



**Gallagher**

Insurance | Risk Management | Consulting

# Global State of the Market Report for Directors' and Officers' (D&O)

January 2022





# WHY GALLAGHER FOR D&O?

With over 450 clients across 20 unique industries and six continents, our team is armed with the wide ranging experience needed to protect the personal assets of high net worth individuals and the companies that rely on them for success.

Our D&O policies help to protect senior executives against claims or allegations made by employees, the company, and third parties. Policies also protect the company balance sheet in the event that indemnification is available or there is a securities class action against the business.

## CLIENT-FIRST APPROACH

We pride ourselves on our ongoing commitment to clients. We treat every client as if they are a new client. Clients have long-standing relationships with us, which helps us have greater understanding of each other and enables better communication, better service and enhances the efficiency of the insurance placements. Each member of your service team will be available to you as and when you need them. For each role in the account team, we have a deputy in place. We believe that this team represents an excellent, diverse, yet complementary pool of broking, account management, claims and consulting expertise.

## OUR INTERNATIONAL PRESENCE

We have offices worldwide. In addition to our growing number of international offices, we also have access to the Gallagher Global Network (GGN), which utilises synergies with Gallagher offices and some of the leading partner brokerage firms in over 150 countries, meaning that we are able to track the legal, cultural and economic factors that could affect our clients' insurance, employee benefits and risk management needs.

## BEING CONSISTENT AND STABLE

We recognise the importance of team continuity, the building of knowledge and trusted relationships. The experience that our team will build in understanding your risks, operations, challenges and its organisational culture will be invaluable. We have robust strategies for staff retention, which include maintaining a fully staffed business. Gallagher's Financial and Professional Risks Division in London comprises over 100 staff and continues to invest to attract new, leading practitioners.

## WHO WE WORK WITH:

- Aerospace and Defence
- Automobiles and Parts
- Communications, Technology and Media
- Construction and Materials
- Financial Services
- Food and Beverages
- Healthcare
- Industrial
- Marine
- Natural Resources
- Pharmaceuticals and Biotech
- Power, Utilities and Renewables
- Real Estate
- Retail
- Transportation
- Travel, Leisure and Hospitality.

## WHAT WE OFFER:

- Commercial Crime
- Directors' and Officers' Liability (D&O)
- Employment Practices Liability
- Excess Side A and 'Difference in Conditions' D&O
- Pension Trustee Liability
- Prospectus Insurance (capital raisings)
- Social Engineering Fraud
- Transaction Liability.

# CONTENTS

## ABOUT GALLAGHER

02

## INTRODUCTION

05

## MARKET OVERVIEW

06

## SECTOR ANALYSIS

07

## TERRITORY UPDATE: AUSTRALIA

10

## TERRITORY UPDATE: CANADA

11

## TERRITORY UPDATE: UNITED KINGDOM

12

## TERRITORY UPDATE: SOUTH AFRICA

13

## TERRITORY UPDATE: UNITED STATES

14

## FORMULAE

15

## CASE STUDIES

18

## KEY CONTACTS

19

# INTRODUCTION



Back in 2020, the Directors' & Officers' (D&O) liability insurance market saw huge rate increases - as much as +70%.

Thankfully, the market is now showing signs of stabilisation as insurers look to compete on programmes that have seen their premiums inflated through the pandemic. New capacity entering the market throughout 2021 has also intensified competition, further leading to some significant rate reductions as we begin the new year.

Whilst we do not expect pricing to return to pre-pandemic or soft market levels any time soon, these reductions are a welcome sign for many of our clients, for whom Gallagher has been able to successfully negotiate favourable rates.

We are confident that 2022 will see some aggressive premium reductions if insurers can close out the year without too many large losses and pandemic-related volatility does not continue to cause havoc in the market.

It is worth remembering, however, that this period of stabilisation is not always smooth sailing for the D&O market given it is a long-tail class of business. We expect the next 12 months to be a period of further adjustment.



