



Gallagher

Insurance | Risk Management | Consulting

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

July 2021



ABOUT GALLAGHER


Founded by Arthur J. Gallagher in Chicago in 1927, Gallagher has grown to be one of the leading insurance brokerage, risk management and human capital consultant companies in the world. With significant reach internationally, our organisation employs over 32,000 people and our global network provides services in more than 150 countries.

Our people partner with businesses across countries and international territories to provide relevant and impactful professional advice. Regardless of what risk and human capital challenges our clients have, we work hard and utilise industry

specific expertise to find the best solution and to deliver it with world-class service. We continue to build on 90 plus years of expertise that spans global industries. No matter the size of the organisation we partner with and the challenges presented by the industry, we work tirelessly to provide solutions that maximise value for our clients.

Our values are core to our culture. Passionate service, strategic innovation, and ethical behaviour form the basis of how we do business. All with one purpose:

TO HELP YOU FACE YOUR FUTURE WITH CONFIDENCE.

Founded in 1927 with headquarters in the US	Revenues* of \$6bn	3.2% organic growth rate
 Gallagher has been named one of the World's Most Ethical Companies® for ten straight years. We've been committed to doing the right thing for over 90 years.	Global insurance broker with local presence	Listed on the NYSE (AJG) \$24.6bn Market capitalisation
	More than 32,000 employees worldwide	150+ countries where we are able to offer client service capabilities

Market capitalisation as at March 2021

All other figures correct at March 2021

**Based on core Brokerage & Risk Management divisions' adjusted revenue for 12 month period.*

WHY GALLAGHER FOR D&O?

With numerous clients across many 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. They 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 were 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.

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EXECUTIVE SUMMARY

For the first time, our State of the Market Report is written during a renewal season where our clients are negotiating based on terms and conditions that were bound during the pandemic, and whilst we cannot completely ignore the continued uncertainty in the D&O market and the wider world, the market is ready to move on from COVID-19.

As we enter the second half of 2021, we want to continue focusing on the way our clients control and present their risk to the market; as we ready ourselves for some tough conversations with insurers about removing the uncertainty reflected in pricing in some Management Liability programmes.

Our experience so far this year suggests we are at the top of the pricing bell curve, with new excess market capacity applying some much-needed relief to overall pricing. Whilst primary policies remain difficult to replace or move, some primary insurers still need to take corrective measures, the appetite to compete for excess Plc business is clear to see.

For the past four years, the London insurance market has been an extremely challenging place to do business – the D&O and Management Liability market, in particular.

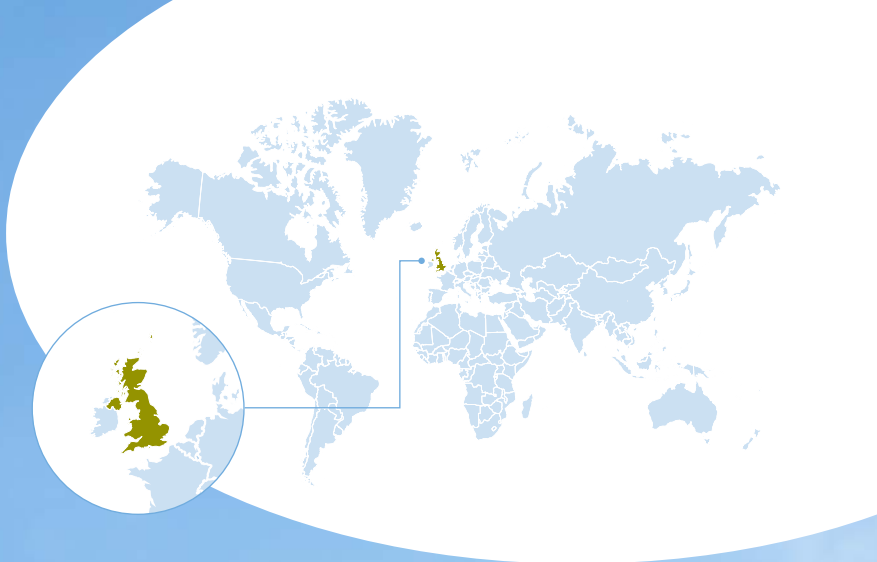
Insurers need to be ready to compete for their existing business, on accounts where the rate has been corrected through an unprecedented year; any Chief Underwriting Officer implemented edicts around “not renewing flat” or “no decreases” will almost certainly see insurers lose quality business.

