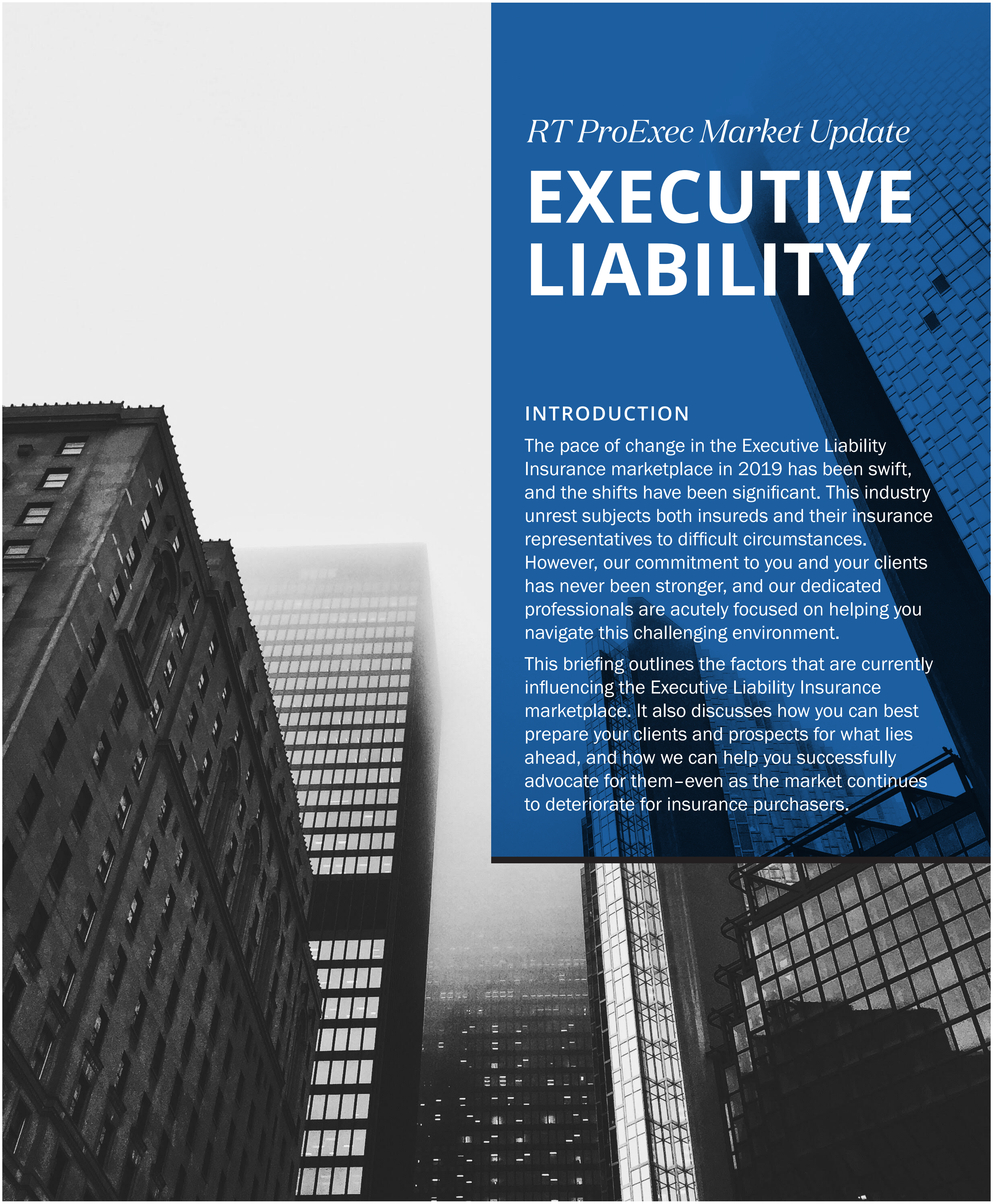

RT ProExec Market Update

EXECUTIVE LIABILITY

INTRODUCTION

The pace of change in the Executive Liability Insurance marketplace in 2019 has been swift, and the shifts have been significant. This industry unrest subjects both insureds and their insurance representatives to difficult circumstances. However, our commitment to you and your clients has never been stronger, and our dedicated professionals are acutely focused on helping you navigate this challenging environment.

This briefing outlines the factors that are currently influencing the Executive Liability Insurance marketplace. It also discusses how you can best prepare your clients and prospects for what lies ahead, and how we can help you successfully advocate for them–even as the market continues to deteriorate for insurance purchasers.

