Financial Services Guide
Directors and Officers

Directors & Officers (D&O) Insurance Market Insights – Q2 2018

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Directors & Officers (D&O) Insurance Market Insights

Overview

- The D&O insurance market continues to harden for listed companies; however, it remains stable, with modest premium increases, for non-listed organisations.
- The securities class action environment remains active and, as a result, we may see an increase in the average settlements.
- Unless substantial premium re-alignment can be secured, local insurers appetite for mid-large listed companies purchasing Side C cover remains limited; this is where the London market is playing a stronger role.
- Some insureds are exploring the economics of bearing increased retention of securities class action risks in an attempt to mitigate premium increases.
- There is ongoing volatility ahead for listed companies; and non-listed companies should expect a stable market with modest increases in the short-medium term.

State of the market

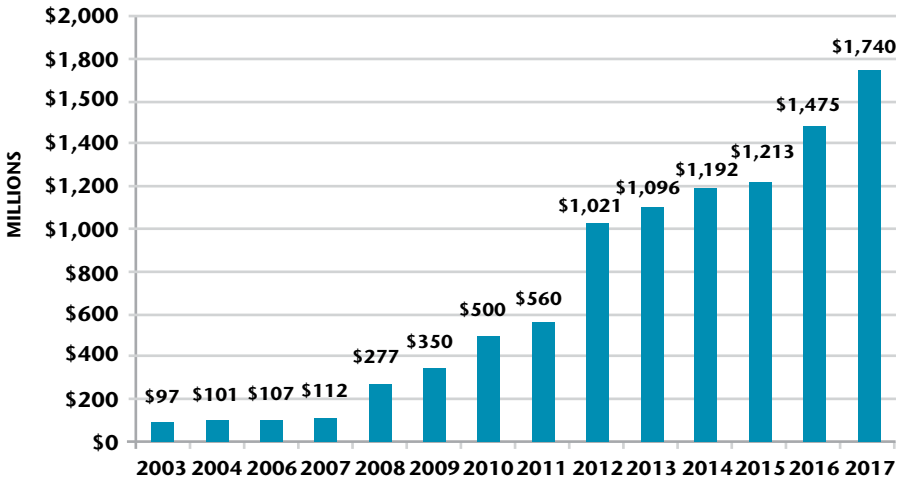
At the mid-point of Q2 2018, the D&O insurance market continues to deteriorate for publicly listed companies. Following the close of 2017, insurers have reviewed the performance of their portfolios and boosted the momentum of pricing realignment to return their portfolios to profitability. The environment is less volatile for non-listed organisations. In Q1, the active securities class action environment has seen a number of new securities class actions filed, or being proposed to redress alleged breaches by companies of their continuous disclosure obligations, or alleged mis-statements, or misleading conduct by companies or their leadership teams. This brings the number of open class actions to circa 20 (excluding multiple actions). The fallout from the *Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry* is further impacting insurers' bottom lines through the payment of inquiry defence costs and securities class action activity. The Royal Commission is the latest chapter in the increased regulatory scrutiny facing Australian companies. For medium sized non-listed organisations, harder market conditions are evident. Insurers have become rigorous in their underwriting reviews and are more commonly limiting coverage based on individual risk profiles. Renewal premium increases of up to 10% are not uncommon.

Settlements may increase

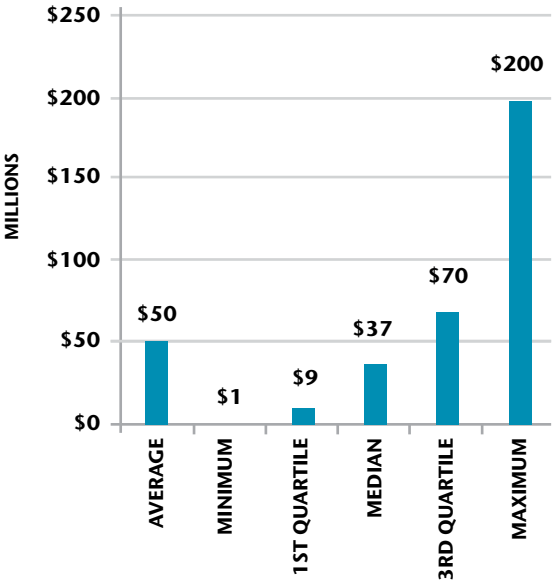
Whilst the average settlement in a securities class action is currently circa $50 million, it is anticipated that the recent QBE settlement ($132.5 million, December 2017) coupled with current open claims activity may result in upward pressure on the settlement average.

