SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

Market Update - FINPRO

South Texas Chapter Risk & Insurance Management Society

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MARKET CONDITIONS - FINPRO
SUMMARY

- In the fourth quarter of 2018, the US FINPRO insurance market generally continued to show some modest premium increases.
- This is the fourth consecutive quarter in which public D&O rates for both the primary and total program have increased. As a reminder, total program public company D&O pricing had not seen any increase since Q3 2014.
- The consistent message from carriers is that there is more focus on profitability than on top-line growth.
- Due to the continued deterioration in D&O loss activity, the insurers reiterated that rates must materially increase.
- For 2019, we expect to see a continued push for rate increases – most notably with public D&O.

MARKET CONDITIONS - FINPRO

SUMMARY

AT A GLANCE — AVERAGE RATE CHANGE RECAP Q4 2018

Coverage	Primary	Total Program
D&O		
Public	+5.4%	+3.4%
Private & Non-Profit	+2.6%	+2.7%
Fiduciary		
All Companies	+2.3%	+2.0%
Crime — All Companies	+0.9%	+0.8%
Employment Practices Liability (EPL) — All Companies	+0.8%	+0.7%

Note: The above reflects average rate changes for Marsh clients only during Q4 2018. The overall FINPRO market continues to be unpredictable with individual risk profiles including loss history, industry and exposure changes critically important and which may materially effect a much higher or lower rate year over year differential.

MARKET CONDITIONS – D&O

Public D&O

- Most insurers are no longer agreeing to premium decreases on primary and low excess.
- Many insurers are even pushing for a higher increase on excess layers than on the primary layer.
- While competition still exists from some markets that are trying to be opportunistic in an attempt to build their book of business, the aggressive nature of these markets has started to wane over this past year, indicating they will be very selective on where they want to be materially lower than the incumbents.

Private D&O

- One of the larger writers of private company business is actively looking to cut capacity; however, other carriers are being opportunistic.
- Terms and conditions continue to be challenging at times for classes of business deemed high risk or financially distressed. With the increase in antitrust claims, insurers are focusing more strictly on the amount of coverage they want to provide for this exposure.
- Carriers are addressing the above underwriting challenges by adding separate, higher EPL retentions for California claims and/or higher separate retentions for sexual harassment claims.
- Clients are also starting to see carriers quote the EPL coverage with sexual misconduct exclusions.

CHANGING PUBLIC D&O MARKET CONDITIONS

Perfect Storm: *noun 1. detrimental or calamitous situation or event arising from the powerful combined effect of a unique set of circumstances:*

It is important to understand that we are seeing some unfavorable changes in the D&O market that have not existed for more than a decade. These changes are a result of the perfect storm effect of the following colliding conditions:

LITIGATION AT AN ALL TIME HIGH

- **Traditional securities suits** showing increased frequency and severity
- **Merger Objection** cases continue with shift from state to federal court
- **Derivative actions** are also now increasing in both frequency and severity
- **Event-Driven litigation** continues to expand to a variety of areas - #MeToo, Cyber Breaches, Social Media, Privacy, Wildfires, Products, Safety – any bad news can lead to a claim
- **London Market in turmoil:** High profile corporate scandals (Petrobras and VW), sector specific challenges (mining / resources and life sciences), Australian D&O claims (securities class actions and third party litigation, royal commission) & UK domiciled companies
- Aggressive and innovative **"two tiered" plaintiff firms** show no signs of relaxation
- ***Cyan*** Supreme Court decision – Section 11 cases can be brought in both federal *and* state courts

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YEARS OF WIDESPREAD PREMIUM REDUCTIONS AND BROADENING COVERAGE

"SOFT MARKET CONDITIONS"

- Abundant capacity
- More coverage for less price (coverage kicking in sooner): i.e. Shareholder Derivative Demand sub-limits; Pre-Claim Inquiry Cost Coverage; Investigations Coverage

DECLINING NEW CUSTOMERS

- 5,350 public companies in 2018 versus 7,994 in 2000
- IPOs not making up for M&A consolidations and bankruptcies

