to be pricey

Additionally, there will be new factors to consider e.g:

- Client **COVID-19 risk mitigation procedures** including return to work strategies
- Does management have a **second wave / pandemic plan** in place?
- Did the company use **government aid**? Eg furlough
- % of staff back at work vs % remaining off work or on furlough
- % change in revenue during first month of lockdown (i.e. did work from home or COVID-19 affect revenue)
- Complaints against the company by employees since **return to work** and/or during lockdown
- Global reception of local **government remedial actions**

Future considerations

Self insurance is likely to become more prevalent if prices continue to increase.

Lack of supply means companies might find no alternative but to follow the Tesla route.

Waiting Game?

Companies that need D&O to retain high quality staff might be willing to pay over the odds to keep D&O coverage and hope it is a temporary hike in prices.

Change in T&C's

This is a market-wide issue but in the case of D&O, exclusions might be added to ensure management decisions in light of lockdowns or pandemics are not covered.

New products

There is potential for a product offering a hybrid of Side A- D but with COVID-19 in mind.

E.g. single tailored policies for companies (likely to be expensive).

Learn from past events

D&O shortages occurred in late 90's which lead to the creation of ACE (now Chubb).

Could something similar occur now? e.g. talks of a Lloyd's D&O Consortium.