## MARKET OVERVIEW

Demand went through the roof in early 2021, with a buoyant US stock market and a considerable amount of US IPOs all needing insurance at a time when, in particular, the London D&O market was under considerable stress due to dislocation between demand and supply.

This created an acute pricing point that clients have been experiencing over the last 12 months. That demand and supply balance is now starting to shift more in our clients' favour as the amount of IPOs brought to market are now fewer than that at the start of 2021.

In addition, we're now experiencing the arrival of new market entrants with diverse strategies and fresh appetites which will enable better decision-making options for clients. These arrivals, coinciding with the reduction in the securities litigation frequency, mean that this forthcoming period will show rate reductions and strong returns on underwriting results which will continue to drive competition.

A mitigating factor here is increased underwriting discipline. Insurers are now deploying smaller lines per risk. In the last year

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The long-tail nature of D&O business resulted in insurers being caught out by these costs, even more than the cost of social inflation.

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or so, we saw two significant D&O players exit the market with the remaining insurers just pulling back on limits. This caused a drop in supply as most markets were putting out five to ten million lines when previously they were between fifteen to twenty million.

Another factor is the price rise of defence costs for US attorneys. The figure is set at a time well in advance of the date on which such costs are paid. Previously, these rates were around \$700-800 per hour and now they are \$1600-1800 per hour. The long-tail nature of D&O business resulted in insurers being caught out by these costs, even more than the cost of social inflation. Now as smaller lines are being deployed, the market will be in a settling period in which we're less likely to see volatility.

The volatility we may see, however, might be because the US SPAC and de-SPAC dynamic is starting to now grow in Europe. Much as in the US, an increasing number of SPACs are listing, driving higher levels of litigation and consequently pricing in certain areas.

Equally, concerns surrounding ESG in a post-pandemic environment will become increasingly prevalent. Naturally, this will increase pricing but at the same time will encourage new entrants to the market.

# SECTOR ANALYSIS

## Life Sciences

Life Science companies, especially late-stage biotech companies and IPOs, have experienced the most severe of the D&O market corrections, with elevated retentions and premium levels being imposed in addition to restricted coverage. As 2021 draws to a close, we are seeing increasing capacity and appetite in this space, principally driven by new market entrants increasing competition. Whilst the market continues to exercise caution in this space (especially again with late-stage biotech companies and IPOs), we are increasingly seeing more competitive terms and pricing, and in some cases, substantial premium reductions on renewals.

## Logistics/ Infrastructure

Clients in the logistics and infrastructure sectors continue to suffer at the hands of disrupted supply chains, changing consumer patterns and levels of demand, plus the short and longer-term impacts of any restrictions to free movement and economic growth caused by COVID-19 and Brexit.

The handling of dangerous goods remains of concern to insurers in the wake of the Lebanon port disaster. Similarly, any concession agreements with central governments which are subject to guarantees are causing complications for insurers.

As with many industries, ESG requirements are firmly in focus. Insurers want to stress test environmental impact in particular. It's now expected that companies demonstrate how they are going to meet their goals rather than just setting ambitious targets without structured plans.



## Natural Resources

The pandemic boosted the prices of many commodities, with COVID-19 enforced shutdowns and labour shortages at some projects, plus geopolitical issues all restricting supply. More recently, we are seeing an increase in activity and demand for commodities as the world recovers, which is a welcome relief for many companies in this sector as well as their D&O insurers, as results and outlooks begin to improve.

Despite this, the marketplace for risks in this sector is becoming increasingly challenging. Many insurers' and Lloyds' ESG targets and guidelines have restricted companies in certain parts of the natural resources sector from accessing the full spectrum of insurers (most notably coal, nuclear, as well as oil and gas companies). Lloyd's, for example, has mandated that the syndicates write no new coal-exposed risks from the start of January 2022. In anticipation of this, there has already been a reluctance by many syndicates to write these risks in 2021. The reduced supply of insurance capacity has been driving up D&O rates to an even greater degree than across most other industry segments. This is a trend that we expect to continue, following the agreements reached at COP26, which will accelerate the shift in demand from fossil fuels to cleaner energy sources.

