MANAGEMENT LIABILITY INSURANCE

GLOBAL MARKET UPDATE

Gallagher

Insurance | Risk Management | Consulting

About **Gallagher**

Gallagher is one of the world's leading insurance brokerage, risk management and consulting firms.

As a trusted insurance broker and consultant in communities around the globe, we help people and businesses move forward with confidence. With more than 39,000 employees worldwide, we connect to the places where we do business.

Within our London-based Management Liability team at Gallagher, we have extensive experience working with many varied sectors, as well as helping companies to navigate potential challenges in the market. We have worked with many private and public companies with market capitalisations ranging from a few hundred million for early start-ups right up to tens of billions for later-stage growth companies.

Gallagher has a strong international presence offering extensive insurance solutions and products worldwide. We continue to expand across the globe through acquisitions and partnerships with well-established and reputable insurance broking and consulting businesses. Thanks to the fantastic personal relationships we have built with the insurance, reinsurance and ART communities, working with us means you can access some of the most innovative products and service offerings wherever you are and whatever the size of your business.

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The first half of 2022 has been an interesting time for the Directors' & Officers' (D&O) liability insurance market.

The good news is that the first half of 2022 has been a brilliant time to analyse your D&O coverage and benefit from some cost-saving opportunities.

At Gallagher, we have seen significant reductions in premium across the board and limits increasing for many of our clients. Of course, these Insured's are very happy to join Gallagher or renew their existing programmes with a return to deflating premiums, especially in a period of rising costs elsewhere in their operations or supply chain and after a bubble of D&O costs that reached unsavoury highs in the past few years. Undeniably, this persistent fluctuation of D&O pricing can be a source of frustration for companies but in the moments of lowering costs, we can find positivity.

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Market **overview**

The wider impact on capital markets has played into clients' favour at times – a stall in IPOs along with the insurance income derived from it means that insurers have to make budget elsewhere, often resulting in them competing aggressively on new and existing business. Additionally, as new insurers continue to enter the D&O market and try to assume space, the related competition means Gallagher is able to secure much lower prices for clients than were available in the market last year.

It's a good time to work with a broker who understands the market.

As further signs of pricing stabilisation came to the fore and insurers continued their renewed appetite for new business this year, the Russian invasion of Ukraine was a moment for many underwriters to stop and reflect on their approach. Such a huge geopolitical incident can give rise to a shift in the market. However, from a D&O perspective, it has proved to be a very specific issue for a small number of companies due to either having Russian exposure or having had sanctions imposed upon them. As the current conditions of spiralling inflation will take time to surface and D&O claims are long tail by nature, the pricing we are seeing right now is likely to remain unaffected for now so It's a good time to work with a broker who understands the market.

Our view for 2022 and beyond remains unchanged; although pricing will not return to the lows of pre-pandemic or soft market levels in the short-term, working with an experienced broker is the best way to secure good premiums. We encourage all of our existing customers and those wanting to make the change to experience the premium support, service and expertise of Gallagher to reach out and discuss the options that will best suit their business. For these companies, we will secure the most competitive terms in this favourable current market, delivered with a first-class personal service.

Life Sciences

The Life Science market has seen further competition, on both primary and excess layers, during the first half of 2022. This has mainly been driven by a combination of additional capacity entering the market and incumbent carriers looking to maintain their participation.

A further improvement in market conditions has seen carriers willing to entertain lower retentions and less restrictive coverage. We expect this positive trend to continue – giving us greater potential for options on forthcoming renewals and greater latitude for our clients.

Logistics and Infrastructure

Clients in the Logistics and Infrastructure sectors continue to suffer at the hands of disrupted supply chains, changing consumer patterns and levels of demand. Restrictions to free movement and economic growth caused by COVID-19 and Brexit have also had significant short and longer-term ramifications.

The handling of dangerous goods remains of concern to insurers in the wake of the Lebanon port disaster. Similarly, any concession agreements with central governments, which are subject to guarantees, are causing complications for insurers.

As with many industries, Environmental, Social, and Governance (ESG) requirements are firmly in focus. In particular, insurers want to stress test environmental impact. It is now expected that companies demonstrate how they're going to meet their ESG goals rather than just setting ambitious targets without structured plans in place to achieve them.

Natural Resources

The pandemic boosted the prices of many commodities due to COVID-19 enforced shutdowns, labour shortages and geopolitical issues restricting supply. Over the past 12 months, we've seen prices and the demand for commodities increase once more. This is a welcome relief for many companies active in the Natural Resources sector (as well as their D&O insurers), as results and outlooks begin to improve on the post-pandemic road to recovery.

