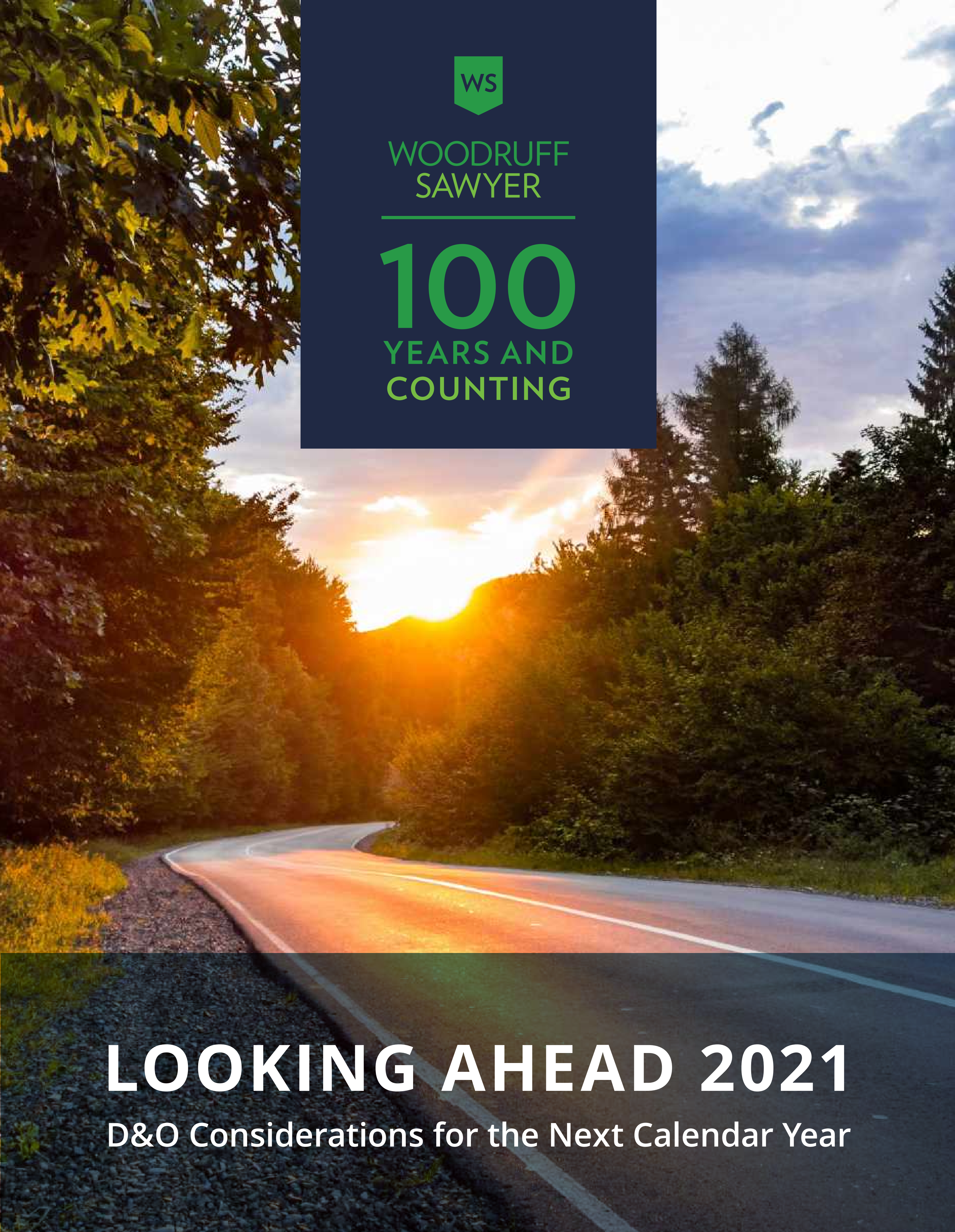

LOOKING AHEAD 2021

D&O Considerations for the Next Calendar Year

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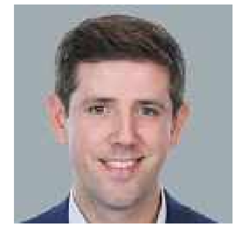

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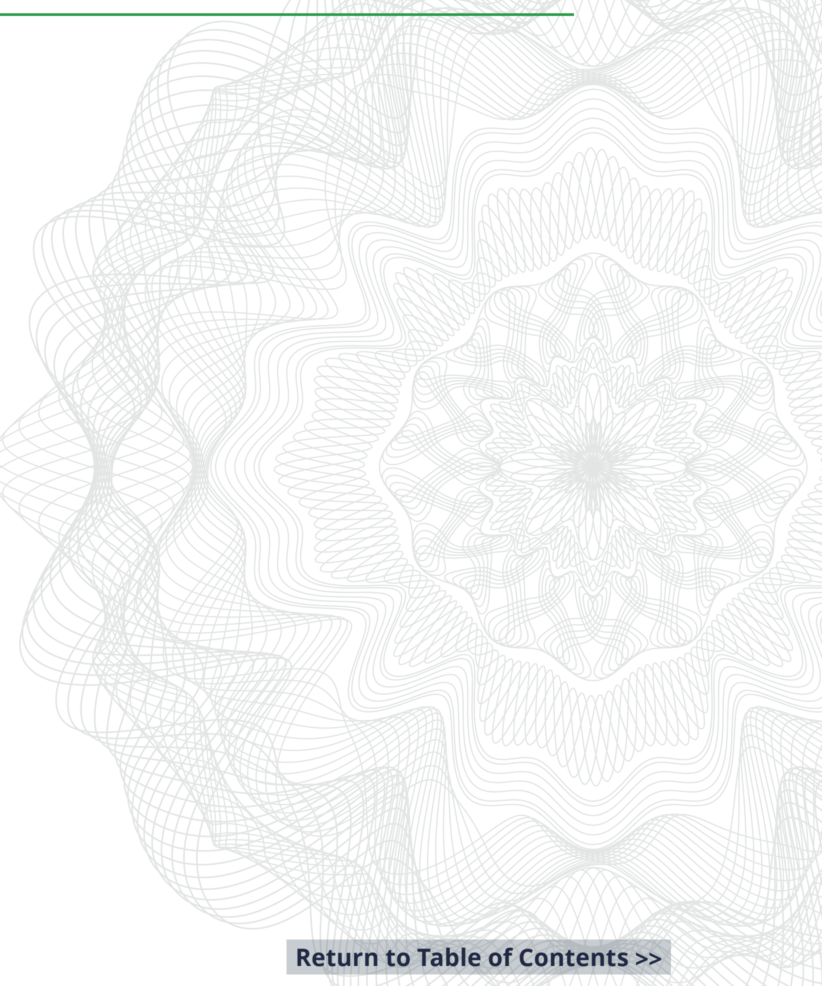
1.0 D&O MARKET UPDATE



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1.1 US Markets

The market for Directors & Officers (D&O) liability insurance in the United States entered 2020 facing a host of hurdles, many of which have only been exacerbated by the uncertainty surrounding the pandemic and global recession.

Impact of COVID-19

To date, we have recorded a relatively modest number of COVID-related securities class action filings. The first few suits filed from March through May were unfortunate, but predictable in that they were directly related to the pandemic. For example, there were two suits filed against major cruise lines: one for alleged misleading statements by management (Norwegian Cruise Line) and another for alleged mishandling of outbreaks on ships (Carnival Cruise Line), resulting in deaths. In addition, immunotherapy companies (Inovio Pharmaceuticals and Sorrento Therapeutics) and a testing kit supplier (SCWorx Corp.) were hit with suits for allegedly exaggerating their ability to deliver COVID-related therapies and tests.

D&O underwriters, however, fear that the longer the pandemic crisis goes unchecked, the more business vulnerabilities and challenges will be exposed and amplified. Insurance underwriters are painfully aware that directors and officers are making decisions and releasing public statements every day about a future more beyond their knowledge and control than usual. Insurance carriers know that, for some, the effects of COVID will not go as management expects. As a result, the bets made and risks disclosed in SEC filings will inevitably be second-guessed by plaintiff's firms in the form of securities suits.

No Abatement in Other Hard Market Drivers

Even without the threat of a pandemic or global recession, the D&O insurance market has been hardening for a couple of years. The factors that contributed to the hard market show no signs of abating in 2021.

As predicted in last year's *Looking Ahead Guide*, for the first time in a decade, D&O rates rose throughout 2019 and continue to do so in 2020.

INSURANCE CARRIERS CITE MULTIPLE FACTORS TO JUSTIFY THEIR UNDERWRITING APPROACH AND D&O APPETITE:

1. Securities class action frequency is coming off an all-time high,
2. Suit severity and settlement costs have increased, making excess layers too cheap relative to risk; and
3. Derivative actions are still on the rise with notable settlements tapping "A-side only" insurance.

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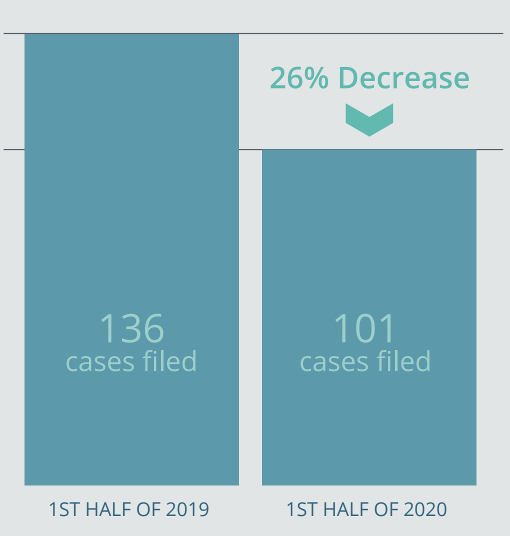
More recently, insurance underwriters are also citing the unusually high number of unresolved cases pending against directors and officers, as explained in more detail below.

The number of total cases and likelihood of being sued have set new records in each of the past five years, and 2019 stands as the all-time high. The likelihood of a public company being sued in 2019 was 5%. That rate jumps to 9% when M&A cases are included. For S&P 500 companies, the litigation rate was 7.2%.

Even if filings remain somewhat muted in 2020 compared to 2019, the record-breaking number of filings over the last five years (2015–2019) still weighs heavily on today's pricing. During that time period, Woodruff Sawyer data indicates that filings increased by 47%, with open cases increasing by 63%. As of mid-year 2020, there is a backlog of approximately 600 cases that have yet to reach a conclusion—a significant concern for D&O insurers.

Securities class action cases through June have dropped 26% from the same period in 2019, but 2020 projections top the 10-year average.



Projected total 2020 filings

JUST OVER 200

EXCEEDS

10-YEAR AVERAGE OF 175 CASES PER YEAR

For the first half of 2020, there were 101 cases filed, a 26% drop compared to the same period in 2019. While this is good news, that rate still projects out to 200 total cases for the year, which exceeds the 10-year average of 175 per year. Moreover, this drop in filings might well be attributed to the fact that many courts have been closed for new civil filings due to the pandemic, and not because plaintiffs do not have cases ready to file.

Excess Layer Pricing On the Rise

Carriers have concluded that historical pricing for excess layers is too cheap relative to the risk of those layers being exposed to a claim. We have certainly observed that the 2019 median cash settlement of $13.6 million was well above the 10-year average of $8.3 million. Over the last decade, while primary and low excess layers arguably garnered a more sustainable

premium relative to risk, excess layers perceived as being “out of the burn” were aggressively targeted by non-incumbents and new entrants to the D&O landscape. This drove excess pricing down to unsustainable levels. Over the last two years, carriers have decided that they need increased compensation on those thin excess layers to better reflect the risk they are assuming.

