# Directors' & Officers' Market Update

Australia - April 2021

After a few dour years for those involved in D&O insurance, particularly insureds, there are at last some signs of positivity for 2021. Many of the hardships recently experienced will continue – increases in premium, pressure on self-insured retentions and restrictions on the availability of limits and coverage. However, new market entrants (largely in London), possible stabilisation of Australian based insurers and mooted changes to legislation, may ease some of the more significant market stressors.

The adversity faced by publicly listed firms in renewing their D&O programs has made headlines over the last few years. The drivers behind it have been well documented and renewals since 2017/18 have been marked by:

- Significant reductions in capacity offered by insurers and the complete withdrawal by other insurers from offering D&O to listed companies.
- Extreme increases in premiums which when measured as a percentage, have been commonly 200%-300%+ for a number of firms.

The impact of COVID in 2020 was to harden insurers' positions. Several insurers had suggested that market balance would only be achieved with a premium pool large enough to sustain anticipated losses – a position where an average rate on line of 5-10%, across the ASX 200, is attained (i.e. a premium pool equating to 5-10% of the limit exposed across the ASX200). For context, that may be taking a 2016 national premium of circa $300m to an amount of $1.5bn. Clearly a major step, even from the position the market was in at the beginning of 2020. However, as the year progressed several insurers looked to accelerate towards this.

The sharp escalation in premium and retentions has caused companies to re-evaluate the standing of D&O insurance at their organisations. Rightfully and advisably, our clients are reviewing their risk management strategies and exploring alternative risk transfer solutions, such as Captives.

In the current market, renewed focus has been placed on determining the scope and level of cover the company needs, because it will pay for every component. For the first time, many companies that purchase Side C are contemplating whether this cover should be retained. Program structures are being assessed, not only to manage costs, but to strike the right balance between coverage tailored to their business needs and risk appetites.

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The Treasurer's announcement in February, that the government will be bringing forward legislation to make permanent the temporary relaxation of the rules around continuous disclosure is significant. If passed, companies and their directors will only be liable for continuous disclosure breaches if "knowledge, recklessness or negligence" can be proved.

The "strict" nature of Australia's disclosure rules has been repeatedly put forward as one of the main drivers of the prevailing market conditions. Some insurers, have gone as far as to say, the strict rules have made it difficult to differentiate the risk of individual ASX listed entities, leading them to address the issue through premium.

Changes to disclosure rules will take some time to wash through the market and result in a tangible improvement for insureds. More immediate relief may be provided by the new market entrants being established in London. Much of the pain suffered by Insureds in recent years has come from the loss of capacity in the D&O market. A number of insurers stopped writing the class altogether and those that remained reduced the limits they were prepared to offer. It has been estimated that the London market alone lost 50% of its capacity in 2020. This resulted in difficulties for those Insureds who maintained significant limits of indemnity. Insurers willing to replace lost capacity charged significant premium to do so. The new market entrants should relieve some of the pressure on replacing excess layer capacity and calm some of the more opportunistic pricing seen in 2020.

In terms of outlook, we expect that where an insured has experienced a substantial rate correction over the last two to three years, the change this year will be less severe in percentage terms, more in the realm of 30%-50% rather than the 200%-600% that was experienced in 2020. As ever, a few market fundamentals remain, including the need for well managed insureds with strong governance to differentiate themselves through personalised market engagement. More optimal results will be achieved by those insureds that are able to renew with considerable continuity of the insurers that currently participate on their programs, especially at at primary and lower excess positions.

Industries involved with, or ancillary to, travel, retail, hospitality and construction, will face greater scrutiny. We expect that where an insured has experienced a substantial rate correction over the last two to three years, the change this year will be less severe in percentage terms, more in the realm of 30%-50% rather than the 200%-600% that was experienced in 2020.

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## Private companies / AB Only

Whilst Side C cover has attracted most of the attention over the last few years, there has been correction too for AB only cover. Feedback from insurers is that whilst this will continue in 2021 the increases will be more measured in the 20% - 30% range. However, there are some important caveats:

- The focus will be on individual risks and the breadth of cover provided – e.g. those clients in industries impacted by COVID-19 (such as travel, retail, hospitality and construction) will receive extra scrutiny. It is likely they will see more of an increase and the imposition of additional restrictions in areas such as Employment Practices Liability and insolvency cover
- Those clients currently paying less than what insurers have set as a minimum rate could see a larger percentage increase just to achieve that rate – e.g. if an insurer requires a minimum premium of $35,000 for a $10m limit then an insured currently paying $20,000 for it will likely see a 75% increase.

## Contact Us

For more information please speak with your Willis Towers Watson broker, or contact:

**Simon Carter**
Broking Director, Finex Australasia
**simon.carter@willistowerswatson.com**
D +61 3 8681 9796

Willis Australia Limited | ABN 90 000 321 237 | AFSL No. 240600
CKA Risk Solutions Pty Ltd | ABN 33 109 033 123 | AFSL No. 276915



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