D&O

Social Inflation Has Boards Under Pressure

The Black Lives Matter and #MeToo movements are also factors in a tough D&O market.

By Alex Wright

Legal actions against directors and officers show no sign of abating.

There is much speculation as to how the industry and those impacted by the current state of the global economy will continue to respond following the outbreak of COVID-19 in the early months of 2020. Directors and officers are likely to face a slew of challenges on all fronts as businesses emerge from the COVID-19 crisis into a this brand new risk environment.

That's the view of Sridhar Manyem, director, industry research at A.M. Best, who presented on the subject at virtual RIMS LIVE 2021 in April.

Among the biggest problems directors and officers will have to contend with in the months and years ahead, he said, are increased litigation stemming from sexual harassment and discrimination; social inflation; cyber risk; and environmental, social and corporate governance.

"There may be light at the end of the tunnel as far as the pandemic is concerned," said Manyem.

"Yet, we haven't seen the end of directors and officers (D&O) lawsuits alleging companies misrepresented claims in industries such as life sciences, cruise ship operators and health care.

"With the effects of various stimulus packages such as the CARES Act and other forbearance mechanisms offered to businesses now unraveling and distressed firms still reeling from the effects of lockdown, we could well see the emergence of more COVID-19-related claims," he said.

The spotlight has fallen squarely on sexual harassment and discrimination in recent times, driven by the Black Lives Matter and #MeToo movements, said Manyem.

Corporations' policies, history, culture and controls have all come into sharp focus, he added, with those who have fallen short suffering untold reputational and financial damage as their directors and officers have been dragged through the courts.

"This is not merely event-driven," Manyem said.

"In some cases where corporations have put particular emphasis on diversity in their disclosures, such as annual reports, but have failed to put them into practice, they can soon find themselves at the center of protracted and agonizing legal action.

"They also need to be aware of legislation, such as in California, where diversity is required in a board's composition, with other states likely to follow suit."

"Society is becoming more litigious, and the economy and stock markets are still in considerably uncertain territory as we continue to recover from the global pandemic."

— Sridhar Manyem, *director, industry research, A.M. Best*

SOCIAL INFLATION PROBLEMS COULD POTENTIALLY IMPACT THE FUTURE D&O LANDSCAPE FURTHER

Social inflation, which is fast-becoming a perennial issue for insurers, has also been exacerbated by the establishment of litigation financing as an asset class, said Manyem.

This in turn, he said, has resulted in increased frequency and severity of litigation.

With ransomware attacks on the rise, too, as more employees work remotely and networks and security engineers are stretched to the limit, Manyem noted that cyber security claims are also spilling over into D&O.

Added to that, regulation such as the European Union's General Data Protection Regulation and the California Consumer Protection Act have shifted the onus of cyber security responsibility onto directors and officers.

"Directors and officers now have

SUMMARY

- ***Average settlement values*** in class actions remain above the 15-year average.
- ***Cyber risks and*** exposures are now one more item on the plates of company officers and directors.
- ***D&O direct premiums*** written increased by $4 billion in 2020

far greater responsibility to ensure that they implement appropriate controls to prevent data breaches, as well as maintaining oversight of cyber risk management, including risk mitigation measures such as risk controls and transfer mechanisms," Manyem said.

"That isn't going to slow down anytime soon."

At the same time, Manyem added that the new Biden administration has put climate change at the top of its agenda, with its first big action to rejoin in the Paris Agreement, which the former president decided to leave back in 2017.

The rejoining of the Paris Agreement now is likely to manifest itself in enhanced disclosure requirements for companies, placing even greater responsibility on directors and officers to conform to sustainable practices, policies and controls, he said.

ALSO CONTENDING WITH A HARDENING MARKET?

While many commentators believe that D&O is in a hard market, Manyem said that it hasn't reached that point just yet for the space.

Direct premiums written have increased by 38%, or about $4 billion in 2020, which is a number more than double the 17% rise the market saw in 2019, after remaining flat between 2014 through 2018 due to a ready supply of capital and a reinsurance market where property and casualty pricing had hit rock bottom.

This was borne out in the fourth quarter of 2020 earnings calls, where large insurers, including AIG, Axis and Everest, had reported more than 35% rate increases, according to Manyem's discussion.

Despite the premium increase, Manyem noted that the direct loss ratio has continued to climb steadily, up to 60%, which is 11 points higher than the 10-year average of 55.4%.

