Client Alert: 2020 Outlook

During 2019, the Directors' & Officers' Liability ("D&O") marketplace changed dramatically for our clients as D&O insurers hit the reset button. Due to increased frequency and severity of securities class action suits, Event-Driven Litigation and other factors we will highlight in this paper, D&O insurers changed how they deployed their D&O capacity. D&O insurers have pushed for rate and retention increases and have decreased the capacity they will deploy on programs. Additionally, we are beginning to see insurers push back on D&O coverage.

As we venture into 2020, it's critical to have a proven, trusted advisor helping you navigate your D&O coverage. Aon's Financial Services Group ("FSG") has the track record to partner with you in this changing marketplace and help you obtain a world class D&O program. In this paper, our team highlights the current factors impacting the Directors' & Officers' Liability marketplace and what you can expect in 2020. We will help prepare you for the challenging year ahead.

2019 D&O Market in Review

The D&O insurance market firmed at an accelerating rate in 2019. The firming market was driven by historically high public company claims activity coupled with 15 years of D&O insurance premium decreases. The rate of litigation for U.S. public companies in 2018 was 8.7 percent, an all-time high, and 2019 is trending similarly. Severity was up as well (both are detailed later herein). Event-Driven Litigation continued to be a key contributor to the increased frequency, and an uptick in non-indemnifiable Side A claims was a growing concern.

Insurers seemed more disciplined in 2019 on risk selection and participation, and we observed some markets begin to publicly message their intentions to improve the composition of their portfolio, reduce limits for lead layers, and more prudently manage limits on excess layers too.

Aon FSG's Q3 2019 pricing data (as of October 29, 2019) suggests D&O pricing increased 20.3 percent on the primary layer and 35.8 percent on the first excess layer. In recent 2019 renewals, virtually all companies experienced rate increases, with insurers citing increased claims frequency, the long-trending soft market, and overall loss developments as catalysts for the price increases. Many insurers deployed initiatives throughout the year to reduce primary D&O aggregate limits and capacity. As noted above, premium increases were more profound on the excess layers as recent claim trends forced excess insurers to revisit pricing in response to higher claim costs and settlements. Corporate valuations are near an all-time high, which also had a direct correlation on the increased severity trends.

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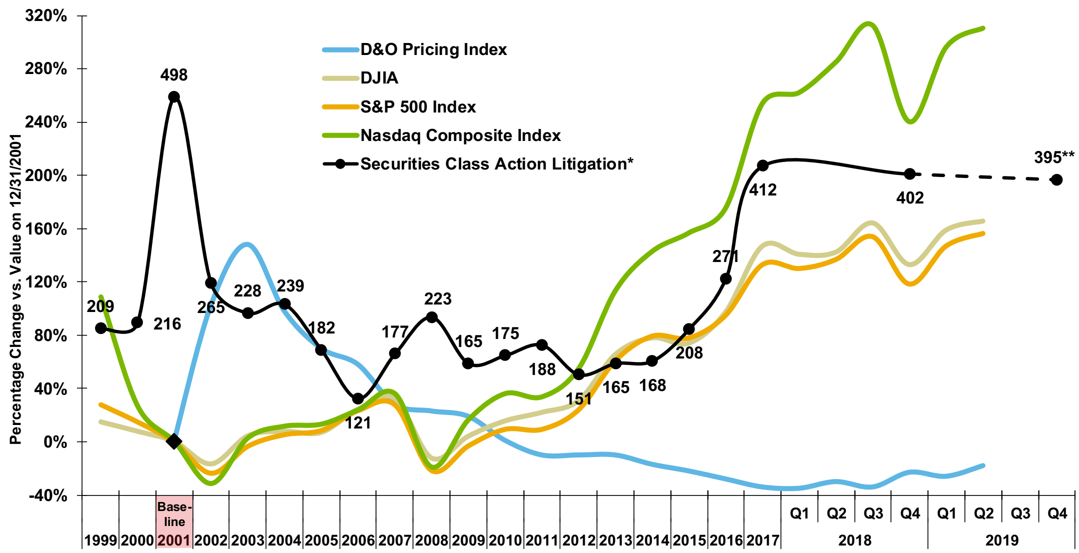
Market Indices vs. Claims Frequency vs. D&O Pricing

Q1 2002 – Q2 2019 | Base year: 2001 = 1.00



* Stanford Law School's Securities Class Action Clearinghouse as of September 3, 2019. These totals include IPO Allocation, Analyst, and Mutual Fund filings.

