Challenging Times: The Hardening D&O Insurance Market

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Directors and officers (D&O) liability insurance has always been an important tool to protect public companies and their management against claims by shareholders for violations of the securities laws, including claims for inadequate disclosures in public filings and allegations of securities fraud. D&O insurance, however, is becoming increasingly challenging to purchase and maintain. Premiums and deductibles have been increasing, sometimes dramatically, and some insurers are cutting back on the number of companies they insure, causing the supply of insurance to lag behind demand. This alert looks at this current "hardening" D&O insurance market and suggests key steps that clients can take to mitigate its negative consequences.

WHAT IS CAUSING THE HARDENING MARKET?

Insurers are reporting that they have seen record numbers of securities claims over the last several years[1] and a related record number of payouts under their policies. Insurers point to factors such as a significant number of IPOs in recent years that have attracted securities litigation, including in state court. (The ability of shareholders to sue in state court on offering prospectus claims has come as a result of a 2018 Supreme Court case, *Cyan*). Other factors cited by insurers include increased settlement values,[2] litigation caused by adverse events such as cyber-attacks, weather or product liability claims (referred to as "event-driven" litigation) and a growing number of plaintiff shareholder law firms eager to bring claims.

WHAT IS THE IMPACT OF THE HARDENING MARKET?

Not surprisingly, insureds are seeing markedly increased premiums, in some cases double (or even higher) than previous premiums, even for those insureds whose risk profile has not changed. Those premium increases are also being transmitted in large part to the excess layers of insurance, with some insurers closest to the first layer of coverage (referred to as the primary layer) seeking almost as much in premium as the primary layer is receiving. Insurers in some cases are also increasing policy deductibles (the point at which an insurer's payment obligation is triggered). For example, a $2.5 million deductible for securities claims might be increased to $5 million or even higher. For companies going through the IPO process, deductibles may set at $10 million or higher. In some cases, insurers have lowered the amount of limits being offered, for example reducing a $10 million primary layer down to $5 million.

Finally, the current hardening market may mean that certain insurers simply decide not to renew their policies, or underwrite new ones, leading to a more limited pool of insurers for an insured to access. On a positive note, it does not appear that insurers are narrowing the scope of coverage offered under their policies, although some insurers may be less willing to grant coverage improvements than in prior years.

WHAT CAN BE DONE FROM THE CLIENT'S PERSPECTIVE?

First, it is important to plan any D&O insurance renewal or insurance purchase well in advance. This will allow companies sufficient time to engage with their insurance brokers and coverage counsel, who can provide feedback on current market conditions, including projected pricing. Bear in mind that actual premium amounts can be different than initial projections even over the course of just a few months. Companies should also plan on engaging in substantive underwriting discussions with insurers, in order to differentiate themselves from their peers and position themselves as attractive insureds. In the event that insurers do impose higher premiums or deductibles, having sufficient time before renewal can allow insureds to seek potential alternative markets. Finally, in the event that an insured is ultimately required to pay higher premiums, it is important to have sufficient time to adjust internal budgeting.

Given daunting premium increases, insureds are also increasingly considering alternative ways to structure their insurance programs. For example, insureds may consider increasing the amount of their deductibles in order to reduce insurer risk, and thereby reduce the amount of premium charged (or reduce the size of a premium increase). In certain situations, insureds have also considered "captive insurance" programs to replace or supplement traditional insurance programs. (Captive insurance programs are in essence self-insurance programs owned and controlled by insureds rather than insurance companies).

Insureds may also consider reallocating more of their insurance program to so-called "Side A Difference-in Conditions (DIC)" coverage, which is less expensive coverage that is for the dedicated benefit of directors and officers only, excess of all other insurance and indemnification available to those individuals. Care should be taken with respect to any of these changes, however, in order to avoid unduly reducing important insurance protections in the event of claims.

CONCLUSION

The key to navigating these challenging market conditions is to address D&O insurance placement issues proactively and well in advance of any upcoming purchase or renewal. Involving internal and external insurance advisors and coverage counsel is likewise crucial to ensure that the best possible terms, premiums and deductibles are being offered.

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[1] *See e.g.*, Stanford Law School, Cornerstone Research, Securities Class Action Clearinghouse, http://securities.stanford.edu/charts.html.

[2] *See e.g.*, Cornerstone Research, Securities Class Action Settlements, https://www.cornerstone.com/Publications/Research/Securities-Class-Action-Settlements.

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