Global FINEX - Directors' & Officers' (D&O)

GB D&O Market Update

H1 2021

Willis Towers Watson

GB D&O Overview

This update provides an analysis of the current conditions in the market for Directors' & Officers insurance in Great Britain for international and domestic companies and the impact this has on board directors, non-exec directors and insurance buyers. The analysis in this update is based on our own observations of the market and using Willis Towers Watson proprietary data unless otherwise stated.

- Following the turmoil in 2020, the London D&O market has begun to stabilize.
- New insurers joining the market in H2 2020 and H1 2021 have brought welcome competition and additional capacity.
- Premium rates overall continue to rise, but at a much more moderate pace.
- In rare cases, some large clients who have experienced particularly extreme increases over the last few years but whose claim record does not reflect that position have seen decreases coming through in their H1 2021 renewals.
- However, this trend has also been affected by the ongoing need on some client's programmes to replace insurers who left the market in 2020. As 2021 continues, this position should ease as those insurers' market positions are fully replaced.

Special Purpose Acquisition Companies (“SPACs”)

- In 2020, we saw an increasing use of insurance in connection with SPACs, both in the US and in GB.
- The insurance market’s appetite for US SPACs is less energetic than in 2020.
  - Underwriters even more selective.
  - Although ABC policies remain available, for some SPACs, the market is only willing to offer Side A.
  - Resolution of the regulatory attention and of the current spate of claims and notifications in relation to US SPACs may re-energise the market if positive.
  - In the meantime, rates remain very high.
- More appetite for European SPACs both in the London insurance market and locally within continental Europe.
- We are seeing more enquiries coming through from SPACs planning to list on the London Stock Exchange and there seems to be interest from London market insurers.
  - Many UK SPACs have been on hold pending the FCA’s consultation. With the 26 July 2021 announcement from the FCA *(https://www.fca.org.uk/news/news-stories/fca-publishes-final-rules-to-strengthen-investor-protections-in-spacs)* of new rules for UK SPACs coming into force on 10 August 2021, we anticipate seeing rapid developments in the London market for UK SPAC insurance.

De-SPACs

- A De-SPAC transaction is a term used to refer to the process by which a SPAC unwinds. This occurs when a SPAC identifies a potential target and undertakes an acquisition process through a formal letter of intent. The execution of a merger agreement unwinds the SPAC.
- De-SPACs are increasing as SPACs come to the end of their intended two-year contractual period.
- De-SPACs attract a different product to SPACs, along the lines of a more standard D&O policy.
- Nonetheless, the insurance market’s appetite remains largely aligned with the market for SPACs – in terms of willingness to underwrite, line size and premium.

Current FINEX GB D&O Market Conditions H1 2021

Capacity	Coverage	Claims and Losses	Premiums & Retentions
Reduced	**More Restrictive Conditions**	**Significant**	**Increasing**