## Retail and Hospitality

After one of the most tumultuous times possible for retail and hospitality companies, we are starting to see some relief. Over the past few months, retail and hospitality clients have seen their premiums start to stabilise, which were at record highs in 2019 and 2020.

While premiums are far from returning to the levels in 2016/2017 and retentions remain largely unchanged, underwriters are providing some premium relief and less restrictive coverage. Companies that continue to face financial struggles will also continue to see pressure on their D&O programmes. However, overall, the market is looking substantially more positive compared to this time last year. New carriers continue to advance competition and existing insurers looking to maintain relationships with clients who have successfully weathered multiple lockdowns and are starting to see a "return to normal".

## Technology

Technology companies, particularly those publicly traded in the US, have endured the brunt of D&O claims for some time, and continue to be the most frequently exposed sector to Securities Class Actions. The onset of a hardening D&O market has seen many technology clients face challenging renewals as carriers looked to manage their capacity in addition to pushing significant rate increases. Whilst technology companies continue to be viewed as being towards the higher end of the risk spectrum, insurers are increasingly more willing to offer favourable coverage and pricing than in than they were in 2020, and we expect this trend to continue going forward in 2022.





# TERRITORY UPDATES



# Australia

There is a genuine feeling of optimism that the market is starting to level out after consecutive years of pricing hikes driven by tightening underwriting appetite and reduced market capacity. Insurers that have taken corrective action across portfolios are now looking to get back in the game. Greater confidence in terms of risk selection and improved trading conditions is resulting in more attractive terms being offered by insurers. Insurers are facing more competition and, importantly, are now showing real willingness to compete for business.

Insurers are being encouraged by major legislative reforms to Australia’s class action regime, which the Federal Government announced during the pandemic to provide a dampening effect to the threat

of opportunistic class actions. These reforms have galvanised insurer appetite, with the greatest shift coming from fresh capacity and/or those insurers with less exposure to prior year development. It’s the prior year development of historical claims losses that have been wagging the pricing tail. As insurer attention returns to the actual risk metrics for each particular insured company, the market swiftly corrects and provides more favourable terms for insureds.

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“It’s the prior year development of historical claims losses that have been wagging the pricing tail.”

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## Canada

Coming into 2022, we expect to see most carriers displaying cautious optimism, and slowly embracing ‘flatter’ prices. In turn, there will be renewed competition for the better (and well-priced) risks. Throughout 2022 budget planning, expect carriers’ underwriting management to return to a growth mandate when it comes to new business, rather than sacrificing growth for the sake of profitability, which has been improving. In the publicly traded environment, we expect to see more competition on mid and higher excess layers, where prices have risen over the past few years, but class action claims activity has remained relatively stagnant.

Despite a generally optimistic outlook, we expect that Canadian D&O rates will continue to rise (though at a slower rate) for public and privately held companies alike on the primary and low excess layers, before stabilising later in 2022. Profitability in the private D&O space continues to be challenged due to EPL claims frequency and the high cost of defending even relatively small claims.

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“We expect to see more competition on mid and higher excess layers.”

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## United Kingdom

The UK market started to stabilise a lot quicker than anticipated as we entered the second half of the year in 2021.

The positive results seen in excess towers (provided by new capacity) and a refreshed approach from existing players in the wake of an improved outlook in respect of the pandemic led to a softening that started to leak into the primary space in H2. As lockdowns lifted and economies bounced back, so too did the willingness of D&O insurers to provide competitive solutions.

Whilst this provides us with cause for optimism moving

into 2022, we are not out of the woods yet, with new variants and disrupted supply chains coupled with an uncertain jobs market leaving caveats around most insurers rating strategies for next year.

