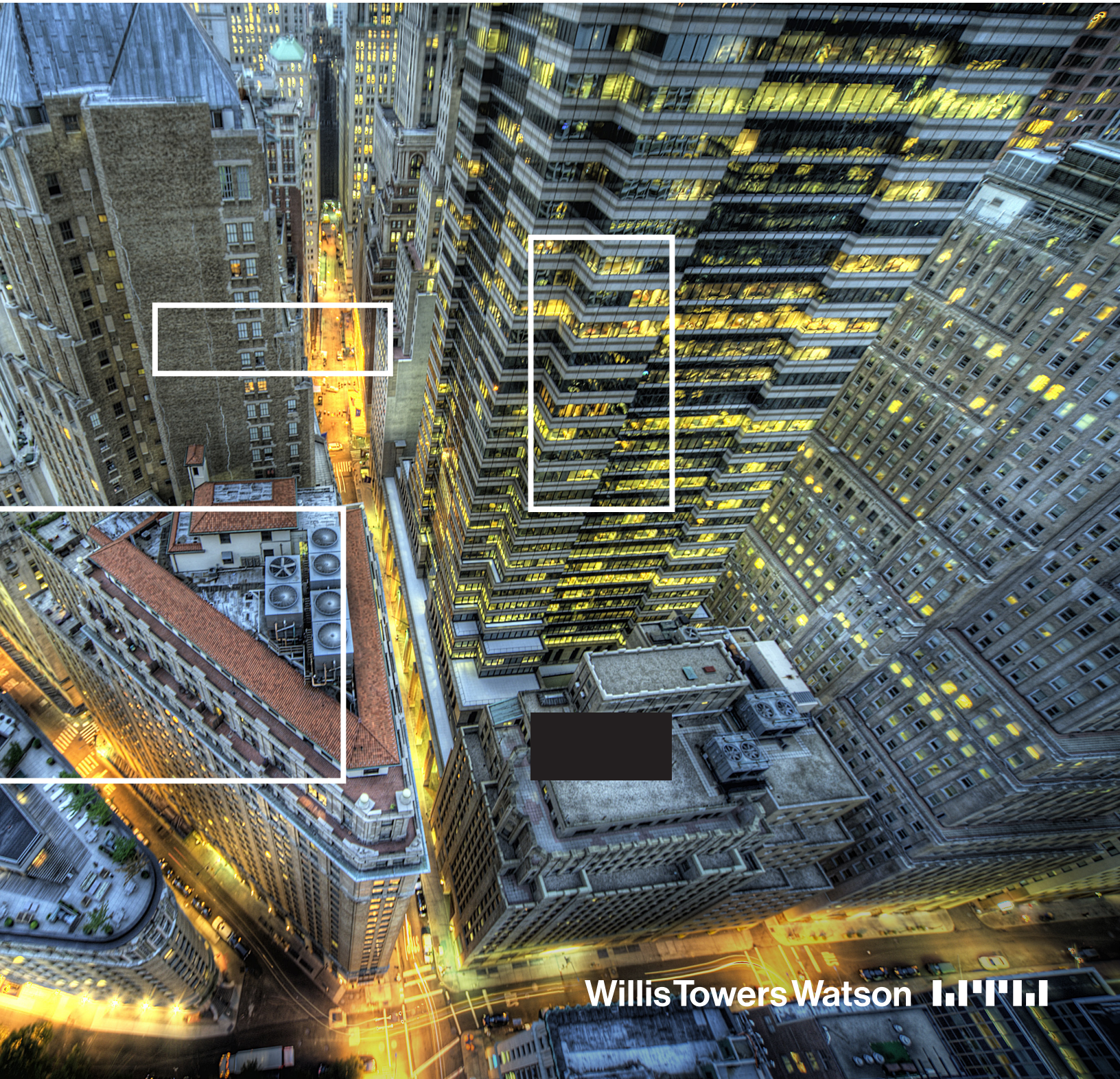
Insurance Company Market Update - ICPL/ E&O and D&O Insurance

Q2 2020



Willis Towers Watson

Executive summary

We are pleased to present FINEX's Insurance Company Market Update for Q2 2020. In this issue, we explore the current state of the Directors' & Officers' and Insurance Company Professional Liability (ICPL) insurance marketplace. In addition, we identify new and emerging issues within the insurance company industry and discuss what impact those issues may have on insurance policies.