▪ Most London market insurers continue to operate with smaller lines compared with 2018-19.
▪ However, line sizes generally appear to have stabilized with few new reductions save where motivated by specific risk appetite.
▪ **New entrants to the market offer some relief by providing new capacity but most of them participate only on excess layers.**
▪ **Competition for primary layers, while increasing, remains comparatively weak.**
	▪ Insurers are narrowing the terms on which they are prepared to write and/or imposing new exclusions.
	▪ Insurers more likely to offer terms on their own policy forms: growing reluctance to use other insurer forms or broker forms.
	▪ Pressure on sub-limits and bolt-on coverages.
	▪ Risk-specific retentions and exclusions being imposed – e.g. Bribery & Corruption.
	▪ Increased contractual subjectivities and inflexibility around timeframes for complying with these.
		▪ Increasingly regulated global environment creating greater exposures and potential for regulatory and follow-on civil claims.
		▪ UK claims environment significantly increasing in terms of frequency & severity, driven by:
		  ▪ Insolvencies
		  ▪ Financial accounting issues
		  ▪ Regulatory investigations
		  ▪ Event driven litigation
		▪ **According to The Stanford Law School/Cornerstone's Securities Class Action Clearinghouse** (http://securities.stanford.edu/charts.html), **Securities Class Actions for H1 2021 are very low, with a marked drop from their highs in 2017-2020.**
