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Industry Insights

# What to Expect from the D&O Market in 2023

Patrick Whalen • February 13, 2023

The Directors' and Officers' Liability (D&O) insurance market remains volatile. The hard market the industry experienced from late 2018 through 2021 has pivoted quickly. New carriers, a lack of transactions in the equity marketplace, and a decrease in the number of Securities Class Action (SCA) claims over the past several years has led to an increasingly competitive environment.

Throughout 2022, insureds witnessed rapid premium relief. Many saw premium decreases while those companies that had gone public during the hard market via Initial Public Offerings (IPOs) or DeSPAC transactions saw even greater decreases and an improvement on terms.

Though the macro-environment continues to be a challenge, 2023 began in a similar fashion for both brokers and clients, who continue to see decreases throughout their D&O insurance program.

There is a feeling that the market is in need of stabilization. Here are several other topics we are focusing on this year:

**Rate Adequacy**

The D&O market experienced a hardening as a result of a decade-plus of rate decreases and an antagonistic Plaintiff's Bar. According to the Stanford Securities Clearinghouse, there was a significant increase in SCAs from 2016 to 2020 (2017, 2018, and 2019 saw the number of filed SCAs exceed 400 per year) compared to the prior years. These potential losses led to a tightening of risk appetite and a focus on profitable underwriting.

Over five-hundred cases remain open, and those results can have a negative impact on carriers' loss ratios. As the market continues to soften, will the rates collected over the past two-and-a-half years prove adequate to offset these legacy claims? If not, we will likely be in for a

swift return to the more restrictive environment.

**What Comes Next for Securities Litigation?**

Securities litigation represents the most significant concern for D&O underwriters. As previously discussed, the number of SCAs rose rapidly from 2016 to 2020, with four of those years ranking in the Top Five for most SCAs filed per year (2001 remains the highest while 2016 comes in at number six) . However, as the Covid-19 pandemic ravaged the world, courts were slowed or shut down. As a result, we have seen a reduction in the number of SCAs filed over the past several years. We are looking at what impact these longer tail cases will have on company reserves and therefore premium requirements.

Through the first month of 2023, we are on track to see SCA filings remain flat compared to the prior two years. But an uncertain macroenvironment can have a negative effect leading to an increase in frequency like we saw in the lead-up to the Covid years.

**Challenging Economic Environment**

Just like the D&O market, the broader economic market remains in flux. The stock market remains challenged, interest rates remain elevated, and the equity markets have all but dried up. This is important to the public D&O market for a number of reasons:

- Loss in market valuation could potentially give rise to a claim;
- Lack of funds in the stock market has led to a decrease in the number of companies going public, therefore decreasing the number of opportunities for insurers; and
- Companies that rely on the equity market for further funding (like those in technology and biotech spaces) face limited access to capital which could result in bankruptcy.

Carriers need to focus on companies' financials, including debt, cash flows, and margin pressure and how they have previously navigated deteriorating economic climates. There are many analysts who anticipate another recession and with that comes further exposures for D&O underwriters to focus on.

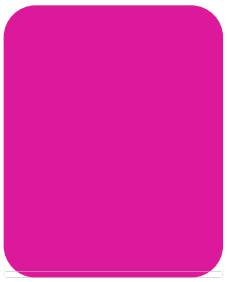
**Further Focus on ESG.**

D&O insurers have always focused on the G in ESG (Environmental, Social, and Governance).  However, added scrutiny by the Securities and Exchange Commission (SEC) and other stakeholders have put more spotlight on the environmental and social aspects of a company's operations . The SEC is pushing rules that would require more detailed disclosures around climate-related risks and board diversity requirements.

Following the Covid-19 pandemic, the war in Ukraine, and the overall geopolitical and social environment, there is an even greater focus on ESG. With a younger and more socially conscious shareholder base entering the investment space, we don't believe ESG is going anywhere. In fact, we believe there will more exposures as a result including greenwashing (or a company's attempts to seem more environmentally conscious than they are) and a war for talent to meet

board diversity requirements. All of which can lead to claims. Companies that have ingrained ESG into their operations, however, are in a better position to succeed over the coming years, though they still risk in failing to hit their targeted metrics or in spending too much time or resources. ESG remains a very difficult environment to get right.

Unsurprisingly, the D&O market has a lot to focus on in 2023. While this list is in no way exhaustive, these are some of the major focus areas we are looking at this year. Time will tell how the industry responds to the turbulence of this decade. Given the many question marks surrounding the industry, carriers and brokers need to focus on all of the exposures that may impact their clients. We believe consistent relationships and quality partners will win the day. Good partners, who have navigated challenges and have experienced multiple market cycles, are crucial to company's risk management solutions.

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