** Projected annual filings based on trailing twelve-month totals.

Self-insured retentions are on the rise as claim costs continue to increase. Through the third quarter of 2019, nearly one-in-four of all renewals have experienced a change in retention, which in almost all instances has also been accompanied by an increase in premium too. Minimum retentions for public company D&O insureds are now ranging between $1 million to $2.5 million, and $5 million to $10 million is becoming the norm for large-cap renewals.

In regard to coverage, some industries experienced specific coverage restrictions in response to certain Event-Driven Litigation trends, but overall coverage remained broad in 2019, especially for non-indemnifiable matters.

Overall Securities Class Actions[1]

Filings

In July 2019, Cornerstone Research released its *Securities Class Action Filings – 2019 Midyear Assessment.*

Cornerstone reported that "Plaintiffs filed 198 new federal class action securities fraud lawsuits ('filings') in the first six months of 2019, 87 percent higher than the 1997-2018 semiannual historical average. 'Core' filings – those excluding M&A filings – increased 17 percent in the first half of 2019. M&A filings decreased almost 21 percent in the first half of 2019, from 91 to 72," but "...remained well above historical levels."

Cornerstone went on to say that "Led by a spike in core filings, federal class action securities fraud lawsuits continued at near-record levels in the first half of 2019. Plaintiffs filed more than 1,000 federal securities class actions in the last five semi-annual periods – over 20 percent of all filings since 1997."

According to Cornerstone, "Six mega Disclosure Dollar Loss filings (at least $5 billion) and 11 mega Maximum Dollar Loss filings (at least $10 billion) propelled aggregate market capitalization losses to the highest, and fourth-highest levels on record, respectively."

In fact, "Disclosure Dollar Loss was $180 billion, the highest on record, and almost three times larger than the historical average. In the first half of 2019, Maximum Dollar Loss rose by 17 percent to $781 billion, a level more than double the historical average."

Through November 30, 2019, Stanford Law School's Securities Class Action Clearinghouse reported 375 filings, up 3.3 percent from the same period last year (363).

If filings continue at the same rate through the remainder of the year, the number of filings in 2019 will be approximately 414, which would be the second highest on record, and would represent a 95 percent increase over the 1997-2008 historical average of 212 filings.

Settlements

In March 2019, Cornerstone also released its *Securities Class Action Settlements – 2018 Review and Analysis.* According to Cornerstone, "There were 78 securities class action settlements approved in 2018 – only slightly fewer than the number of settlements approved in 2017 (81)."

"Total settlement dollars increased substantially over the 2017 near-historic low to just over $5 billion, which was 50 percent higher than the average for the prior nine years (3.4 billion)."

"Compared to the historically low levels in 2017, in 2018 the average settlement amount more than tripled to $64.9 million, while the median settlement amount (representing the 'typical' case) more than doubled to $11.3 million."

"Among 2018 settled cases, the average time to reach a ruling on a motion for class certification was 4.8 years."

Cornerstone noted that "Recent data on case filings can provide insights into potential settlement trends. Specifically, record levels of market capitalization losses reported for case filings in 2018 may suggest that large settlements will persist in upcoming years."

1 Securities Class Action Filings – 2019 MidYear Assessment. Cornerstone Research. July 2019.

Event-Driven Litigation

A new age is dawning on the nature of class action securities litigation. Today, companies and directors and officers face a myriad of allegations from an active plaintiffs' bar claiming corporate mismanagement following a negative event in connection with the company's operations. Commonly dubbed Event-Driven Litigation, this new rendition of securities litigation occurs when a press-worthy event happens (think, cyber breach, sexual harassment allegation, or product liability event). Following such an event the "Street" reacts, and the company's stock price falls precipitously. These events often are followed by a lawsuit alleging the company should have disclosed the negative operational event earlier.

A common premise in the Event-Driven Litigation involves mismanagement — corporate mismanagement in connection with the company's business operations. Whether the allegations relate to cyber breaches, FDA approval issues, a product-liability issue, a hostile corporate culture, an airplane crash, a corporate corruption scandal or a dam collapse, plaintiffs almost always allege any previous statements the company made relating to the alleged operational problem were misleading for failing to disclose the event. Those statements could be, among other sources, a part of the risk factors companies describe in their financial statements or statements made by management in public press releases, analyst or investor forums. Any statements are fair game for inclusion in an Event-Driven complaint, particularly statements following the disclosure of the event. Post-event statements will be held out by plaintiffs as a presumption of mismanagement – meaning, bad news must equal bad behavior.

