Global FINEX - Directors & Officers (D&O)

GB D&O Market Update

March 2021

Willis Towers Watson

GB D&O Overview

This update provides an analysis of the current conditions in the market for Directors' & Officers insurance and the impact this has on board directors, non-exec directors and insurance buyers.

- During 2020, the London D&O market underwent a huge period of turmoil, with rates increasing at an unprecedented pace and insurers dramatically reducing their line sizes.
- In addition to capacity reductions resulting from changes in insurer appetite, 2019 had already seen a number of insurers exit the D&O market. This continued in 2020, with both AXA XL and Argo exiting the D&O market in Q3.
- The outlook for 2021 is better than 2020.
  - While we continue to anticipate rate increases, for many clients we would expect rate increases to be at a more moderate level than we saw in 2020, particularly for clients renewing in Q2 or later who have already been through a renewal in the height of the hard market in 2020.
  - Clients who currently have AXA XL as an incumbent insurer will face challenges in replacing them but, particularly for excess layers, there are a lot of new entrants into the market who may be able to assist.
  - Nonetheless, total capacity in the market seems likely to remain constrained and clients with large limits, particularly in challenged sectors, may find their limits reduced if they have not already seen this happen over the last year.

Special Purpose Acquisition Companies (“SPACs”)

- 2020 saw an increasing use of insurance in connection with SPACs, both in the US and in GB.
- WTW has placed many SPAC policies in both jurisdictions over the last year, with enquiries continuing to show strong demand.
- However:
  - appetite from some of the main insurers is now reducing as a result of:
    - increased regulatory attention from the Securities & Exchange Commission (SEC)
    - increase in notifications in this area
    - reduced capacity in the market generally leading to insurers not needing to write what they perceive as the higher risk profile accounts
  - premiums are increasing, with rates of $100,000 per $1,000,000 becoming more common
  - retentions are increasing: 2 years ago they were in the region of $500,000, now at least $2,500,000 and $5,000,000+ is becoming more common.

Current FINEX D&O Market Conditions Q3 2020

Capacity	Coverage	Claims and Losses	Premiums & Retentions
Reduced	**More Restrictive Conditions**	**Significant**	**Increasing**
▪ London market insurers continue to operate on a reduced capacity basis, with most offering smaller lines. ▪ We are seeing: ▪ **UK:** capacity reductions of 25% to 50% ▪ **US securities exposure:** capacity reductions of 33% to 50% ▪ **Australia:** extremely challenging ▪ **Israel:** extremely challenging ▪ **LATAM:** capacity reductions of 30% to 50% ▪ New entrants to the market offer some relief by providing new capacity but most of them participate only on excess layers. ▪ Competition for primary layers, while increasing, remains comparatively weak.	▪ Insurers are narrowing the terms on which they are prepared to write and/or imposing new exclusions. ▪ Insurers more likely to offer terms on their own policy forms: growing reluctance to use other insurer forms or broker forms ▪ Pressure on sub-limits and bolt-on coverages ▪ Further corporate insolvencies are anticipated, leading to increased use of insolvency exclusions particularly for SME business. However, a number of insurers have stated that they do not consider that insolvency exclusions are an appropriate response in the majority of situations. ▪ Risk-specific retentions and exclusions being imposed – e.g. Bribery & Corruption. ▪ Increased contractual subjectivities and inflexibility around timeframes for complying with these	▪ Increasingly regulated global environment creating greater exposures and potential for regulatory and follow-on civil claims ▪ UK claims environment significantly increasing in terms of frequency & severity, driven by: ▪ Insolvencies ▪ Financial accounting issues ▪ Regulatory investigations ▪ Event driven litigation ▪ According to The Stanford Law School/Cornerstone's Securities Class Action Clearinghouse website (http://securities.stanford.edu/charts.html), the last four years have seen the largest number of US securities class action filings since 2001. ▪ Australia significantly impacted by Royal Commission reviews.	▪ Renewals for during 2020 saw primary layer premium increases of an average of 183% to 304%. These figures are down from the higher levels seen earlier in 2020 but were (and continue to be) significantly higher in extreme cases. However, these averages are distorted by some extreme cases while the average client saw much smaller increases of between 47%-110%. ▪ Insurers continue to indicate that premiums remain unsustainably low and will continue to increase in 2021, although perhaps at a more moderate rate. ▪ Side B & C retentions: continue to see significant upwards pressure ▪ USA Side C retentions: we are seeing insurers targeting minimum $2.5m ; however may be as high as $5m or $10m depending upon market cap