Whilst the distant bugle of the excess layer cavalry is audible on the horizon, we are still realistic about the clear and present challenges facing our clients. The Chancellor remains adamant about redressing the balance of the public purse, and a lifting of lockdown does not necessarily mean an instant return to economic recovery. As furlough schemes lift, the fallout will start to be felt, and as we have learned from the last soft market, not just in the UK, but in many developed nations, the tail for D&O claims is a long one.

As we have stressed before, a quiet accident year (in terms of notifications) coupled with historic rate increases for insurers does not necessarily equate to a profitable return, and this long tail nature of D&O claims means payments for historic investigations (as far back as 2013) are still being made. Coupled with impending changes to audit reforms and the turbulence caused by UK IPOs and SPACs/De-SPACs – the outlook remains uncertain for the UK economy and its Company Directors.



TERRITORY UPDATES



United Kingdom

As we enter the second half of 2021, some of the pandemic-induced turbulence seen throughout 2020 is starting to subside. Since our last update in February, the UK has started to transition out of lockdown, and the wider optimism in the economy is starting to be felt in the D&O marketplace, with a softening of the pricing curve being observed.

Disregarding COVID-19 for a moment, there remains much uncertainty for UK companies and their Directors. Brexit remains a key driver of turmoil, with “Sausage Wars” breaking out and further upset to free trade only adding to woes felt at the border.

There is also increased financial scrutiny on the horizon, with audit reform proving to be a key risk consideration for most UK board members.

There has also been an unprecedented level of attention paid to the UK listing environment since our last State of the Market report. Whilst there has been a healthy level of IPO activity since the turn of the year, some have been more successful than others have. Any attempts by the Chancellor and Lord Hill to relax the listing rules² and

make the UK and its exchanges the country of choice for technology and unicorn flotations have been tempered by the perceived failure of some high profile IPO's. The jury is still out.

Whilst the COVID-19 impacted industries remain difficult, retail and hospitality is bouncing back and some improvements to D&O terms and conditions are being seen. Aviation, meanwhile, will only likely see material positive movements once free travel and tourism returns to popularity.

Looking ahead, the next quarter will see the anniversary of XL exiting the market, bringing some much-needed calm to renewal seasons. Replacement primary policies will be in place and the aforementioned excess capacity can really add value. We are more optimistic now about the outlook for our D&O clients than we have been for some time.

“The wider optimism in the economy is starting to be felt in the D&O marketplace, with a softening of the pricing curve being observed.”

² <https://www.gov.uk/government/publications/uk-listings-review>



Australia

D&O insurers of Australian domiciled companies continue tightening capacity and risk selection. Market conditions saw premium increases and restricted underwriting accelerate in 2020 amid uncertain financial markets and economic conditions in anticipation of the impact of COVID-19 in 2020; this prompted the need to review buying patterns and prioritise leverage of existing relationships to secure renewal terms with limited alternative options in a distressed global insurance market.