It remains to be seen what the success rate will be with this new style of class action securities litigation. Regardless and rightfully so, corporations and their directors and officers will undoubtedly look to their D&O policies to back stop the cost of defending the litigation, either through a successful dismissal or settlement. It is paramount that today's vintage of D&O policy has the expansive coverage offering, especially on terms that will be tested by Event-Driven Litigation, such as: broad definitions of derivative demands and loss, narrow conduct exclusion and severability provisions, less ridged reporting requirements and flexibility for defense arrangements. Aon FSG stands prepared to empower our clients with risk advisory and risk transfer solutions to meet today's evolving securities litigation landscape and the future of directors' and officers' liability exposures.

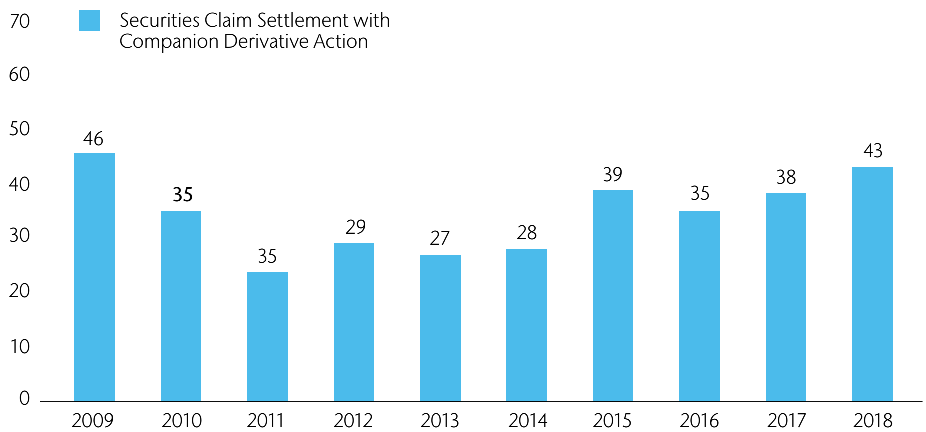
Derivative Suits & Non-Indemnifiable Claims Exposure

Much has been written regarding the rising securities claims trends. However, an emerging exposure that is not as widely discussed, but has the potential to be even more concerning for directors and officers, is the rising tide of non-indemnifiable claims. The exact reasons for this trend is uncertain, but the underlying causes include financial insolvency, derivative claims, and regulatory actions. The impact to individuals can include significant personal financial loss, due to the very nature of non-indemnifiable matters. Expectations are that severity of non-indemnifiable loss will continue to grow.

Derivative Claim Trends

Derivative lawsuits are an important proxy for non-indemnifiable claims, as (with some exceptions) derivative settlements generally are non-indemnifiable. While derivative claims are by nature relatively opaque, it is possible to review securities claims settlements with a companion derivative action as a proxy for derivative claim frequency. Taking this approach, according to Cornerstone Research the number of derivative claim filings has risen since 2011.[2]

Frequency of Derivative Actions



Many derivative claim settlements are large in nature, with several recent examples in excess of $100 million. Several of the large settlements could be considered a part of the Event-Driven Litigation phenomena as well. The combination of rising derivative action frequency plus large derivative claim settlements, portends an increasing concern for potential increased personal liability for corporate leaders.

Other Side A Claim Payments

In addition to derivative claims, other Side A Claims can arise from Difference in Conditions ("DIC") Coverage, financial insolvency, and fines/penalties from regulators, such as the Federal Deposit Insurance Corporation.

Recommendations

In light of these trends, Aon FSG recommends that clients:

- Evaluate indemnification provisions and corporate bylaws, with qualified advisors
- Consider Appropriate Side A Limits
- Carefully Evaluate Side A Insurers

2 Securities Class Action Settlements – 2018 Review and Analysis. Cornerstone Research.

D&O Exposure Increasing as the Frequency of State Court IPO Suits Increases

Following the United States Supreme Court's decision in *Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund*, 138 S. Ct. 1061 (2018), plaintiffs have viewed state court as a breeding ground for suits commenced under the Securities Act of 1933 ("Securities Act"). The trend of filing class action securities suits in state court under the Securities Act, which increased in frequency following *Cyan*, continued in the first half of 2019. Post *Cyan*, which was decided in March 2018, and through the first half of 2019, there were 61 new Securities Act filings: 23 parallel filings (filed in both state and federal court), 12 filings in federal court only, and 26 filings in state court only. As respects the first half of 2019, 19 cases were filed in state courts under the Securities Act – which compares to a semiannual average of 11 filings from 2010 – 2018. This trend is continuing in the second half of 2019 – with an estimated 19 Securities Act filings expected in state courts – and notably the trend is expected to continue into 2020.[3]

