Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 10 - The D&O Renewal Market: Will the Wild Ride of Premium Increases, Stretched Capacity and Restrictive Terms Continue?

By [Lynda A. Bennett] **Guests: Rob Crocitto**

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Lynda Bennett: Welcome to "Don't Take No for an Answer", an Insurance Recovery podcast. I'm your host Lynda Bennett, Chair of Lowenstein Sandler's Insurance Recovery practice. And today we're going to be talking about the D&O renewal market. Without question, 2020 brought us many unprecedented and unwelcome challenges across every business and no industry was immune. We know all too well that companies were thrown into a state of chaos and upheaval one year ago when the pandemic hit and workforces were required to transition into a fully remote working environment almost overnight.

Team members got sick with COVID-19, supply chains were disrupted, and that was only early spring. Over the summer, we experienced unprecedented social justice events that included, in part, significant losses for some businesses, and we saw an entirely new and disruptive security and privacy threat surface that resulted in a sharp uptick in ransomware and cyber-attacks that cost companies millions. Once again, corporate contingency planning and careful risk management measures were put to the test.

As we transitioned into the fall and the early beginnings of winter, we thought we had survived these early waves, but Mother Nature said, "Hold my beer," and companies felt the impacts of severe weather events. And now as we head into our next spring, we're seeing a highly volatile stock market and related securities litigation due to activity in new and emerging external forces intersecting with the market. Against that overlay of Armageddon, companies are bracing for their next D&O insurance renewal with some fear and trepidation.

Last year, many companies and even those that had clean claims histories saw historic increases in their premiums and self-insured retention. They saw a capacity squeeze on the market, particularly in the excess insurance space, as many insurers tried to soften the blow of large claim paths associated with event driven litigation like Me Too and increasing averages for settlements of security claims. They also saw insurers generally refining their terms and conditions with an eye toward narrowing coverage, as underwriters sought to reduce their risk profile.

Lynda Bennett: Some industries were hit harder than others, but in general, nearly all insureds felt the pinch. So today, I'm very fortunate to have with me Rob Crocitto from ARC Excess & Surplus, who's going to help our listeners buckle up and learn what to expect in this year's D&O renewal market. Rob has been an insurance broker specializing in the placement of D&O insurance for public and private companies for more than two decades. Sufficed to say, Rob's been there and he's done that in the insurance space for quite a while. Rob, let's start at a high level.

In general terms, how is 2021 shaping up as compared to 2020 with respect to some of the issues that I just outlined on pricing capacity and risk appetite?

Rob Crocitto: Thanks, Lynda, and it's an honor to be part of this. So thank you for that. Look, 2007, there were 8,000 public companies. Fast-forward to 2020, we have half that number. From 2007 to 2016. There was an average of 220 new securities class actions filed each year. In 2018, 2019, and 2020, there was an average of 420 securities class actions filed per year. What do we have? We have half the number of public companies with almost twice the number of securities claims. It's more than the market can handle.

And therefore, when you take that combination of decreased number of buyers and increased number of claims, something's got to give in order for the insurance companies to remain viable players in this market. Higher insurance premiums, higher insurance retentions were right out of the gate. In 2018, we started seeing rates tick up a bit. 2019, the rates really hardened with retentions coming into play, higher retentions. 2020, D&O rates went through the roof, D&O capacity became scarce, and D&O retentions continued to rise.

On the private side, we had all of the above, but the D&O insurance carriers started trying to limit coverage and where they did that is on the entity side. They really took a look at where their claims were coming from, and they were coming from extensions of the entity coverage that were, in the insurance company's eyes, really not meant to protect the individuals. They were really extensions of the balance sheet protection.

We started seeing antitrust sub limits or outright antitrust exclusions, false advertising exclusions, higher employment practices retention is being applied. And when you factor in the venture litigation that's been on the rise lately, and we'll get into this later with the #MeToo movement, the wildfires, the claims from cyber breaches, on the D&O side, something had to give. This is kind of the state of where we are now. Capacity is scarce and inexpensive capacity right now is just not existing. But there is some and I'm not...

Rob Crocitto: I don't want this to be total doom and gloom because there is some positive developments in the terms of new insurance capacity coming into the market with the entrance of Bowhead, Ascot, Balance Partners, Endeavor. We have new players coming into the market. Why are they coming into the market? Because right now the rates are where they are attractive for a new player to come in. They don't have the legacy claims. These new players are coming in. Where are they coming in? They're coming in on the excess. They're coming in.

They're offering capacity on the higher excess layers. Hopefully what that will do is that will put pressure on those higher excess carriers that are existing right now to come down to try to maintain market share and work their way lower into the tower. And then those insurance companies that are on the lower excess will hopefully in order to maintain their market share work their way into the primaries.