GB D&O Market Analysis

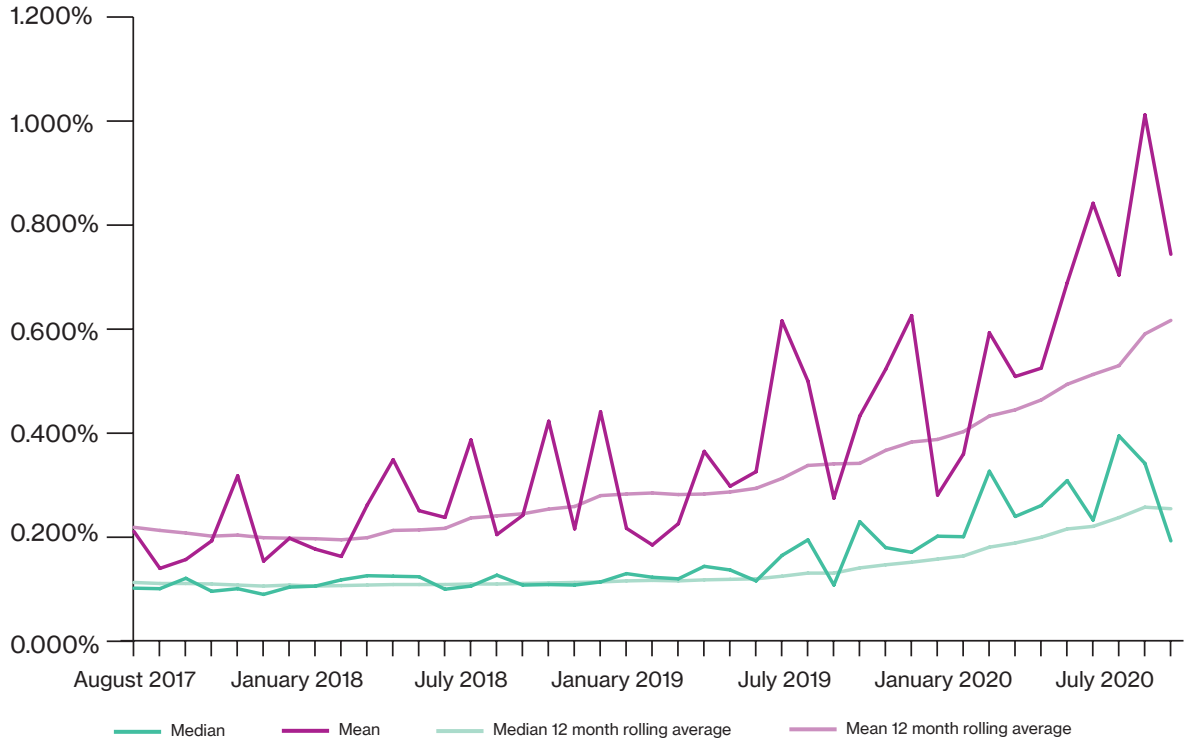
We have undertaken several analyses to look at the impact of the hard market on our clients and these follow on the next pages.

- Change in the average rate on line ("ROL")
- Change in capacity offered by each insurer in the GB market

Rate on Line Analysis

Primary layers only

The monthly average ROL for primary layers has been steadily increasing since early 2019. In extreme cases, we saw primary ROLs approaching 6-7% for US exposed, listed companies and in some cases even higher. These extreme cases distort the mean figures, with the average rate for the majority of clients being significantly lower (shown by the two green "median" lines below).



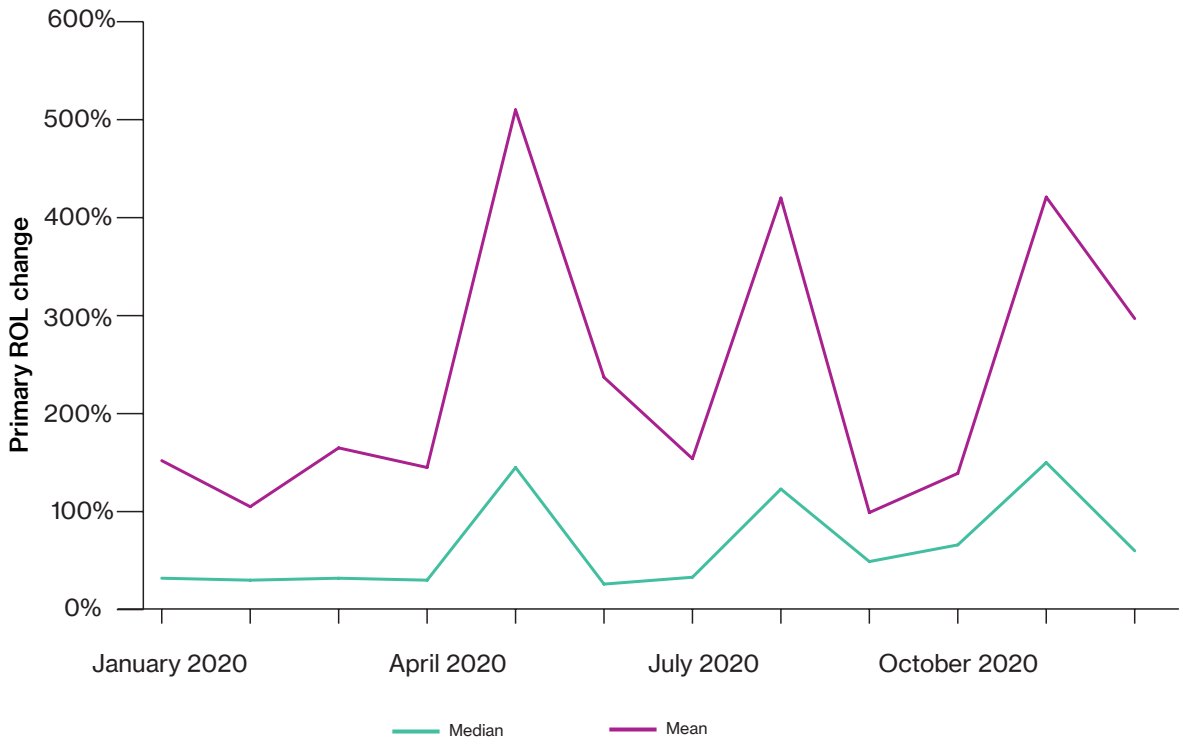
Source: Data from WTW FINEX FINMAR client placements, sourced as at 28 January 2021, see Appendix I for further information.