Despite this, the marketplace for risks in this sector is becoming increasingly challenging. The ESG targets and guidelines set by Lloyd's and many insurers have restricted certain companies from accessing the full spectrum of insurers (most notably coal, nuclear and oil and gas companies).

For example, Lloyd's mandated that the syndicates write no new coal-exposed risks from the start of 2022. And we noticed that many syndicates were reluctant to write such risks in 2021 as well. This reduced supply of insurance capacity has driven up D&O rates for clients in this area of the sector. It's also a trend that we expect to continue as agreements reached at the 2021 United Nations Climate Change Conference (COP26) accelerate the shift in demand from fossil fuels to cleaner energy sources.

Russia's invasion of Ukraine and the West's movement away from Russian-sourced energy and resources have introduced a further dynamic into the market. The scramble for alternative energy sources is a good opportunity for companies without Russian assets, as well as for the prospects of a quicker transition to greener energy sources.

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Those clients with people or assets in or related to Russia, Belarus and/or Ukraine – and not just companies in the Natural Resources sector – are finding that insurers are closely assessing the impact of sanctions and their exposures. This has led to restrictions in cover being implemented in some cases.

Retail and Hospitality

As the world and businesses emerge from COVID-19, retail and hospitality companies are starting to experience big reductions on premiums and less restrictive coverage. This is a deviation from the otherwise challenging market conditions of the last two years.

Retail and Hospitality companies that were less than a year ago feeling the effects of a hard market are now experiencing premium reductions that are trending toward pre-COVID-19 levels. Enterprises such as hotels, restaurants and travel agencies with strong finances and a favourable outlook are enjoying big reductions on their premiums. Something we expect to see continue through Q2 and the rest of the year.

New entrants and more inclusive carrier appetites have stimulated price reductions even further. While some hospitality companies might not experience the same kind of reductions as others, most should expect improvement in their D&O programmes from either a pricing or coverage perspective.

Technology

Technology companies – particularly publicly traded US firms – have endured the repercussions of D&O claims for quite some time and continue to be one of the most frequently exposed sectors to litigation.

High levels of global inflation and changing consumer patterns have negatively affected the performance of technology companies, their prospects and share prices.

A collective desire for less volatile and more undervalued investments has led to reduced appetite from investors and a stale marketplace, with limited capital raising apparent within the sector.

The hardening D&O market has seen many technology clients face challenging renewals, as insurers seek to manage their capacity and push significant rate increases.

Even though technology companies continue to be viewed as being on the higher end of the risk spectrum (unlike in 2020 and 2021), insurers are increasingly more willing to offer attractive coverage and pricing. We expect this trend to continue for the rest of 2022.

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Australia

Australian D&O insurers are finding their appetite to trade again after a period of subdued underwriting.

A preference to simply hold renewals and existing relationships has, until now, limited the available market for alternatives. This is changing as new entrants offer fresh capacity to companies in need of options.

The renewed appetite for underwriting amongst incumbent insurers is evident, with insurers determined not to concede market share to new entrants. The result is that heavy pricing increases in recent years are easing.

However, what hasn't changed is the underwriting rules and coverage restrictions introduced as the market hardened. Insurers remain prepared to walk away from relationships if the terms aren't seen as desirable to them or if there's negative sentiment associated with the sector in question.

Most D&O insurers are ready to be convinced

The narrative remains all-important to securing the best outcome for clients.

Insurers seem to be announcing an ever-diminishing appetite for risk, whether by sector, size or industry. Some of the more challenging D&O placements involve global financial institutions, complex construction, and global technology or carbon-intense industries. Any listing, debt, or equity capital raising can limit the available options.

Most D&O insurers are ready to be convinced that a risk is better than is normal for a sector or that there should be relief from new heavy underwriting restrictions that might otherwise apply. Companies and their brokers need to work hard to get insurers over the line.

ESG must be more than just benchmarks and rankings

Environmental, Social, and Governance (ESG) risks need particular care.

Activist investors are railing against companies using ESG criteria as a marketing concept and fundraising tool. Some activist investors are exposing the perceived hypocrisy of companies and service providers who appear to be capitalising on positive ESG market capital to drive profits without living up to the actual ESG expectations.

Gallagher is working with our clients to anticipate potential issues that may attract scrutiny.

With our deep knowledge of the client's risk conditions and insurance programme, we help them develop and refine an effective underwriting submission that addresses the insurer's key ESG concerns.