Carriers Cutting Capacity

Another way insurance carriers are managing their exposure to claims is by cutting the limit they were previously willing to provide. Carriers that were once willing to put up $10 million for the D&O program for a single client are cutting back to half of that, or in some cases even less. Indeed, in this year's Underwriters Weigh In survey, one underwriter noted that "there is still a giant segment of the market that is underpriced—large commercial risks—which will also be subject to limit shrinking by carriers."

When a carrier cuts capacity, brokers are in the unenviable position of trying to find a carrier to fill a spot that the substituting carrier knows the incumbent carrier thought was underpriced. Predictably, the substituting carrier will charge extra for stepping into the abandoned spot.

Lastly, we have seen little fresh capital enter the D&O market. Traditionally, new carrier entrants have reliably entered the D&O marketplace when rates increased. These opportunistic entrants into the D&O insurance market created new competition, a dynamic that consistently has saved D&O buyers significant premium in the past. We are three years into this challenging market, however, and disruptive new sources of D&O insurance capital have yet to emerge to reduce premiums in this unpredictable environment.

Side A Insurance

The situation is perhaps even more stark for Side A insurance. For a decade or more, underwriters aggressively competed and drove prices down on the DIC A-side portion of D&O insurance towers. As a reminder, A-side coverage sits above the traditional ABC program and is exclusively for the benefit of the individual Ds and Os and is not shared with the entity. Carriers no longer regard Side A insurance as "safe," and as a result, it is not immune from substantial price increases.

LARGE 2020 DERIVATIVE SUIT SETTLEMENTS

Derivative actions, suits in which shareholders sue individual Ds and Os on behalf of the company, are on the rise with notable and high-profile insurance settlements in 2020 including Equifax ($32.5 million), Tesla ($60 million), McKesson ($175 million), and American Realty ($286.5 million).

Derivative suits are claims that Side A insurance is designed to cover. A veteran of the D&O insurance market remarked, "I've paid out on more A-side claims in recent years than in my prior 20 years combined."

FIND OUT WHETHER SIDE A-ONLY D&O PROGRAMS ARE WORTHWHILE >

Employment Practices Liability

The pandemic is driving Employment Practices Liability (EPL) insurance concerns as well, and carriers are responding with increased premiums and retentions. In fact, in this year's Underwriters Weigh In survey, one underwriter noted: "I am of the opinion that the financial lines insurance was in a soft market for 15 years, which resulted in thin margins for primary and low excess D&O carriers and I think there will be a rate push for the foreseeable future on D&O. I also think that given how fluid the economy is, EPL is an area of concern for carriers going forward."

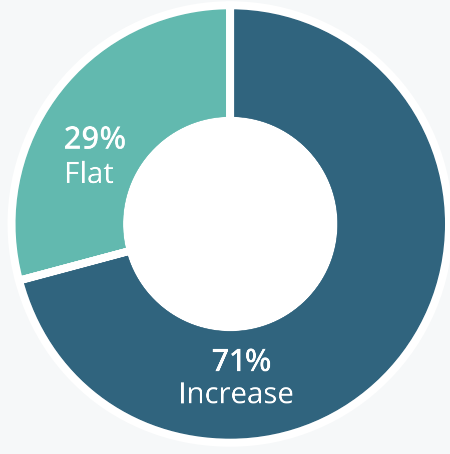
We typically see an increase in EPL claims accompany economic downturns. In the current pandemic-driven economic downturn, carriers predict an increase in individual and class action claims as the unemployment rate rises. In addition, carriers are concerned about workers bringing COVID-related health and safety suits. Employee allegations are also certain to include accusations of denied wages, discrimination, and unsafe workplace conditions. This combination will drive more losses for carriers in their EPL books and will lead to a further increase in EPL premiums in 2021.

1.2 Self-Insured Retention Trends

Changes in self-insured retentions for securities claims at renewal fall into two very different categories. A sizable portion of our clients are renewing with flat self-insured retentions. However, clients experiencing increases are usually seeing retentions increase by 50%-100%. Typically, these increases are on accounts that have had relatively low retentions—often for a long period of time. Other increases are attributable to changes in a company's risk profile, for example a large increase in market capitalization. For smaller companies, retentions now trend towards $1 million, while larger companies are seeing retentions move up to $5 million and $10 million. Self-insured retentions for recent public companies may be even higher.

LEARN ABOUT CLAIMS BEST PRACTICES IN THIS ENVIRONMENT OF INCREASING SELF-INSURED RISK RETENTIONS >

71% OF SELF-INSURED RETENTIONS ARE INCREASING AT RENEWAL*



Typical Increases:
50%-100%

Largest Increases:
- Retentions below $1M
- Significant stock volatility
- Recent IPO

*Trailing 12 months through Q2 2020

1.3 Pricing Trends from CIAB: Rates Are Up

The Council of Insurance Agents & Brokers' Commercial Property/Casualty Market Survey reports that in the second quarter of 2020, the average D&O rate increased 16.8% over the prior quarter. Ninety-three percent of the respondents saw rate increases in Q2, with 80% of respondents experiencing a rate increase of at least 10%. No respondents saw a decrease in rates.

AVERAGE D&O RATE INCREASE IN Q2 2020

Avg Rate Increase	
Up 30%-50%	13%
Up 20%-29%	28%
Up 10%-19%	39%
Up 1%-9%	13%
Flat	6%
Not Sure	1%

93% of respondents saw rate increases in Q2.

No respondents saw a rate decrease

1.4 Woodruff Sawyer Client Renewal Pricing

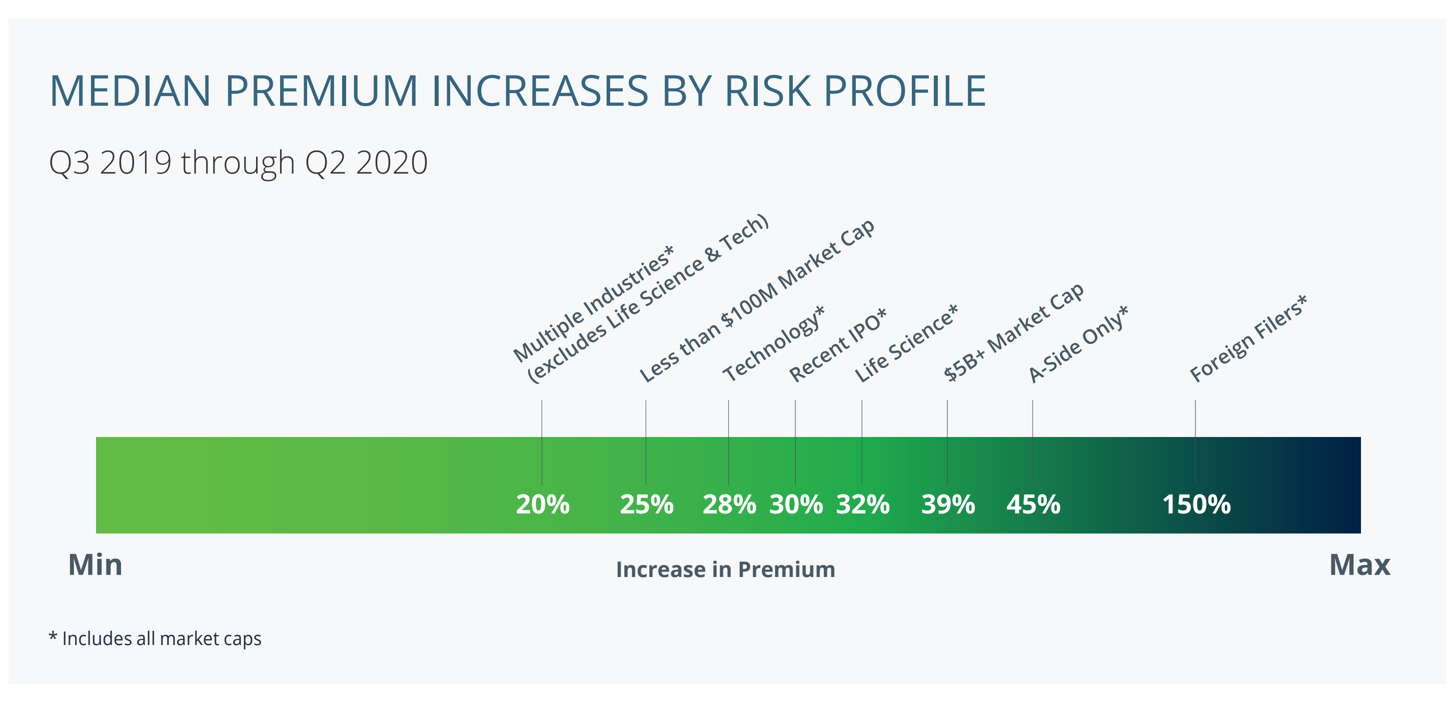
Any broker's perspective on and experience with D&O insurance renewals necessarily reflects the demographics of their clients. We are a leader in negotiating D&O insurance for companies in the life science and technology industries, including companies that are aggressively disruptive, not to mention engaged in IPOs or direct listings. Many of our clients fall on the higher end of the risk spectrum. Consequently, they are more impacted by market changes. We note, however, that our clients with more gentle risk profiles are experiencing the same general trend as our riskier clients, albeit in a somewhat more muted way.

READ OUR TIPS ON HOW YOU CAN MAXIMIZE YOUR CHANCES OF A SUCCESSFUL RENEWAL.

In 2020, with rare exceptions, companies continue to experience increases in total cost and retention on their D&O programs, regardless of size and industry. Given the small number of clients that experienced a flat or decrease in their most-recent renewal, this report focuses on what the data reveals concerning trends in the increases.

Based on the data (perhaps unsurprisingly), insurance carriers tend to have a broad consensus that certain risk types should be charged higher premiums than others.

The spectrum graphic here illustrates percent increases in total premiums experienced by different types of companies.

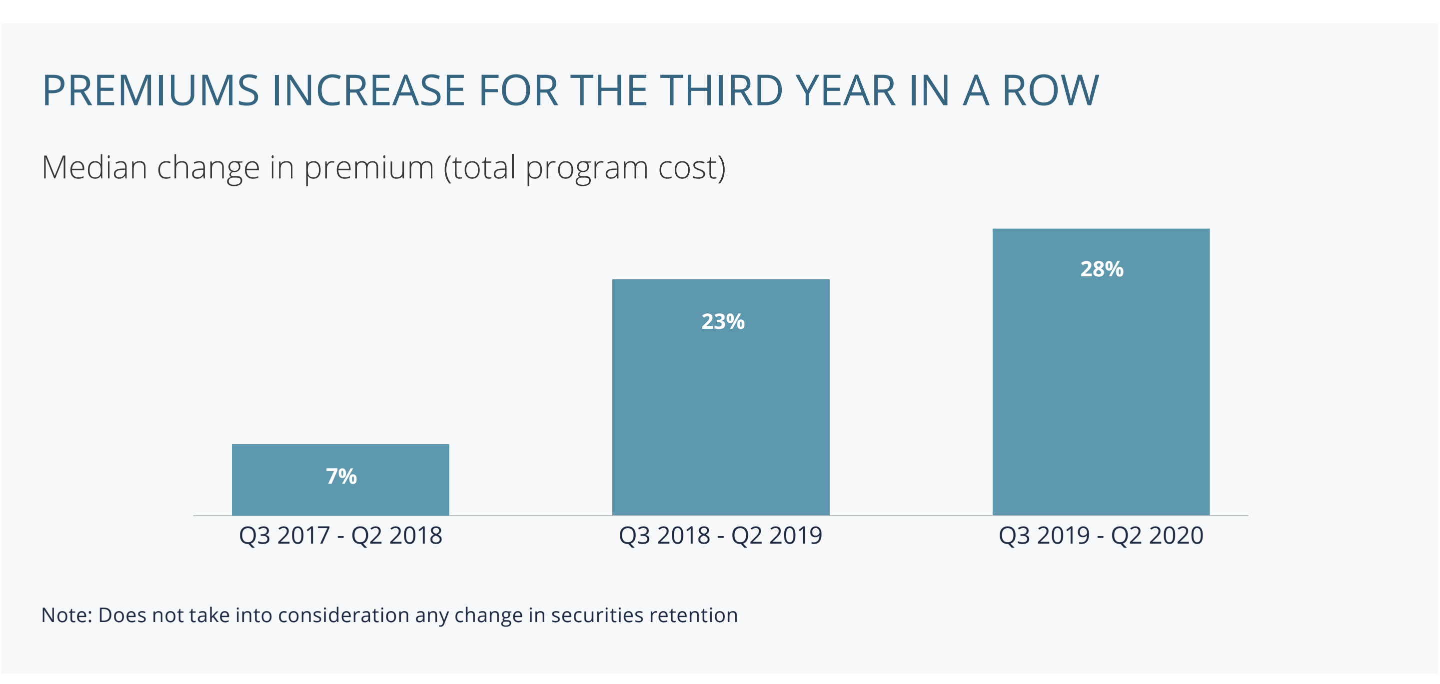


Note: Higher percent increases in premium may not translate into higher overall premium dollars. A client experiencing a painful increase on a percentage basis may still have an at- or even below-market premium.