Rate on Line is calculated by dividing the premium by the limit of liability that is being purchased and expressing that as a percentage. This shows the proportional cost of the limit of liability being purchased by each client.

Rate on Line ("ROL") Analysis

Primary Layer - Annual change seen by clients

For renewals in 2020, clients faced a mean increase of 221% in their primary layer ROL. The median increase was 47%. Placements in the second half of 2020 had larger increases (239% mean, 62% median).



Source: Data from WTW FINEX FINMAR client placements, sourced as at 28 January 2021, see Appendix I for further information

Primary ROL change

Annual change seen by clients

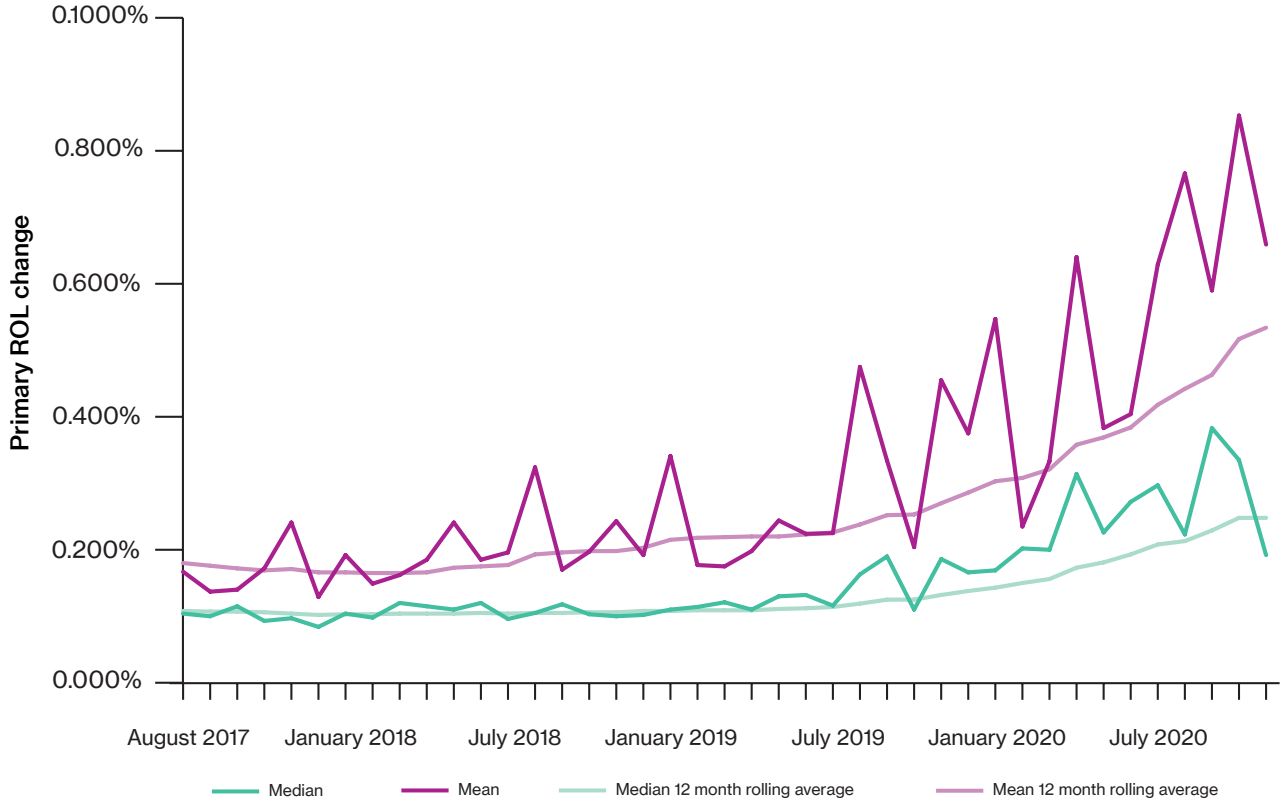
Comparing the Primary ROL movements over the past twelve months, we can see that US exposed public companies actually saw smaller proportional increases than other US exposed companies. This likely reflects the fact that US exposed public companies have had higher rates historically. Again, however, it is worth noting that these averages are significantly distorted by some of the extreme increases, with the median increase being only 47% (across the "all companies" category).