Canada

At the mid-way mark of 2022, we can see that the predictions made at the start of the year are generally playing out as expected.

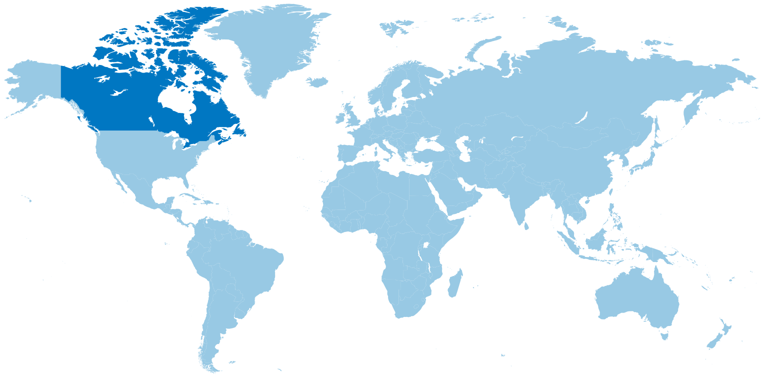
Small increases on primary and low excess layers continue, however, competition is heating up. We have seen towers renew flat, and some at a decrease, as excess limit factors come down from the highs of 2020 and 2021.

With two years' worth of rate increases and capacity reductions having helped to 'repair' D&O portfolios, carriers are now turning their attention to new business goals.

Carriers writing public D&O are showing flexibility in a relatively stable class action claims environment. Some carriers who previously only wanted to write Side A will now consider the lower ABC layers. Carriers who previously only wanted high excess business are now considering primary and lower attachment points.

In the private space, D&O and EPL claims frequency and the high cost of defence continues to be a problem for this space, where the rates have been historically low. The focus in private is also on raising retentions and reducing some extremely broad historical coverage grants.

The Canadian D&O market is not soft. There is still a focus on risk quality and in-depth underwriting is common. However, it's good to see that a degree of 'normality' has returned to the Canadian marketplace.

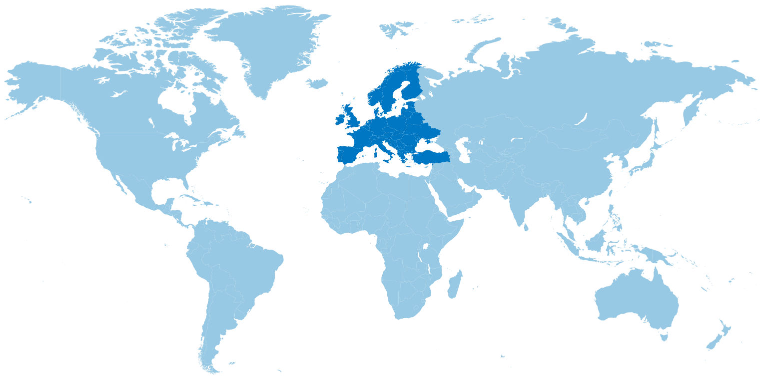


The United Kingdom and Europe

With relief coming largely in the form of premium reductions, these markets have softened significantly in the first half of 2022.

Companies who are purchasing larger programmes will benefit more as we are seeing great savings in the excess D&O market.

The new capacity providers in London and the revival of the more established markets and their wider scope for new business in 2022 are driving these savings.



As international borders reopen without restriction, lockdowns and COVID-19 measures are looking to be a thing of the past. This gives underwriters comfort around European businesses concerning COVID-19 controls. However, with difficult worldwide events hitting the headlines, supply chain disruptions, rapid inflation and fluctuating commodity pricing are preventing the market from softening further.

We are seeing a broadening of coverage, with programmes being more openly placed onto broker forms, rather than more restrictive Insurer wordings, and additional competition in the market driving down self-insured retentions.

We will continue to see those programmes that renew in the second half of 2022 benefit from softening market conditions.

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South Africa

The South African D&O marketplace continues to be diverse.

The local market remains vibrant for any privately held South African company, or any public company traded on the local market exchange. It continues to be competitive for these types of risks, particularly when it comes to pricing and retentions and there is often enough capacity in the local market.

For US-listed companies, approaching the international market is mandatory to get any risk placed. The local underwriters continue to shy away from US-listed companies on a primary basis and have a limited appetite on an excess basis. London remains the go-to-market for these clients.

While Singaporean and European carriers have expressed interest in writing global South African companies, the knowledge and expertise relating to these risks continues to reside in London.