The increase in securities class actions, combined with an increased concentration of filings in state court under the Securities Act, amounts to an increase in exposure for directors and officers. Not only are motions to dismiss granted at a lower frequency in state court, but one of the significant issues that remains outstanding post-*Cyan* is whether the Private Securities Litigation Reform Act of 1995's ("PSLRA") automatic stay of discovery pending a motion to dismiss applies in state court. 2019 saw a handful of decisions on this topic, all with different analyses and outcomes. For example, in *Matter of Everquote Inc. Sec. Litig*., 2019 N.Y. Misc. LEXIS 4285 (NY Cty, 2019), the court conducted an in-depth analysis of the text of the PSLRA and the Securities Litigation Uniform Standards Act ("SLUSA"), and held that "the simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss '[i]n any private action arising under this subchapter,'" and "[n]owhere in [the PSLRA] does the statute indicate that it applies only to actions brought in federal court." The decision, which stayed discovery, is particularly intriguing as it runs counter to two earlier New York County Commercial Division decisions, decided in 2019, holding that the PSLRA discovery stay did not apply in state court actions. See, *Matter of PPDAI Group Sec. Litig*., 2019 N.Y. Misc. LEXIS 3481 (NY Cty, 2019); *Matter of Dentsply Sirona, Inc. Shareholders Litig*., 2019 N.Y. Misc. LEXIS 4260 (NY Cty, 2019).

Given the increased frequency of state court litigation under the Securities Act, which is expected to continue, the determination of whether the PSLRA's stay of discovery pending a motion to dismiss applies in state court is particularly important in minimizing the already expensive burden of defending such actions. Without the PSLRA's stay of discovery in place, combined with an increase in state court and parallel filings, directors' and officers' exposure is a heightened concern.

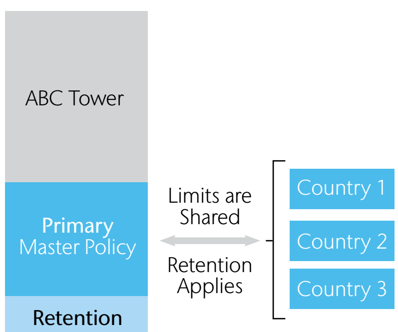
3 Securities Class Action Filings – 2019 MidYear Assessment. Cornerstone Research. July 2019.

International D&O Exposures & Solutions

The majority of publicly traded U.S. multi-national parent companies purchase admitted D&O insurance in some or all the countries where they have foreign subsidiaries. The reasons a company purchases foreign D&O insurance vary. Before deciding where to purchase, most companies consider the following during the due diligence process: country specific insurance regulations and laws; insurance premium and excise tax issues; D&O liability and claims activity in specific countries; and importantly, laws on the permissibility and extent of corporate indemnification.

Often overlooked, but equally important, is to consider the structure of any purchase. Historically, there were limited options when structuring a D&O program with admitted insurance policies for foreign subsidiaries. Now, a multitude of options exist, each with pros and cons.

The traditional structure includes the placement of locally admitted country D&O policies that share all or a portion of the U.S. parent company's Master primary policy limits.



The locally admitted, country specific, policies provide coverage for both Side A and B claims on a DIC basis (with some exceptions). A U.S. Parent company focusing only on its non-indemnifiable risk abroad may confine coverage on its foreign D&O policies to Side A only. The retention on the locally admitted country policies typically mirrors that of the Master Primary policy. On a rare occasion and at a significantly increased price, the locally admitted country policies have a lower retention than the U.S. Master Primary policy. Regardless, the traditional structure may be supplemented by the placement of locally admitted country D&O policies that do not share the limits of the U.S. Master Primary policy.

While the traditional approach has its advantages, there are shortcomings. One of the most significant concerns when choosing this structure must be the elevated rate of U.S. securities class action suits over the last few years. Exhaustion of the U.S. Parent Company's primary D&O policy limits by a securities class action claim also exhausts the shared limits of the locally admitted policies. So, even when a U.S. Parent company does its due diligence in choosing where to place locally admitted D&O insurance, those policies may not have any limits left to respond in the event of a claim.