Lynda Bennett: As a policy holder advocate, I'll just note there that there are benefits to joining that new round of carriers that are coming in. But if I'm a longstanding customer of a particular excess carrier, I'm going to try to leverage that pricing, but probably stick with my existing carrier because we don't know what the claims history is going to be on these new entrance to the market, right? There are different ways that you can use those new entrants. One is if you're a particularly difficult risk to place, they may be your only option.

But if I'm a well-established risk, I'm probably going to want to use them more from the point of creating competition for my premium dollar and stick with the companies that I've built up a pretty good track record of paying premiums without claims and not be the guinea pig that's going to find out how that new entrant to the market's going to do on claims.

Rob Crocitto: Or they could serve as a source of additional capacity for an insured, maybe wanted to build limits over their existing program.

Lynda Bennett: Yeah. Good point there. Let me ask you this, Rob, are there particular industries that are having an easier or harder time navigating this difficult market right now?

Rob Crocitto: Yeah. When you look at the historically challenging industries to place D&O for, immediately cannabis risks, crypto risks, biotech life science, financial services comes to mind. Now we have this global pandemic that we're dealing with. And in light of that, we are seeing risks that are effected by the pandemic the most. We look at, for instance, cruise lines, airlines, hospitality risk, entertainment, risks.

Rob Crocitto: They're having an equally as difficult a time, and you couple that with what I just said earlier about the number of claims and what's going on in the industry, it's very difficult for those industries.

Lynda Bennett: Is it that they can't get coverage or they're going to have to go to some of these peripheral players in the market and have to pay a higher price with more restricted terms?

Rob Crocitto: Yeah, it's the latter. It's very rare that we can't find coverage for an insured. There's always an insurance company if the insured is willing to pay and willing to accept the terms they offer that will be able to provide capacity. At this point, it's not optimal. For instance, if you're a cannabis risk, there's only two or three primary public options for you. And that's why those cannabis risks are paying seven figures for a couple of million dollars of insurance, excess of a five or $10 million retention.

Lynda Bennett: The business case for that one is, in some instances, you need to have D&O to get some of the folks that you want to serve on the board. You need to show them that you have D&O coverage, but can you comment on the benefit of paying the higher price now and demonstrating yourself to be a good risk and what you would see the premiums look like over a five or a 10 year horizon and what you can do to kind of drive it down?

Rob Crocitto: Yeah. I've told clients three years ago that if they really tightened up their balance sheet, got rid of the debt and straightened out everything that their rates were going to go down. And three years later, some of them want to choke me. I'm just the messenger. No, no. I'm really not. It's all about preparation, and it's all about establishing... A D&O policy is more than just a policy. It's a relationship that goes with that policy. While clearly what you're buying the words matter, and we're going to get into that for sure in a minute.

When you enter into a contract with a D&O insurer, you're forming a relationship, and that D&O insurer is your partner for the purposes of, A, protecting the management of the company, and B, protecting the balance sheet for the company's obligation to either indemnify the individuals or for an entity type scenario. When a risk is having difficulties, what a good broker will do is think like an underwriter and really kind of walk the client through what the issues are that the underwriters have with that particular insured.

For instance, it might be something associated with their balance sheet. Maybe their burn rate is such that they don't have enough cash on hand to sustain operations. And therefore, you have to work with your insured to make the best case possible to the insurance company in terms of laying out to the insurance company why we're going to remain viable going forward, how we're going to get through this. And that could be, we have a credit facility lined up. We have a new client in the pipeline. We have a new investor coming in.

Rob Crocitto: But if the insureds are not taking the initiative to work with their brokers to explain to the insurance companies these happenings, the insurance companies can only go by the piece of paper that says their financial statements are struggling and that's how they go on it.

Lynda Bennett: That's why they need you, Rob, to be the storyteller, to help them be the best risk possible, right? You talked about preparation and even the run of the mill "easy risks" to place the have had a hell of a time the last couple of years going through the renewal process. So let's just talk for a couple of minutes about the things that companies should be thinking about. When does renewal start? I mean, one of the things I've noticed, it used to be 60 days out and it feels like the renewal process is now a 365 day event.

When do you start and what are some of the important things that companies need to be doing to get ready for their renewal this year?

Rob Crocitto: If you had asked me this question three years ago, I would have told you 90 days. If something's really difficult, I might've told you 120 days. We want to get out in front of it. In light of today's market, it's a yearlong process. The preparation for a D&O renewal starts immediately after the policy is bound, that you just have now. That preparation comes in the form of education. A good broker needs to stay on top of what is happening in the market and keeping their client educated in terms of developments.

Because I can tell you, if you want to have a really upset client, have a client who's not prepared for a difficult D&O renewal, both from a budget standpoint, but also when a risk manager or a CFO or a general counsel has to go to their board meeting and say, "Hey, independent directors, you now have less coverage." That's when things get real sticky.

So if you can get out in front of it early, explain to your insureds what's going on in the market, talk to them about the statistics I went through earlier, talk about what pain the carriers are feeling, and then lay out the plan. The most important thing management can be doing is infusing them into the process. I'm a very good insurance broker, and I think I know the D&O products as well as anyone, but what I don't know is an insured's operations as well as they do. And I need them to become a very, very viable part of the renewal process.