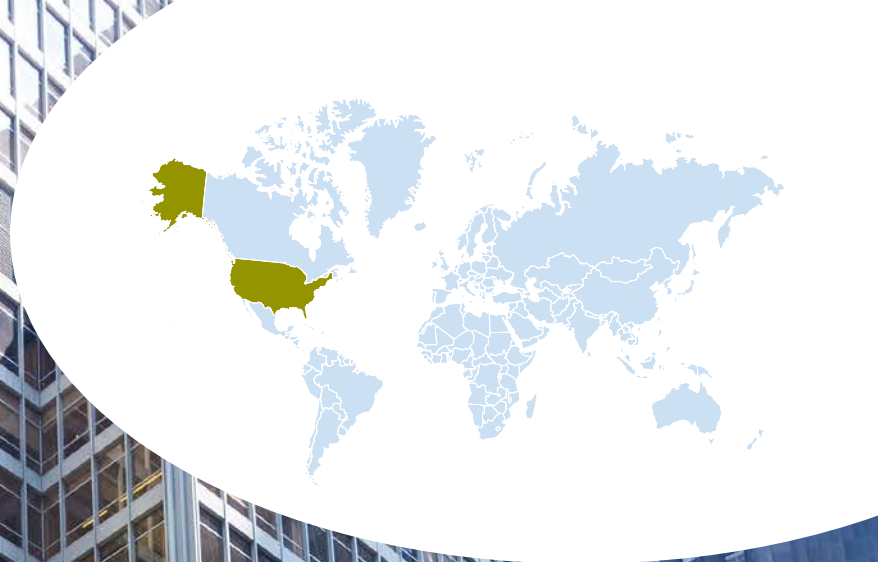
At mid-2021 there is more cause for optimism with signs that insurers are willing to trade on new opportunities and, in many cases, on more adventurous program structures. Premium strengthening year on year has given insurers more confidence. While we have not yet seen the predicted wave of insolvencies even after the 'fiscal cliff' of government stimulus and JobKeeper Payments ended in 1Q21, there is caution about the extent of harm for the economy if the largest cities continue to experience the uncertainty of extended lockdowns. Government action seeking legislative and judicial reform to corporate regulation is signalling more balance for a director community craving business efficacy to capitalise on trading opportunities in changing economic condition.

Sector sentiment is a key challenge with insurers tending to apply a broad-brush industry response, regardless of the risk metrics and variable characteristics of each distinct entity. In these conditions, directors can be effectively differentiated to get better than sector outcomes though this takes real skill and finesse.

Other key market trends

- Premium levels are causing many large listed companies to drop Side C (and sometimes Side B) completely and take the balance sheet risk. Some small caps just cannot justify Side C premium/retention levels.
- The market is hot with IPOs/Offerings. We are seeing more adventurous structures with more dual listings proposed for ASX/TSX or ASX/NYSE or ASX/LSE or ASX/NASDAQ or even delisting ASX. SPACs while increasingly common in the US are not able to list on ASX due to cashbox rules but this may change. Australian companies may be SPAC acquisition targets.
- There is a continuing increase in the number of consumer law claims accompanied by a decrease in securities claims filed, with a continued gradual increase in the number of employment claims filed. Less Securities, claims will help the D&O market. Consumer/Employment claims tend to have far less impact on D&O insurers.

“The challenge for directors is to break sector sentiment assumptions and get credit for what makes their unique risk different and acceptable for risk transfer to insurers.”



United States

The US D&O hard market is improving

As predicted in our initial 2021 forecast, US D&O prices continue to go up, though not as much as in 2020. Price increases vary based primarily on industry sector, size and growth, financial health and outlook, and claims history. As such, we see US underwriters pricing accordingly with four tiers of client companies in general. Tier 4 is very disadvantaged and is mainly driven by industries most affected by COVID-19. The other three Tiers and their typical price increases are as follows, noting that all three tiers are seeing on average, about a 25% reduction in the size of increases compared to 2020. We expect these reductions in the amount of premium increase to accelerate.

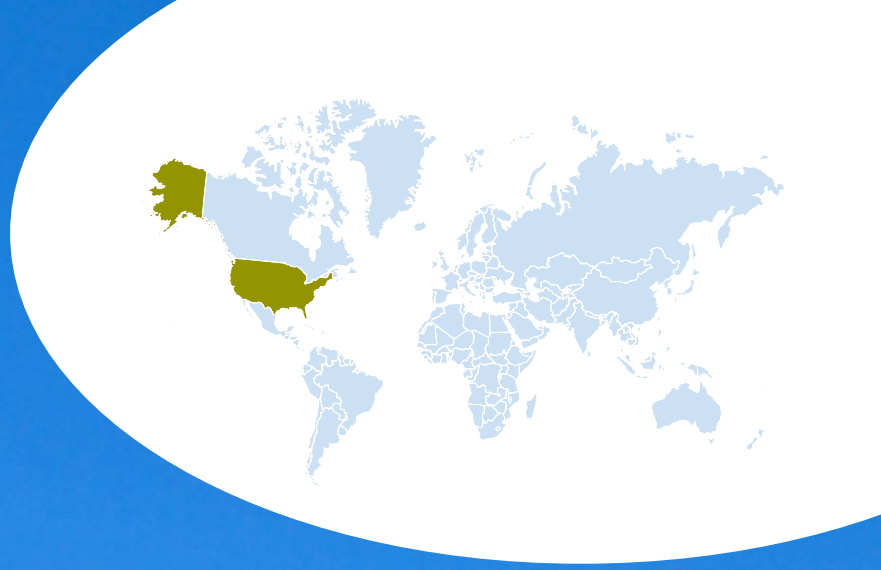
Tier 1 – Primarily Financial Institutions with healthy balance sheets, good earnings and no significant claims activity; pricing typically up 18% in 2020, now up by 13.5% and expected to continue lower. We have also started to see other industries creep into Tier 1, and the lower end of the Tier 1 range may quickly approach the flat renewal result.