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“As lockdowns lifted and economies bounced back, so too did the willingness of D&O insurers to provide competitive solutions.”

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## South Africa

The South African marketplace for D&O continues to be fragmented. The local market remains vibrant for any privately held South African company, or any public company traded on the local market exchange. It continues to be highly competitive for these types of risks, particularly when it comes to pricing and retentions and there is more often than not enough capacity in the local market.

For US-listed companies, approaching the international market is mandatory to get any risk placed. The local underwriters continue to shy away from US-listed companies on a primary basis and have a limited appetite on an excess basis. London remains the go-to market for these clients. While Singapore and European carriers have expressed interest in writing global South African companies, the knowledge and expertise relating to these risks continue to reside in London.



## United States

The June 2021 D&O renewals have proven to be an inflexion point towards a quick move to steadily declining increases for Public Company D&O renewals. Price increases continue to vary based primarily on industry sector, size and growth, and now to a lesser extent incorporating financial health and outlook, and claims history. As such, we see US underwriters pricing business in close to two tranches now versus the four tiers of risk we were seeing earlier in 2021. There are one set of accounts (the vast majority) being pursued and written for premium increases now in the high single digits, while another set is either somewhat higher (15% to 25%) as “recovering” accounts, or much higher than that as viewed as “disadvantaged” based on these factors – including impacts from the COVID-19 pandemic.

Driving these improvements versus a year ago is competition. We have seen 16 new markets play varying roles in offering capacity at friendly pricing in the last two years. Markets may be unique to the UK or Bermuda, but some are US-centric and very competitive.

COVID-19, for the most part, has had at least a temporarily positive impact on the market, as the number of COVID-19-driven securities cases have had negligible costs for the most part. COVID-19 has also slowed down the court system and is partially responsible for the reduced frequency of D&O cases. The number of bankruptcies has also been fewer than originally predicted.

From the US D&O carrier perspective, securities class action frequency is still significant versus historical norms. Rising defence costs and the backlog of

potentially troublesome open cases (over 500 securities class actions for example) continue to be the main reasons for most carrier increases.

However, those concerns are balanced with some positive trends, including:

- The continued drop in securities class action frequency since 2020
- A substantial drop in M&A claims
- Higher case dismissal rates (likely over 50% now), especially for Merger-Objection cases
- Claim severity was down for 2020 per Cornerstone’s Spring 2021 report
- (and most of all) D&O pricing has reached levels high enough to attract serious new capacity

In short, cautious optimism pervades publicly-traded D&O accounts, but keep in mind that capacity is still being looked at carefully and retentions may still go up, so have a few extra markets in reserve for your next renewal.

As to private company D&O, there has been little change over the last 12 months and D&O price increase remain mostly in the 10% to 15% range. Per pundits at the key industry seminars, we do not see that changing in the immediate future.

The toughest part of the market remains IPOs, including SPACs and de-SPACs, and that will improve more slowly. In this case, as with all markets, the principle of supply and demand is firmly at work.

# FORMULAE

As we mentioned in our previous state of the market report, over the last 12 months, the UK D&O landscape has been altered by increased class actions and changing legal and regulatory environments globally – emphasising the accountability and liability of directors and officers. Companies that used to be partially shielded from claims exposures in other territories, despite purchasing multinational D&O programmes, are now having to take into account global claims trends. It is no longer just the US-traded companies that are suffering. As a result, the market saw significant premium and retention increases, as well as coverage restrictions, in all sectors, geographies and for all types of companies.

Cascade, Gallagher’s in-house risk management tool, can simplify the entire intelligence collection and risk assessment process in a way that is scalable across organisations ensuring that the process is dynamic and consistent.

With increased supply coming into the D&O market over the last 12 months, it has created more competition as well as a reduction in prices. Our aim, as before, is in using Cascade along with the skill set of the team to outperform the market and offer our clients the best possible renewal outcome. Last year when the market was up c. 50%, we were able to commit a 40% increase, whereas today, now that the market is heading down about 10%, our goal is to once again improve even further upon this.

