Aon Risk Solutions
Financial Services Group

2018 Update for Financial Institutions

Under the current US administration financial institutions have experienced a more favorable regulatory environment (including the recent partial roll back of the Dodd Frank Act); broad tax cuts and financial markets at record levels (albeit with volatility). Abroad, focal points include Brexit and May's implementation of the European Union's General Data Protection Regulation ("GDPR").

Pricing and Coverage

As we entered 2018, insurers were quite vocal about the need to stabilize pricing and end the soft rate environment. While the term "hard market" was generally avoided for financial lines, insurers labeled it a market "in transition". Through the end of the first quarter, our data does support this description. In Q1 2018 we saw Directors & Officers Liability (D&O) pricing increase across the board for the first time since Q1 2013. Comparing Q1 2018 and Q1 2017, our data shows D&O Price per million increased 3.2%; and for primary policies renewing with same limit and deductible pricing increased 1.5%. Insurers have been successful in pushing for more significant rate increases in Professional Liability (E&O), such as Bankers Professional Liability, while rates for Investment Advisor E&O remain competitive. In some instances, we have seen insurers become less flexible when negotiating coverage terms. Whether insurers will seek to restrict coverage terms more aggressively remains to be seen.

Claim Trends

In 2017, there were 412 total Securities Class Actions (SCA) which represents a 52% increase vs. the elevated levels of 2016, and a 118% increase vs. the prior ten-year average of 189. The probability of a public company facing a shareholder suit is approximately 10%. Financial Institutions professional liability (E&O) continues to see heightened levels of claims, including those related to lending and regulatory investigations. Furthermore, claims related to sales practices at a large US bank have resulted in insurers paying out hundreds of millions of dollars in losses in the first half of 2018 with significant D&O derivative claims still pending.

Fintech, Blockchain and Big Data

Fintech and big data are transforming financial services. It is critical for both established financial institutions and emerging fintech companies to understand the related risks and available insurance solutions. Blockchain, a "distributed ledger technology" ("DLT"), is garnering much praise and many large financial institutions have blockchain projects that are expected to go live in 2018. New exposures emerge as companies utilize and/or develop their own DLT-based solutions and client offerings. When there is a distributed ledger, who is in control (and, by extension, liable for potential loss)? Risks will vary depending on the structure and features of the blockchain – for example, is it "public" or "permissioned"? As financial institutions increase their reliance on technology, Aon recommends an in-depth review of professional liability (E&O) and cyber policies to avoid potentially significant gaps in coverage.

Insurance Capacity and M&A

Insurance capacity remains at an all-time high. Recently we have seen considerable M&A among insurance companies, including the March announcement that XL Group Ltd will be acquired by AXA. In general, these transactions have not materially impacted the amount of capacity available to our clients. If anything, they have increased the financial strength of many insurers participating on our clients' programs. We expect to see further consolidation, but time will tell if there will be any impact to insurance capacity.

continues

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Fiduciary Liability – proprietary funds
Following on the heels of the 36(b) excessive fee claims that hit the investment management industry, in recent years we have seen a wave of ERISA suits for excessive fees of proprietary funds in sponsored retirement plans. Plaintiffs view these cases as likely to get past motions to dismiss, thus this trend is likely to continue. Many insurers have responded by attaching exclusionary language, increasing retentions and/or pricing and seeking the completion of related questionnaires at renewal.

Employment Practices Liability ("EPL") - #metoo movement
Workplace harassment allegations are front page news, with examples ranging from pop culture icons, to government leaders, to corporate-wide scandals. The potential fallout from workplace harassment, either by individual leaders or enabled by corporate culture, goes far beyond the devastation to the victims and the dollars and cents associated with the defense and settlement of the allegations. 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. At Aon, we have seen an increase in first time buyers of EPL.

Cryptocurrencies and Initial Coin Offerings ("ICOs")
In 2017 both the valuations and awareness of cryptocurrencies soared. Furthermore, in 2017, the ICO market raised almost $4B in 210 ICOs including over $1B in December alone. There was much euphoria as we entered 2018 but, not surprisingly, all of this caught the attention of regulators. The SEC has since sent at least 80 subpoenas and requests for information to various firms involved in the ICO and crypto space including issuers, advisers, investors, exchanges and other "gatekeepers". Furthermore, state and provincial securities regulators in the U.S. and Canada recently launched "Operation Cryptosweep" to crack down on fraudulent ICOs, crypto investment products and those behind them. Nonetheless, the pace of ICOs has only accelerated - in Q1 2018, $6.3B was raised which is more than all of 2017 according to CoinDesk.com. In addition to the continued growth of "pure crypto" entities, we have seen established financial institutions gradually enter the space, largely in response to customer demand. We would expect this pace to accelerate if/when there is greater regulatory certainty and more solid infrastructure.

Companies have prudently been seeking insurance solutions to address their crypto exposures. Established financial institutions should consider whether their current insurance policies (including Crime, Cyber and E&O) are covering these exposures. It is critical that policy wording is tailored to address a company's unique exposures.

Top Cyber Risk Trends in 2018

- Regulatory scrutiny will increase; EU's GDPR could lead to significant fines; and the SEC is more focused than ever on cybersecurity
- Cyber related losses not limited to Data Breaches
  - Denial of service & ransomware attacks can be more severe than data breaches. Financial statement impact of breaches has shifted to business disruption. The 2017 WannaCry and NotPetya ransomware attacks resulted in significant and extended interruptions to organizations
- Third-Party Cyber Risk
  - Continued dependency on third-parties to operate IT infrastructure and other critical applications will heighten cyber risks associated with vendors
  - Cyber market continues to provide broadened risk transfer solutions around dependent business interruption and dependent systems failure to address this exposure
- Emerging Technology
  - New cyber risks emerge as Financial Institutions deploy new technologies such as mobility, Internet of Things, Cloud Computing, Artificial Intelligence and Big Data

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 $2.2 billion in annual premiums, assists with annual claim settlements in excess of $1 billion, and uses its unmatched data to support the diverse business goals of its clients.

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