2018 Management Liability Market Update

With the calendar fully transitioned to a New Year, it is natural to take stock of recent trends within the Directors' & Officers' ("D&O") Liability marketplace, as well as consider what may be to come in 2018. With that as background, Aon has identified some of the key considerations that marked 2017, as well as those that may define 2018. By no means is this list all-inclusive, but these items are sure to impact the market dynamics in the year to come, so clients and brokers alike are advised to monitor them closely.

Exposure

Securities Class Action Filings

In 2016, following key judicial decisions, merger objection claims began to migrate to federal courts, and this migration helped drive an unprecedented 412 total Securities Class Actions (SCA) in 2017[1]. Four hundred and twelve SCAs represent a 52 percent increase vs. the elevated levels of 2016, and a 118 percent increase vs. the prior ten-year (2007-2016) average of 189. While the spike in the number of SCAs is remarkable, the probability of a public company facing a shareholder suit is quite concerning. With an estimated 4,000 U.S. public companies (4,331 at the end of 2016 to be exact, according to the World Federation of Exchanges), the probability that a U.S.-listed company will be defending itself against alleging shareholders is approximately 10 percent. While the 412 SCAs in 2017 are well-above recent averages, the probability of an SCA is significantly above long-term averages. This trend has D&O underwriters pointing to SCA activity levels with heightened concern.

Cyber Risk is D&O Risk

For years, insurance industry pundits predicted that cyber-related losses could lead to D&O claims. Prior to 2017, that concern was largely overstated since most headlining cyber breaches resulted in dismissal of the related 'follow on' shareholder derivative litigation. However, 2017 chronicled a different story. The $350 million reduction in purchase price for a leading technology company following its disclosure of massive breaches, the WannaCry ransomware incident, the NotPetya ransomware incident, and the Equifax security breach have changed the paradigm. Cyber events now rank among the top three triggers for D&O derivative actions (along with M&A activity and environmental issues). It is paramount that corporate leaders assess, test, quantify, mitigate, and plan for such a risk.

EPL Risk is D&O Risk

Workplace harassment allegations are front page news, with examples ranging from pop culture icons, to government leaders, to corporate-wide scandals. These allegations are first and foremost devastating for the victims involved. The increasing exposure is impacting companies' bottom lines and no industry is immune. Workplace harassment can have a significant adverse business impact, such as damage to a company's reputation or strained relationships with investors, and may mandate change in the c-suite.

The growing frequency of sensational harassment examples serves as a call to action for corporate leaders to revisit tools available to mitigate the exposure and to review their insurance program.

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[1] *2017 Securities Class Action Filings." Stanford Law School Securities Class Action Clearinghouse. Accessed 8 January 2018.*

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Coverage

D&O

With few exceptions, 2017 was once again a year of enhanced coverage for most industries, products, and insureds. General trends included:

- Entity investigation coverage continues to be available for most public company clients, albeit with a meaningful additional premium
- Aiding and abetting, books & records costs, and express plaintiff's attorneys fee coverage are commonplace
- Side A limits reinstatement provides additional protection for individuals; enhanced fines and penalties cover also is available on a Side A basis
- Side A enhancement cover (within the ABC tower) continues to grow in availability with selected markets
- Increasingly unique innovations from Aon out of both Bermuda (Aon Enforcer, CAT-5, Chief Compliance Officer, Chief Information Security Officer, Compensation Clawback) and London (Aon A+ Protect) offer companies customized solutions many of which are exclusive to Aon clients

While the benign pricing environment has led to many happy insureds with regard to price results, for D&O the "devil is in the details," and 2017 served as an excellent opportunity for insureds to achieve additional coverage enhancements (in many cases, for no impact to premium). While many insurers are pushing for rate increases in 2018, they have not yet indicated the intent to reduce D&O coverage.

Other Lines

While the D&O coverage environment was favorable for insureds in 2017, and expected to continue to be in 2018, the reality of other lines is mixed. Some general observations and predictions include:

- **Crime:** Significant social engineering limits are available (often for additional premium); Cryptocurrency will be a focus coverage topic in 2018.
- **EPL / Wage & Hour:** Traditional EPL remains stable, with nuanced improvements available; Pricing and retentions for Wage & Hour coverage continues to become more attractive.
- **Fiduciary:** Excessive fee exposures are of particular focus for underwriters, and insureds can expect more questions and potentially higher retentions specific to financial institutions. Some insurers are excluding loss related to proprietary funds in sponsored retirement plans, which has resulted in numerous "excessive fee" claims.

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Markets

Insurer consolidation continued in 2017 (with Sompo/Endurance; Liberty/Ironshore; AWAC/Fairfax as selected examples). Thus far, the industry consolidation has had minimal disruption on D&O capacity, although it remains to be seen if:

1. **The expected further consolidation occurs, and**
2. **What impact such consolidation may have on capacity supply trends.**

Of note in 2017, natural disasters in the fourth quarter have had a significant earnings impact. The near-term impact is likely to be occurring in the property market, with one analyst report indicating that, "record 2H17 catastrophe losses give insurers air cover to raise prices," and that "property prices could be up mid-to high-single digits following the 2H17 cats."[2] Further, many direct D&O insurers have indicated they intend to seek rate increases in 2018, following both D&O-specific claims activity as well as the 2017 P&C losses.

> "Many classes of D&O and employment practices liability are not adequately priced. Loss frequency and severity have been increasing. Combined ratios have reached a point in certain classes that are simply unacceptable. For example, in U.S. publicly traded D&O, rates went flat in the second quarter and were, in fact, up 2% in the third."
>
> - Insurer Q3 2017 earnings call

2018 Outlook

Insurance underwriters can be accused of "chicken little syndrome" quite frequently, as the sky seemingly is always falling. However, 2018 seems unique in that current pricing levels, recent claims activity, natural catastrophe losses, and public stances by leading insurers all point towards a market inflection point. The advice to differentiate an insured's risk is no more relevant than it is in 2018. Further, we recommend insureds carefully evaluate emerging exposures, such as Cyber and EPL, strategically consider the many coverage innovations recently achieved in the marketplace, and prepare for a potentially different purchasing environment in 2018 relative to recent years.

[2] *DeWitt, Sarah. 2018 Outlook: Industry Could Benefit from Gradual Rise in Prices, Low Inflation and Tax Reform Is Net Positive. J.P.Morgan. 15 December 2017.*