KEY FOCUS

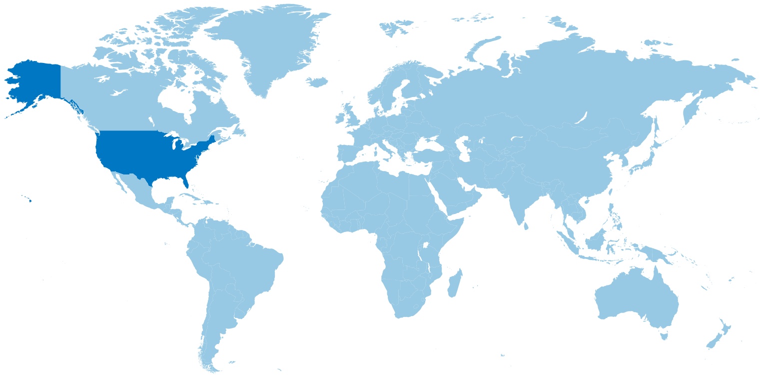
The United States

It's generally felt that the hard market for D&O has been consigned to history in the US as results improve and competition returns.

The forecast for the state of the US D&O marketplace for the rest of 2022 is one of increasing competition for almost all sectors – leading to significant rate improvements.

Price increases decelerated throughout 2021, particularly at the very end of the year. This carried into Q1 of 2022 with some prices flat, or even decreasing, at times.

Notably, recent interviews with D&O insurance company executives highlighted that carrier loss ratios have continued to improve.



A little background to the recent market movements supports this perspective. Before COVID-19 shut down the economy, we preferred to describe the D&O market as 'firm' versus 'hard'. Even though price increases were significant, capacity was still available for the most part and terms and conditions were unchanged.

However, after the COVID-19 shut down, economic factors and adverse D&O loss trends hardened the market. By Q2 of 2020, every aspect of our D&O placements was impacted: premium, retention, deployed capacity, excess attachment decisions, and even terms and conditions.

Yet that is all 'history' now as flat renewals (or better) are now possible in 2022 for the best accounts in key sectors. This is after two years of tightly controlled 'increases only' strategies previously put in place by most D&O markets.

Perhaps the most interesting aspect of the 2020-21 D&O hard market was the evolution of D&O underwriting by class of business, which we labelled the "Hard Market Expansion." By 'expansion', we mean as rates went up, the difference between pricing for the 'lowest' 20%, (or most difficult accounts) and the 'highest' 20% (or best accounts) went from being nearly imperceptible (ranging from minus 5% to plus 5% on average) to being quite dramatic. For example, there were more than 100 percentage points of difference in some cases.

Now, as we head further into 2022, the D&O market movements are contracting quickly. In fact, you could say that we're starting to see a 'Tale of Two Cities' market reaction as many underwriters have already collapsed the four pricing tiers of 2020 and 2021 into just two tiers. Namely, the quick and aggressive quotes and the carefully reviewed, more cautious quotes.

KEY FOCUS

The United States

THE CURRENT STATE OF THE UNITED STATES MARKET

We've found that the key to beating the averages is to start early with your D&O renewal, communicate effectively with underwriters, and demonstrate that your company-specific risk factors perhaps 'reclassify' you into a more attractive category of risk.

We forecast that 2022 D&O rates will continue their decline and that many companies will see vast improvements in their renewal terms. A few market sectors (such as Life Sciences or other hard-hit industries with better-than-expected recent results) will see healthy decreases, often around 20%, along with improved retentions and coverage. The reason for our favourable forecast is as follows:

- Reduced securities class action frequency, with a significant drop in Merger-Objection (M-O) cases, but also the numbers for core (non-M&A) securities cases are down.
- D&O severity stabilising in 2021 versus 2020 with a circa 2% settlement cost inflation and defence costs levelling off after huge increases over the last several years.
- Core case dismissal rates continue at nearly a 50% pace, and close to 90% dismissals for the more recent M-O cases.
- With fewer claims and solid premium growth over the last 2 years, many carriers have privately acknowledged improved D&O loss ratios and subsequently new strategies for growth in 2022.

We forecast that 2022 D&O rates will continue their decline and that many companies will see vast improvements in their renewal terms.

- Related to all the other positives above, we have seen about 20 newer markets playing significant roles in competing against current pricing levels (note that some markets are unique to the UK or Bermuda, but many new ones started focusing on US business over the last six months in particular); and
- Many established markets have shown a greater willingness to quote primary D&O recently. As an example, a publicly traded risk with minor challenges typically obtained three primary quotes a year ago compared to primary D&O quotes available from eight different carriers in 2022.