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RT ProExec

Many Executive Liability insurers are taking action to correct for continuously poor underwriting results, stemming from years of depressed premiums brought about by the intense competition of the past decade. Market corrections began in the second half of 2018 and have continued at an accelerating pace during 2019, with steeper premium increases, higher retentions, and – at times – reduction in capacity, the addition of restrictive terms, and even non-renewal. The hardening of the market is most pronounced with regard to initial public offerings (IPOs) and for publicly traded companies, particularly those in the technology and life sciences sectors.

Market Illustrations

In its midyear report detailing changes in the D&O market, FitchRatings observed that market recognition of deteriorating results and the need for underwriting and pricing actions have taken hold. The Fitch report suggested that corrective measures executed by market leaders such as AIG and Zurich are promoting rate movement in the broader D&O marketplace, and speculated that rate hardening will endure through 2020. Notably, the Fitch report commented that even while pricing actions gain momentum, it remains unclear whether rates can outpace loss trends.

AIG

On AIG's 2019 third quarter earnings call, AIG General Insurance CEO, Peter Zaffino, mentioned that in North America financial lines, AIG reported 30 percent rate increases across commercial D&O led by increases exceeding 35 percent for public D&O. The insurer reduced primary commercial D&O aggregate limits by over 40 percent in the quarter compared to a 30 percent reduction in the second quarter. It reduced primary commercial D&O policies with limits greater than $10mn in lead layers by over 40 percent.

CHUBB

Chubb has taken a noticeably more conservative approach to underwriting D&O over the past year. In a Q3 2018 earnings call, executive chairman and CEO John Keogh commented that D&O rates had not been adequate in recent years, and, in a subsequent earnings release, the company made it clear that it was willing to trade growth for adequate pricing. The same philosophy was reiterated (more broadly) in the insurer's 2018 Annual Report, which stated that "[i]t's about the discipline to walk away from business and shrink when necessary…" In the earnings call, Chubb's Chairman and CEO, Evan G. Greenberg said that Public D&O rates increased over 17.5% for major accounts during the 2019 third quarter and 32% for middle market accounts.

ZURICH

On its Insider webpage, Zurich has commented on how the world of D&O insurance is changing. In a May blogpost, Zurich acknowledged that for a decade, risk managers were accustomed to negotiating D&O renewals with regular premium reductions and coverage enhancements, but Zurich cautioned that this had changed in the past year, leaving many who had sought to renew D&O cover shocked by insurers' changing appetite for the coverage line.

CNA

In an earnings call, CNA's Chairman and CEO, Dino Robusto, revealed that CNA achieved a composite rate increase of 42% across its Public D&O business for the 2019 third quarter. This compares to a 15% increase in the second quarter.

Market Share

Both industry consolidation and underwriting corrections are impacting market share. M&A activity is likely to continue as insurers seek non-organic growth, which can hamper competition. But the largest influence on market share has resulted from established carriers executing new underwriting strategies with an eye toward underwriting profitability. As AIG has re-underwritten its book of business in an effort to improve profitability, AXA XL has assumed the leading market position for D&O liability insurance for the first half of 2019.

D&O MARKET SHARE: First Half of 2019 Direct Written Premium ($3.4 Billion)

TOP 5 MARKETS[1]

AXA-XL	15%
AIG	12%
Chubb	11%
Tokio Marine US	7%
Travelers	5%

Public Company Directors & Officers Liability Insurance

The Public D&O insurance marketplace continues to harden. While premium and retention increases have become the norm across the board, the magnitude of the increases varies depending on insureds' class of business, with healthcare, life sciences, technology, communications and financial services companies often experiencing the most drastic changes.

> *"The annualized litigation rate during the first six months of 2019 was 8.4%, which would match the historically high litigation rates seen in 2017 and 2018"*

The recent heightened pace of Securities Class Action (SCA) lawsuit filings remains a significant concern. 2017 was a record-setting year for SCA lawsuit filings, when there were a total of 412 federal court securities suit filings. The intense pace of securities suit filings continued in 2018, with a total of 403 actions in federal court. Chubb reports that in 2018, SCA filings were highest in three industry sectors: healthcare, technology and financial services. There is also variation depending on domicile of the insured, with companies in California, Texas, Florida and New York being the most often sued.

The amplified pace of SCA litigation continued into the first half of 2019, when there were 199 federal court SCA lawsuit filings. The 199 securities suit filings during the year's first half projects to a year-end total of 398 securities suits, which, while slightly below the 2017 and 2018 year-end totals, would significantly exceed the 1997-2017 annual average of 203 SCA lawsuits.