With the first half of 2020 now behind us, we can say with confidence that virtually all industries and financial institutions are facing a challenged insurance market with no immediate relief in sight. Insurance company E&O premiums are up across the board, with even the most favorable risk profiles subject to increases of 5-30% and more challenging exposures driving pricing up by 30%+ on a year-over-year basis. D&O premium changes will vary greatly, depending upon whether an insurer is publicly-traded and in line with any perceived weakness in capitalization as credit downgrades and bankruptcies soar.

In addition to seeking meaningful premium increases, carriers are also being very thoughtful in revisiting their limit outlay and the appropriateness of retentions across their book. Most insurers in the financial institutions space have restricted the amount of authority residing with line underwriters and as a result, substantially more scrutiny is being applied to all accounts.

The final source of adjustment to prior terms that we have seen is on the policy language itself. For P&C insurers with business interruption exposure within their portfolio, ICPL carriers are imposing various exclusionary wordings to ensure that a maximum of one aggregate limit is exposed to matters arising out of COVID-19. The breadth and nature of these exclusions is not consistent and as such, it is extremely important that our clients work closely with their broker and claims advocates to address any potential gaps created.

We expect that the Directors' & Officers' and Insurance Company Professional Liability (ICPL) insurance marketplace will continue to be challenging through the balance of 2020. However, we hope this publication offers valuable insights to help you successfully navigate through these turbulent times. Should you have any questions or wish to discuss any of these issues in greater detail, please engage myself or a member of your Willis Towers Watson team.

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Insurance Company Market Update

ICPL Insurance Market: 2Q 2020 Update

Cost and retentions

- **Pricing:** Premium increases are accelerating, with favorable accounts subject to rate increases of 5-30%.
  - Those insureds with poor claims experience and/or more challenging risk profiles can expect increases of 30%+.
- **Retentions:** Renewed pressure is being applied to increase retentions in line with unprecedented uncertainty, legal fees and settlements.
  - If available, sales and marketing coverage for life insurers typically requires a split retention which can be multiples of the base level.

Markets

- Appetite for primary ICPL is increasingly limited with little to no competition available for large and complex risks.
- Even middle market insurers now face a marketplace with approximately 10 viable primary carriers.
- ICPL insurers are content to attain growth targets through renewal premium increases and less likely to compete on new business.
- The London and Bermuda markets have tepid appetite for US insurers, often limited to opportunistic or high excess attachments.

Targeted segments

- **Favorable:** subsets include mutual insurers, reinsurers and middle market insurers (less than $2bn in revenue).
- **Unfavorable:** P&C (particularly with significant BI exposure), life, auto, travel and long term care insurers.
- Greater scrutiny on insurers with substantial exposure to COVID-19 both in terms of liability and investments exposure. Along with a sharp increase in questions and information requests, carriers are now reluctant to release formal terms more than 30 days prior to renewal.

Capacity

- Carriers are applying fresh scrutiny on limit outlay and looking to cap at $5m-$10m, particularly where claim payments have been made.
- Primary ICPL remains a loss leader for carriers, relative to other financial institutions, so packaging with opportunities on more profitable lines of coverage is necessary to drive meaningful interest.
- While excess layers remain more competitive, several insurers have become more conservative in their minimum attachment point.

Coverage

- For P&C insurers, several carriers have introduced language designed to exclude claims arising out of the handling of COVID-related claims under future policy periods – limiting their exposure to a single aggregate limit.
- Sales and marketing coverage for life insurers is increasingly difficult to obtain, with many markets solely affording sub-limits, higher split retentions or excluding altogether.
- Coverage for cost of insurance litigation is extremely limited and often restricted to defense costs only.
- Broad regulatory coverage is of paramount importance, due to the increasingly complex supervisory framework.
- Starting in the UK and Europe, carriers have begun to address 'silent' cyber through the addition of clarifying language which either affirmatively grants or excludes coverage for claims related to a cyber event.
- For middle market insurers, certain carriers have started to require that policies be written on a 'duty to defend' basis.

Impact of COVID-19

- The impact of the pandemic on Insurance Company D&O and ICPL renewals is yet to be fully determined and is evolving daily.
- Carriers are generally behaving very cautiously, with competition significantly reduced as the appetite to compete for new business has largely dissipated.
- Allow for more time in the renewal process and expect several questions relating to both the impact of, and response to, the pandemic.

Insurance Company Industry Trends

Key issues to watch

COVID-19: Business Interruption Claims Handling

Observation:

Many P&C insurers have been subject to suits alleging bad faith and/or wrongful denial of business interruption suits. The expectation among writers of ICPL coverage is that nearly all insurers with this exposure will be subject to one or more such claims.

