

Directors & Officers Liability Market Update

with Dan Bailey of Bailey Cavaleri, LLC

Q4 SELECT
BLENDS

McGriff Financial Services Division held the Fourth Quarter 2019 Select Blends seminar on Thursday November 14 with Dan Bailey, Chair of Bailey Cavaleri's D&O Practice Group, for a round table discussion about the current state of the market. In addition to Mr. Bailey, several underwriters were in attendance and provided their perspective on the changing landscape heading into 2020. Below is a summary of the discussion.

In describing the current Securities Class Action environment, Dan Bailey provided the following takeaways:

Shifting Landscape

There has been a recent shift in the plaintiffs' bar from top tier law firms representing institutional investors as the lead plaintiff to emerging law firms representing individuals as the lead plaintiff. The change occurred as a result in institutional investors becoming indifferent to Securities Class Actions (SCA) due to the increased expenses over a long period of time. Over 50% of SCA cases in 2018 were filed by three law firms, all of which are considered emerging law firms attempting to establish themselves as leaders in this field. Of the 50% of SCA filings brought by emerging law firms, half of those have been dismissed - this represents a much higher dismissal rate than historical filings of 25% - 30%. This high dismissal rate is reflective of the quality of cases emerging law firms are taking on.

Proven Playbook

The Life Science industry continues to lead all industries with the highest frequency of SCA filings. This class of business is low hanging fruit for the plaintiffs bar as it is a proven strategy to identify and allege misrepresentations if a company's stock drops once they fail to receive regulatory approval. Similar to the proven playbook the plaintiffs' bar have for Life Science companies, merger objection cases continue to account for a large portion of SCA filings. Merger Objection filings were historically filed in state courts until the Delaware Court of Chancery identified the lack value the suits brought to shareholders and stopped approving settlements. The plaintiff's bar readjusted their strategy and are now filing these claims on the federal level as SCA claims related to disclosures. This has caused an inflation in the # of SCA filings.

Looking Beyond

Though it is important to understand the increase in overall number of filings, the more important figure that is not being discussed is the amount of defense costs being spent for each of these cases, even if they are getting dismissed. Twenty three percent of Chubb's total losses paid constituted defense costs - a surprisingly high number. The amount of defense costs being spent is increasing faster than the number of cases filed which should be a bigger focus for clients and carriers. The average amount of defense costs has increased 50% in the last 10 years, therefore attorney fees that were close to \$1,000 / hour are now closer to \$2,000 / hour.

Dan Bailey

Dan is a nationally recognized expert regarding directors' and officers' responsibilities, liabilities, indemnification, insurance, and loss prevention. As Chair of Bailey Cavaleri's Directors & Officers Liability Practice Group, he represents and consults with directors and officers, corporations, insurance companies, and law firms across the country. In addition to advising boards and drafting most of the D&O insurance policies in the market, he has represented clients or served as an expert witness in many of the largest D&O claims for more than 30 years. He is co-author of *Liability of Corporate Officers and Directors*, a leading treatise on the topic, has published dozens of articles and speaks at more than 20 seminars a year on the subject. <http://baileycav.com/>

What Does The Insurance Market Say?

As a result of the large inventory of over 700 SCA claims that have not yet been settled or dismissed, carriers expect to contribute to these losses for many years to come. In anticipation of upcoming losses in an attempt to correct prior losses, several markets are pushing for double digit rate increases across their portfolio. Those same carriers pushing for rate are also retaining those accounts; a signal to the market that the increases might be justified. AIG is achieving an average 37% rate increase on accounts with under \$1B in revenue and 20% rate for accounts with over \$1B in revenue. Rates will continue to go up in 2020 in order to begin to correct these losses. AIG advised they are paying closer attention to retentions for this reason, especially the M&A retention. AIG is working to push M&A retentions up to \$2.5MM throughout 2020.

Don't focus too much on frequency, the more alarming issue at hand is the increase in defense costs and the increased severity of settlements (including recent mega derivative settlements). Average size of settlements are up 15%.

The Origin of Pre-Claim Inquiry

As a result of a lack of formal claim made against Sharron Watkins (the Enron whistleblower), proceeds from Enron's D&O policy never extended to the Time's "Person of the Year 2002" responsible for sounding the alarm on Enron's accounting irregularities. Called to testify as a witness before committees of the U.S. House of Representatives and Senate, Watkins incurred a large amount of legal expenses though she was never sued directly. Her inability to recoup legal fees under Enron's policy instigated the inclusion of pre-claim inquiry coverage in D&O policies to allow for defense costs coverage to be triggered upon a fact finding enforcement authority investigation or requests for document production as a witness.

As the soft D&O market progressed, pre-claim inquiry coverage became more prevalent in primary traditional ABC policies and has been utilized by individuals beyond its intent. Even though there have been several significant losses as a result of the early reporting of a claim, the market on average has not witnessed a significant uptick in claims as a result of the expanded coverage.

Other Noteworthy Comments

- The market and insureds alike should keep an eye on the SEC's Whistleblower Initiative as whistleblowers have been incentivized by the SEC and typically receive 25% - 30% of recovery costs. This could be a concerning factor for defense counsel and insurance carriers if insiders are motivated to turn on their co-workers for financial gain.
- Policy coordination between the D&O and Employment Practices Liability policy is necessary now more than ever as a result of the #metoo movement. Claims alleging sexual harassment against executives have the potential to trigger both policies. Insureds should think about which policy responds first and how they interact. At the very least, McGriff recommends amending EPL reporting to be optional on a D&O policy in order to help resolve late reporting in the event the matter needs to ultimately be reported to the D&O carriers.