While it is interesting to look at the absolute number of securities lawsuits filed, a more contextual way to assess securities litigation activity is to consider the rate of litigation–that is, the number of securities lawsuits filed relative to the number of publicly traded companies. The litigation rate has increased significantly in recent years while the number of publicly traded companies has decreased (due to mergers, bankruptcies, etc.). According to Cornerstone Research's mid-year 2019 review of securities class action filing activity, the annualized litigation rate during the first six months of 2019 was 8.4%, which would match the historically high litigation rates seen in 2017 and 2018 (i.e. a company has an 8.4% chance of being sued). At these litigation rates, the likelihood of a listed company getting hit with a securities suit is arguably as high as or higher than it has ever been. Even if the merger lawsuits are taken out of the equation, the 2018 securities litigation rate calculates to 4.6%, which was also the highest-ever frequency. By way of comparison, according to Cornerstone Research, the average annual litigation rate during the period 1997 to 2017 was 2.9%.

Now that we are in our third year of heightened levels of securities litigation filing activity, it is apparent that the increased pace of securities suit filings represents the new normal. The increased risk of a SCA lawsuit is a problem for all U.S.-listed companies and for their insurers, and the increased securities litigation activity during the last three years is one of the significant factors contributing to the current increases in pricing and retentions for D&O insurance.

The United States Supreme Court decision in Cyan Inc. v. Beaver County Employees Retirement Fund[2] has also significantly impacted the D&O marketplace, particularly with regard to companies conducting initial public offerings. In brief, Cyan affirmed that state courts have concurrent jurisdiction with federal courts to adjudicate SCA claims brought under the Securities Act of 1933. State court filings of Section 11 claims, alleging material misrepresentations in a securities offering by a corporate issuer, are indeed on the rise since Cyan. Stanford Law School Professor and co-director of the Rock Center on Corporate Governance, Joseph Grundfest, has commented that while Section 11 claims were historically litigated predominantly in federal court, with state court Section 11 litigation being a "minor sideshow that warranted little, if any, attention," by 2018, state courts had come to dominate Section 11 litigation. In a recent Rock Center report, Grundfest notes that of 41 issuers facing newly filed Section 11 claims in 2018, only 27% faced actions filed exclusively in federal court, whereas 73% faced claims either exclusively in state court, or in both state and federal court. According to the Rock Center report, the maximum dollar loss exposure associated with recent state court Section 11 actions has surged to $25 billion, a 38-fold increase over 2010 levels.

A byproduct of Cyan for corporations and their D&O insurers is significant legal uncertainty. State judiciaries are generally less familiar than their federal counterparts with Section 11 litigation, and parallel proceedings increase the likelihood of inconsistent rulings. Further, a relatively lenient bar at the motion to dismiss stage in state court has arguably allowed weaker claims to proceed, which has opened the door to "emerging" plaintiffs firms enticed by the potential for substantial attorneys' fees, and a surge of new, less meritorious litigation against smaller companies. Finally, whereas prior to Cyan, state court Section 11 litigation was concentrated in California, since Cyan, Section 11 litigation has increased sharply in the state of New York.

Merger Objection Lawsuits

Of the 199 federal court SCA lawsuits filed in the first six months of 2019, 73 (about 37%) were merger objection lawsuits. This compares to 45% and 48% for full year 2018 and 2017 respectively. The percentage decreases can be directly related to the judicial disdain for disclosure only settlements.

In light of the above, the plaintiffs' bar has changed its approach to merger objection lawsuits. Instead of aiming for disclosure-only settlements, the plaintiff's lawyers are increasingly agreeing to dismiss their suits in exchange for the defendant's agreement to add additional disclosures and pay the plaintiff's counsel a so-called mootness fee.

All of the foregoing factors have led to additional defense and settlement expenses for SCA claims, which in turn has led to significant changes in underwriting appetite among D&O insurers, especially when pricing IPOs. D&O pricing for IPOs has increased substantially–in some cases evidencing a rate on line of 20% to 30%+ (rate on line is a method of measuring premium dollars as a percentage of the limit purchased, so, by way of example, an insured paying $1,000,000 in premium for a $5,000,000 limit is paying a 20% rate on line for that policy). Retentions have also increased to new heights, as insurers are requiring companies to assume much more risk before policy coverage responds.