	Average Change
All Companies	221%
Public Companies	304%
US exposed companies	237%
US exposed public companies	183%

Rate on Line ("ROL") Analysis

Whole tower

The increases seen in ROL for primary layers, continues throughout D&O towers, which have also been steadily increasing since early 2019. In extreme cases, we have seen ROLs for the whole tower approaching 7% or even higher.



Source: Data from WTW FINEX FINMAR client placements, sourced as at 28 January 2021, see Appendix I for further information

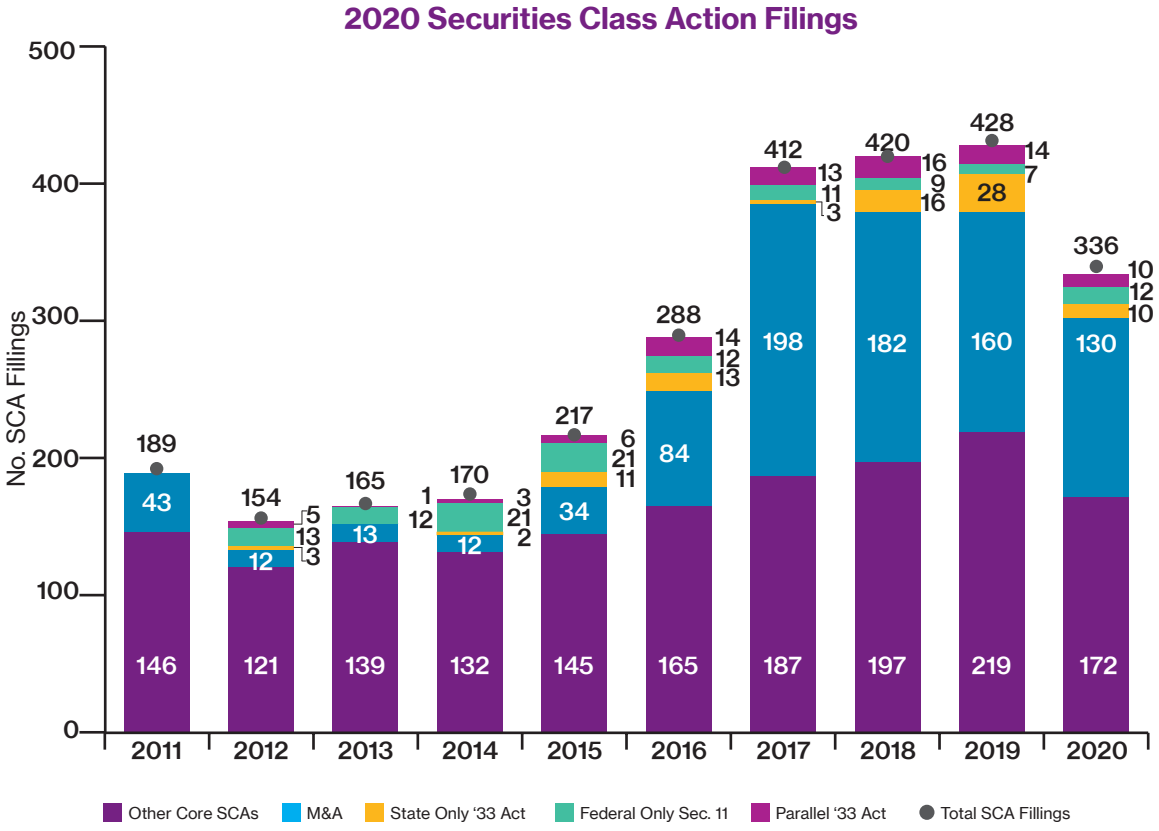
D&O Market: Insurers & Capacity

- As discussed in our previous update, we have seen a reduction in insurer capacity in the London D&O market of in the region of 50%.
- While there is increased appetite from some insurers, there remain limited markets to replace AXA XL on the primary.
- Capacity on excess layers may see some relief from the new entrants who have either come in or who are anticipated in the first half of 2021 including:
  - Convex Insurance UK Limited
  - Awbury Insurance Limited
  - Applied Financial Lines
  - Landmark Underwriting
  - Scor Specialty Insurance
  - Ki (Lloyd's Syndicate Kii 1618)
  - Hiscox Consortium
  - Arcadian Risk Capital
  - Inigo Ltd.
  - Tempo Underwriting
  - ERS (Lloyd's Syndicate 218)

Drivers behind the hard market

Driver 1 – Class Actions

- There is an increasing trend in many jurisdictions around the world to facilitate methods of bringing group legal actions. This is found most strongly in the US, but Australia and Israel, amongst other jurisdictions around the world are also now perceived as similarly challenging by insurers.
- Since 2012, US Securities Class Actions have been increasing, with 2017-2020 seeing the four highest levels of actions since 2001.