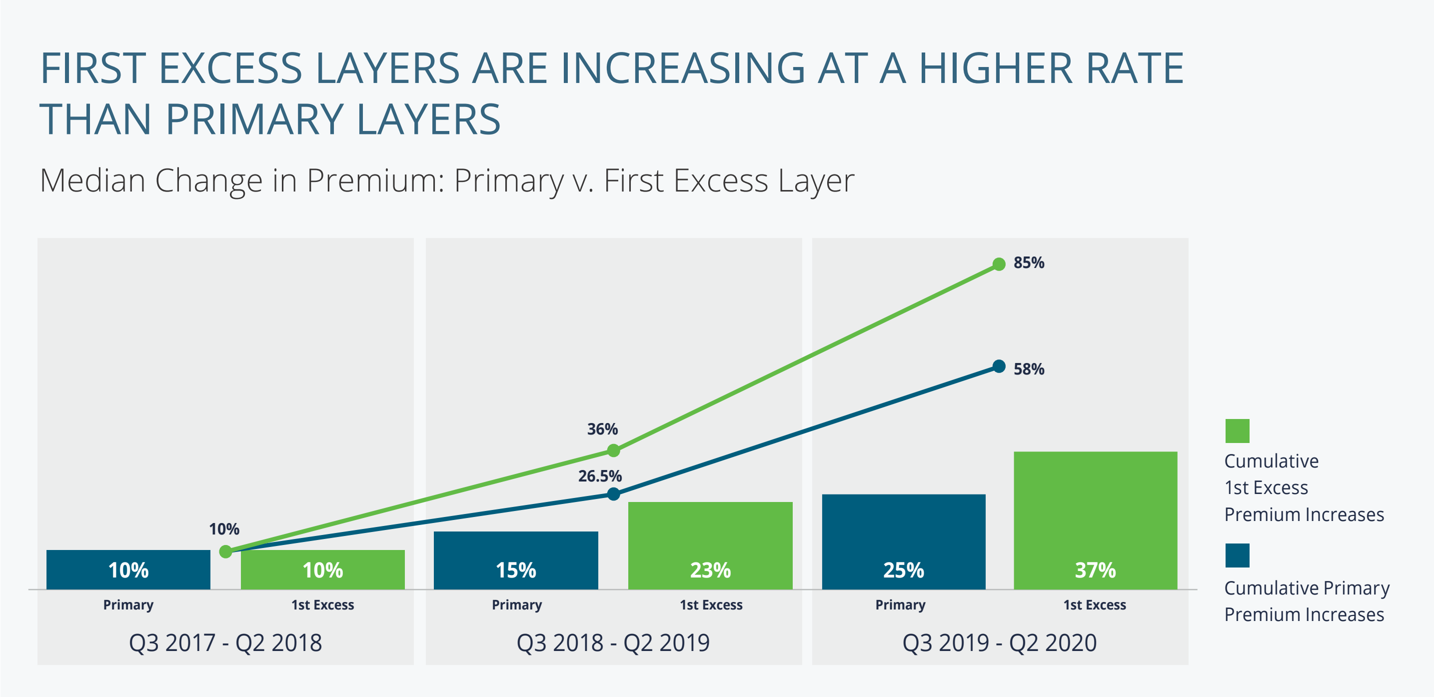
Woodruff Sawyer's book of business is dominated by technology and life science companies, the two sectors that experience the most D&O litigation. As such, it is unsurprising that in the past 12 months only a handful of Woodruff Sawyer clients experienced a flat renewal or modest decrease in their premiums.

The vast majority of clients experienced an increase in their premiums, though the range of increases varied widely from 2% to over 300%. The median increase for all clients regardless of size or industry for the last four quarters has been 28%.

This trend is especially painful for clients given that this is the third year in a row of increasing premiums, and the second year in a row of dramatically increasing premiums.



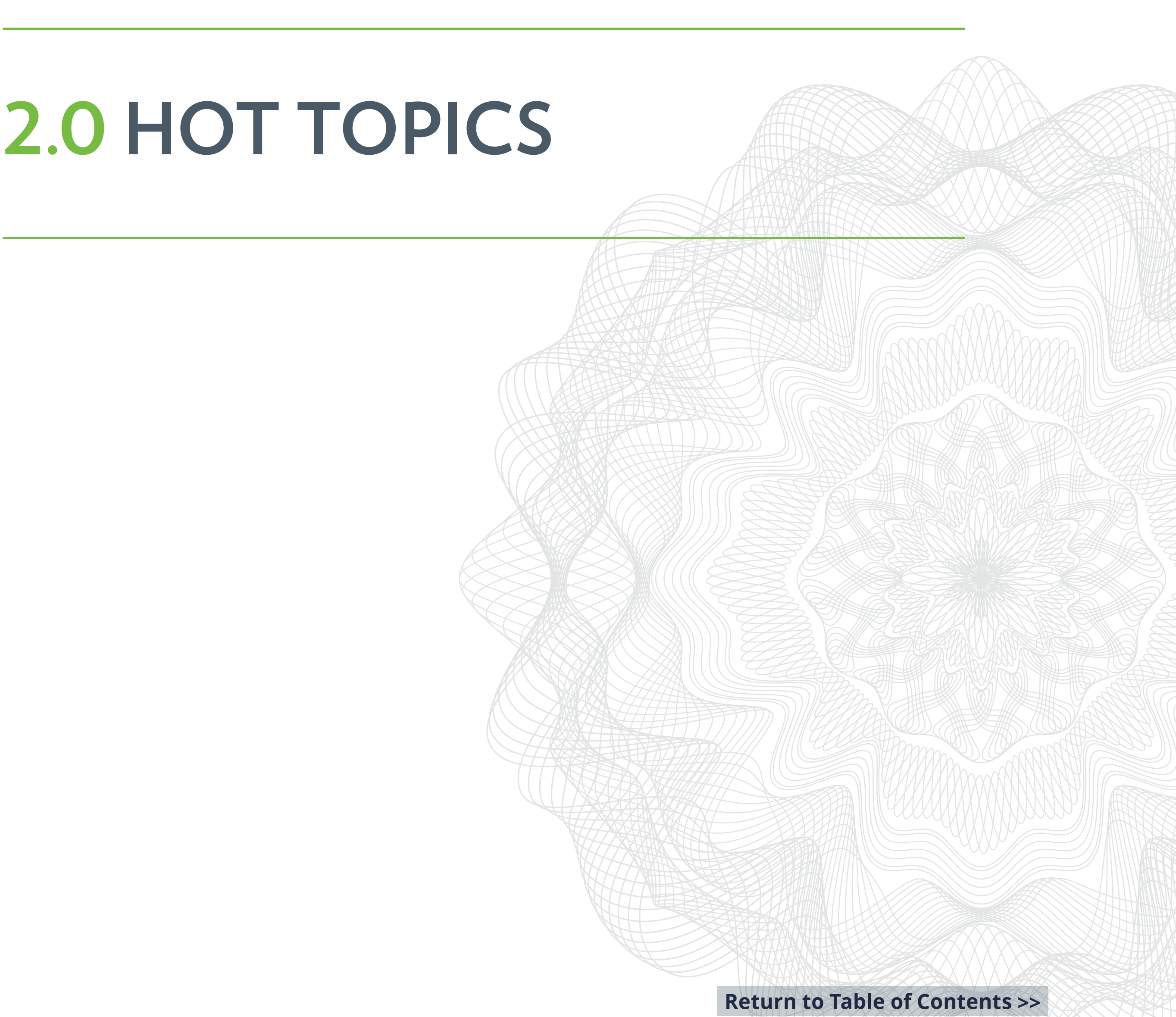
If we look more closely at the renewals, we can see that the premium trends are different when we separate primary layers (the first layer of D&O insurance in a multi-layer D&O insurance program) from excess layers.



To understand why this is interesting, it helps to remember that, traditionally, excess layers would follow whatever price increase or decrease that the primary layer experienced. The chart below illustrates how the current market has turned this traditional dynamic on its head.

This dynamic of the first excess—and often higher excess layers as well—being unconstrained by the increase negotiated by the primary layer adds tremendous complexity to the exercise of estimating renewal costs. It also requires much more aggressive efforts to create competition for each layer of excess insurance all the way up the D&O insurance program tower. Put simply: Every renewal is a knife fight.

2.0 HOT TOPICS



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2.1 COVID-19

The first-order impact of COVID-19 from a D&O insurance perspective is a story of winners and losers. Some industries, particularly any industry that supports working from home, immediately did well. Other industries, particularly travel, hospitality, restaurants, and in-person entertainment such as movie theaters, immediately suffered.

Early in the pandemic, many commentators promptly predicted a slew of litigation, and indeed there has been some. Good boards of directors, however, immediately leaped into action by asking the right questions and helping to support management in the face of an unprecedented crisis.

As companies plan for 2021, they are faced with considering the long-term impact of the pandemic. Some companies will have to deal with the continued fallout from D&O litigation that has already been filed against them.

SELECT SECURITIES CLASS ACTION EVENT LITIGATION RELATED TO COVID-19

Through August 2020

Immunotherapies and Vaccines
March 2020
Statements made by CEO alleging that they had developed a COVID-19 vaccine and were planning to start trials in April 2020. A derivative shareholder suit was filed in April 2020.

NORWEGIAN CRUISE LINE

Major Cruise Line
March 2020
Misleading statements by management and sales staff about the seriousness of the coronavirus outbreak. Investigation announced in March 2020 by Florida Attorney General into its marketing practices.

Network Security
March 2020
Failure to disclose the significant impact the pandemic was having on their revenue growth that has led to a private equity firm pulling out of its $1.4B deal to acquire the company.

蛋壳公寓
Phoenix Tree Holdings

Residential Real Estate
April 2020
Misrepresentation at IPO of the risks the company faced from the pandemic. They are an operator of apartments in ten Chinese cities with an online platform that links property owners with mostly young renters willing to share living spaces for cost-saving purposes.

Healthcare Supplier
April 2020
Misleading statements about imminent plans and ability to sell millions of COVID-19 rapid testing kits. SEC halted trading of their stock in late April.

zoom

Video Conference Services
April 2020
Misrepresentation at IPO of data privacy and security measures, and lack of transparency about user data that was being transferred to Facebook – vulnerabilities that surfaced as a result of ramped up usage of their product during the pandemic.

Carnival

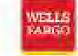
Major Cruise Line
May 2020
Mishandling of its response to the initial outbreak of the coronavirus in which 19 cruise ships were connected to nearly 2,000 reported cases of COVID-19 and at least 58 deaths.

sorrento THERAPEUTICS

Immunotherapies
May 2020
Statements by CEO alleging a recent breakthrough in its COVID-19 treatment trial "demonstrated 100% inhibition of SARS-CoV-2 virus infection" and who later insisted that management did not say it was a cure.