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SCA litigation is increasingly represented by so-called "event-driven" lawsuits, which allege corporate mismanagement following an adverse event related to a company's operations (e.g., a cyber breach, sexual harassment allegation, hostile corporate culture, environmental event or product liability issue). Just as they have done when faced with traditional securities fraud allegations tied to financial reporting, corporations and their executives are looking to their D&O liability insurance coverage for protection from defense and settlement costs for event-driven securities claims. Traditionally, the vast majority of D&O claims arose from financial and other internal control issues. Over the past three decades, underwriters have developed reasonably reliable underwriting processes to judge a prospective insured's approach to financial reporting and internal control processes. The increasing risk of SCA claims stemming from events has proven much more challenging to underwrite, and carriers are still struggling with how to incorporate the risk of an event driven SCA lawsuit into their underwriting models.

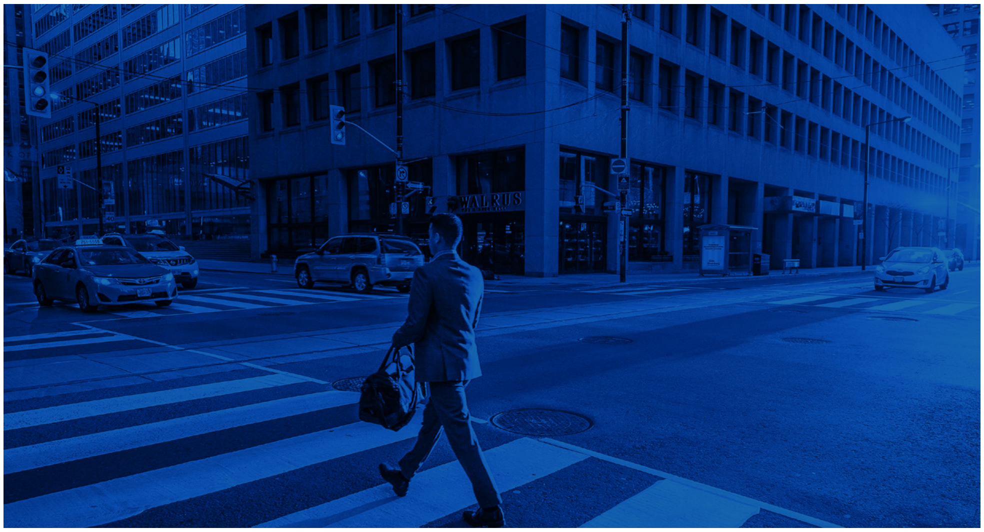
Event Driven Lawsuits[3]

FILED 2018 - 2019

COMPANY	YEAR	LAWSUIT	CAUSE
Boeing	2019	Securities Class Action Lawsuit	Ethiopian Airlines fatal plane crash
Boeing	2018	Securities Class Action Lawsuit	Lion Air fatal plane crash
PG&E	2018	Securities Class Action Lawsuit	California wildfires
Intel	2018	Securities Class Action Lawsuit	Security flaws in its microchips
J&J	2018	Securities Class Action Lawsuit	Personal injury case regarding baby powder
Google	2019	2 separate Derivative Actions	Sexual misconduct involving 2 former executives
Teladoc	2018	Securities Class Action Lawsuit	Inappropriate sexual relationship between CFO and subordinate.
Lululemon	2018	Derivative Action	Sexual harassment and gender discrimination
Papa John's, Nike, CBS, National Beverage, Wynn Resorts	2018	Securities Class Action and/or Derivative Action	Sexual Harassment
Federal Express, Facebook, Google, Marriott	2018 - 2019	Securities Class Action and/or Derivative Action	Breach and non-breach events

Generally speaking, total D&O capacity available in the marketplace has remained consistent. It is the deployment of that capacity that has changed dramatically. Fewer insurers are competing for the primary positions in D&O towers that are comprised of multiple insurers, and excess insurers are charging increased limit factors (ILFs) in the range of 70% to 75% of the underlying price per million. There are many expiring D&O towers in which the ILF was in the 55% to 65% range. Increased ILFs will serve to exacerbate primary premium increases throughout the remainder of the excess towers.

There are other factors influencing D&O underwriters in addition to those mentioned above. Although the regulatory environment is significantly less onerous to companies than it was four years ago, government investigations and whistleblower activity still remains a meaningful exposure for public companies. Increasing legal fees is also a significant concern. In a June 2019 paper by Chubb entitled "From Nuisance to Menace: The Rising Tide of Securities Class Action Litigation", the authors comment that over the last five years, the total cost of securities litigation, including settlements and attorneys' fees, is $23 billion. Of that astonishing total, half of the amount has gone to the attorneys (plaintiff and defense).