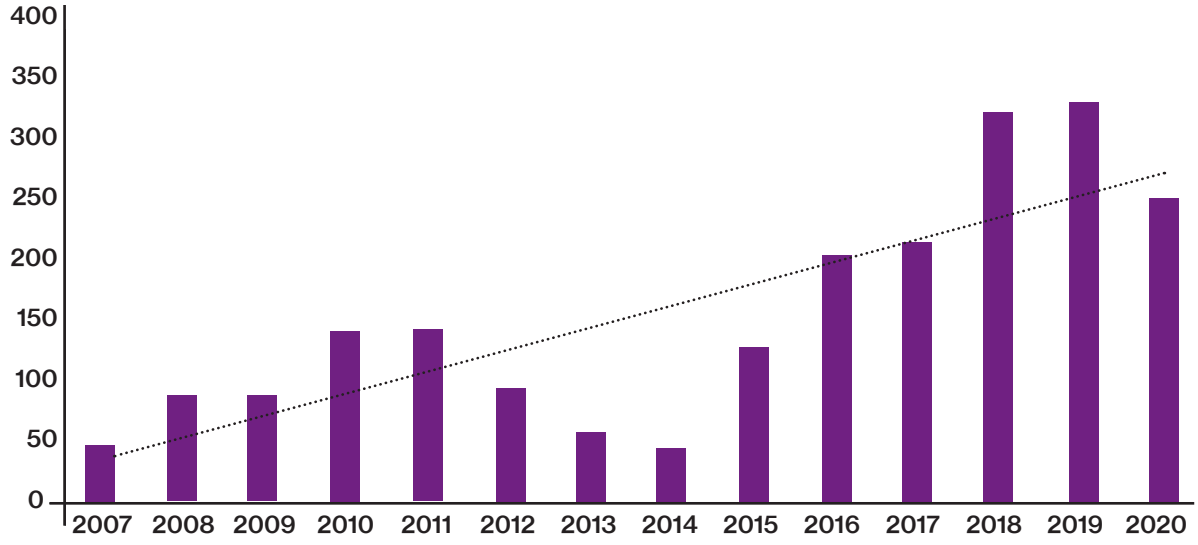
Source: Securities Class Action Clearinghouse data (http://securities.stanford.edu/charts.html) and Cornerstone Research's "Securities Class Action Filings 2020 (https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review)

Drivers behind the hard market

Driver 2 – Increased Notifications

- Our internal data shows a significant increase in the number of notifications to D&O policies by our clients between 2016-2020.
- While the estimated full year figure for D&O notifications by our clients is estimated to be lower than 2018 and 2019, it remains the third highest in the data collection period. Whether that is a result of fewer claims, a result of tightening cover by insurers or just a delay following the impact of COVID-19 remains to be seen.

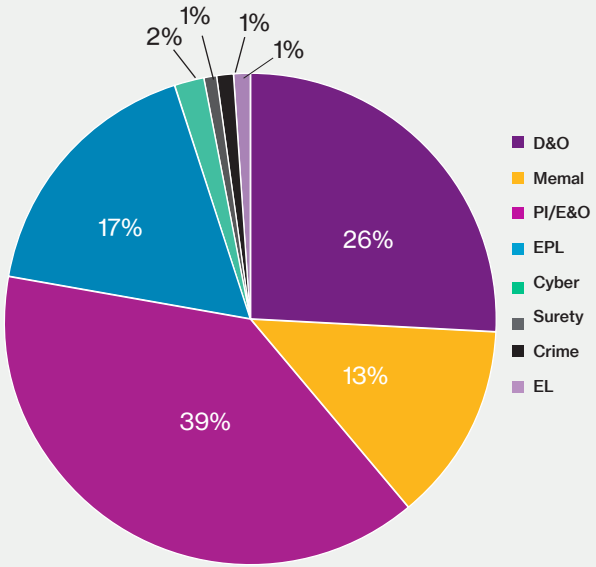
Commercial D&O - Number of notifications



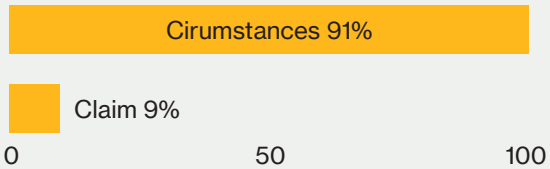
Source: Reported D&O claims for Willis Towers Watson clients where insurance policies are placed in the UK (31 December 2020)