ColonyCapital

Real Estate Investment Trust
May 2020
Misrepresentation of revenue growth. Despite statements of addressing all of its near-term debt maturities, the company had an unsustainable level of debt in hotel and healthcare related properties and has defaulted on $3.2B in debt.



Global Banking
June 2020
Mishandling of Payment Protection Program applications that have led to lawsuits by small business owners, and inquiries by federal and state regulators.

Molecular Diagnostics
June 2020
Misleading statements about the accuracy of its COVID-19 diagnostic test in which they claimed their test results were 100% accurate – a claim that has been refuted by the FDA.

CHEMBIO DIAGNOSTIC SYSTEMS, INC.

Point-of-Care Diagnostics
June 2020
Misrepresentation of the accuracy and performance of its antibody test for COVID-19 which has led to a revocation of its Emergency Use Authorization status by the FDA.

Real Estate Investment Trust
July 2020
Misleading statements about its response to the COVID-19 pandemic while an online news report revealed its inadequate response to highly hazardous conditions at one of its federal halfway houses – subjecting residents to significant health risks.

Digital Imaging and Chemicals
August 2020
Questionable stock dealings and activities prior to and around the announcement of a $765M COVID-19 drug development loan to Kodak to produce pharmaceutical materials that has led to federal government investigations and the loan being put on hold.

Source: Woodruff Sawyer DATABOX

Most companies will continue to update their disclosures vis-à-vis the impact of COVID-19. For lucky companies, these updates will merely be a question of reframing revenue guidance. Less lucky companies face the trickier challenge of discerning whether there have been fundamental economic shifts that impact their business, and then informing their shareholders about these changes in a responsible way. Failure to get this right will, of course, inevitably lead to D&O litigation.

2.2 Bankruptcy

Personal and corporate bankruptcy filings have been significant in 2020, and this unfortunate trend will continue in 2021. This is the inevitable result of the COVID-19 pandemic's terrible impact on broad swaths of the economy. Chapter 11 bankruptcies will allow some major corporations to restructure, and thus live to fight another day.

J.CREW

JCPenney

Other companies, particularly smaller companies, are facing Chapter 7 liquidation.

Facing a short, financially distressed runway, some directors will want to resign from the board, which may or may not be a good idea, depending on the situation.

All directors and officers will be well-served to make refinancing or liquidation plans sooner than later. Doing so will help them avoid the most common mistake, which is failing to realize how much time and money it actually takes to get through a Chapter 11 or Chapter 7 bankruptcy proceeding effectively.

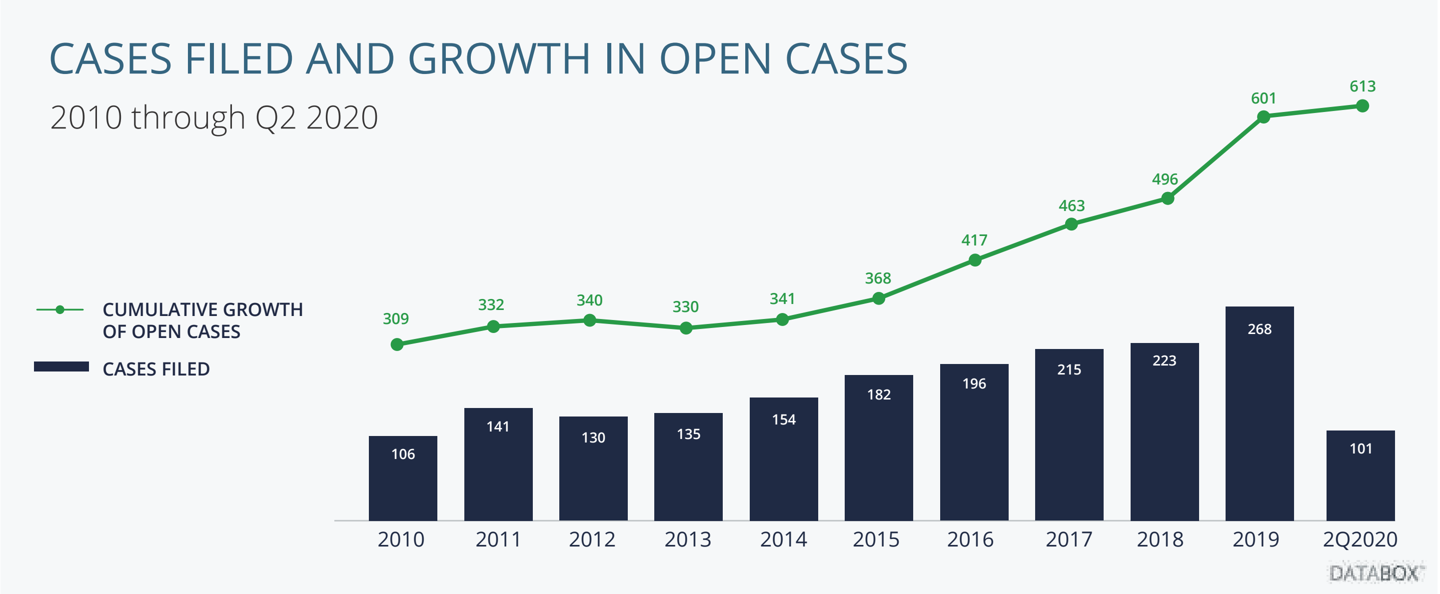
2.3 Securities Class Action Lawsuits

Is the dip in the rate of securities class action filings due to courts being closed for business as a result of the pandemic? Possibly.

We will know more by the end of the year. It is certainly premature to celebrate given the volatility we have seen in the D&O market.

Even if the case count is trending somewhat downwards, we still expect to see a significant number of class action cases to be filed through the end of 2020 as well as in 2021.

Further, there is an unfortunate and historically large number of open securities class action cases waiting to be settled.

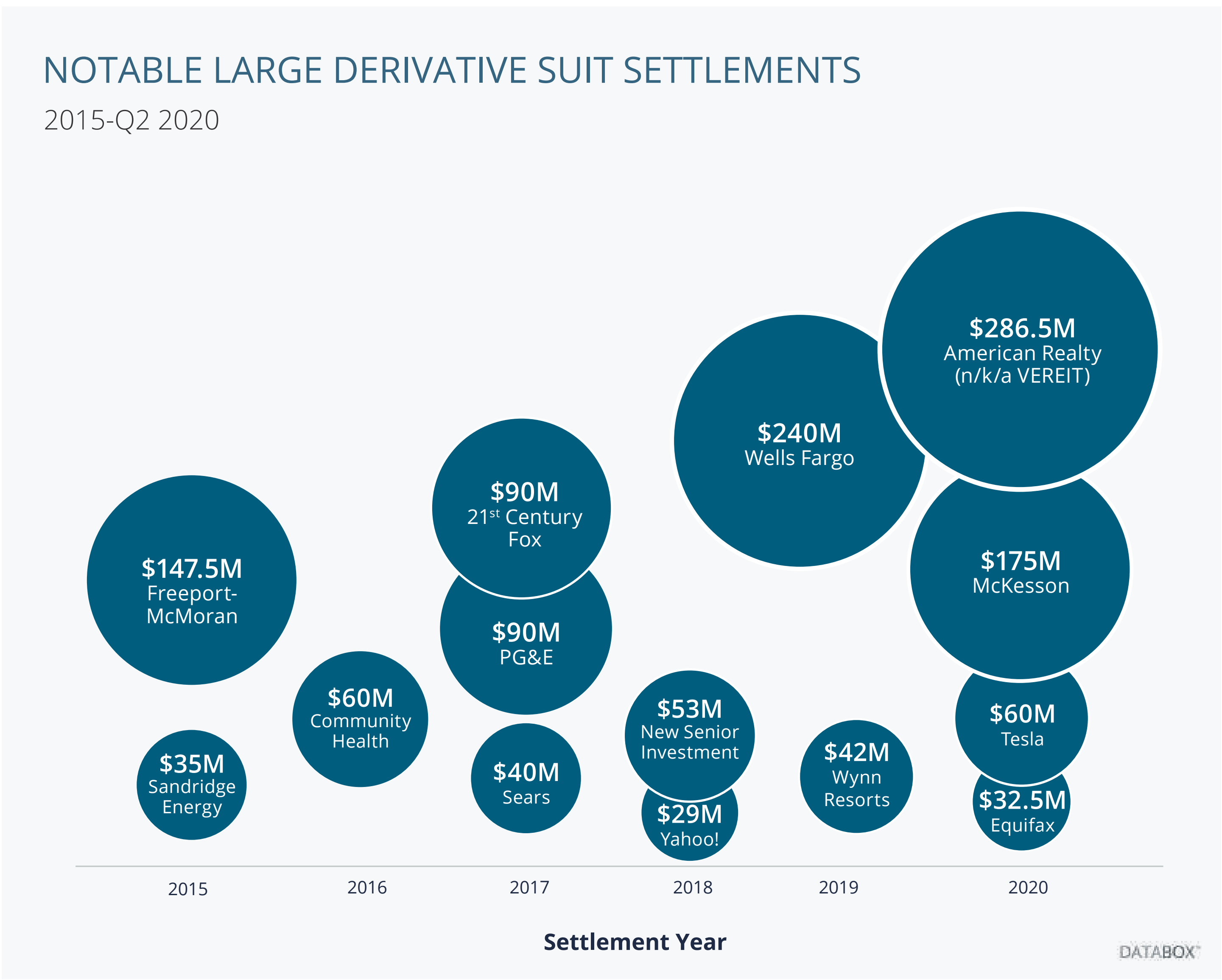


There is, however, a bright spot: We predict an overall downward trend in Section 11 cases being filed in state courts. This will be the result of the March 2020 win in the Delaware Supreme Court case *Sciabacucchi*, in which the court held that provisions mandating shareholders only bring Section 11 cases in federal court are facially valid under Delaware corporate law.

Sciabacucchi should have two results through the end of 2020 and into 2021. First, companies with federal choice of forum provisions that are currently being sued in state court for Section 11 liability should win their motions to dismiss for lack of jurisdiction. Indeed, in September 2020, the Superior Court of San Mateo County, CA in *Restoration Robotics* dismissed the Section 11 case for lack of jurisdiction due to the federal forum provisions in the company's certificate of incorporation. Second, future IPO companies as well as existing public companies who are looking for ways to improve their D&O risk profile will start to adopt federal choice of forum provisions. This move will lead to fewer future Section 11 cases being filed in state court.

2.4 Derivative Suits

Breach of fiduciary duties suits brought derivatively against directors and officers are the most personally threatening type of suits because, under the law of most states, including Delaware, these settlements are not indemnifiable by the corporation. Unfortunately, we are seeing more ultra-large derivative suit settlements, something that portends poorly for the future. D&O insurance underwriters have taken note, and it is perhaps reflected in the underwriters' view, as noted in this year's Underwriters Weigh In survey results, that a company's board is the most important influence when it comes to mitigating D&O risk.



The plaintiffs' bar win in 2019 against Wells Fargo ($240 million) coupled with 2020 settlements paid by American Realty ($286.5 million) and McKesson ($175 million) provide a lucrative paradigm that will inevitably fuel plaintiff enthusiasm for these types of cases.

In addition to plaintiffs' monetary motivation, recent cases like *Marchand* and *Clovis Oncology* make it clear that Delaware courts have significant expectations when it comes to the manner in which directors exercise their fiduciary duties.

Fortunately, notwithstanding the increasing threat posed by derivative suits, underwriters are willing to write stand-alone Side A insurance for companies with stable balance sheets.

2.5 SPACs (Special Purpose Acquisition Companies)

A bright spot for the capital markets in 2020 has been the continued acceptance of Special Purpose Acquisition Companies (SPACs) as legitimate investment vehicles. Indeed, the first half of 2020 saw more equity raised through SPACs than through traditional IPOs. With the increased activity in SPACs comes the increased possibility of SPAC-related litigation.