		▪ Australia continues to have a high exposure to class actions but the Australian Joint Parliamentary Commissions have made recommendations which could bring some relief. (https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Litigationfunding/Report)
			▪ Premiums in H1 2021 continue to increase for the majority of clients, although generally at a significantly slower rate than in 2020.
			▪ The increase for the average client purchasing an ABC D&O programme in H1 2020 was 65% but there has been considerable variation (based on FINEX GB placements). For clients who had particularly challenging renewals in previous years, some have had lower increases of 0-10% and in some cases discounts in the region of 10-30% have been achieved.
			▪ On the other hand, clients for whom it has been necessary to replace an insurer during H1 renewals have seen much more significant increases.
			▪ Side B & C retentions: higher retentions likely to remain common.
			▪ USA Side C retentions: we are seeing insurers targeting minimum **$2.5m**; however, may be as high as **$5m** or **$10m** depending upon market cap.

GB D&O Market Analysis

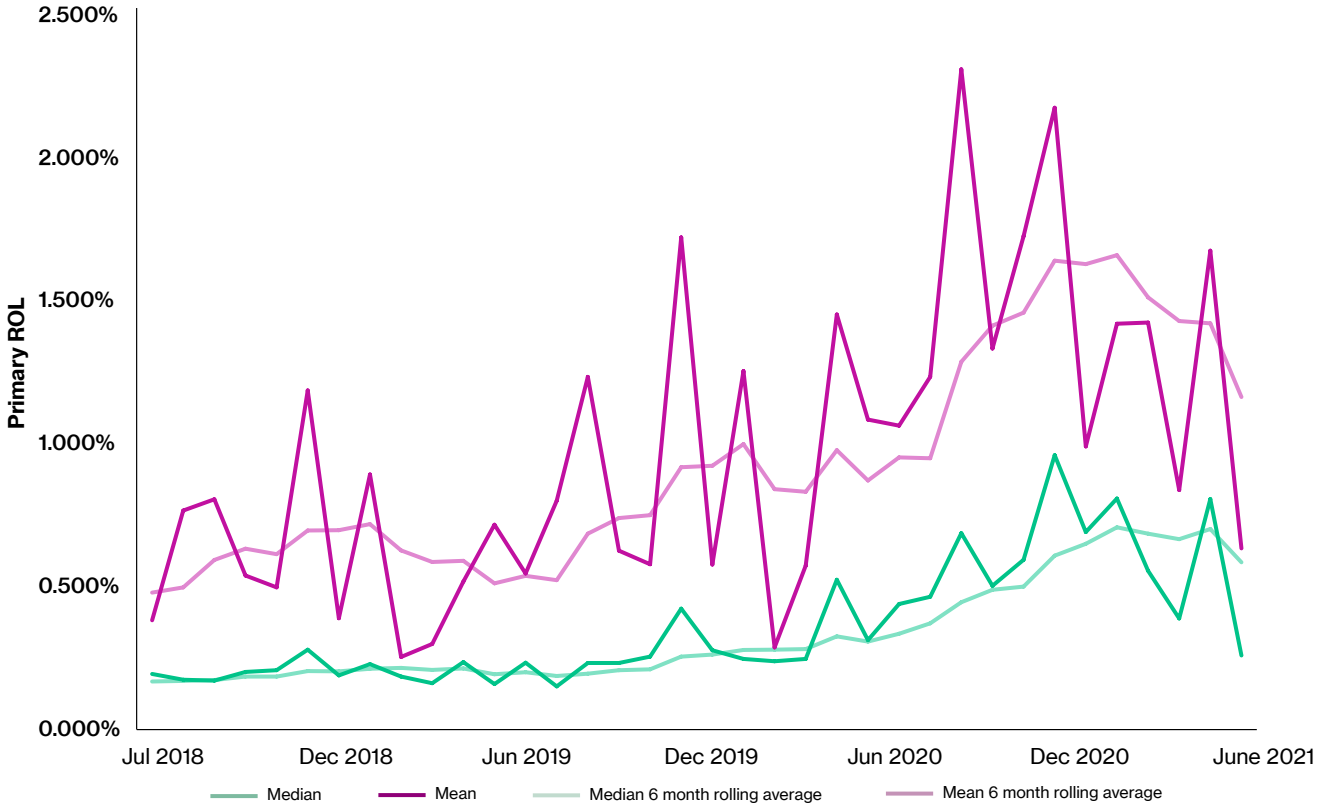
We have undertaken several analyses to look at the impact of the hard market on our clients and these follow on the next pages.

