2019 D&O Market Challenges & Strategies

Expectations for the 2019 Directors' & Officers' ("D&O") market are for rising rates and challenging renewals. As referenced in our January 2019 Client Alert, the heightened frequency of claims, unpredictability of Event Driven Litigation, and shrinking insurer profit margins are leading insurers to push for adjustments. In many cases, clients are finding difficulties in replacing insurers with as-expiring pricing, and in selected situations coverage terms are becoming more restrictive. With this backdrop, it is critical to understand the expected market environment in 2019, as well as strategies for addressing it.

Primary D&O Rates

For many years, primary D&O rate has been the major focus of D&O insurers. Indeed, Aon's D&O Price Index reflects this focus, as the first three quarters of 2018 witnessed an increase in average primary public company D&O rates (with the fourth quarter expected to yield similar results). In 2019, this focus on primary public company D&O rates is expected to continue and the magnitude is expected to increase. Notably, for certain classes of business (such as private companies, selected healthcare risks (i.e., opioid exposure), and placements with current pricing meaningfully below what insurers now view as "sustainable" rates), insurers are expected to seek larger premium adjustments.

> "...we've been observing in many classes our D&O business where rates simply aren't keeping pace with loss cost trends... So this has led to, as a result, shrinking our business."
> – D&O Insurer Q3 2018 Earnings Call

Excess D&O Rates

In recent years, ample capital in excess layers caused downward pressure on pricing in a classic supply/demand imbalance. However, as severity concerns rise due to several factors (the Cyan decision and proliferating Side A settlements, to name two) and some predominately excess insurers begin to discover profitability concerns, excess pricing is expected to stabilize, at the least, and in many cases begin to adjust upwards (often at a greater percentage than the primary).

Of particular concern is the first excess layer on many programs; while primary rates have declined significantly in the past decade, it is widely believed that first excess layers have declined more precipitously. Take for example a placement where the primary layer, ten years ago, charged $1, and the first excess layer was priced at 75% of that, or $0.75. Fast forward to today's environment, and that primary layer may be priced at $0.75, while the first excess layer may only receive 50% of that, or $0.375. While the primary layer experienced a 25% decrease over that period, the first excess layer saw a 50% decrease, while perceived exposure at this attachment is now trending upwards. For that reason, many incumbent insurers are pointing to the first excess layer as that in which even greater rate adjustments will be sought; it remains to be seen in 2019 as to whether competing insurers will step in to these layers to maintain stable pricing.

Coverage & Claims

Finally, expect some restrictions in coverage and heightened scrutiny of claims by insurers. For example, certain healthcare companies with opioid-related exposure may face opioid exclusions, or at least confirmation that opioid claims previously have been noticed. D&O placements for initial public offerings may experience more difficulty in avoiding warranty statements or prior acts exclusions. Certain coverage extensions, such as excess derivative demand investigative coverage, may begin to diminish in terms of availability. While we at Aon do not want these possibilities to become a self-fulfilling prophecy, the potential for such outcomes is real enough that it is prudent to prepare for such possibilities.

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Finally, as insurer profitability in D&O has declined, as prior year reserves are depleted, and as some D&O insurers experience increased scrutiny of this line of coverage from c-suite leadership at these companies, expect that many insurers will be taking a more "hard line" stance on claims accommodations. Examples of potentially problematic areas include coverage for plaintiffs' attorney fees, allocation between covered and uncovered loss, and greater scrutiny of exhaustion language relative to underlying claims payments.

Strategies for Successful Renewals

With some of the potential placement challenges outlined above, the following suggestions are possible strategies for addressing these challenges and can help maximize the success of your 2019 D&O placement:

- ***Maintain the Leverage of Time*** Nothing decreases available options like running out of time. Typically, we recommend starting the renewal process 90-120 days in advance of the renewal date, which allows for a disciplined approach to market, and the ability to explore all relevant options.

- ***Access All Viable Insurer Platforms*** Despite recent restrictions in market capacity, the depth of the D&O market remains robust. Consider accessing all viable insurers, including those in Bermuda and London, as underwriters can have dramatically varied perspectives on a given submission.

- ***Access Senior Insurer Leadership*** While accessing viable markets is important, ensuring visibility by senior decision makers at critical insurers is key. Underwriting meetings and break-out sessions with strategic markets is an effective way to ensure this.

- ***Proactively Evaluate Optimal Program Design*** In some cases, insureds may be forced to choose between higher pricing vs. higher retentions; analytical tools, such as Aon's D&O Insight analysis, can help clients evaluate the risk/reward tradeoff inherent in those decisions. D&O Insight can quantify the expected return on investment of D&O insurance, which often is positive even in the context of higher premiums.

- ***Prioritize Coverage*** Often, when clients are faced with rising prices, it is tempting to consider inferior coverage in an effort to minimize up-front premium costs. However, too often these considerations are "stepping over dollars to pick up dimes," as coverage restrictions can have a significant impact in a claims scenario. Consider maintaining the breadth of coverage wherever possible, and expanding it (via Aon's Diagnostic Review) as well.

- ***Create a Compelling Submission, Including Employment Practices and Cyber Security*** A compelling submission is critical, and demonstrating that a company seriously evaluates its enterprise risk profile (including employment and cyber matters) will help position it for a more successful D&O placement.

2019 is expected to be a dynamic year in the D&O marketplace. However, for insureds that follow the suggestions above, opportunities to mitigate price changes and maximize coverage are ample.

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