Drivers behind the hard market

Driver 3 – COVID-19



D&O COVID-19 Notifications Claims vs Circumstances



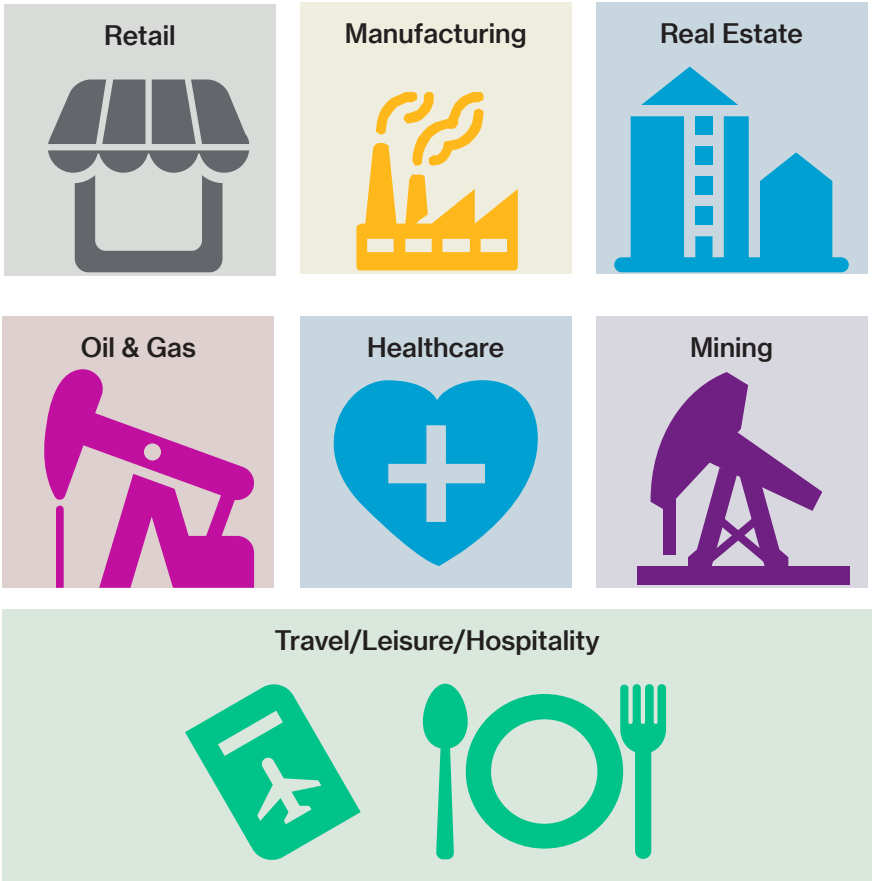
Source: Reported notifications for Willis Towers Watson Global FINEX clients (5 January 2021)

- The London D&O insurance market was already experiencing considerable upheaval and the COVID-19 pandemic has made the market even more challenging.
- The fear of a systemic impact across D&O portfolio's has continued driving steep increases in rate and reduction or in some cases removal of capacity.
- The direct impact of COVID-19 has yet to materialise in terms of claims.
- While there were a flurry of initial notifications to D&O policies, they were mostly precautionary.

Drivers behind the hard market

Driver 3 – COVID-19

- Notwithstanding the fact that the claims impact from COVID-19 has so far been low, insurers continue to anticipate the potential for a significant impact on D&O policies.
- After an initial flurry of COVID-19 exclusions, London D&O insurers now appear willing to underwrite around the issue in most cases.
- Insurers continue to focus on liquidity and industry. Sectors that continue to see the most challenging renewals include:

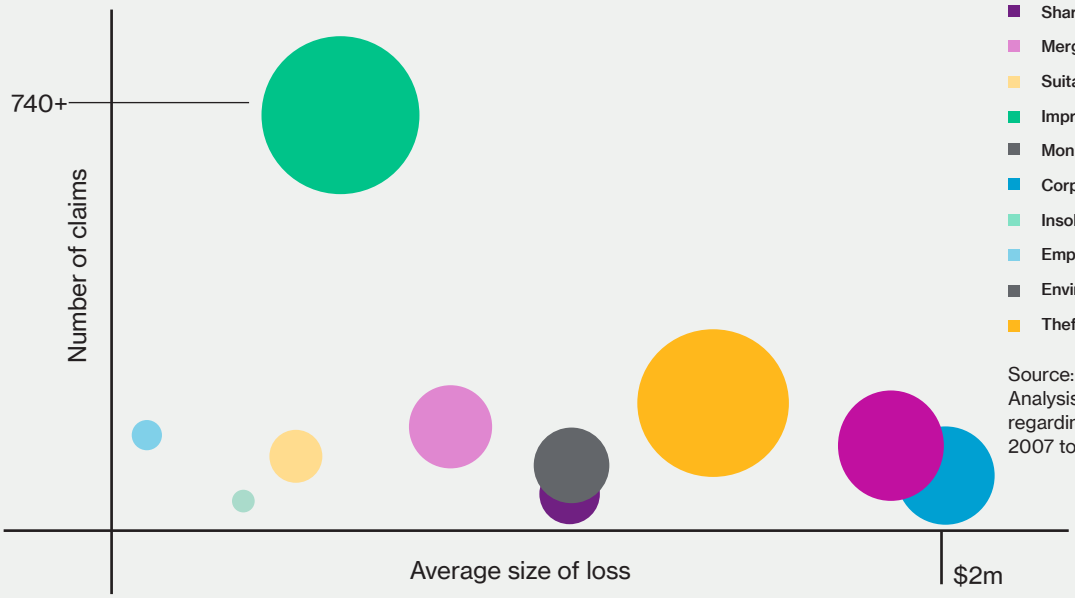


Claims Environment: London Market Loss Events

(WTW client portfolio data)

- The graphic on the below page shows the different types of claim made under D&O policies, by both frequency (vertical axis) and average size of loss (horizontal axis). The size of the bubble represents the total costs of each loss event category.
- Corporate governance losses were the highest on average in terms of cost followed by safe environment losses. These include employee and third-party general liability type losses where injuries have occurred on sites and premises the insured own, operate on or are responsible for.
- The graphic highlights the significant costs associated with theft & fraud losses. Theft & fraud losses can be split between external (no employee involvement) and internal (employee involvement) fraud related matters. Additionally, internal fraud claims can be divided into two distinctly different categories.
- Improper business practices claims were the most frequently notified and relate to breaches of regulations and legal requirements as well as market manipulation, money laundering and anti-competitive behaviour matters.
- An explanation for all type of loss categories can be found in Appendix II.