Concern:

Leading insurers in the ICPL marketplace have begun to impose exclusionary language to ensure that their exposure to such claims against their insureds is capped at a single policy limit. Others have required that insurers make representations regarding the extent to which such claims were reported to prior policy periods – particularly non-incumbent insurers considering a new opportunity on the ICPL program.

Considerations:

While bad faith statutes vary by state, P&C insurers can expect to be challenged regarding the extent to which they have investigated each individual claim on its own merits.

Insurance companies should consult with their broker and claims advocate in evaluating any proposed exclusionary language and representations requested by insurers.

COVID-19: Investment Portfolio of Life and Health Insurers

Observation:

Despite improved equity markets that have seen the S&P 500 rebound to pre-COVID levels by late July, the Dow Jones US Life Insurer Index remains a significant laggard at -28% since January.

Rather than being tied to expected losses on the insurance side, much of the market sentiment is that life insurers have significant exposure on the investment side. Fitch Ratings cut its outlook on the life and health insurance industry to negative, citing lower interest rates and leveraged equity and corporate bond holdings as material challenges for the industry.

Concern:

With shares of public life and health insurers seeing tremendous volatility, the likelihood of shareholders bringing suit increases. D&O carriers have been extremely cautious in deploying capacity, often reducing limits.

Considerations:

Carriers are very wary of life insurers – especially those which are publicly-traded. Clients can expect to see their insurers revisit their total capacity on the D&O side and look to impose higher retentions.

Insurance Company Industry Trends

Key issues to watch (continued)

COVID-19: Regulatory Environment

Observation:

State mandates, like cost-sharing waivers for healthcare expenses, may lead to significant additional costs for insurers. Several countries and states have explored legislation compelling insurers to reimburse policyholders for claims which are explicitly excluded.

S&P's latest estimates are that the coronavirus could result in $30bn-$90bn in insured medical expenses in the US – the higher end of the range representing almost 100% of annual revenues for impacted insurers.

Concern:

As states are applying new mandates around policyholder notification, barring standard cost-sharing practices and potentially requiring insurers to pay uncovered claims, insurance company clients need to stay on top of these evolving requirements for all jurisdictions that they are exposed to.

Considerations:

Insurance companies must have robust processes in place to monitor and adhere to the rapidly changing regulatory landscape. The scope of regulatory coverage under policies remains a key priority to address any potential lapses or oversights.

COVID-19: Sales and Marketing

Observation:

The Chairman of the House Oversight and Reform Subcommittee on Economic and Consumer Policy has launched an investigation into travel insurance industry practices after carriers have indicated that coverage may not apply for coronavirus-related claims. Similar exposure may arise for other lines of coverage (ie healthcare and business interruption) where policyholders may have thought coverage would have applied due to advertising practices.

Concern:

With policies (event cancellation, healthcare, travel, etc) being tested more than ever before, the disclosures and representations made in the marketing of products – especially when it comes to individual and unsophisticated customers – may be scrutinized.

Considerations:

Affirmative coverage for sales & marketing practice remains of paramount importance. This coverage is not widely available among the limited group of carriers willing to write primary, so insurance companies may need to accept either sublimits or higher retentions.

Insurance Company Industry Trends

Key issues to watch (continued)

COVID-19: Business Continuity Planning and Disclosures

Observation:

Business continuity planning is being stressed to the maximum and any perceived failures that negatively impact performance of insurance companies could lead to claims for failing to adequately prepare. Lack of accurate risk disclosures and perceived over-concentration to certain industries, classes of business and/or geographies could also lead to D&O claims.

Concern:

Shareholders may allege that stated risk factors do not address the significant challenges resulting from the coronavirus outbreak. For publicly-traded insurers, any negative impact upon share price as a result of failure to adequately function during quarantine could give rise to a D&O claim.

From an IT perspective, underwriters are scrutinizing the ability of insurance companies as well as any vital third party services providers (ie TPAs) to operate remotely without a negative impact on service and claims handling.

Considerations:

Clients should be prepared to speak to their carriers regarding the evolving risk landscape and how the company is updating its disclosures to reflect such.

Insurance Company Industry Trends

Key issues to watch (continued)

Technology – Disruptor

Observation:

The successful IPO of Lemonade is an example of the belief that streamlined InsureTech firms pose a significant threat to traditional insurance companies. Lemonade has recently entered the pet insurance space and a number of other InsureTech ventures (i.e. Hippo, Root Stockholdings and Metromile) aim to leverage AI in an effort to disrupt the insurance industry.

Concern:

Absent continued innovation and adaptation, longstanding insurance companies stand to lose market share to AI-based InsureTech firms. This dynamic is especially true among the younger generations, where ease of use and social consciousness are viewed as increasingly necessary characteristics.