With the increased activity in SPACs comes the increased possibility of SPAC-related litigation. This includes litigation related to the de-SPAC process of the kind suffered in *Akazoo*.

Fortunately, SPAC sponsors are becoming increasingly savvy when it comes to insurance for SPACs. Being strategic about D&O and Reps & Warranties insurance will be helpful to SPAC sponsors in 2021 and beyond.

2.6 IPOs and Direct Listings

IPOs are great—and they are also incredibly expensive. The expense has caused some influential investors and founders to consider going public through a new vehicle: direct listings.

There was some hope that, in addition to saving money on banker fees, an advantage of direct listings might be less Section 11 litigation exposure compared to what traditional IPOs face.

Hopes in this regard have been diminished by a federal district court ruling in Slack's direct listing litigation. The court held that the case can move forward notwithstanding infirmities in plaintiffs' ability to trace shares in the class to the S-1 registration statement.

We will still see direct listings in 2021 if the markets hold up, and we will also see the same type of Section 11 suits filed against direct listings that we have seen filed against IPO companies in recent years. This also means that there will be no discount in the price of D&O insurance for direct listings compared to IPO companies.

GET ADVICE ON HOW TO MINIMIZE IPO COSTS IF YOU ARE PLANNING TO TRANSITION FROM A PRIVATE TO PUBLIC COMPANY.

2.7 ESG and Politics in the Boardroom

The trifecta of environmental, social, and governance challenges, or "ESG," is not going away for boards of directors and the companies they serve.

For a long time, many corporate boards argued that their shareholders care about shareholder returns, not ESG issues, so boards need not concern themselves with ESG issues.

Since at least 2018, however, investors like Blackrock, a large shareholder in an enormous number of public companies, have made it clear that ESG is a concern. Blackrock doubled-down in 2020, announcing that environmental sustainability would now be a cornerstone of their investment approach.

Of course, the devil is in the details, particularly when it comes to an emerging area of disclosure that lacks a shared business community consensus on how things are measured or even what things should be measured.

This lack of clarity, however, should not be mistaken for a lack of accountability. We have already seen numerous instances of consumers and employees flexing their power in response to corporations and their CEOs taking significant political positions.

In addition, we are starting to see shareholders file breach of fiduciary duty suits against the boards of major corporations for failing to live up to their diversity commitment disclosures. Expect to see more of these in 2021.

2.8 Personal Indemnification Agreements

Personal indemnification agreements—contracts between directors or officers and the companies they serve promising to advance legal fees and pay settlements on behalf of the directors or officers—are more important than ever.

D&O insurance self-insured retentions are increasing, which means more time will elapse between the beginning of a claim and the moment a D&O insurance carrier starts to pay legal bills or settlements. Before D&O insurance carriers start to make payments, what controls the flow of money to lawyers for settlements? Personal indemnification agreements. Directors and officers who understand this dynamic will continue to upgrade their personal indemnification agreements in 2021.

The price of D&O insurance is going up as well. In some cases, these cost increases have caused companies to purchase less D&O insurance than they have in past years.

There have been a few reports of companies dropping D&O insurance altogether—a startling revelation given that even wildly solvent companies in most cases cannot indemnify directors and officers for settlements of derivative suits.

Instead of directing a company to buy traditional D&O insurance, some wealthy individuals are choosing to indemnify entire boards of directors. It is an interesting gambit and one that is unlikely to become a trend in 2021 given the numerous challenges of this approach.

3.0 UNDERWRITERS WEIGH IN

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Good brokers are first and foremost advocates for their clients. As part of this advocacy good brokers also listen to their insurance carrier partners to better understand their view of the world, including their current appetite for risk. Woodruff Sawyer is in conversation with insurance carriers every day. For this section of Looking Ahead, we surveyed 34 insurance carriers with whom we place D&O insurance around the world. We asked questions regarding the current risk environment, risk appetite, and future pricing expectations.

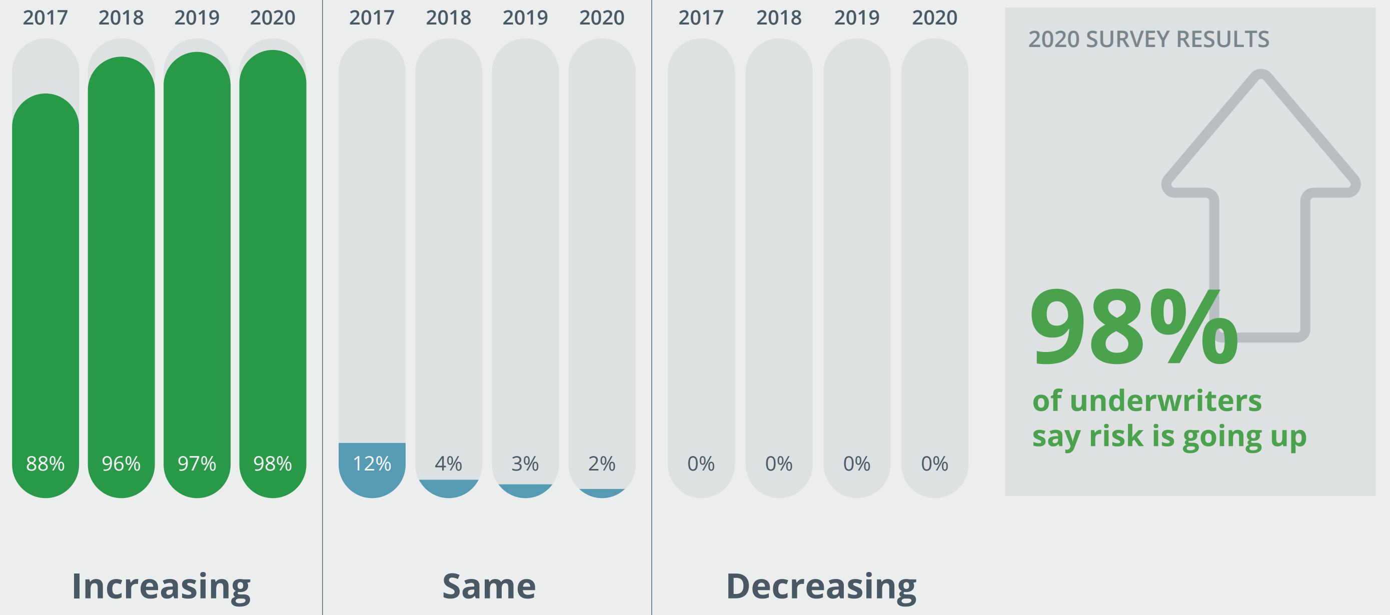
Our survey includes responses from top D&O carriers including: AIG, AXA XL, Great American, Lloyd's, Old Republic, and Tokio Marine HCC.

New this year, we asked the underwriters if they would like to share any specific thoughts they have regarding the D&O insurance market in 2021. The responses we received are insightful and could prove to be prescient. Here are just a couple of the comments we received:

> "*Anticipate reductions in additional coverage items for new and renewal business—reduced / removed derivative investigation sublimits, fewer language grants, removal of preset discovery provisions..."*

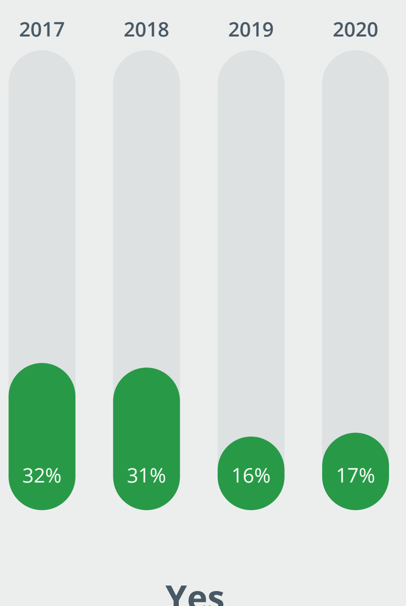
> "*The industry together with defense counsel needs to take a few select cases to trial to put plaintiffs on their heels and establish good case law surrounding scienter and fraud on the market."*

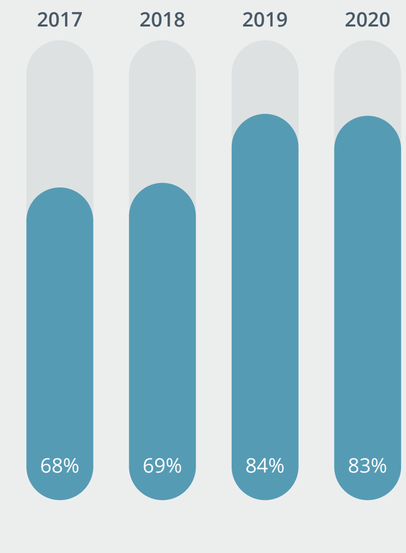
Is D&O risk going up?



Underwriter sentiment in response to this question has accurately predicted the increasingly hard market for the past few years. If the past predicts the future, the underwriters' responses in 2020 say nothing good for the prospects of a softening D&O market in 2021.

Are companies as aware as they should be about the risk and cost of D&O litigation?





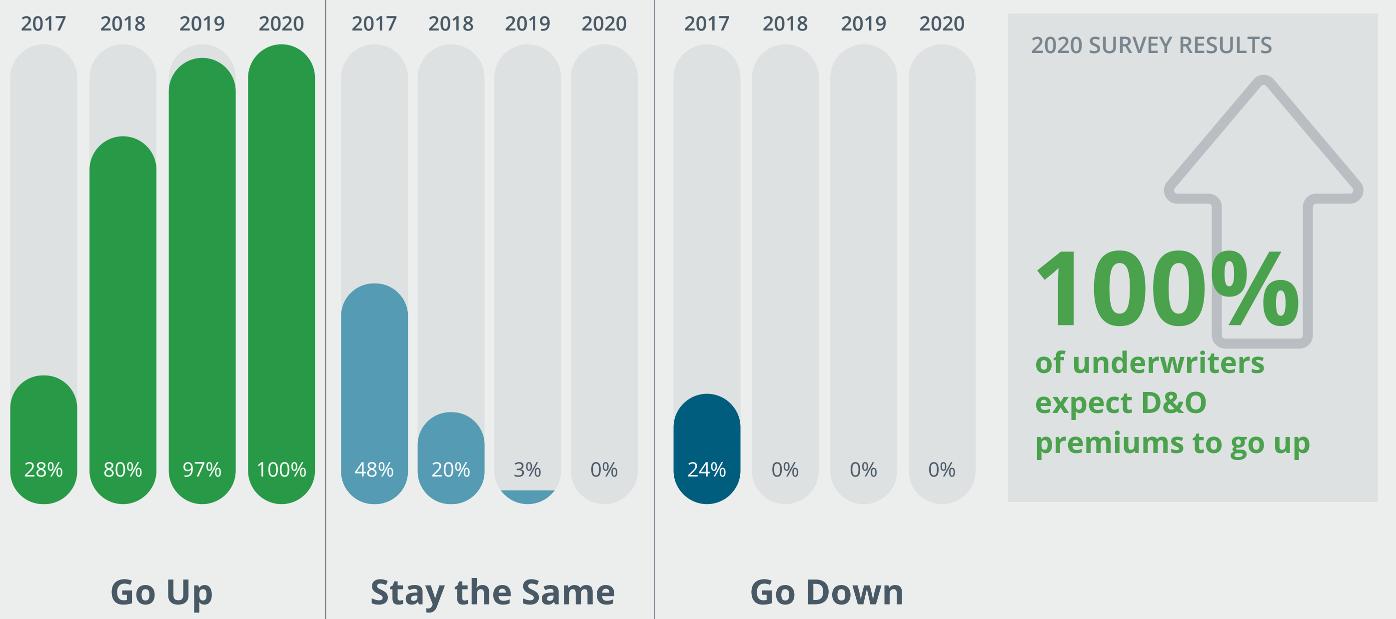
2020 SURVEY RESULTS

83%

of underwriters think that companies underestimate the current risk and cost of litigation