- Change in the average rate on line ("ROL")
- Change in capacity offered by each insurer in the GB market

Rate on Line ("ROL") Analysis (ABC policies)

Primary layers only

The monthly average ROL for ABC placements peaked in late 2020 and has been decreasing throughout H1 2021, despite an additional peak in May 2021. The mean ROL paid in Jul20-Jun21 was 59% higher than seen the previous year (1.32% v 0.83%). The rolling 6-month ROL average for more extreme placements now stands at 3.6%.



Source: Data from WTW FINEX FINMAR client placements, sourced as at 12 July 2021, see Appendix I for further information.

ROL is calculated by dividing the premium by the limit of liability that is being purchased and expressing that as a percentage. This shows the proportional cost of the limit of liability being purchased by each client.

An **ABC** placement is one which includes cover for Side A (D&O non-indemnified loss), Side B (D&O indemnified loss) and Side C (Company Securities Claims).

Primary ROL change

Annual change seen by clients

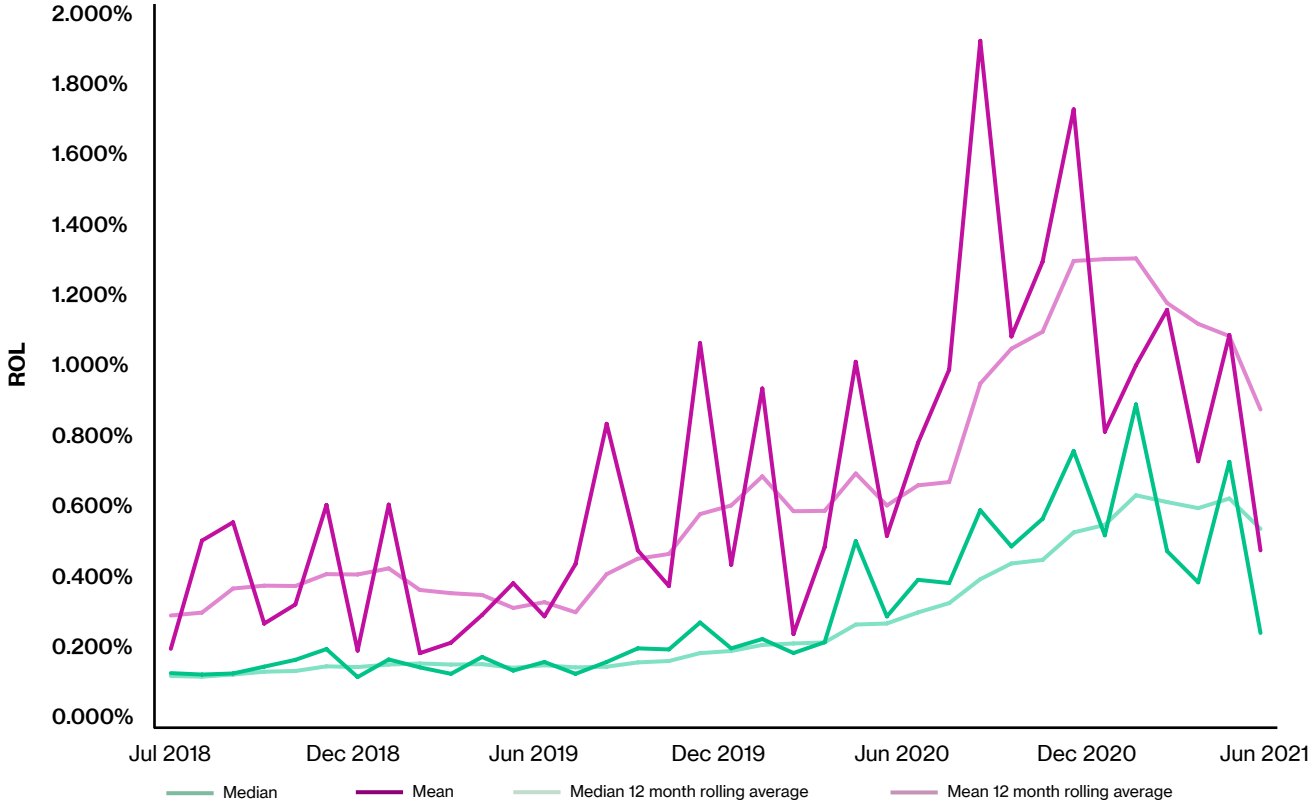
Comparing the Primary ROL changes seen at renewal for clients purchasing ABC D&O coverage over the past twelve months, the average change has significantly decreased since 2020, with the average from all clients going down from 221% in the 12 months from January 2020 to January 2021 to 125% for the first six months of 2021. These averages continue to be significantly affected by more extreme cases, although the extremes are narrowing. The average client purchasing ABC coverage saw increases of only 65% (across the "all companies" category") while the position for the average client purchasing narrower coverage of Side A or Sides AB only was even better.

	Average Change June 2020-June 2021	Average change H2 2020	Average change H1 2021
All Companies	150%	169%	125%
Public Companies	175%	223%	116%
US exposed companies	141%	135%	156%
US exposed public companies	131%	150%	81%

Rate on Line ("ROL") Analysis – ABC only

Whole tower

The monthly average ROL paid for ABC placements increased throughout 2020, peaking in December. Since then, the mean ROL has been slowly decreasing. The mean ROL paid in the past year was 84% higher than seen in the previous year (1.05% v 0.57%).



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GB D&O Market: Insurers & Capacity