Of course, if a U.S. Parent's primary D&O policy is with an insurer that does not have a global footprint or does not partner with a third party or friendly fronts, the traditional structure will not work.

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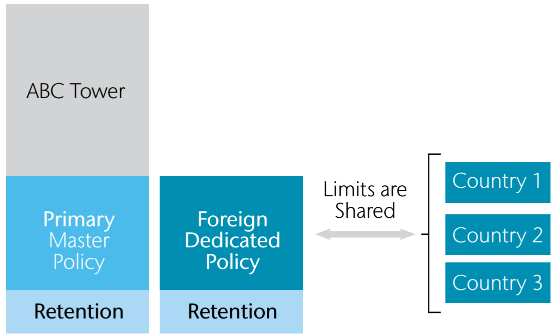
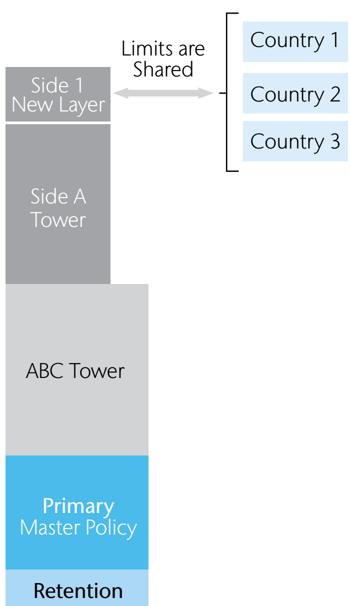


To overcome some of the limitations noted with the traditional structure, U.S. Parent companies can purchase locally admitted D&O policies that do not share limits with the Parent. This solution is accomplished with a variety of different structures. The most basic is to place individual locally admitted D&O policies with separate limits in countries where a risk exists. This approach ring fences the individual locally admitted foreign policy limits from depletion or exhaustion by both the U.S. Parent and foreign subsidiary D&O risks in other countries. However, this requires full underwriting of the D&O risk in each country where a policy is being purchased, including the submission of separate applications and disclosure of the most recently audited financials. To avoid a full underwriting exercise in each country and still ring fence the locally admitted policy limits from the U.S. Parent, a dedicated standalone international D&O program is a viable option. A separate foreign dedicated Master policy is put in place outside the U.S. This policy is then used to insure all or a portion of the Parent Company's foreign subsidiary D&O risk. The foreign Master policy excludes coverage for both the U.S. Parent company and U.S. subsidiaries. Then, just as with the traditional structure, locally admitted D&O policies are put into place that share all or a portion of the foreign Master D&O policy limits. The local policies can provide coverage for both Side A&B, or Side A claims on a DIC basis (with some exceptions), in most countries. Typically, the retention of the foreign Master policy is expectedly lower than the retention on the U.S. Master. This is significant if a company is wishing to insure its Side B risk abroad because most foreign D&O claims never rise to the level of a U.S. primary D&O policy's retention.



In the event a U.S. Parent is only concerned with a foreign subsidiary's Side A D&O risk, there are additional structures to consider. One approach is placing a Side A DIC D&O product through Lloyd's. For example, the Aon A+ Protect is a Side A DIC policy underwritten and placed with a Lloyd's' syndicate. This product offers a D&O policy in the countries where Lloyd's is licensed to place D&O insurance. The policy includes three (3) reinstatements, including an option for the same claim; broad coverage for investigations, including internal investigations; full-limits for 'compensation claw-back'; and affirmative coverage for fines, for fraud/improper conduct. For those countries where Lloyd's is licensed, this option, in many instances, eliminates the chance that a claim on the primary layer of the U.S. Master D&O policy will exhaust the D&O policy limits in Lloyd's licensed countries. U.S. Parents who choose this option and have D&O risk in countries where Lloyd's is not licensed, can then place additional locally admitted policies with a different insurer. Another approach is to place an additional Side A layer at the top of a Parent company's U.S. Master D&O tower, with an insurer that has a global footprint, or partners with a third party that has a global footprint. Locally admitted country policies can then be purchased that share the limits with the new Side A layer. This approach contains DIC wording and requires drop down wording to trigger coverage of the locally admitted country policies.

This structure helps minimize the likelihood that a U.S. claim will exhaust the limits of the locally admitted country policies due to the placement of the foreign policies on the U.S. D&O program.

Regardless of the approach, it is important for a U.S. Parent to consider options carefully when determining which structure to utilize to insure its foreign subsidiary D&O risk.