Tier 2 – The best of the commercial accounts – some manufacturing, some services, but overall top performers may come from almost any class, including retail. Typical increases have moved from 36% last year to 27% this year, with a current range of 15% to 40%. Most homebuilders have now moved down to this tier, and many other improving business sectors will soon join.

Tier 3 – Ranges from typical to challenged accounts; you would expect to see most large technology accounts, established biotech and pharmaceuticals and recently many of the former Tier 4 companies that have recovered and rebuilt their balance sheet and income stream. Increases have recently been in the 35% to 50% range, but are improving each month.

From the US carrier perspective, here are their current priorities.

- Capacity continues to be examined carefully. Although most cuts in capacity took place in 2019 and 2020, there may be a few more to come. In the toughest sectors, Tier 4 IPOs and SPACs will often see a primary USD2.5m layer. USD15m layers may be economically unsustainable at this point for excess D&O carriers whose books cannot sustain multiple hits.
- Excess attachment points were moving up as carriers formerly attaching at USD25m on average were looking to attach at USD50m in 2020; we now see this reverting, which is a good sign.
- Retentions are also be carefully reviewed and in many cases, new minimums will continue to be enforced; IPOs and reverse flow clients will see very large retentions.
- Price must continue to follow an upward trend for most carriers and they will start to lose some of their renewals to competition, as rejuvenated and new capacity comes into the market.
- Terms and conditions are only seeing mild restrictions for the most part. This is good news.



United States (cont'd)

Overall, it is not just supply and demand economics with new and revived capacity, nor stock market turnaround and success compared to a year ago, that are propelling relief from a hard market. Other factors allow for some optimism, such as the drop in the core claims (federal securities class actions) though likely COVID-19 related; the substantial drop in M&A claims; higher case dismissals (especially for Merger-Objection cases) and overall motions to dismiss won by our clients about 50% of the time, newly formed companies increasing the number of publicly-traded insureds for the first time in a long time, and claim severities down as well per Cornerstone's March 2021 report.

Then why the carrier angst and what is driving it? Clearly, some carriers want to make sure their recent accident years are supported by new premiums in addition to the current year. Other carriers have continuing concern over primary D&O layer costs, but may feel most excess layers (including Side A) are now profitable. Still others on high excess D&O recognise the need to enforce minimum premiums. However, one theme identified by AM Best in their Market Segment Report of 28 April 2021 was that "lingering uncertainty

about prior and future accident years result in rate hikes and strategic market shifts." Indeed, this uncertainty is supported by a backlog of over 500 open federal securities class actions (SCAs), many of which are feared to be quite costly upon resolution. COVID-19 has likely delayed case resolutions, and thus potentially contributing to the "improving" severity.

As 2021 progresses, we see most carriers displaying some cautious optimism, and slowly embracing lower prices and even increased competition for the better or "fully-priced" risks.

"The D&O marketplace is now being driven largely by carrier uncertainty over results for prior and current years – primarily due to a backlog of over 500 open securities class actions, yet overall price increases have diminished significantly compared to 2020."



Canada

The D&O market in Canada began hardening much later than the US market, and as such, we expect the market to remain hard throughout 2021 before seeing some moderation in 2022. Public and private organisations that saw rate increases of 25% or higher in 2020 should expect another round of increases in 2021. In addition, new wordings are being launched by the major carriers, and many of them have stripped out coverages that were previously “thrown in”. We continue to see reduced capacity, tightened terms, higher retentions, and the removal of extensions like defence outside the limit and additional Side A, among others.