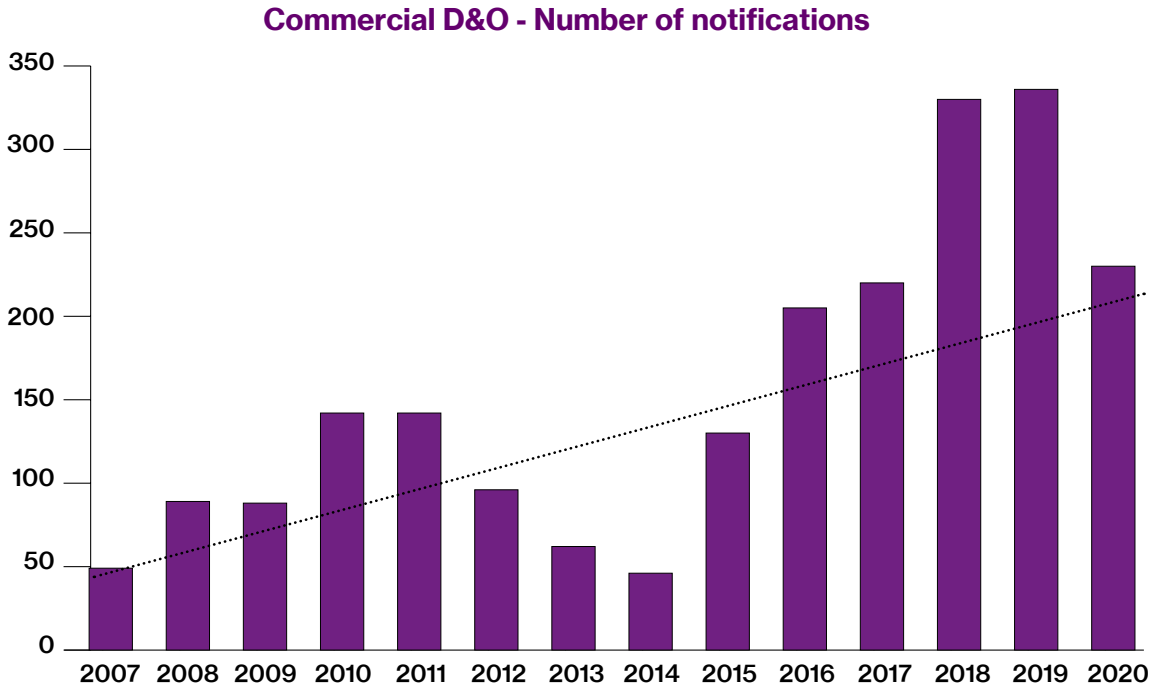
- Increased capacity from new entrants to the D&O market is beginning to have a significant effect on some renewals in H1 2020.
- This should continue into H2 2021 as we anticipate more insurers coming into the D&O market and expansion of interest from some incumbent insurers.
- While the average client continued to see increases, in the region of 65% in H1 2021, for some clients who had seen previous extreme uplifts in their premium, some insurers have recognised this as over-correction with a consequent discount being offered for the 2021-22 renewal.

Class Actions

- The London insurance market is exposed to risks from companies with operations across the globe and therefore one of the major risk factors is group litigation and, in particular, Class Actions in a variety of jurisdictions.
- There has been an increasing trend in many jurisdictions around the world to facilitate methods of bringing group legal actions. This has been found most strongly in the US, but Australia and Israel, amongst other jurisdictions around the world are also now perceived as similarly challenging by insurers.
- However, there are recent developments which suggest that the position could be changing:
  - US Securities Class Action filings between 2017-2020 highest since 2001 and all four years were in the top 5 recorded. However, the number of filings in 2020 were down on 2017-2019 and the level of filings in H1 2021 appears to have dropped off a cliff, with only 119 filings being reported on https://securities.stanford.edu/charts.html as of 21 July 2021.
  - There has also been a recent US Supreme Court decision allowing defendants to class actions to argue at the certification stage that representations are only generic in nature. Clearly a positive development for defendants, but it remains to be seen how much it will affect the number of class actions achieving certification.
  - The Australian Government's pending response to the Joint Parliamentary Commission calling for reforms of the litigation funding and class action system which, if implemented, could provide some welcome relief in that jurisdiction as well. https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Litigationfunding/Report

D&O Notifications

- Our internal data shows a significant increase in the number of notifications to D&O policies by our clients between 2016-2020.
- While the full year figure for D&O notifications by our clients was lower than 2018 and 2019, it remains the third highest in the data collection period. Whether that is a result of fewer claims, a result of tightening cover by insurers or just a delay following the impact of COVID-19 remains to be seen.