Simultaneously, however, Cornerstone Research has found that class action lawsuits have decreased to 334 in 2020 from 427 the previous year.

Despite being significantly higher than the long-term average, that data point provides hope for prospective loss ratios.

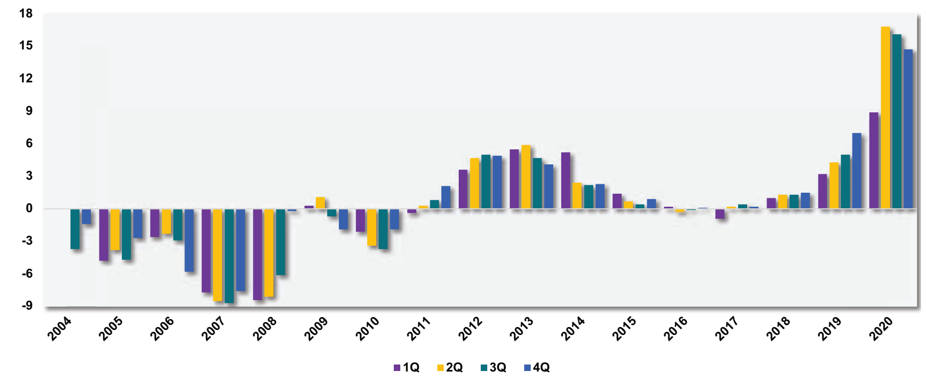
Average settlement values, meanwhile, are on the rise, with values in the region of $54 million, above the 15-year average, according to Manyem.

Defense cost containment expenses are also mounting, he added, with some reaching a peak of around $1.1 billion in 2020, accounting for 13% of direct premiums earned — higher than the 10-year average of 11% and most other P&C lines.

"Society is becoming more litigious," Manyem said.

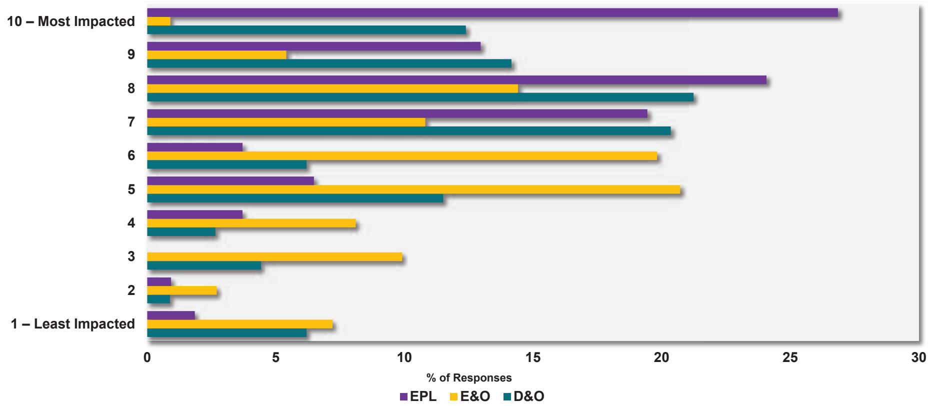
"And the economy and stock markets are still in considerably uncertain territory as we continue to recover from the global pandemic," he added.

US Directors & Officers Liability – Quarterly Rate Changes



Source: Council of Insurance Agents and Brokers (CIAB)

The Long Tail Of COVID-19
Relative Severity of the Pandemic on Certain Professional Lines



"Admist all this doom and gloom, the market conditions are finally tightening and are starting to favor the supply side ... The one bright spot is that some established insurers are taking advantage of the hardening market and new entrants will create greater capacity."

*— **Sridhar Manyem,** director, industry research at A.M. Best*

A LIGHT AT THE END OF THE TUNNEL FOR D&O

Following the price decreases during the soft market of 2004 to 2010, Manyem said that rates continued on an upward trend.

"Amidst all this doom and gloom, the market conditions are finally tightening and are starting to favor the supply side," he said.

However, in capacity terms, more than 50% of respondents to an A.M. Best and the Professional Liability Underwriting Society survey believe that D&O capacity will be constrained, with only 10% hopeful terms and conditions will ease.

"The one bright spot is that some established insurers are taking advantage of the hardening market and new entrants will create greater capacity," Manyem said.

"While A.M. Best maintains a negative outlook on the professional liability market, we view D&O insurance as a vital component to the marketplace that ensures that directors and officers continue to provide adequate and appropriate oversight of their business on behalf of their stakeholders." &

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