Directors & Officers (D&O) Insurance Market update

Overview

- Insurers' are re-evaluating their pricing models and overall appetite for public company D&O in the face of significant securities class action claims activity.
- Insurers' appetite for private company D&O risks remains strong and this market sector remains stable.
- Longer lead times will be required for marketing or remarketing of cover, in order to ensure pricing contestability and to secure optimal outcomes.

State of the Market

The marketplace is transitioning from an actively competitive environment with an abundance of capacity to an increasingly cautious environment, where insurers are demonstrating more selective capacity deployment and less aggressive pricing strategies.

This is most acute for public company D&O who are seeking the inclusion of cover for securities entity claims (Side C), and difficult to place D&O due to prior claims activity, financial profile or participation in more volatile industry sectors.

Insurer's aggressive pricing strategies over a number of years, brought about by an abundance of capital and competition from new entrants, has placed the Australian premium pool under enormous pressure. The Australian pool is currently around $250 million, yet we have seen successful individual claims in excess of $100 million.

With the Australian premium pool struggling to cover the quantum of current claims activity, insurers' profitability has suffered to the extent that current pricing and capacity models (i.e. the amount of capital insurers' are willing to offer insureds) have become unsustainable.

Insurers' corrective action includes taking a stronger focus on capacity management, with reductions in capacity being commonly offered on low attachment excess positions. Insurers are also employing various strategies to ventilate their participation, including;

- Agitation for co-insuring certain risks with other insurers,
- Seeking opportunities which allow smaller participation on multiple layers,
- Participation above perceived "burn zones" of $70 million to $100 million, and
- Taking a greater interest in and competing more aggressively for AB positions (participation on layers that do not include cover for securities entity claims), or participation on Side A "Difference in Conditions" programmes.

At a primary attachment, most insurers are limiting their capacity outlay to not greater than $10 million, where cover is included for securities entity claims, although some insurers have recently reconfirmed a preparedness to maintain larger capacity outlay on preferred risks.

For private company risks, or public company risks which do not include exposure to securities entity claims, insurer appetite remains relatively stable, subject to Insured's individual risk profiles.

Whilst breadth of policy coverage also remains stable, a number of insurers have recently released new or refreshed primary policy forms which will allow them to compete on primary opportunities. Some of these insurers are new entrants to the primary D&O market, previously only participating on excess D&O programmes.

Overall however, participation on securities entity claims cover (Side C) is expected to be cautious.

A more Litigious Environment

The securities class action activity is being fuelled by an increase in the number of litigation funders in Australia (currently 17), as well as a growth in the number of law firms that are attempting to establish repeat class action practices. In effect, this has created a business model whereby opportunities to bring class actions are actively investigated for the benefit of aggrieved shareholders based predominately on alleged lack of timeliness in the provision of disclosures to shareholders or alleged misrepresentations to shareholders.

Higher Premiums; Lower Capacity

Insurers are exerting significant pressure on rates for primary and low attachment ABC programmes.

This re-alignment of pricing at low attachments recognises the changing claims landscape and the increased frequency at which low attachment excess layers are exposed to claims.

Insurers are also much more cautious about stepping in to fill capacity shortfalls that may have arisen as a result of other incumbent insurers reducing the amount of capacity they're prepared to offer, particularly at low attachments.

Insurers are also clearly differentiating between pricing for incumbent programmes and participation on new risks, with premiums for first time purchasers of securities entity coverage being up to threefold the premium quoted for existing purchasers.

Whilst we expect Insurers to continue to look for opportunities to secure premium increases, especially on layers in the first $100 million, D&O pricing remains volatile, as Insurers seek to "fine tune" their forward moving strategies, whilst maintaining competitiveness. Given the current market pricing inconsistencies clients will need to allow longer lead times for the marketing or remarketing of their cover to ensure pricing contestability.

Terminology

Side A - Directors & Officers

Provides indemnity to directors & officers for claims brought against them where they are not indemnified by their Company. (Natural Person Protection)

Side B - Company Reimbursement

Provides indemnity to the Company where the Company grants indemnification to its directors & officers in respect of claims brought against the directors & officers. (Balance Sheet Protection)

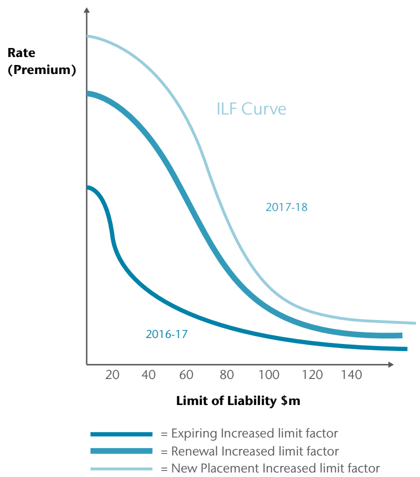
Side C - Securities Entity

Provides indemnity to the Company in respect of securities claims brought against the Company by security holders. (Balance Sheet Protection)

London beginning to Harden

Over the last 12 months, the London market has demonstrated a strong appetite for Australian risks at competitive premiums, as the London market had not suffered the same level of losses as the Australian market. However, the London market is now catching up in terms of premiums, and while it is still possible to source competitive opportunities there, the appetite for low attachment coverage that includes securities entity cover, is much less than it was six months ago.

What's Happening in the D&O Market
Public Companies, including Side C



More than just Class Actions

Although securities class actions have dominated the D&O story, there has also been considerable activity in other areas, which is also driving insurer's decision making. This includes increases in regulatory investigations, and other general claims against directors. There have also been a few claims around insolvencies — some of them involving quite high-profile directors.

In D&O, hits against insurers are coming from every direction.

Looking Forward

The market has reached a stage where the lower appetite for moving into low attachment Side C coverage is enabling insurers to achieve some of the corrective pricing they're seeking.

Insureds should expect to incur high double digit rate increases on renewal of primary or low attachment ABC layers. Where current programmes are priced very aggressively, the consequent correction may be higher. On new business, many insurers will be seeking minimum rates for participation on primary ABC and low attachment excess ABC.

Insurers are reviewing the adequacy of retentions, and for Side C coverage, looking at a minimum retention of between $1 million to $5 million.

For private company risks, or public company risks which do not include exposure to securities entity claims, or volatile industry sectors, insureds should anticipate flat to modest increases in premium.

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