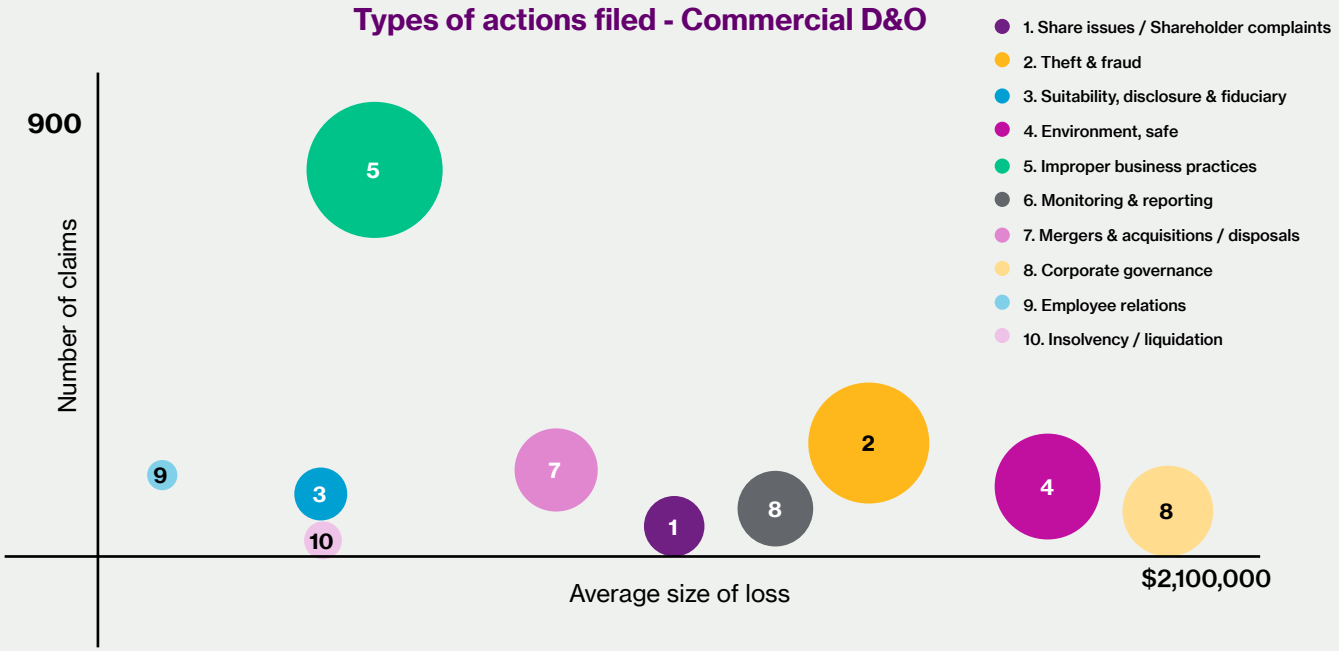


Source: Data based on D&O claims reported for insurance policies placed in GB for clients of Willis Towers Watson between 01 January 2007 and 01 June 2021

Claims Environment: London Market Loss Events

(WTW client portfolio data)

- The graphic below shows the different types of claim made under D&O policies, by both frequency (vertical axis) and average size of loss (horizontal axis). The size of the bubble represents the total costs of each loss event category.
- Corporate governance losses were the highest on average in terms of cost followed by safe environment losses. These include employee and third-party general liability type losses where injuries have occurred on sites and premises the insured own, operate on or are responsible for.
- The graphic highlights the significant costs associated with theft & fraud losses. Theft & fraud losses can be split between external (no employee involvement) and internal (employee involvement) fraud related matters. Additionally, internal fraud claims can be divided into two distinctly different categories.
- Improper business practices claims were the most frequently notified and relate to breaches of regulations and legal requirements as well as market manipulation, money laundering and anti-competitive behaviour matters.
- An explanation for all type of loss categories can be found in Appendix II.