<b>For intelligence</b>	Make it simple to analyse and organise potential threat information and to monitor the effects of risk treatment through data.
<b>For threat</b>	Provide a graphic and dynamic way of monitoring and changing intent, capability and tactics.
<b>For assets</b>	Create a canvas to record and maintain location, criticality, vulnerability, documents, pictures and asset types.
<b>For risks</b>	Build a one-click method for connecting threats to assets and calculating risk scores – and carrying out dynamic risk assessment.
<b>For projects</b>	Build a one-click method for connecting threats to assets and calculating risk scores – and carrying out dynamic risk assessment.



Key	
<b>P = Premium</b>	X = time
<b>α = company risk</b>	Financial stability, corporate governance, US exposure, majority shareholder(s), mergers and acquisitions (M&A), share price performance and claims.
<b>β = market risk [Supply of Capital + IS(0:1) MK(0:1, 1-1.2)(MP)]</b>	Supply of capital in the market and minimum premiums, market capitalisation and industry sector.
<b>1 = Standard offering from insurers</b>	If 1 = standard offering / value-add from insurers. So anything <1 = broker's ability to undercut the market standard pricing which clients will pay.

Note: assume that everything is minimum and constant from one year to the next. Should the minimum in the market go from one per million of limit to two per million, on a low exposed D&O risk, the premium will still double.

## Alpha (α)

The client can control the variables in the company risk (alpha). For clients to maximise their savings versus the market, clients must focus and improve on the variables that they can control.

### These include:

**Financial stability** – this is critical, as solvency is a material risk factor for insurers. If you have public debt, the insurers will peer analyse this measure. Additionally, they will look at liquidity, cash positions, leverage and debt maturity when measuring risk. **The weighting placed by insurers is 1-10 (FS) (with 1 being debt-free/no concerns and 10 being solvency issue in the next 12 months)**

**Corporate governance** – this is an equally important point. It is vital to have controls and procedures in place to help reduce insurers' concerns over the potential frequency and severity of claims. Entities that are well managed, with excellent corporate governance, will have the best results in a difficult market. **The weighting is 0.5-2.5 (CG) US exposure – US exposure tends to be a point of concern for underwriters as, historically, the US has been where the most frequent and severe claims have occurred. This ranges from no assets located in the USA to a full Nasdaq/NYSE listing. The weighting is 1-10 (USA).**

**Majority shareholder** – this variable has changed throughout the years. Previously, having a major shareholder was considered a positive by underwriters, as there were fewer shareholders who could sue. However, in recent times, this has given rise to claims, as majority shareholders have more control and influence over the alpha side of the equation. **The weighting is 1.1-5 (MS).**

**Mergers and acquisitions** – the amount and area of the M&A that the business conducts will affect the weighting, as there will inevitably be some unhappy stakeholders. **The weighting is 1-1.25 (M&A).**

**Share price performance** – factors such as the level of volatility and poor performance of the business and, therefore, the share price will affect this weighting. A volatile share increases the chances of a securities class action being brought against the company and key individuals. **The weighting is 1-5 (TC).**

The alpha is comprised of all the above:

$$FS + CG + US + MS + M\&A + TC$$

**The implications on clients' D&O policies** – particularly for those who have purchased D&O cover intending to protect their personal assets – could mean that the structure and breadth of the policy can leave individuals exposed to personal losses when the policy is instead utilised for corporate protection.

The purchase of a Side A D&O policy will affect the beta side of the equation. This is why, especially at this moment in time, coverage selection is critical and should be a key consideration. Purchasing a Side A only programme will increase the market capacity (i.e. D&O limits) available by around 25%, so this would be up to a 0.75 weighting.



## Beta ( $\beta$ )

Looking to the beta side of the equation, we can see the factors included are those dependent on the natural cycle of the market – factors that clients do not have control over.