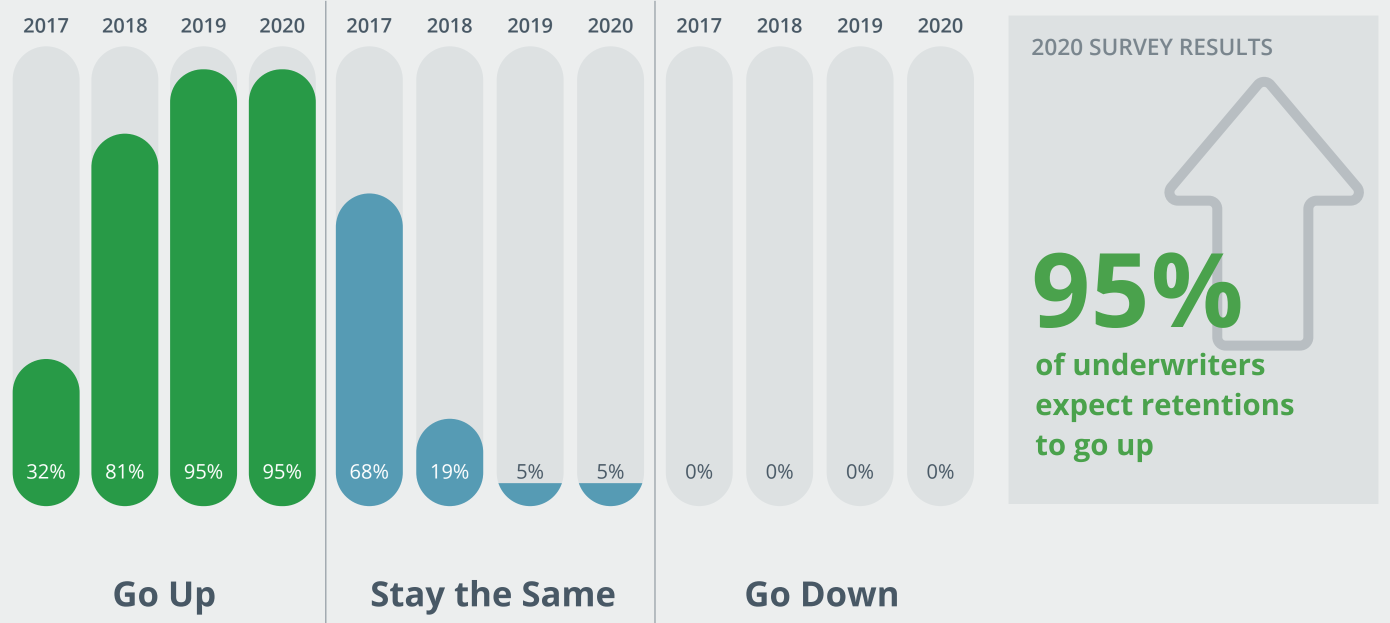
For the second year in a row, underwriters are clearly concerned that their insureds are unaware of just how much the cost of defense has escalated. It's not a leap of logic to see that this underwriter concern is a driver of the increasing self-insured retentions that were offered in 2020, a trend that is likely to persist into 2021 based on underwriters' responses to this question.

Industry-wide, do you expect D&O insurance premium rates for mature public companies to go up, stay the same, or go down?



Ask not for whom the bells tolls, it tolls for thee. The response to this question is really, really bad news for the 2021 pricing outlook.

Industry-wide, do you expect D&O self-insured retentions for mature public companies to go up, stay the same, or go down?



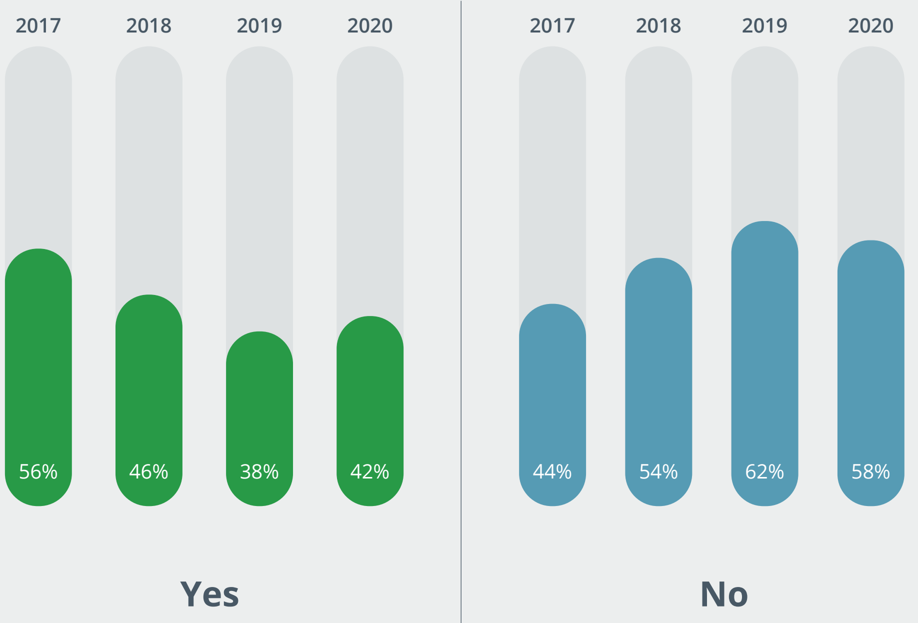
2020 SURVEY RESULTS

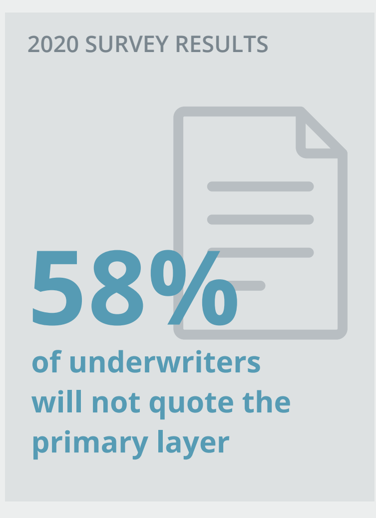
95%

of underwriters expect retentions to go up

This answer, which is consistent with 2019 responses, implies that self-insured retentions (SIRs) will not be going down and, in many cases, will go up in 2021. Note that, per Question 3, these increasing SIRs are unlikely to translate into better pricing as compared to 2020.

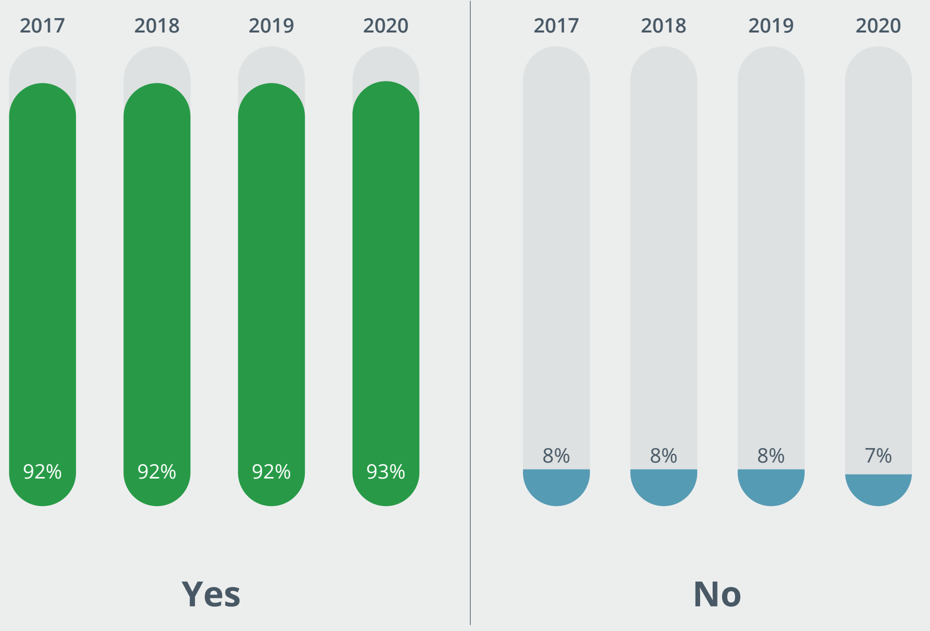
Will you quote the primary layer for most public companies?

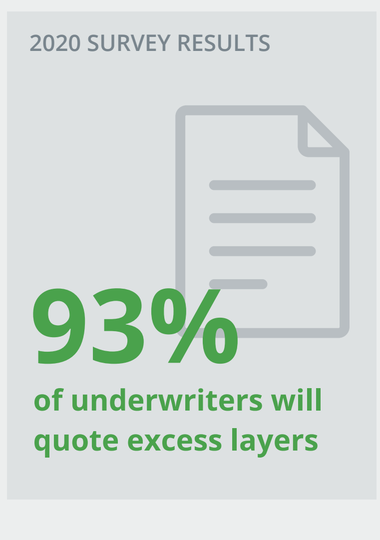




Based on this response, it looks like primary layer premiums and self-insured retentions have reached a level that is attractive to a modest number of insurance underwriters. If this sentiment persists, we may see more stabilization (as opposed to continuing increases) in the pricing of the primary insurance layer. However, given overall underwriter sentiment, it's not a surprise that excess pricing continues to increase.

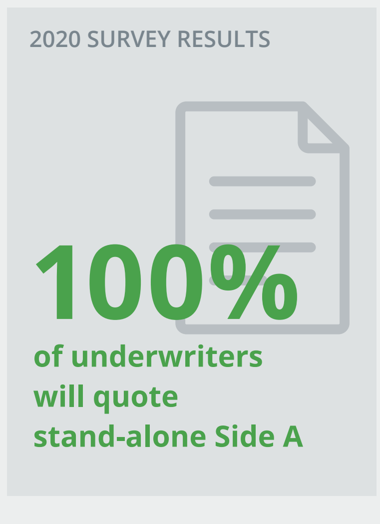
Will you quote excess layers for most public companies?





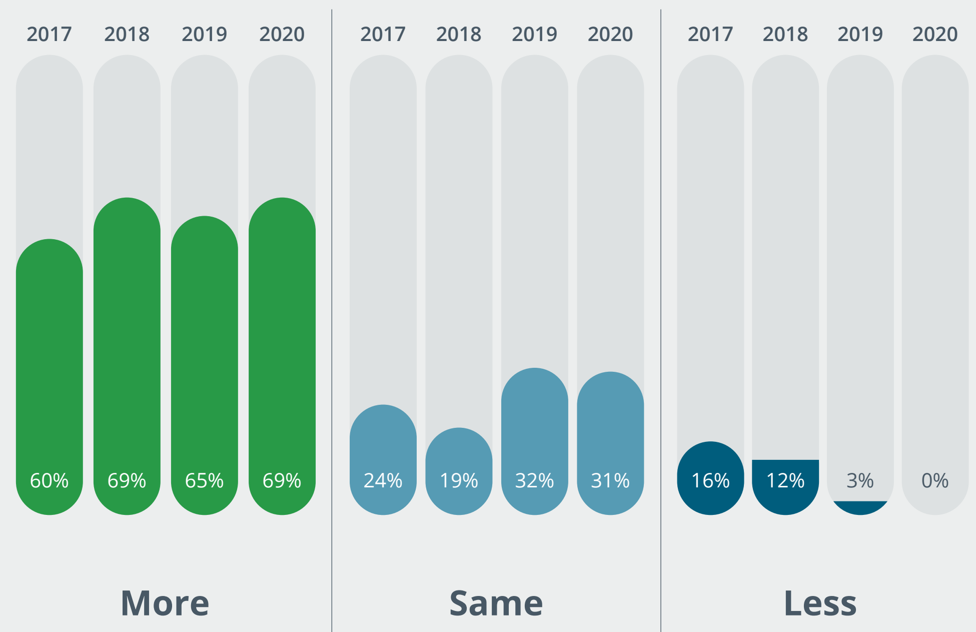
As always, this question has no pricing parameters. Given the rate at which excess layer pricing has increased, we are not surprised that more underwriters are willing to write excess layers and have observed that their enthusiasm increases the higher up the program tower they go.