And that means likely having both the CFO and the general counsel involved in a D&O renewal. The CFO can handle all of the accounting, the balance sheet, the financial issues, while the general counsel can address any and all litigation matters that have underwriters concerned. Sometimes underwriters, they might read about a litigation matter in a six week old 10K and that matter has been resolved. But if it's not communicated, we have to make sure the underwriters know in real time.

Rob Crocitto: And it's also very important that the insureds keep their brokers in the loop on any and all developments that they're doing corporately. And what I mean by that is from an M&A perspective especially, if an insured is making an acquisition, there are terms and conditions in a D&O policy that based on the size of that acquisition could prohibit the D&O coverage from responding to future claims arising after that acquisition for that acquisition.

So for instance, if we make an acquisition of ABC Company and ABC Company's asset size exceeds an asset threshold that's in all D&O policies, well then there might not be automatic coverage for that acquisition on a going forward basis. And therefore, it's very important that when an insured is making an acquisition or maybe merging into someone else, that these things are communicated to the insurance broker, as well as their attorneys. These are legal contracts. These need to be interpreted from a legal standpoint.

Lynda Bennett: Right. And I was going to tell you, Rob, I love you, but we have to always be preserving privilege when we're having those conversations, not only with the underwriters, but also with our brokers. We need to make sure that the factual information is shared, but we have to be super careful about maintaining the privilege over self-critical analysis documents and things of that nature. It really is a partnership. Everybody's got to work together.

So tell me this, Rob, this year in particular, during the underwriting process, what kind of questions are we going to get about COVID-19? What are the things that the underwriters want to hear from our clients about lessons learned from COVID-19 or particular risk factors that the spotlight got shined on as a result of the pandemic?

Rob Crocitto: So it's going to be about disclosure first, especially if you're a public company. Did you disclose to your investors what COVID-19 and the global pandemic, what effects it's having on your business? What steps the company is taking to get out in front of those issues, whether it be from a supply chain, because it doesn't always just affect the insured. It could affect the insured's supply chain, or it could infect the insured's customer base. And where the securities claims are going to come from is when we don't fully disclose those potential issues, right?

They're going to want to look at how things were disclosed. They're going to want to look at the steps the company is taking to manage it's at home workforce now, right? And what I mean by that is making sure that when employees are operating remotely, that they're operating in a manner that's professional and in accordance with what would have taken place in the office, making sure that employees are educated. Think about this, we now have employees using their personal computers remotely, right?

Are they taking the same steps procedurally to a hacker getting in or a potential ransomware situation? And I know this is a D&O discussion, but if management doesn't take the proper steps to make sure that these procedures are in place, management has liability from a director and officer liability standpoint because they didn't do their due diligence in supervising the process.

Rob Crocitto: We have a whole host of new thought processes that are coming into play on top of the normal, how much money have we lost over the last 10 to 12 months because of COVID, or what has our stock price done in this market because of how much money we've lost, and are we going to be a viable risk going forward, and can our industry bounce back.

Lynda Bennett: Well, exactly right. Now, Rob, we're just about out of time and it's going to really cut against my grain. But on this one occasion, I'm going to give you the final word.

Rob Crocitto: No way.

Lynda Bennett: Is there anything else that companies should be thinking about to get ready to navigate their D&O renewal?

Rob Crocitto: Look, the insurance companies are famous for coming out with a new form when they quote something or changing an endorsement. Brokers need to be diligent when reviewing the renewal terms to make sure that any and all changes are identified. When an insurance company says, "It's the same as the old endorsement number 12. It's our intent to provide the same coverage," it's not.

Lynda Bennett: We've seen that one.

Rob Crocitto: If it was, they wouldn't have changed it.

Lynda Bennett: Right.

Rob Crocitto: And therefore, Lynda, you've said it a thousand times, the words in the policy matter, and it is imperative when these changes are made that you consult with your coverage counsel to make sure that these policy terms are reviewed thoroughly, because the slightest change in a lead into an exclusion or in a certain type of coverage enhancement endorsement can take away so much coverage.

Rob Crocitto: And the last thing you want to do as an insured is have to explain to one of your outside directors that there's no coverage for something for them because somebody wasn't paying attention.

Lynda Bennett: Well, that's great, Rob, and we do enjoy working with Arc on doing exactly those types of reviews. This was a really terrific discussion. I think it gave our listeners a strong sense that the D&O market is going to remain an important and challenging part of every company's risk management program. We appreciate that you've stayed true to our core values here at Don't Take No for an Answer by keeping it real and keeping it practical.

Lynda Bennett: I look forward to having you back for our next episode when we'll discuss the impact of SPACs and de-SPACs backs that are having on an already challenged D&O market. Thanks so much for joining us and we'll see you soon.

Rob Crocitto: Thanks for having me, Lynda.

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