Commercial D&O types of loss



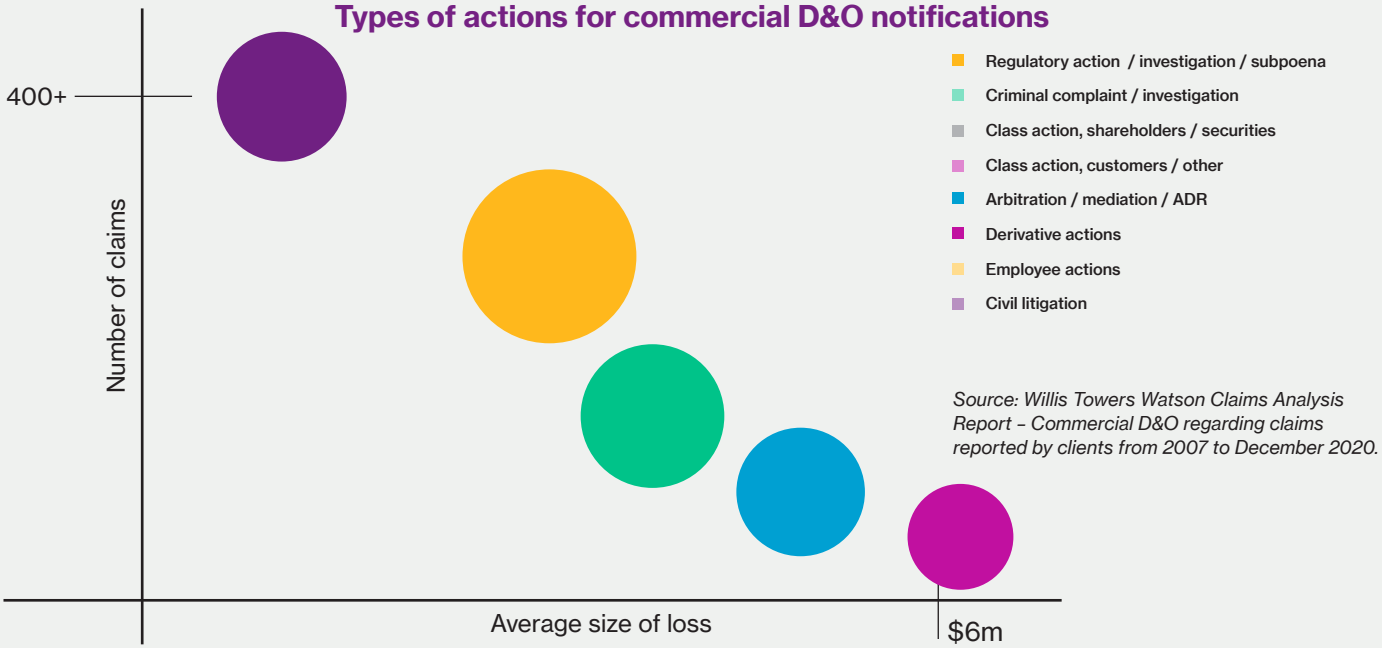
- Share issues / Shareholder complaints
- Mergers & acquisitions / disposals
- Suitability, disclosure & fiduciary
- Improper business practices
- Monitoring & reporting
- Corporate governance
- Insolvency/liquidation
- Employee relations
- Environment, safe
- Theft & fraud

Source: Willis Towers Watson Claims Analysis Report – Commercial D&O regarding claims reported by clients from 2007 to December 2020.

Claims Environment: London Market Action Types

The chart highlights the different types of actions that have been filed against insureds.

The chart shows the various action types by both frequency (vertical axis) and average size of loss (horizontal axis). The size of the bubble represents the total costs of claims involving each action type. The total cost includes both insured and uninsured elements.



The Outlook for 2021

- We anticipate that many clients renewing in Q1 2021 will face similar levels of challenge and particularly premium increases as were seen in 2020. This is particularly true for clients who have AXA XL as the primary insurer on their programme as insurers willing to write primary D&O remain scarce.
- However, we are seeing increasing exceptions, particularly for clients who have already been through a number of years of significant increases to their premiums where we have seen only very moderate increases for their latest renewal.
- We anticipate more differentiation in the market based on industry sector and specific client risk profiles. However, clients whose premium is below the average are still likely to see significant price increases.
- Israel and Australia continue to be particularly challenging for D&O placements, with few insurers willing to offer terms below $50m.
- As the year goes on, more clients will be renewing in circumstances where they have already been through a renewal in the peak of the hard market in 2020. There are also increasing numbers of new insurers coming into the D&O market, easing some of the pressure on capacity. However, even later in 2020, we continue to anticipate that challenged industries, jurisdictions and clients with recent claims are likely still to face challenging renewals.
- We are seeing increasing focus by insurers on external data eg ESG scoring companies, S&P data and we expect this trend to continue.