Private Company Exposures & Trends

In 2019, management liability rates for Private and Nonprofit clients firmed across industry sectors, escalating as the year progressed. While in prior years rate increases were typically reserved for certain lines of business with increasing loss trends, recent trends indicate insurers are making significant adjustments across several management liability lines including D&O, EPL, Fiduciary, and Crime. Additionally, as exposures converge, and Event-Driven Litigation has the potential to impact multiple policies, insurers are often capping aggregate capacity available to any one client.

Private and Nonprofit clients are increasingly scrutinized by insurers in the wake of exposures related to M&A, bankruptcy, regulatory oversight, Event-Driven Litigation, and heightened legal and investigatory costs. The number of large private companies (over $1 billion in revenue) are growing and insurers view them more akin to public D&O accounts, as market premiums are not keeping pace with claims brought against the organization. A few insurers are seeking to restrict entity coverage for those large clients, as entity coverage continues to be the leading driver of losses with significant defense costs resulting from allegations of anti-trust, privacy, False Claims Act, breach of contract, and false advertising. Broad D&O coverage remains available for most clients, but insurers are pushing back more often on new coverage requests. We expect insurers will continue to leverage rate, retention and coverage to address the historically depressed premiums amid increasing loss trends, especially on larger companies.

Despite mounting concerns about the increase in claims arising from #MeToo, employee privacy issues and rising claim costs, the EPL insurance market, including capacity, remained stable in 2019. We expect to see price increases in 2020 relative to risks stemming from gender pay equity, disability accommodation and various Biometric Information Privacy Act claims. Insurers continue to closely monitor exposure in California, and clients with claim history or those in certain high-risk industries (Healthcare, Higher Education, Financial Institutions) are likely to see a greater uptick in rate and/or retention.

Lagging the changes for D&O and EPL, Fiduciary exposures arising out of 403(b) and 457 Retirement Plans, Excessive Fee Litigation and increased analysis of mortality tables utilized for Defined Benefit Plan calculations are all starting to influence pricing and retentions. Insurers are beginning to push for higher retentions, particularly for Financial Institutions that sponsor plans investing in proprietary funds. For the Crime coverages, phishing and social engineering fraud claims continue to inflate year-over-year and we expect this trend to continue into 2020 and beyond.

Private and Nonprofit clients should anticipate more robust submission requirements across management liability programs. Providing more information and lead time in partnership with your FSG brokers will result in a more successful renewal. Aon is uniquely positioned with a Private and Nonprofit Team with dedicated brokerage experience and market knowledge to assist clients in navigating the capricious marketplace.

Alternative D&O Program Structures

With intense pressure on pricing and reduced capacity, companies are turning to alternative risk solutions to alleviate these challenges, exploring both traditional and non-traditional alternative structures. In the traditional vein, companies, especially those with strong balance sheets and the ability to take on more self-insured risk, may want to consider the cost benefit analysis around the value of increasing retentions to levels that can provide a more competitive pricing environment for primary insurers. Companies may even consider additional retentions at higher levels within the tower – "ventilating retentions." Other traditional structures, such as Side A only or Indemnity only, can also provide more flexibility and additional options to diffuse the dependence on the prohibitively expensive pricing environment and lack of available capacity. Non-traditional alternative structures may include utilization of a corporate captive to fill a layer or layers of capacity; perhaps because of prohibitive pricing terms or even a complete lack of interest in the market for a certain layer of capacity. Often, a key to the non-traditional structures includes seeking out ways to unlock alternative forms of capital, for example, through a risk retention program or finite risk structure. Many of the non-traditional structures can pose certain challenges to risk shifting the non-indemnifiable exposures and so such structures need to be carefully examined before implementation. The need to be creative and innovative will become even more crucial as pricing firms even further and available capacity becomes less accessible.

Industry Sectors

Financial Institutions

Pricing changes for D&O turned into positive territory as we entered 2018 and the rate of increases has escalated in 2019. Historically, the Financial Institutions ("FI") sector is among the leaders in a firming rate environment. However, this current cycle is different as D&O pricing increases for Financial Institutions is well below that of other industries. According to Aon FSG's D&O Pricing Index, pricing for Financial Institutions increased 4.6 percent year to date. A breakdown of the 2019 pricing changes by quarter is as follows:

Sector	Q1	Q2	Q3	Grand Total
Financial Institutions	2.8%	3.8%	6.5%	4.6%

While the disparity in these pricing changes is quite striking, there are a few considerations to bear in mind. First, during the soft market cycle, D&O pricing for Financial Institutions decreased at a much slower rate than for other sectors. Second, this data set includes primary layers, excess layers as well as Side A coverage. During the soft market, the excess pricing for commercial risks (i.e. non-FI) decreased sharply and the discount from one layer to the next, known as the increased limit factor ("ILF") dropped to 50 percent or below. For Financial Institutions, the ILF's did not drop nearly as much and for most risks they remained in the 60-70 percent range. Now that pricing is increasing, insurers are sharply increasing the pricing on excess layers that have insufficient ILF's. This is having a greater impact on commercial risks than FI risks. Another consideration is that many large Financial Institutions purchase D&O programs that are Side A Only which is a more profitable class of business for insurers. Underwriters for Side A D&O have increasing concerns about large derivative claims, so pricing for this coverage is going up, but to a more modest degree. Finally, the above data set does not include Errors & Omissions ("E&O") coverage or combined D&O/E&O coverage. Financial Institutions E&O, including Bankers Professional Liability and Insurance Company Professional Liability, have become more challenging risks to place in this firming rate environment and, anecdotally, are experiencing pricing increases that are meaningfully higher than D&O due to a heightened frequency of claims, including those related to sales practices, lending, and regulatory investigations.

One phenomenon that has been consistent across industries is the insurers' efforts to manage and recalibrate the overall capacity they deploy on risks. As a result, we have seen insurers reduce the total limits they will deploy on a risk as well as the limit they will deploy per layer. This is being experienced on FI E&O, D&O, Side A Only, Fiduciary Liability, and Crime risks.

Fiduciary Liability coverage for FI's remains challenging for entities that have (or had) any exposure to potential ERISA suits for excessive fees of proprietary funds in sponsored retirement plans. From 2011 to the present, the plaintiff's bar has initiated at least twenty-five "proprietary funds" cases. Many Fiduciary Liability insurers have responded by attaching exclusionary language, increasing retentions and/or pricing, reducing capacity, and requiring completion of related questionnaires at renewal.

Life Science

Life Science companies remain one of the top targets of the plaintiffs' bar. Unfortunately, the pace of shareholder litigation does not seem to be diminishing for this industry. In fact, the "cottage industry" created by less than a handful of plaintiffs' firms bringing 90 percent of the litigation against life sciences companies continues to proliferate. The source of the claims largely is systemic to the industry — allegations of misrepresentation of likelihood of FDA approval and/or promise in the clinical trials, product efficacy, or marketing of the product. Life Science companies also hit the headlines with the on trend Event-Driven Litigation including cyber, mass product liability, and of course, opioids. Additionally, Life Science companies with frequency look to create capital through initial public offerings. In today's complicated '33 Act securities law environment bolstered by *Cyan*-related federal and state exposures, Life Science companies face increased shareholder vulnerabilities. The D&O insurance market remains challenging for Life Science companies for all the reasons just mentioned. The availability of viable primary markets is leaner than for other industries and the appetite for excess capacity is not appreciably better. Risk differentiation is critical to successfully building a robust D&O program.

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Retail

The Retail industry is not immune to the current market environment and is expected to continue to face pressure on capacity, rate, and retentions into 2020. In 2019, through Q3, there has been a significant correction in pricing, with many retailers also facing changes to their D&O program structures, reduced individual insurer participation levels, and increased retentions.

For Consumer Discretionary retailers, insurers are focused on understanding the retailer's financial condition, consumer relevance, and strategies for growth. Increased trends in bankruptcies and financially distressed insureds, particularly department stores and specialty retailers, have led to more dramatic D&O program changes.

For Consumer Staples retailers, insurers are focused on understanding the omni channel strategy, adapting to the changing consumer need and, for those with pharmacies, the exposure to opioid litigation. We expect the concern with opioid exposures will continue to develop into 2020 and may result in significant securities class action and/or derivative litigation, which could have a material impact on D&O pricing and coverage in this sector.

The chart below depicts Aon FSG client's Public D&O pricing results for the primary and first excess positions, for the two Retail segments, through Q3 2019.