Considerations:

Tenured insurance companies can expect underwriters to ask questions about any initiatives being implemented to combat this potential shift in the marketplace – whether created in-house or through acquisition. Highlighting improvements or achievements in terms of social governance and charitable giving would also be viewed favorably by carriers.

Technology – Opportunity

Observation:

The coronavirus pandemic forced many insurance companies to quickly convert to agile working arrangements. With many of the initial technological hurdles now addressed, insurers now have a framework for deploying tools like virtual claims adjusting to more efficiently evaluate property claims, without needing to be in an office or on-location.

Additional benefits can include improved employee satisfaction, which results in lower turnover and less reliance upon costly travel as a means of accessing insured locations.

Concern:

Adjusting claims without traditional in-office oversight of claims handlers could raise concern among ICPL insurers regarding oversight of adjusters and escalation when issues arise.

Considerations:

Underwriters have inquired about plans to implement remote working arrangements for adjusters. It is important that insurance companies can articulate how they plan to implement and enforce robust controls outside of the office.

Insurance Company Industry Trends

Key issues to watch (continued)

Cost of Insurance – Universal Life

Observation:

With interest rates at historical lows and stock markets in freefall, carriers with Universal Life Insurance exposure are struggling to keep associated cash value accounts above water. In order to sustain the policies, insurers have been forced to adjust the premiums charged to policyholders and have faced significant litigation as a result.

Concern:

Insurers face challenges both from regulators and from class action policyholder suits as to whether adjustments to premiums are illegal or outside contractual bounds. Several such cases have settled with amounts in excess of $100M. According to the WSJ, regulatory bodies were already aiming to implement new disclosure rules prior to equity markets being decimated by COVID-19.

Considerations:

Insurance companies need to secure the broadest regulatory and investigations coverage possible. Care must also be taken to limit the applicability of exclusions pertaining to underwriting, contractual liability and inadequacy of reserves. Coverage specific to sales and marketing practices may also be implicated.

Cybersecurity Requirements for Insurers

Observation:

The National Association of Insurance Commissioners (NAIC) proposed a Data Security Model Law in 2019 which has been adopted by 8 states, with other states likely to follow the lead of NY and CA in implementing their own regulations. Outside of the US, General Data Protection Regulation (GDPR) in Europe applies stringent guidelines and threatens substantial penalties for failure to implement appropriate controls and procedures.

Concern:

Failure to juggle an increasingly complex and evolving regulatory framework could result in substantial fines and penalties. Insurers must be able to demonstrate that they have maintained a robust information security program.

Considerations:

Insurers – particularly those operating on a national or international basis – must ensure that all applicable regulations are being accounted for and adhered to. Interplay between the D&O, E&O/ICPL and Cyber insurance policies should be carefully considered, especially where the market may look to address "silent cyber" through an exclusion.

Insurance Company Industry Trends

Key issues to watch (continued)

Climate Change

Observation:

Insurance companies face exposure to climate change on multiple fronts. There is risk for P&C carriers which insure against natural disasters, reputational risk in insuring companies connected to fossil fuels and challenges both as an investor (in selecting which firms to invest in) and as an investment (attracting partners seeking ESG adherence).

Failing to address any of the foregoing exposures could result in liability for Directors and Officers, coming from regulators, shareholders and potentially sovereign nations as a human rights issue.

Concern:

Leadership at insurance companies – particularly those which are publicly-traded – may be held liable for taking inadequate steps to prepare against Climate Change risks.

Considerations:

Coverage for investigations and special sublimits like Public Relations Costs and Asset Protection Costs are especially important given the focus on individual accountability.

Social Inflation

Observation:

The term "social inflation" has featured prominently in recent earnings calls and commentary among leadership in the P&C insurance industry. Many executives have attributed challenges in profitability to this dynamic, particularly when it comes to commercial auto insurance and general liability.

Concern:

Social inflation is anticipated to drive an increase in frequency, cost to defend and ultimate settlements for certain classes of business.

Considerations:

Limit purchase should be revisited to account for the substantial increase in settlement values – particularly as it applies to extra-contractual liability.

Conversely, insurers of ICPL are looking to impose higher retentions and premiums to counter this same dynamic.

Challenging Venues and Jurisdictions
According to the American Tort Reform Foundation

Top 10 least favorable states, cities, counties and courts

Philadelphia Court of Common Pleas
A preferred jurisdiction for asbestos litigation and home to a $8bn product liability verdict in 2019.

California
Stance against arbitration and broad application of employment law liability.

New York City
Significant amount of ADA claims against small business as well as consumer suits targeting the food and beverage industries.