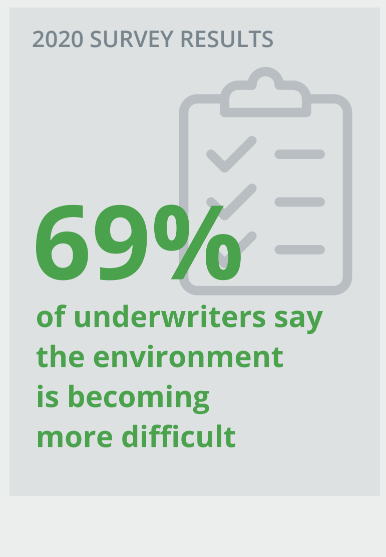
Will you quote stand-alone Side A insurance for most public companies, assuming a stable balance sheet?



We asked underwriters this question after the pandemic was well underway. Given that the question assumes a stable balance sheet, the underwriter response is not surprising. It also indicates that underwriters are not throwing up their hands in the face of recent, very high breach of fiduciary duty suit settlements.

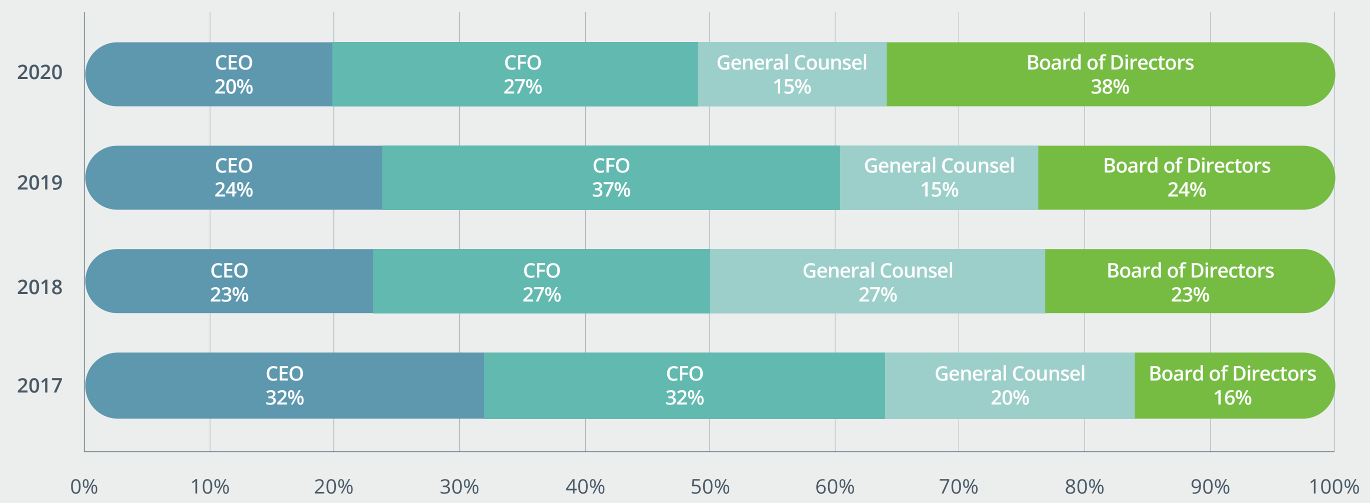
Is the governmental regulatory environment getting more or less difficult for public companies and their Ds and Os?





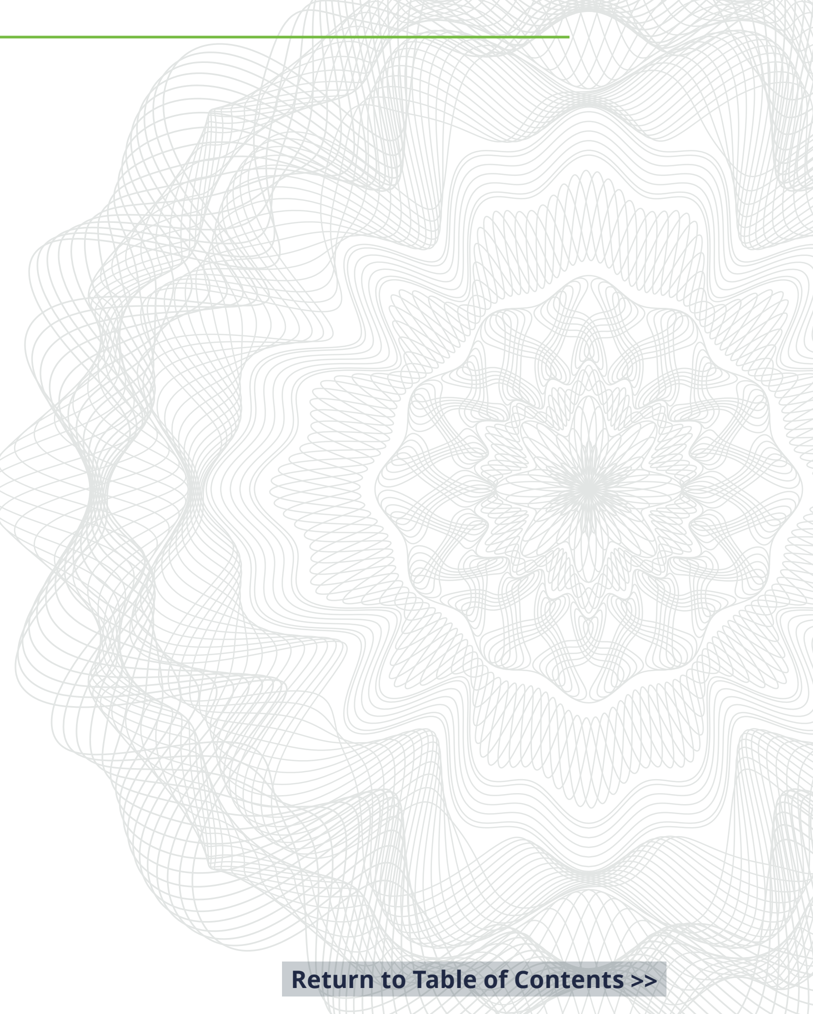
Is there a difference between 3% and 0%? For this question, the answer is really no. The majority of the underwriting community continues to worry about the regulatory environment.

Who is the most critical person at a company when you think about mitigating D&O risk?



2020 saw a big increase in underwriters' views of the board's role when it comes to risk—even more than the CFO. This may be consistent with the enhanced scrutiny recent large derivative suit settlements have placed on boards.

4.0 EXPERT INSIGHTS



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Seth Pfalzer, Esq.

Senior Vice President,
Northern California
Management Liability
Practice Leader

READ SETH'S BIO >

4.1 Process

Q. In the face of such a difficult D&O insurance market, what can I do during the renewal process to maximize my chances of a successful renewal?

A. In the midst of the most volatile and disruptive D&O insurance environment we have seen in decades, the best way to ensure a successful D&O outcome is to communicate early and often with all stakeholders. With your broker's help, developing a strategic plan that assesses your unique risk factors and goals (e.g., cost savings, retentions, claims resolution) is essential and should serve as the lodestar for the difficult decisions and potential compromises that lie ahead. Investing time on camera answering questions from insurance underwriters about your business and risks is still essential. At the end of the day, relationships matter and the best insurance underwriters, if given enough time, are willing to partner with clients and explore various coverage options that help get you closer to a clearly expressed objective. Finally, clients that engage and educate their CEO, CFO, and/or GC early in the process avoid unnecessary and alarming last-minute communications to the audit committee or board.

Brendan Williams

Senior Vice President,
Southern California
Practice Leader

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Your Guide to D&O Insurance for IPOs

4.2 Private to Public

Q. How do I ensure that I'm doing everything I can to minimize spiraling IPO costs as I transition from a private to public company?

A. First, consider aligning and placing your private company D&O insurance program with D&O insurers that can write your IPO policy instead of leaving you at the altar when you go public. It is preferable to do this 12 to 24 months before your anticipated IPO. While there are a significant number of private D&O insurance carriers, there are only a select number who will be willing to write your public company policy. Proactively making this transition will allow you time to establish a relationship with IPO-able insurance carriers well in advance of your IPO filing. In a hard market, these pre-IPO relationships can be very valuable.

In addition, you will want to feature your strong corporate governance to the D&O insurance carriers. While financial information will be readily accessible in your S-1, the strength of your corporate governance will be less obvious. D&O underwriting meetings are an opportunity to tell your corporate governance story, as D&O insurers will be more interested in writing the insurance program of a company that has articulated strong corporate governance. This can include broader terms and conditions…and lower pricing.

Lauri Floresca

Senior Vice President,
Cyber Liability

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4.3 Side A-Only Programs

Q. With D&O rates continuing to rise, should I switch to a Side A-only D&O program? Are the savings worth it?

A. In some cases, switching to a Side A program can have a significant impact on D&O premiums, although companies may be surprised to learn that Side A premiums are increasing as well. As a result, the savings are often not as significant as might otherwise be expected.

Side A coverage only pays out when a company is otherwise unable to indemnify its directors and officers. The two most common examples are bankruptcy and derivative lawsuits. Unfortunately, exposure is rising on both fronts.

The economic impact of the pandemic has D&O underwriters bracing for a wave of bankruptcy filings (and Side A claims). In 2019 and 2020, plaintiffs' attorneys have won unusually costly settlements in derivative suits and have even publicly commented about their desire to tap into Side A insurance limits. As a result, in most cases, D&O underwriters have increased Side A rates in lockstep with traditional ABC rates.

Compared to what they would pay for the same amount of customary D&O insurance, mature public companies can expect savings of 20%-30% by moving to a Side A-only program that drops the balance sheet protection portion of their D&O insurance. The dollar savings can seem attractive, but the tradeoff is significant, since you are self-insuring the most common (and often most severe) type of claim.

Emily Maier

Senior Vice President,
National Group Leader M&A

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Representations and Warranties Insurance Buying Guide

4.4 Reps & Warranties

Q. What was useful about the Reps & Warranties market response to COVID-19?

A. Reps & Warranties (R&W) insurance is still a relatively new product and a small underwriting market, compared to D&O or other traditional lines. Seeing how individual markets react to unforeseen circumstances and challenging times tells us a lot about them. It's this kind of intimate knowledge of underwriters, both at a company and individual level, that we bring to the table when helping you decide who is right for your deal.

At the outset of the pandemic, the 23 active R&W insurance markets responded in one of three ways:

- *Some markets put broad, all-encompassing exclusions, not only on new quotes but on anything that was currently being underwritten*
- *Some put broad, all-encompassing exclusions on new quotes but honored existing deals*
- *Some markets were willing from the beginning to "write to the risk" which meant understanding the nature of the deal and target and trying to narrow any potential COVID exclusion as much as possible.*

Over time, as M&A deals dried up and insurance markets started to better understand the impact of the pandemic, we saw many carriers who had taken the first two approaches noted above move to the last one. Unfortunately, some carriers are still writing broad exclusions.

Jane Njavro

Senior Vice President

READ JANE'S BIO >

4.5 International

Q. Are there any special considerations for non-US companies listed in the US when it comes to preparing for their upcoming D&O insurance renewals?