What we have seen

- **Defence cost inflation:** Over the past 10 years, average hourly rates for law firms specializing in D&O defence work have seen average annual inflation of roughly 7%. Defence costs on a securities class action may be in the range of USD6m – USD10m, not counting the settlement itself.
- **12 years of soft market:** From 2006–2018, coverage in Canada expanded drastically, while competition was fierce, driving prices to USD1k/1m or even lower.
- **A shrinking market for premium:** Publicly traded companies in Canada drive most of the market premium in Canada. As the number of public companies in Canada shrank, so did the amount of premium available to pay claims.
- **Loss frequency:** Over the past few years, claims in the private D&O world have risen significantly.

From private shareholder claims, to insolvency, and employment practices issues, private D&O became a money loser for carriers. In the publicly traded world, sectors like cannabis, fintech, and life sciences drove both frequency and severity issues for insurers.

Maximizing outcomes

Beating the averages

- Start early (120 days out or even earlier), but anticipate delays in the quoting process.
- Communicate early and often with internal stakeholders.
- Develop relationships with underwriters—incumbent as well as alternatives.
- Showcase positive risk factors.
- Consider leveraging ancillary lines.

What to expect for the remainder of 2021 in order of carrier priority

- **Capacity:** Even though most cuts in capacity took place in 2019–2020, capacity will be reviewed intently.
- **Retentions:** We are seeing retention increases in 2021, rather than in 2020. 2020 seemed to have seen more focus on rate.
- **Premium:** Price increases continue to take effect across the board and remain in the double-digits.
- **Terms and conditions:** Tightening of ERP, Side A/DIC reinstatements, and reductions in derivative demand investigative costs are seen frequently.



South Africa

In South Africa, capacity continues to be largely available for locally listed companies, but we continue to see submissions still coming into the London market as local carriers look to cut back the total capacity they are willing to deploy on any one risk.

Larger D&O programmes tend to need to be restructured as a result, and companies are looking to London to replace any lost capacity. Those South African companies listed in the US still ultimately need worldwide capacity – as always – in order to complete their programmes.

There are fewer than five local carriers willing to provide capacity to a local company that is also US-listed, so the dependence on London is considerable. Helpfully, the

market in London for South African risks remains vibrant – but any capacity of course comes at a cost. All locally placed primaries are being heavily scrutinised and it is worth being aware that underwriters are sometimes reluctant to follow locally-set rates, policy and terms and conditions.

As the South African market lags slightly behind the green shoots of the improvements seen in London, there will continue to be a need for UK capacity. The traditional South African risks (such as mining) are also attracting a lot of scrutiny – especially around ESG. Many markets are simply not quoting mining risks or only deploying capacity where all green ticks are present from a wider corporate and social responsibility standpoint.



RISK CONSULTING FOCUS

Jake Hernandez – Senior Consultant | Gallagher Specialty

Jake advises clients on the threat and risk environment and how they should respond to it, with a specific focus on D&O and corporate governance. He has worked with clients in 55+ countries to develop their capability to respond to risks and reinforce corporate governance.

He began his career working in high-risk locations in the Middle East for government, NGOs and private companies. He is fluent in Arabic and proficient in Spanish.

Jake has worked with national and publicly-traded transportation companies, some of the world's largest oil and gas companies, innovative life sciences firms and major global banks.

- Jake and his team of 10 consultants work with clients to **anticipate, prepare for, and respond** to potential significant crises or losses.
- He works with partners in the insurance industry to **efficiently transfer net risk** into (re)insurance markets.
- In the last year alone, Jake has worked with our D&O broking teams **to risk assess and place coverage** for companies with a total market capitalisation of over USD30bn.

Please refer to **CASE STUDY 3** on the following page for our risk consulting success story.

CASE STUDIES

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

CASE STUDY 1

A life science company wanted to source the same limit as they had last year, but without an increase in premium. The company has worked with Gallagher for over six years and each year there have consistently been sizeable premium increases, reflective of the market and the company's activities, such as a Nasdaq IPO in 2015. To put these conditions into perspective, between 2016 and 2020 the company's total D&O programme limit reduced by a third but the premium cost rose by 500%.