This follows the fact that insurers' appetite for the provision of cover for securities entity claims has substantially diminished. Insurers are becoming increasingly selective in relation to the risks they are prepared to insure and the terms upon which insurance will be provided. This is particularly evident in respect of insurer participation in the first $100 million of coverage provided.

Settled Securities Class Actions – Cumulative Total ($millions) by Year[1]



Settled Securities Class Actions ($millions) – Quartile Metrics[1]



Appetite is low; targeted and considered marketing strategy is key

Increasingly, insurers are expecting insureds to bear some of the risk of a securities class action through the increase in minimum retentions for securities entity claims. In addition, we are seeing attempts by some insurers to extend this practice to retentions borne by the company in relation to the company's reimbursement of Insured Persons under deeds of indemnity and the like. There is significant volatility regarding primary and low attachment excess pricing with insurers seeking substantial premium uplift, in many cases greater than 100%. For some insureds, including those operating in market sectors with disruptors, or those with small market capitalisation, securities entity coverage is becoming less available. The London market is playing an increasingly important role in the placement of mid to large listed company risks due to capacity shortfalls or prohibitive pricing in the Australian market. It is clear that insurers are prepared to "walk away" if pricing for their exposure does not meet their minimum expectations.

Despite pricing pressures, insured's limit of liability (sum insured) purchases have remained relatively stable. However, insureds are increasingly exploring the economics of bearing an increased retention of the securities class action risk via various structures with a view to mitigating premium uplifts at a primary level. In addition, there is renewed focus on ensuring that an adequate portion of the overall limit of liability is ring-fenced for the specific benefit of Insured Persons through either the purchase of Side AB or Side A "Difference in Conditions" policies.

Scrutiny on litigation funders

The Victorian Law Reform Commission has recently completed its report on *Access to Justice: Litigation Funding and Group Proceedings* and provided the report to the Attorney General. The review considered a number of issues including whether lawyers should be allowed to charge contingency fees; and whether litigation funders should be subject to additional supervision. The report is expected to be tabled in parliament in the near future. The Australian Law Reform Commission is conducting a similar review in relation to whether class actions and litigation funding should be subject to Commonwealth regulation. The Report in relation to this review is tabled for delivery on 21 December 2018. The outcome of these reviews may change some of the market dynamics; however, it is unlikely that those changes will provide relief from securities class actions.

If plaintiff law firms are permitted to charge contingency fees, a larger number of smaller class actions may be explored by plaintiff law firms.

What about coverage?

Whilst breadth of coverage remains largely stable, insurers have little appetite to entertain further coverage enhancement.

[1] Data for the production of the graphs has been sourced in part from; Maurice Blackburn Website https://www.mauriceblackburn.com.au, https://www.mauriceblackburn.com.au/past-class-actions/rivercity-class-action/ Slater & Gordon Website; https://www.slatergordon.com.au/class-actions, https://www.slatergordon.com.au/media-centre/media-releases/billabong-shareholder-class-action-reaches-45-million-conditional King & Wood Mallesons, The Review; Class Actions in Australia 2015/2016 http://www.kwm.com/en/au/knowledge/downloads/class-actions-2015-2016-year-review-increased-threat-new-normal-20160826, Oz Minerals Limited ASX Media Release dated 160615, https://www.ozminerals.com/uploads/media/160615_Class_action_settlement.pdf, Investor Claim Partner Website https://www.icp.net.au/icp-claims/tamaya-6-75m/, https://www.icp.net.au/icp-claims/slater-gordon/ https://www.icp.net.au/icp-claims/treasury-wine-estates-mb/ https://www.icp.net.au/icp-claims/qbe/ https://www.icp.net.au/icp-claims/gio/

Looking ahead

For listed companies, insurers are becoming less willing to provide premium guidance more than 3 months out from renewal. This is a sign of ongoing volatility. Upward premium pressure is expected to continue unimpeded until tempered by competitive forces. For non-listed companies, a stable environment is expected in the short to medium term with tightened underwriting controls and moderate premium pressure.

It is essential that insureds commence their renewals early and work in partnership with their brokers to differentiate their risk profile from their peers to secure an optimal renewal outcome.

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