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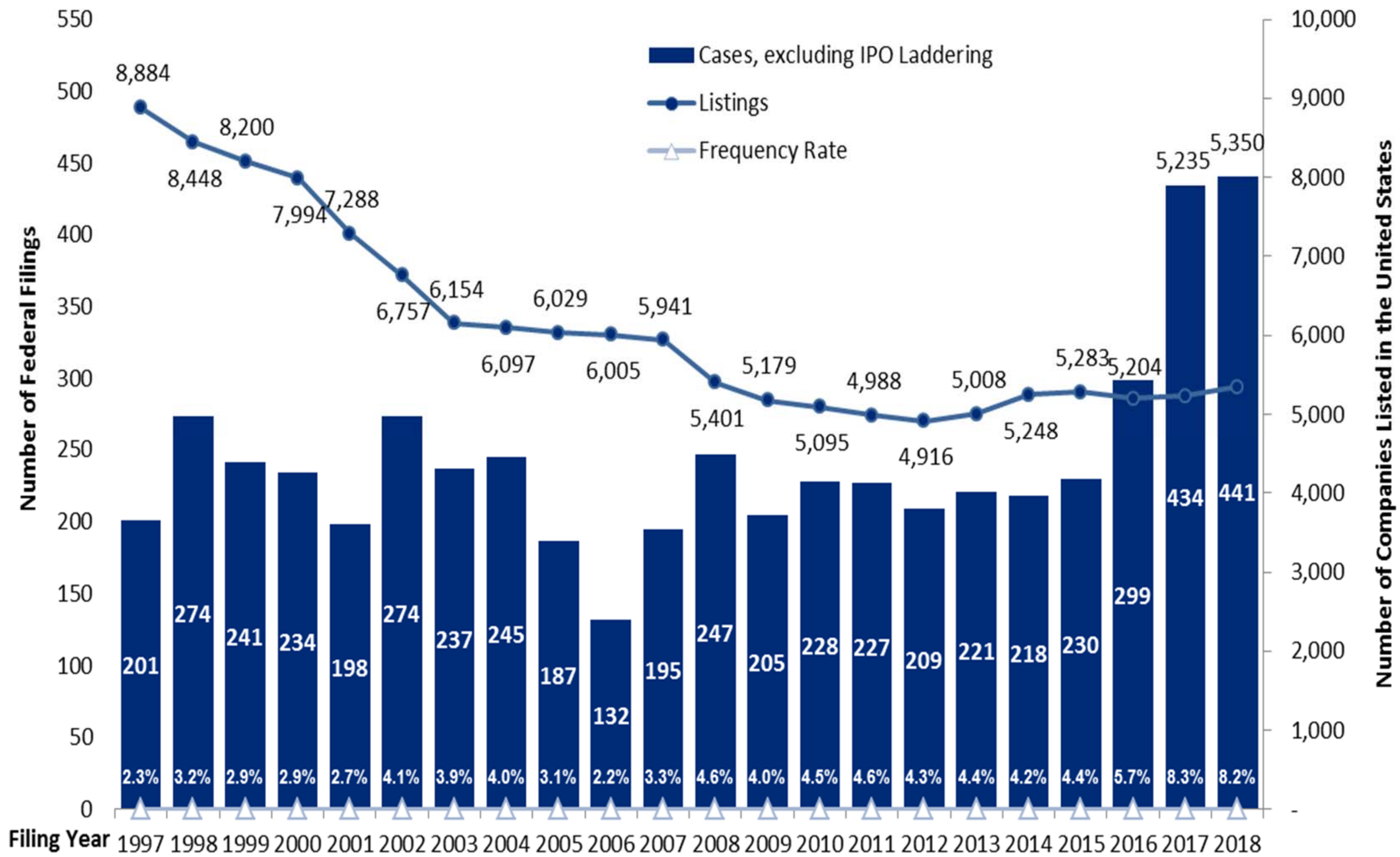
Inadequate insurer pricing for risks assumed

Federal Filings and Number of Companies Listed in US (January 1998 – December 2018)



Source: NERA Economic Consulting: Recent Trends in Securities Class Action Litigation: 2018 Full Year Review

6.16%	5 Year AVG Frequency Rate – US Securities Exchanges 5,264

MARKET CONDITIONS – EPL

- Capacity is stable but rates are trending up
- Employment class action settlement amounts were halved in 2018, to $1.32 billion, from 2017's record high of $2.72 billion, according to Seyfarth Shaw.
- #MeToo claims (most of which are not susceptible to class treatment) are a different story, with both frequency and severity up dramatically. Sexual harassment charges filed with the EEOC increased more than 13% from FY2017 to FY2018.
- Employers are challenged by new and evolving theories of claims under the Americans with Disabilities Act (regarding website compliance, medical marijuana, and use of service animals).
- Pay equity is another area seeing growing attention, with new state and local laws seeking to eliminate pay differentials on the basis of sex and other protected categories.

MARKET CONDITIONS – CRIME

- Despite heightened awareness, incidents of loss due to SE/FI/BEC continue unabated. These schemes, which are most often perpetrated via telephone and/or email by someone purporting to be an employee (often a senior executive), customer, or vendor of the insured, are designed to induce the targeted employee(s) to initiate fraudulent electronic funds transfers.
- SE/FI/BEC coverage is now available and, depending on the desired limit/sublimit, may be subject to completion of a specific underwriting questionnaire. Additional premium is typical.
- The London Market has experienced a lot of loss activity this past year, so they are more cautious in their offering of full SE/FI/BEC coverage.
- Be sure that any coverage does not impose conditions precedent to liability, such as callbacks or other verification procedures.

MARKET CONDITIONS – FIDUCIARY

- For the sixth consecutive quarter, fee litigation continues to be the key concern for insurers and is driving rate changes, regardless of loss experience. This is due to rising settlement amounts, an increase in frequency, and an aggressive plaintiffs' bar. ERISA security holder claims are diminishing slightly as excessive fee claims become more prevalent.
- We are still seeing more claims against financial institutions for alleged self-dealing in using proprietary funds in their own plans; these claims can sometimes be compounded by excessive fee allegations as well.
- More insurers are considering imposing higher retentions and/or rates for excessive fee claims, regardless of the policyholder's due diligence in this area; expect underwriting questions or questionnaires.
- Financial institutions using proprietary funds or services from affiliate entities can expect probing questions, higher retentions, higher prices, or possibly exclusions.

MARSH