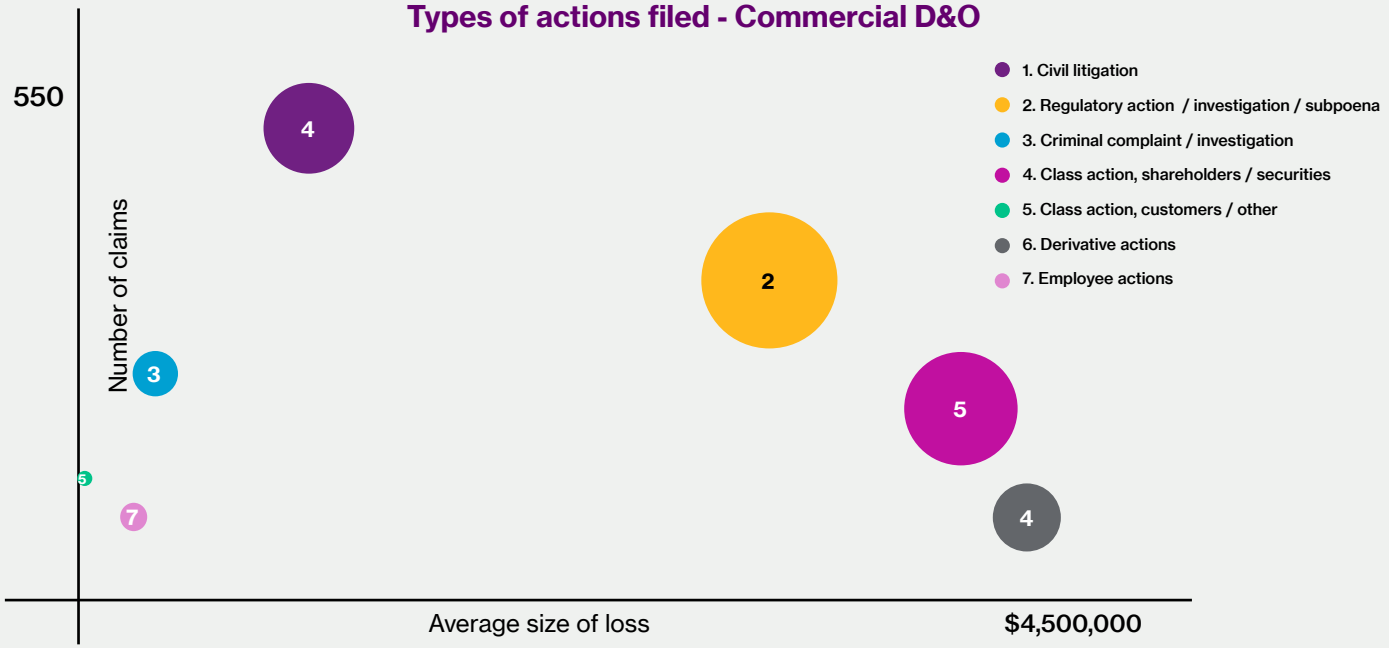


Claims Environment: London Market Action Types

(WTW client portfolio data)

The chart highlights the different types of actions that have been filed against insureds.

The chart shows the various action types by both frequency (vertical axis) and average size of loss (horizontal axis). The size of the bubble represents the total costs of claims involving each action type. The total cost includes both insured and uninsured elements.



The Outlook for H2 2021

- We anticipate continuing to see rate increases in H2 2021 in the GB D&O market, albeit the rate of increases should continue to slow. The number of clients able to achieve a discount, while still rare, should increase.

- We anticipate more differentiation in the market based on industry sector and specific client risk profiles. However, clients whose premium is below the average are still likely to see premium increases.

- In some cases, for clients that have seen particularly extreme premium increases in 2020, the increased capacity in the excess layer market in particular is leading to decreased premium in the 2021 renewal.

- While there may be some challenges in the GB market for US SPACs, insurance remains possible although expensive. Continuing appetite for European SPACs but underwriters remain selective. New entrants into the D&O market may also bring additional capacity for SPACs. Rates likely to remain high notwithstanding potential additional capacity.

- Rapid developments are expected in the insurance market for UK SPACs over the next few months in light of the FCA's new rules coming into force on 10 August 2021.

- Further De-SPAC activity is likely and we anticipate the market's appetite will continue to be closely linked to their appetite for SPACs.