Private Company & Not-for-Profit Organization Management Liability Insurance

In the first quarter of 2019, private company management liability insurance carriers were generally seeking premium increases of 5% to 10% (absent any material exposure changes). Since mid-year, many of the same carriers have gravitated toward double-digit premium increases based on actual rate need as well as updated market based underwriting strategies. In addition, a number of established carriers are approaching particular industry classes with significant shifts in underwriting appetite. Of particular note is the healthcare industry. Several D&O insurers with large books of healthcare business are seeking 20% to 30% premium increases at renewal, as well as increasing (often doubling) retentions, and reducing both limits and coverage. Antitrust and unfair business practices coverage has been a hot button issue for healthcare D&O insurers in recent years, as M&A activity has led to increased enforcement action - and thus the potential for significant losses. As a result, healthcare insureds are seeing this coverage removed or sub-limited at renewal, as well as subjected to a higher retention and/or coinsurance.

D&O pricing for "unicorns" (private companies with a valuation of $1 billion or more), has skyrocketed as of late, to near public company premium levels. The marketplace for such risks is also shrinking as D&O underwriting appetites have become more conservative. Of the carriers that are still willing to write D&O coverage for unicorns, some are seeking to convert coverage to public company policy forms, which results in less coverage than privately held companies are accustomed to receiving.

While not the sole driver, Securities and Exchange Commission (SEC) enforcement actions in recent years against privately held companies and their executives have contributed to the hardening private company D&O market (most notably, but not only, for unicorns). The 2018 SEC "massive fraud" complaint against Theranos, Inc., a consumer healthcare technology startup once valued at $10 billion, but now operationally defunct, provided a stark reminder for many in the D&O insurance industry that privately held companies are not exempt from federal securities law enforcement actions.

The Lucent Polymers matter emphasizes that a privately held company does not have to be highly visible or have a high valuation to be in the crosshairs of the SEC. In February 2019, the SEC brought an enforcement action against two former executives of Lucent Polymers, a shuttered Indiana-based plastics and polymers manufacturing company. The two executives allegedly concealed the company's fraudulent financial reporting practices and made misrepresentations in connection with the sale of Lucent to Citadel Plastics Holdings, later profiting substantially from the sale. These executives were separately indicted by a federal grand jury in connection with the same incidents.

The DOJ's press release about the indictments quotes an agency official as saying "Corporate officials who put deviousness over good faith degrade the integrity of our markets and impugn the reputation of American industry. This office will continue to prioritize the investigation and prosecution of corrupt corporate executives who enrich themselves through fraud and deception." The DOJ statement says nothing about the fact that Lucent was a private company.

As the Fenwick & West law firm noted in its February 2019 memo about the SEC's and the DOJ's actions, "The government's aggressive action here is a reminder that securities regulators and law enforcement agencies are increasingly scrutinizing statements

made by private companies, especially statements that create investor fervor and lead to inflated share valuations."

With mounting evidence that the SEC will pursue private company executives for securities law violations, some underwriters are beginning to price in this potential risk.

Employment Practices Liability is an integral coverage part of a well negotiated Private Management Liability Policy. While the changes in the EPL environment have not been nearly as pronounced as those in the D&O space, there are a number of recent legislative changes which warrant discussion.

Statutory developments will continue to drive changes in Employment Practices Liability Insurance (EPLI) pricing, retentions and coverage. #MeToo laws in California, Illinois, New York and other states that mandate sexual harassment training and/or require businesses to take other steps designed to address workplace misconduct may affect EPLI carriers' underwriting appetites.

Also, a recent development in California could set the stage for a national shift in the way independent contractors are treated as well as impact EPLI coverage. California lawmakers recently approved Assembly Bill 5, which codified the state supreme court's 2018 decision in Dynamex Operations West, Inc. v. Superior Court[4], that companies must treat certain independent contractors as employees. The bill provides eligible "gig economy" workers with the right to minimum wage, workers' compensation and other benefits, which, in aggregate, represent a 30% employment cost increase for the affected companies. For EPLI insurers, laws like Assembly Bill 5 could significantly impact ratable exposures (e.g., headcount), leading to higher retentions and pricing for these insureds.