The market risk is essentially the amount of underwriting capacity available, which is directly correlated to capital in the industry sector. This concept is binary (0:1) and has no weighting in the equation.

### Beta includes:

**Supply of capital in the market and minimum premiums** – this directly affects the available underwriting capacity in the market and we have seen signs of new capacity in the D&O sector. Insurers who previously did not entertain this line of business are now interested in writing financial lines insurances, as well as new players entering the market.

**Market capitalisation** – will inevitably have been affected by COVID-19. This is also binary (0:1). A large market capitalisation will preclude certain insurers from participating. Once this is past a certain point, it will have a significant impact on the weighting of the equation (up to 1.2). This is not a linear concept, meaning that retentions can often be more affected than premiums in this variable.

**Industry sector** – after one of the most tumultuous times possible for many sectors we are starting to see some relief. After the past few months, we have seen premiums start to stabilise. Whilst

premiums are far from returning levels we were seeing a few years back, underwriters are starting to provide some premium relief and less restrictive coverage, particularly with diverse, new capacity entering the market.

### Standard insurer offering (1) – how Gallagher can help

Standard insurer offering  $P = 1.\alpha + \beta$

Gallagher offering  $P = 0.8.\alpha + \beta$

The take-away from this means that all options must be explored and considered. All licenced markets must be approached wherever in the world they are located.

Despite all the market and company factors that we have explored, Gallagher remains fully operational and open for business. We appreciate just how uncertain times have been for all of our clients, especially on an individual basis, however, we are starting to see the market ease.

If you are concerned about the level or breadth of your D&O cover or would like to know more about protecting your personal assets, please get in touch with us now.



# CASE STUDIES

Below are some examples from the past quarter to further illustrate Gallagher's analysis of recent market conditions:

## CASE STUDY 1

Despite this large UK-based and listed technology and retail company quickly growing over the past 12 months surrounded by hard market conditions, Gallagher aggressively marketed their risk and managed to save them nearly GBP100,000 in premium, whilst also getting them an extra GBP20m of limit.

**The client benefitted from a Gallagher risk assessment report, which helped them demonstrate their improved corporate governance and risk management framework to insurers.**

## CASE STUDY 2

This USD100m market cap Nasdaq-listed biotechnology company benefitted from both Gallagher teams in London and the US working together to secure the best rate possible for their insurance tower, regardless of which team placed the risk.

This client-focused collaboration and dedication to ensuring we always do the best for our clients go to show where our priorities sit.

## CASE STUDY 3

One of the largest independent owners, operators and developers of shared telecommunications infrastructure in the world had been working hard on planning its initial public offering for the last few years. The company brings the power of mobile technology to hundreds of millions in developing nations, accelerating the digitalisation of economies through the acquisition, management and construction of critical national infrastructure.

Finding placement in markets across the globe, the team successfully helped the client go public in October 2021.

**Comments from David Ritchie: "The teams in London and the US worked tirelessly on this account. As with all IPOs, it was important that we fully supported the client through this major transition – particularly with the challenges that COVID-19 has brought to the insurance market. A fantastic result – well done to everyone involved."**



# KEY CONTACTS

## United Kingdom

### **David Ritchie**

Managing Director, Financial and Professional Risks

T: +44 (0)20 7204 8565

E: David\_Ritchie@ajg.com

### **Steve Bear**

Executive Director, Financial and Professional Risks

M: +44 (0)7849 613826

E: Steve\_Bear@ajg.com

## Australia

### **Michael Herron**

National Head, Professional & Financial Risks

T: +61 (0)466 391 061

E: Michael.Herron@ajg.com.au

## United States

### **Phil Norton**

Senior Managing Director, Management Liability Practice  
(Chicago, IL)

T: +1 312 803 7429

E: Phil\_Norton@ajg.com

## Canada

### **Dan Lewis**

Senior Vice President, Management Liability Practice Leader  
(Calgary, AB)

T: +1 403 705 3596

E: Dan\_Lewis@ajg.com

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