Solutions in a Hard Market

- We are increasingly working with clients to review the structures of their D&O programs.
- Arrangements purchased in a soft market may no longer be appropriate and/or achievable in a hard market.
- We are seeing:
  - Increasing focus by clients on Side A coverage.
  - Increasing willingness by clients to take on significant retentions for Sides B and C to reduce the overall premium and/or to increase the number of insurers willing to participate given the higher attachment.
  - Increasing use of captives to replace holes in programs where insurers have withdrawn from the market or where insurers are seeking to impose unsustainable premiums or exclusions.
  - Some use of co-insurance (i.e. where only part of a layer is insured and part is uninsured).
- Many clients are exploring their D&O programs and we are working with them to consider alternative structures. As a global broker, we are able to obtain the best from the insurers who remain in the D&O insurance market and we have dedicated teams of captive experts working with our clients to develop solutions where the commercial market is unable to meet our clients' needs. We are also increasingly deploying our risk and data analysts to ensure our clients risk profiles are best presented to insurers.

Appendix I

Methodology for statistics

	Min	Max	Notes
ROL	0.01% ROL	No max	These graphs and stats are looking at the ROLs paid each month. Currently we only have a minimum value for ROL, we could consider having a max ROL.
ROL change	0.01% ROL	No max	We are comparing the ROL paid last year to the ROL paid this year for a given client at renewal. The outlier rule ensures an erroneously small ROL isn't compared to a normal one resulting in a gigantic value (eg 1% / 0.0001% = 10,000 times increase). We could also add a maximum increase cap, eg no more than a 10 fold increase in ROL.
Deductible change	x - 10	x 50	As above, here we are comparing the deductible last year to the deductible this year for a given client at renewal. Given the hugely different sizes of programmes placed it is difficult to set a min or max for the actual deductible value so instead we have tied the rules to the change in deductible seen. A max increase of x50 was set as the previous x20 was seen as too small. This may want to be reviewed.
Limit	0.01% ROL	No max	Again, it is difficult to set a min for limit value due to the spread of clients we have. Given the ROL value combines premium with limit it can be used to identify an error in one of the two. However, it could result in us excluding placements with correct limit values (and incorrect premiums). We could consider adding minimum and maximum limit values instead.
Limit change	x - 10	x 50	Similarly to deductible change, here we are comparing the limit bought last year to the limit bought this year for a given client at renewal. Given the challenge in setting min and max limit criteria the outlier rule looks at the calculated limit change and sets boundaries for that. A max increase of x50 was set as the previous x20 was seen as too small. This may want to be reviewed.

Appendix II

Loss event descriptions

- **Improper business or market practices** - This will include claims where there has been a breach of laws and/or regulations, such as antitrust, market manipulation, insider trading and money laundering. Claims based on civil liabilities such as defamation and breach of contract will also sit within this category alongside unfair and disputed level of fees/ charges.
- **Corporate governance** – These losses relate to the running of the insured's business and often have a regulatory aspect to them. Included will be claims related to inadequate control procedures (for anti-money laundering, insider trading, anti-bribery and corruption etc.)
- **Mergers & acquisitions** - This category includes claims in relation to any M&A activity for the insured's own business.
- **Monitoring & reporting** - Will include claims where requirements for financial returns, compliance reporting, tax reporting (such as FATCA) etc. have not been met. We include reporting requirements for governments (national or local), government departments, administrative bodies and regulators.
- **Theft & fraud** – Where the insured has been defrauded or had assets stolen. This category will include securities fraud, theft of assets or information, conversion, forgery, insider trading, account impersonation (social engineering) and other systems security type losses (hacking damage, denial of service attacks etc.). Theft & fraud losses can be divided into external (no employee involvement) and internal (employee involvement) related matters. Internal fraud claims can be further divided into two different categories. Firstly, there are claims where the insured has been the victim of the wrongdoing. For example, an employee stealing from the insured, or receiving bribes for the benefit of the individual, without the knowledge of the employer. By contrast, there are also claims where allegations centre on the insured itself committing the theft/fraud for the benefit of the company – such as tax evasion, or paying bribes with the knowledge of the company.
- **Share issues/Shareholder complaints** – Claims in relation to the offering of for sale of shares in a business. Often relates to the information provided during the share issues (such as the prospectus etc.)
- **Employee relations** – Claims/potential claims concerned with maintaining employer-employee relations. Includes claims related to compensation/benefits, termination, unfair treatment at work and other employment contract issues/disputes.
- **Environment, safe** – Claims/potential claims against the insured claims related to the safety of the working environment.
- **Suitability, disclosure & fiduciary** – As well as breaches of fiduciary duty, this category will include claims where suitability requirements have not been met, such as "know your client" failures. The disclosure aspect includes claims based on what the insured should have disclosed and also what it should not have disclosed, such as breach of privacy claims. Sales practices and mis-selling sit within this category alongside conflicts of interest – both disclosing and managing.

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