Appendix I

Methodology for statistics

	Min	Max	Notes
ROL	0.01% ROL	No max	These graphs and stats are looking at the ROLs paid each month. Currently we only have a minimum value for ROL, we could consider having a max ROL.
ROL change	0.01% ROL	No max	We are comparing the ROL paid last year to the ROL paid this year for a given client at renewal. The outlier rule ensures an erroneously small ROL isn't compared to a normal one resulting in a gigantic value (eg 1% / 0.0001% = 10,000 times increase). We could also add a maximum increase cap, eg no more than a 10 fold increase in ROL.
Deductible change	x - 10	x 50	As above, here we are comparing the deductible last year to the deductible this year for a given client at renewal. Given the hugely different sizes of programmes placed it is difficult to set a min or max for the actual deductible value so instead we have tied the rules to the change in deductible seen. A max increase of x50 was set as the previous x20 was seen as too small. This may want to be reviewed.
Limit	0.01% ROL	No max	Again, it is difficult to set a min for limit value due to the spread of clients we have. Given the ROL value combines premium with limit it can be used to identify an error in one of the two. However, it could result in us excluding placements with correct limit values (and incorrect premiums). We could consider adding minimum and maximum limit values instead.
Limit change	x - 10	x 50	Similarly to deductible change, here we are comparing the limit bought last year to the limit bought this year for a given client at renewal. Given the challenge in setting min and max limit criteria the outlier rule looks at the calculated limit change and sets boundaries for that. A max increase of x50 was set as the previous x20 was seen as too small. This may want to be reviewed.

Appendix II

Loss event descriptions

- **Improper business or market practices** – This will include claims where there has been a breach of laws and/or regulations, such as antitrust, market manipulation, insider trading and money laundering. Claims based on civil liabilities such as defamation and breach of contract will also sit within this category alongside unfair and disputed level of fees/ charges.
- **Corporate governance** – These losses relate to the running of the insured's business and often have a regulatory aspect to them. Included will be claims related to inadequate control procedures (for anti-money laundering, insider trading, anti-bribery and corruption etc.)
- **Mergers & acquisitions** – This category includes claims in relation to any M&A activity for the insured's own business.
- **Monitoring & reporting** – Will include claims where requirements for financial returns, compliance reporting, tax reporting (such as FATCA) etc. have not been met. We include reporting requirements for governments (national or local), government departments, administrative bodies and regulators.
- **Theft & fraud** – **Where the insured has been defrauded or had assets stolen. T**his category will include securities fraud, theft of assets or information, conversion, forgery, insider trading, account impersonation (social engineering) and other systems security type losses (hacking damage, denial of service attacks etc.). Theft & fraud losses can be divided into external (no employee involvement) and internal (employee involvement) related matters. Internal fraud claims can be further divided into two different categories. Firstly, there are claims where the insured has been the victim of the wrongdoing. For example, an employee stealing from the insured, or receiving bribes for the benefit of the individual, without the knowledge of the employer. By contrast, there are also claims where allegations centre on the insured itself committing the theft/fraud for the benefit of the company – such as tax evasion, or paying bribes with the knowledge of the company.
- **Share issues/Shareholder complaints** – Claims in relation to the offering of for sale of shares in a business. Often relates to the information provided during the share issues (such as the prospectus etc.)
- **Employee relations** – Claims/potential claims concerned with maintaining employer-employee relations. Includes claims related to compensation/benefits, termination, unfair treatment at work and other employment contract issues/disputes.
- **Environment, safe** – Claims/potential claims against the insured claims related to the safety of the working environment.
- **Suitability, disclosure & fiduciary** – As well as breaches of fiduciary duty, this category will include claims where suitability requirements have not been met, such as "know your client" failures. The disclosure aspect includes claims based on what the insured should have disclosed and also what it should not have disclosed, such as breach of privacy claims. Sales practices and mis-selling sit within this category alongside conflicts of interest – both disclosing and managing.

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