2019 Public D&O	Consumer Discretionary			Consumer Staples		
Layer Pricing/Quarter	Q1	Q2	Q3	Q1	Q2	Q3
Primary	+16.6 percent	+10.7 percent	+12.7 percent	+6.9 percent	+4.2 percent	+18.3 percent
First Excess	+16.5 percent	+19 percent	+27.6 percent	+7.9 percent	+7.2 percent	+15.5 percent

Technology

2019 has been an extraordinary year for the Technology sector. The S&P 500 Information Technology and Materials sector is up 40.5 percent* year-to-date, versus 24.5 percent* for the S&P 500. While this is very impressive and shows the continued excellence in innovation in the U.S., it is also clearly daunting for D&O insurers at a time of record public company D&O litigation rates. Such high valuations leave the potential for meaningful damages should a company negatively surprise the market and attract shareholder litigation. At the most extreme end, the combination of highly valued private companies and the *Cyan* decision has led to a significant contraction in available insurance limits for IPO's.

Certain segments of the Technology sector, more than others, had to contend with increasing regulatory oversight in areas such as privacy, data security, competition, and #MeToo. With media of all forms quick to pick up on these topics, plaintiffs are finding plenty of opportunity to question governance and oversight by company boards. All of this has led to a "risk off" mentality from many insurers as the year has progressed.

With the above backdrop, it is critical to evaluate where insureds may have perceived heightened exposures, and seek to address them directly with insurers, including mitigating controls and board oversight.

Emerging: Crypto

The marketplace for digital assets risks continues to evolve with some insurers exiting or pulling back, and others maintaining or increasing their appetite. There is volatility regarding the products insurers are willing to provide (e.g., D&O, cyber, crime, specie). Key issues facing insurers include constant changes to the underlying technology, adverse headlines, and a fragmented regulatory environment. Nonetheless, Aon's Digital Asset and Blockchain team continues to collaborate with the insurance marketplace to drive capacity and develop bespoke risk transfer solutions for our clients. Specifically, Aon has driven capacity and product innovations within Crime/Fidelity and Specie markets. Some of the latest developments facing the industry include:

- On September 30, 2019, a company called Block. one paid a $24 million fine for an unregistered securities offering as part of a settlement with the SEC.
- In October, the U.S. Commodity Futures Trading Commission ("CFTC") announced Ether is a commodity. This is a material development noting commentary from the law firm, White and Case: "Digital assets like Ether should now expect to be subject to the CFTC's rules and regulations, and industry participants should be prepared to face the compliance burdens associated with the CFTC's registration, anti-fraud and anti-manipulation obligations."

*As of Novermber 15, 2019

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- On October 15th, the Government of Bermuda announced that it would accept cryptocurrency payments for taxes and other government services. The Premier of Bermuda, David Burton, seems to want to make Bermuda a destination for digital asset companies noting that fintech innovation is a "national strategic imperative." Certain characteristics that make Bermuda a destination for insurance also appeal to digital assets, including an innovative insurance and business environment supported by government and regulators.
- On November 12th, Wyoming introduced a new set of rules to regulate the custody of digital assets. Wyoming is one of the few states to introduce new legislation focused on digital assets. Some suggest that the new rules could be a challenge to the existing NY Bitlicense framework.
- Also, on November 12th, the chairman of the CFTC, Heath Tarbert, was quoted saying that, "America needs to lead on crypto" and suggested a clearer regulatory framework would be beneficial, but remains a work in progress. In addition to the CFTC, regulators of digital asset firms include the SEC, the Financial Stability Oversight board, and certain states (e.g., NY and Wyoming).

While the insurance marketplace remains challenging, the blockchain space is exciting. We are hopeful that our proactive process in collaborating with insurers, clients, and other industry constituents will lead to increased optionality for buyers.

Conclusion

FSG has successfully navigated challenging insurance cycles for our clients for, decades. We are well-positioned to help you navigate through your management liability renewals in 2020, and will help you design and obtain an industry leading D&O placement by creating solutions. We have the analytical tools to help you successfully evaluate limits, pricing, retentions, and program structure. We can help you quantify the expected return on investment of your D&O insurance. Additionally, our Legal & Claims practice, the bedrock of FSG, can draft D&O policy language responsive to a D&O claim and we are available to advocate on your behalf when you have a claim!

We look forward to serving as your trusted advisor in 2020.

About Aon's Financial Services Group

Aon's Financial Services Group ("FSG") is the premier team of executive liability brokerage professionals, with extensive experience in representing buyers of complex insurance products including directors' and officers' liability, employment practices liability, fiduciary liability, fidelity, and professional liability insurance. FSG's global platform assists clients in addressing their executive liability exposures across their worldwide operations. Aon's Financial Services Group manages more than $2.4 billion in annual premiums, assists with annual claim settlements in excess of $800 million, and uses its unmatched data to support the diverse business goals of its clients.

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