A. Historically, many non-US companies bought an almost luxurious amount of D&O insurance because it was inexpensive, particularly compared to what US-domiciled companies were paying. This is no longer in the case. The first salvo, which began in 2018, was a significant increase in price. More recently, insurers outside of the US are limiting the amount of traditional D&O insurance they are offering to companies. In some cases, companies will be unable to renew the total size of their D&O insurance program for any price. In an environment where securities claims are settling for higher amounts, this creates a conundrum for boards as they decide how much insurance to purchase.

Most companies will want to attempt to maintain as much traditional capacity as possible to provide some risk transfer. It may be the case, however, that instead of insuring to the 75th percentile of historic settlements, the available limits are closer to the 50th or 25th percentile. Faced with this decision, our recommendation is to seek coverage with the broadest terms and highest quality insurers, stressing quality over quantity. Boards that still want to maintain the total insurance limit they carried in prior years may be able to do so by purchasing the rest of their historical limit in the form of Side A-only insurance (which provides coverage for individuals for non-indemnifiable claims but does not include balance sheet protection).

Sean Coady

Senior Vice President,
New England Practice Leader

READ SEAN'S BIO >

4.6 Life Science Companies

Q. What is the best strategy for picking a D&O limit as a life science company undertaking an IPO?

A. Determining an appropriate D&O limit for any company can be a challenging endeavor. The D&O coverage amount will be a function of many factors, including the management and board's tolerance for risk, the specific risk factors of the issuer, and budget, to name a few. Life science companies also have the significant potential for stock price volatility due to the binary nature of clinical trial results, which makes setting an appropriate D&O limit that much more challenging and important. It is imperative that companies are thinking through the potential for large market cap swings during the policy period and evaluating how such events could impact their risk analysis. Moreover, with securities retentions continuing to trend upwards of $10 million for IPO insurance programs, companies must take their self-insured risk into account when determining the proper level of coverage. The D&O limits analysis for a life science company undertaking an IPO, based on these factors, has taken on increased importance and potential issuers are wise to dedicate the requisite attention to the analysis prior to the IPO.

Dan Burke

National Cyber Practice Leader

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Cyber Insurance Buying Guide

4.7 Cyber

Q. How are consumer privacy laws such as CCPA impacting risk?

A. There is a wave of privacy regulation sweeping the globe with laws such as GDPR in Europe and the recent move by California to start enforcing its California Consumer Privacy Act (CCPA), which grants consumers broad rights with regards to collection, processing, and storage of their personal information. These laws also carry significant penalties for non-compliance and failures to protect personal information. The CCPA allows for not only a fine issued by the California Attorney General, but also grants statutory damages between $100 and $750 to each California consumer affected by a data breach.

Litigation under similar laws like the Illinois Biometric Information Privacy Act (BIPA) has proven that these statutory damage claims are sufficient to move class action lawsuits past a motion to dismiss and ultimately towards settlement. These settlements are a new factor in quantifying cyber risk, increasing the severity of an event for many companies and insurance carriers alike.

Beyond investing in cyber insurance, company management should conduct a quantification analysis of their cyber risk to make sure they have appropriate cyber insurance limits to account for these new risks.

Priya Cherian Huskins, Esq.

Senior Vice President

READ PRIYA'S BIO >

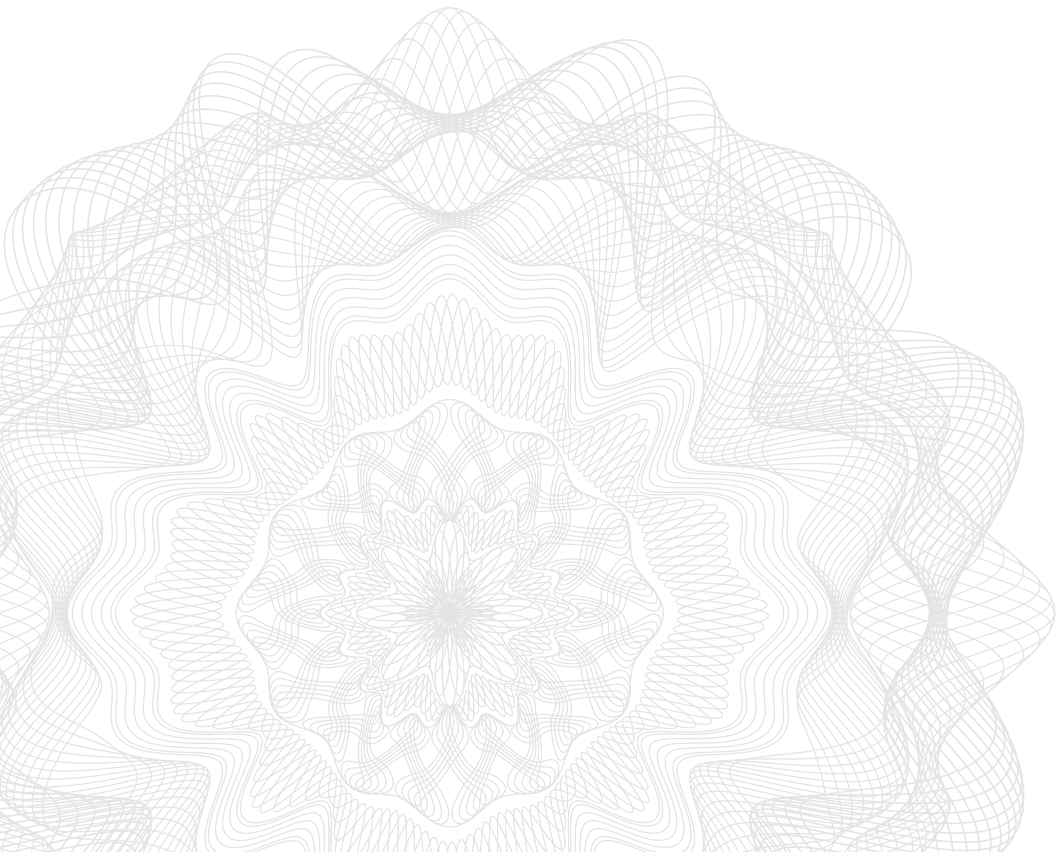
4.8 Claims

Q. Is the claims dynamic with insurance carriers different now that most self-insured retentions are so high?

A. Higher self-insured retentions are no reason to stray away from best practices when it comes to claims management. You are still obligated to have your choice of counsel approved by your primary insurer, something you will want to do sooner than later. In some cases, your insurance carrier may have a mandated panel from which you must choose, or they may offer a discount if you select an attorney from the carrier's panel. In all cases, you will want your counsel to be aware of your carrier's litigation guidelines.

Some self-insured retentions are so high that it might be a long time—in some cases years—before you start getting reimbursed for your defense costs. Nevertheless, you will want to continue to keep your insurance carriers posted on the status of your claim. Providing carriers with updates and giving them a chance to give you feedback on your litigation strategy fosters a positive working relationship. This working relationship is especially valuable if you end up needing your carriers' capital to settle your claim.

5.0 CONCLUDING PERSPECTIVE



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A MESSAGE FROM

Carolyn Polikoff

National Commercial Lines Practice Leader

This year's *D&O Looking Ahead Guide to 2021* offers a look forward at a very uncertain time—when the D&O market exhibits more risk than ever and having an experienced, trusted broker on your side is essential.

COVID-19 has caused unprecedented volatility in the economy, the workforce, and the insurance market. As noted in our "Underwriters Weigh In" survey in last year's *Looking Ahead Guide*, underwriters correctly anticipated increased losses and more D&O litigation as well as the resulting upward adjustments on premiums and retentions in 2020. As our D&O experts have discussed in this year's *Guide*, the coronavirus pandemic and subsequent lockdown have added even more uncertainty to the D&O litigation environment. Underwriters are worried that COVID-related layoffs, bankruptcies, supply chain disruptions, and stock volatility could result in lawsuits against directors and officers. Indeed, securities class action suits have already been filed due to factors such as misleading statements about the outbreak, deceptive claims regarding potential vaccines, and privacy concerns. These additional risks are surfacing in a litigation environment in which the severity of securities class action suits is increasing and the growth in open cases is up for the sixth year in a row, with an enormous backlog of approximately 600 cases that have yet to reach a conclusion.

The right D&O insurance program can help provide directors and officers with the financial backstop they need to be confident when making critical business decisions in an increasingly uncertain environment. Our team at Woodruff Sawyer is exceptionally good at providing expert advice and counseling to put into place the management liability program best suited to a company's industry, size, and risk tolerance.

Now more than ever, Woodruff Sawyer is a champion for our clients. We help clients find cost-effective, sensible, and often innovative ways to protect themselves in the face of uncertainty. We take a systematic, focused approach to each renewal, allowing us to achieve the best possible results for our clients. Our diligent, data-driven approach has helped our clients effectively navigate the complex D&O marketplace with confidence for more than 100 years, allowing them to focus on the growth and success of their business, even in especially difficult times.

Additional Resources

D&O Notebook >

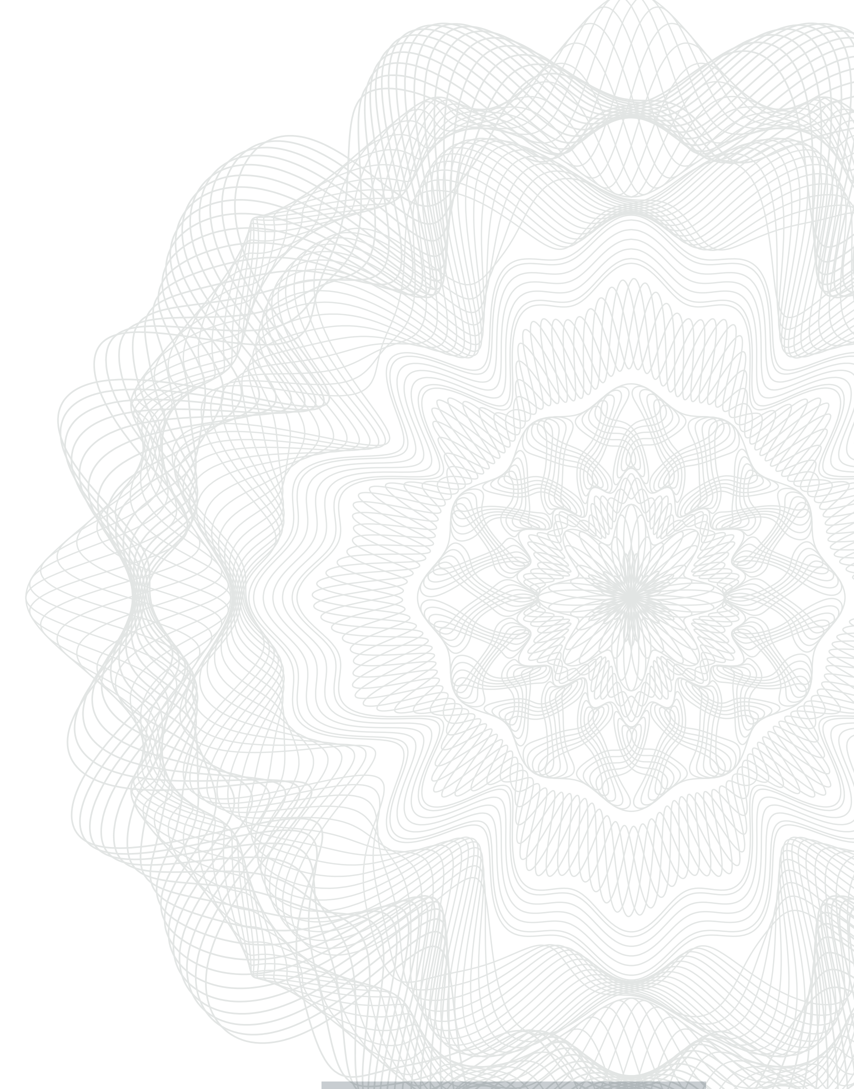
Cyber Insights >

M&A Insights >

P&C Insights >

SPACs Insights >

Woodruff Sawyer Events >



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