At the 2021 renewal, Gallagher managed to achieve our client's goals and negotiate a successful reduction in premium cost.

The market has new entrants and a new appetite. More underwriters were interested in the risk than in recent years, which enabled Gallagher to secure the best possible deal. As more insurers that are interested enter the market, the better rates our clients will get.

For our client, having a solid D&O programme has always been a necessity, so a decrease in premiums meant they were able to save money in their budget. They were incredibly pleased with the high quality of Gallagher's service and hope to continue our long-standing and trusted relationship.

The outlook for our client looks very positive and Gallagher will continue to secure the best terms for them going into the future.

CASE STUDY 2

As the newly appointed broker to a large industrial manufacturing client, Gallagher were able to secure a positive outcome for the insured, leveraging both existing and new relationships with insurers in the market.

As with many of their peers, the client had suffered a reduction in D&O limit at 2020 renewal, from more than EUR100m to only EUR60m, as well a significant premium increase.

As promised from the outset, Gallagher were able to deliver a total programme increase of less than EUR15k despite the first two layers being increased by EUR50k, as well as securing additional capacity to EUR100m.

CASE STUDY 3

A Nasdaq-listed biopharmaceutical company with a longstanding Gallagher relationship wanted to renew their D&O programme this year.

In a challenging year for the pharma industry, their financial performance was weaker than at previous renewals. Coupled with an increasingly problematic D&O market, the prospects for securing attractive terms seemed doubtful. Life science companies also tend to carry more risk and face more litigation, even after the achievement of significant milestones, such as FDA approval for newly developed drugs and treatments.

Knowing it would be a challenge, Gallagher seized the opportunity to perform a full risk assessment of our client's business in order to improve their prospects in the market. This extensive risk assessment provided more clarity for insurers, established our client's differential and clearly demonstrated the mature and sophisticated controls they have in place at their business.

The risk assessment was met with a hugely positive response from the market along with premium cost decreases.

In this environment, premium decreases are not usually the norm, yet we were able to achieve this for our client with the incumbent insurer. This was largely due to Gallagher's risk assessment report, created through our in-house risk consulting capability.

Our hands-on approach with our client not only resulted in a hugely positive outcome and with great feedback, but also provided significant time-saving opportunities for the insurers we work with too.

The extensive risk report will remain relevant for insurers to base the future risk profile on for our client. It also gives underwriters a fantastic benchmark on what controls our client has in place. These can be monitored on a year-by-year basis, allowing space for continuous improvements.

We know that underwriters are currently bombarded with risk information, so creating a risk report using our in-house capabilities reduced the time that an underwriter would have had to spend on assessing the risk themselves.

Gallagher's level of service for our client and the insurers enabled both parties to save time and money.

CAPABILITIES

Collectively, consultants at Gallagher have decades of experience working with organisations to help protect their people, operations, and information through intelligence collection, threat assessment, asset identification, risk analysis and project management.

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

CLAIMS HANDLING

We understand that what happens in the event of a loss is the reason that our clients buy insurance in the first place.

At Gallagher, we know it is essential to provide a first-class claims service to support the insurance programmes that the broking divisions arrange. Our Claims team is structured by specialist class and predominantly based in London, working very closely and alongside the broking teams to ensure a joined up approach. In each sector, the claims team is comprised of experienced professionals whose goal is to produce outstanding results by adding value in the claims process. In short, we will explore every angle and make every effort to arrive at a proper and successful conclusion to our client's claims.

With regard to claims advice, we would provide the following:

- Claims professionals that have taken the time to understand your business and objectives.
- Significant strength in depth and procedures to manage conflicts of interest in, for example, D&O scenarios where a conflict may arise between individual directors and officers as well as the entity.
- Claims workshops (if required) with, for example, non-executive directors; or with particular business units to assist the insurance team with identifying and outlining notifications requirements and processes.
- Formal claims handling protocol (if required) with insurers to support the delivery of service from insurers.

The minimum expectation of any client should be that its broker undertakes all the necessary administrative and communication functions to ensure a notice of claim or potential claim is properly and promptly presented to insurers. Naturally, we execute these duties as a matter of course. We do not, however, leave it at that.