KEY FOCUS

The United States

A CALL FOR CAUTION AMIDST THE PREVAILING OPTIMISM

It was clear 2022 was going to be much more favourable than the last 3 years, with underwriting capacity supply significantly exceeding demand for the first time since 2015.

The majority of renewals have improved due to more capacity across every layer. This is because incumbent carriers often deploy more capacity – and offer stable retentions with strong coverage terms – while facing real competition for the first time since 2018.

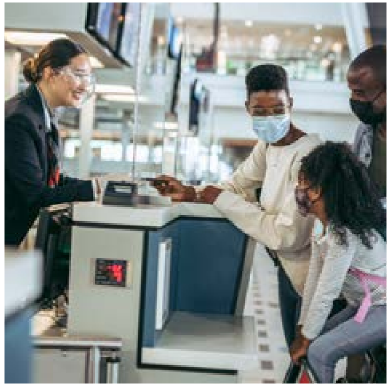
Yet, despite this optimism, caution is urged. The market is still fragile from prior adverse claims experience, and the backlog of open securities class action litigation is quite concerning. Furthermore, recent trends for more (and more costly) derivative actions as well as the interest in ESG issues could present new claims problems for the future.

There are several important items to consider for the remainder of the 2022 D&O Market. These are:

1. Pricing levels will continue to improve, with flat renewals occurring more often and key industries having some nice decreases after seeing large premiums last year. The better risks will be characterized by strong capital adequacy, earnings power and management excellence.
2. The ‘reverse flow’ companies, (defined as corporations trading on major US exchanges but with headquarters outside the US) will see improvements too, although it will still be a very tough marketplace to negotiate.
3. Market competitiveness is represented by the number of carriers and the capacity they deploy. This will increase and the newer capacity will gradually become more aggressive – as will many of the established D&O carriers, particularly for primary D&O and Side-A.
4. Underwriters will continue to underwrite as intensely as ever with many new considerations to take into account. These include a heavier emphasis on ESG issues, a deep dive into cyber security measures and cyber insurance, the impact of the pandemic and business stresses relating to economic uncertainty.
5. Medium severity claims brought largely by newer plaintiff attorney firms will level off, but associated defence costs will be much higher than historic levels in many cases. Certainly, we can confirm that the spectrum of market cap sizes being sued in an SCA has been expanding recently.
6. The frequency of securities claims may increase slightly but stay well below those in the 2017-2020 period and return to levels more like the 2010 to 2015 period.
7. Dismissal rates are likely to remain high, clearing 45% as a longer-term target, as we work through some ‘weaker’ D&O cases in the mix. Though large cases will be revealed, we expect D&O claims cost severity to remain stable on average.
8. As recent cases do resolve, a decent percentage will show carriers benefitting from higher retentions.
9. D&O coverage quality will remain high, though we foresee market resistance to further expansion.
10. Individual D&O protection or ‘dedicated Side-A’ limits will remain extremely popular; most programmes already invest 30% of their total D&O limits into Side-A only layers.

Notwithstanding the above, carriers still emphasise to us that the client’s risk profile remains the primary variable dictating renewal outcomes. Therefore, you can expect that each client’s market cap and unique industry, loss experience, location, financial health, communication style and other individual account nuances will continue to have a substantial impact on their D&O renewals.

Case Studies



CASE STUDY 1

For a large, global, UK-domiciled company in the tourism sector heavily impacted by COVID-19, Gallagher successfully secured a doubling of limit for less than half of the expiry premium. The client saved over £200,000 in premium, a drop in the retentions and a move away from an insurer policy wording to Gallagher's own much broader broker policy form.

The client benefitted from an in-person meeting with the underwriters and an improving D&O market with new entrants providing competitive pressure.

CASE STUDY 2

This large retail-sector family lifestyle brand experienced significant challenges during COVID-19, and with that, their insurance premium increased. Since Gallagher's appointment in 2022, we thoroughly remarketed the risk and our team was able to save the client nearly £250,000 in premium.

CASE STUDY 3

Specialising in the running of hundreds of pub and bar locations across the UK, the COVID-19 induced hard market over the previous two years also hit this client's D&O programme with a great deal of force.

However, in 2022 a mixture of the softening D&O market – together with a new panel market partnership between Gallagher and trusted London carriers – has helped the client save 50% on their total premium while doubling their expiring limits and broadening their coverage.

This client serves as a great example of where the market stood on COVID-19 sensitive sectors a year ago in comparison to today.

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