Louisiana
Auto insurance outcomes and judicial misconduct.

The City of St. Louis, Missouri
Decisions have ignored state and federal precedent, expanding liability.

Georgia
Premises liability, medical liability and nuclear jury verdicts are all on the rise.

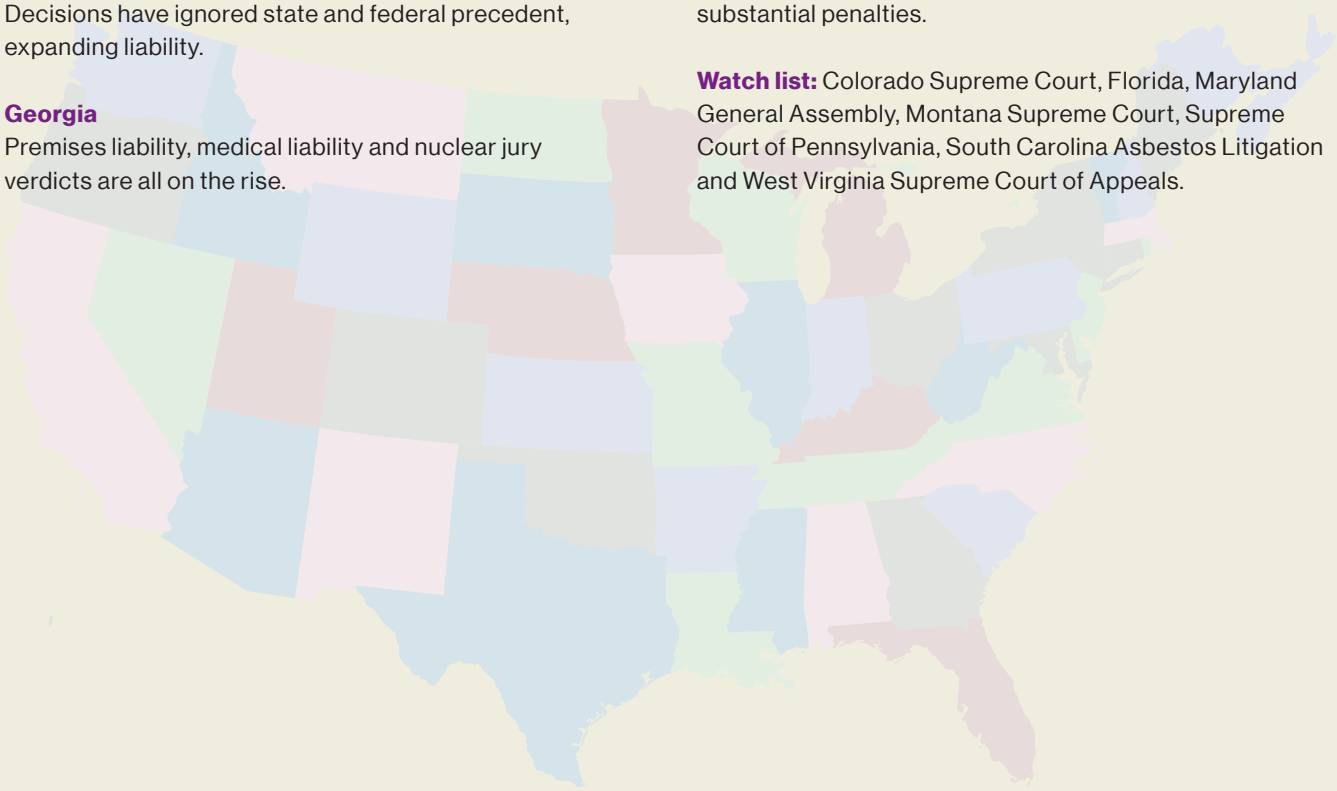
Cook, Madison & St. Clair Counties, Illinois
Prominent venue for no-injury class action lawsuits, asbestos litigation and have been flexible in permitting questionable Biometric Information Privacy Act suits to proceed.

Oklahoma
Questionable handling of opioid litigation and Supreme Court interpretation has expanded liability.

Minnesota Supreme Court / Twin Cities
Expanded medical liability and employer liability under workers' compensation laws, while upholding disputed sanctions against an in-state employer.

New Jersey Legislature
Anti-arbitration and introduced a "Wage Theft" bill with substantial penalties.

Watch list: Colorado Supreme Court, Florida, Maryland General Assembly, Montana Supreme Court, Supreme Court of Pennsylvania, South Carolina Asbestos Litigation and West Virginia Supreme Court of Appeals.



Source: American Tort Reform Foundation

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