Our approach is to go well beyond these minimum obligations.

We will engage with our client – and with the insurers, on the client's behalf – at every stage of the life of the claim. We maintain active involvement throughout the life of each claim in order to ensure momentum is maintained – as opposed to the “drift” which can occur when insurers and their representatives are left to their own devices.


We will provide advice, counsel and guidance at every stage, beginning with the initial notification, through to settlement.

The client executive on the broking side will also be involved, to ensure that the insurers' response is in line with the coverage intent and design. A feature of our central location is that we are able to work in a unified manner with the account service and broking teams, ensuring that all Gallagher personnel are fully involved in the process and we are able to deliver a cohesive approach to our clients.

We will engage with both the insurers' claims professionals and their underwriters, to ensure a properly commercial response.

Where loss adjusters or solicitors are appointed by insurers, which is typically the case for professional lines claims, we will also communicate with them on your behalf, as and when appropriate.

We have invested in claims advocacy because we believe that the complex claims typically experienced in the professional lines cases benefit from legally trained individuals to assist in the document review, tactical consideration, negotiation and overall management of the claim, in conjunction with the wider team.



The key service benefits our integrated claims team provide are:

A proven track record

Our claims specialists have many years' experience in handling significant, complex claims, and have negotiated successful outcomes often over and above expectations. Certain members of the team have also held previous positions within the claims teams of the major London market insurers, as well as in certain cases, law firms or loss adjusters, and this blend provides a wealth of varying experience for us to deploy as a clear benefit for our clients.

A team approach

We will regularly involve two individuals from the team, particularly in complex claims, not only to ensure continuity and consistent availability, but also to challenge our views and ensure that the next strategic steps are debated appropriately.

Persuasiveness

They will advocate on your behalf, echoing your objectives and using our advantage in the insurance market place. Our reputation with all the key insurers – and their lawyers – is very clear. We are very much client orientated and never shy away from challenging their interpretations when they differ from both our, and more importantly, our client's views.

FORMULAE

Key	
P = Premium	X = time
α = company risk	Financial stability, corporate governance, US exposure, majority shareholder(s), mergers and acquisitions (M&A), share price performance and claims.
β = market risk [Supply of Capital + IS(0:1) MK(0:1, 1-1.2)(MP)]	Supply of capital in the market and minimum premiums, market capitalisation and industry sector.
1 = Standard offering from insurers	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). In order 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 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 US to a full Nasdaq/NYSE listing. *The weighting is 1-10 (US)*

Majority shareholder – this variable has changed throughout the years. Previously, having a major shareholder was considered a positive by underwriters, as there were less 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 with the aim of protecting 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 have an effect on 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.

How clients have responded to COVID-19 will naturally also have an effect on the weighting of the equation. As companies of all sizes begin to re-open and operate in the "new normal", it is likely that certain companies (and, therefore, their directors and officers) will be singled out for their handling of the crisis by customers, employees, regulators or shareholders, and could face litigation for the perceived "mismanagement" of their company during the crisis.

These claims could be related to the decisions made about when (or how) the business managed employee or customer safety, how the company communicated to customers or shareholders, or how the business failed to be compliant with rules, regulations or laws – and test cases will certainly inform whether or not we see an uptick in litigation relating to corporate management of the COVID-19 crisis.

Beta (β)

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 which 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 are seeing signs of new capacity in the D&O sector (albeit there will continue to be further casualties, with insurers being forced out of the market due to the volume of losses sustained in recent years). Insurers who previously did not entertain this line of business are now interested in writing financial lines insurances, in a period where D&O premiums are at a record high. We expect this to continue throughout 2021.

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 – unsurprisingly, the aviation, hospitality, travel and leisure sectors have become incredibly challenging when designing D&O insurance programmes, with additional exclusions being applied, along with specific requests for COVID-19 underwriting information.

This scrutiny is now moving into other industries, especially lockdown affected industry sectors.

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 dearth in capacity means that all options must be explored and considered. All licenced markets must be approached wherever in the world they are located.

In spite of the pandemic, and all the market and company factors we have explored, Gallagher remains open for business and fully operational during this lockdown period, and we appreciate just how uncertain times have become for all of our clients – especially on an individual basis.

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.



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