Further, in September 2019, the U.S. House of Representatives passed the Forced Arbitration Injustice Repeal Act (FAIR Act), which aims to invalidate mandatory arbitration agreements and class-action waivers for employment, consumer protection, antitrust, and civil rights matters by amending the Federal Arbitration Act. Among other things, the bill prohibits companies from requiring workers and consumers to resolve legal disputes in private arbitration, a common practice that has often made it difficult for employees to pursue action against colleagues and superiors for workplace harassment. Passage of the FAIR Act would undoubtedly impact the EPLI marketplace, as workers tend to be less successful in private arbitration than in the courts. Restoring court access to millions of workers who have signed away their right to sue would likely lead to higher defense and settlement costs for companies and their EPLI carriers. As of this writing, support for the FAIR Act in the Senate and by the White House is far from certain. However, its passage in the House is a significant development, and we will be following its progression in order to assess how it may affect EPLI insureds in the future.

Although to a lesser degree than public and private company placements, we are starting to see premium increases in the not-for-profit (NFP) executive liability segment. At least one established D&O carrier is re-underwriting its entire NFP book of business, and exiting certain classes altogether. It appears that as carriers seek to address poor underwriting results - and the broader executive liability insurance marketplace hardens, no stone is being left unturned. That said, while NFP D&O business has received significantly less attention than public or private D&O business with regard to rising rates, a major industry survey reports that 63% of NFP insureds have reported a D&O claim. As such, further changes in the NFP D&O space may be on the horizon.

> *"The government's aggressive action here is a reminder that securities regulators and law enforcement agencies are increasingly scrutinizing statements made by private companies, especially statements that create investor fervor and lead to inflated share valuations."*

Market Challenges & Response

Some experts speculate that the hard market for D&O will last 18-24 months, however much uncertainty remains. We believe that the hard market will continue for the remainder of 2019 and possibly for all of 2020. Despite the uncertainty, what does seem clear is that the executive liability marketplace is currently moving in the direction of favoring insurers. While this trend continues, it is vital for insureds to receive constant communication on potential changes to their executive liability insurance premiums, retentions and coverage, as well as the underwriting process.

IPOs and public companies seeking or renewing coverage for the rest of 2019 and in 2020 should anticipate pricing and retentions significantly higher than what the D&O market has been able to offer over the past several years. Private companies and NFP organizations should also be prepared for changes to their terms and conditions, with perhaps more movement between carriers than normal. It is critical to communicate with insureds about the state of the market and the importance of budgeting for increases well ahead of each renewal date.

RT ProExec Can Help

WE CAN ASSIST YOU IN ANSWERING THE FOLLOWING QUESTIONS:

1. How long will the hard market last?
2. What anecdotal evidence will emerge signaling the end of the hard market or a continuation?
3. If the hard market has reached its peak, what does that really mean?
4. How long do you anticipate market discipline to last before competitive pressures emerge?
5. Is there new capacity coming to the market?
6. Are underwriters still re-underwriting their respective books of business?
7. What is the likelihood that Congress will address Cyan? If with a stroke of a pen, Congress resolves the ill effect of Cyan, how will underwriters treat future IPOs and how will they address IPOs when they come up for renewal?
8. During our most recent renewal, our premiums and applicable retentions increased dramatically. Should we expect the same for the upcoming renewal?

We are available to answer the above questions on a general and account specific basis. Further, while the hardening market will certainly present challenges to you and your clients, our resources and support can lighten the burden. Our expertise, diligence and position in the market will help you achieve results for your clients even as carriers attempt to exercise leverage. Having placed over $1 billion of premium in 2018, RT ProExec has become the leading financial lines wholesaler in the U.S. We appreciate that our success is wholly dependent on your success, and we will continue to strive every day to the benefit of you and your clients. As we have when the executive liability marketplace was more buyer friendly, we will negotiate the best possible coverage, for the best possible premium. Our knowledge and resources will remain at your disposal, and as we stay abreast of industry developments, we will aim for our deliverables to assist and support you in the communication of difficult messages.

Finally, our highly proficient claims experts are always available to advocate for your clients on a broad array of issues. As we near the end of 2019 and look forward to 2020, we are un-phased by the changing market or challenges that lie ahead, as we are confident in our ability to serve you well. We thank you for your partnership.

About the Author

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Citations

1. *Stanford Law Securities Class Action Clearinghouse database*
2. *Cyan Inc. v. Beaver County Employees Retirement Fund, 138 S.Ct. 1061 (2018)*
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4. *Dynamex Operations West, Inc. v. Superior Court, 4. Cal. 5th 903 (2019)*