Zurich Commercial Insurance
Customer and Broker Webinars 2021

As pandemic tide eases, a new wave of D&O liabilities appears

Be prepared: Considerations for insureds in today's D&O market

Insurance customers should be prepared for a post-pandemic world that is bringing changes to the directors and officers liability market. Zurich's experts recommend that customers consider:

- Insurers will want to see evidence of scenario planning and testing that will reveal the hardiness of an organization's financial position and its ability to survive in a post-pandemic economic environment.
- Litigation funding means legal expenses will be higher as cases remain open longer. That calls for aggressiveness in getting cases closed.
- Disclosure by the Board on the impact of COVID-19 must be precise and clear.
- As government support is withdrawn, some companies should be prepared for financial distress. Make sure financial reporting is accurate, and check the financial strength of your supply chain.
- Underwriters will want to see robust risk management processes that considers broader D&O exposures in the post-COVID world.
- Lots of people claim to be ESG experts. Make sure those chosen to help with an organization's ESG exposures have proper experience and know-how.

"We're looking to confirm insureds are as prepared as they can be," said Timothy Powell, Zurich's Global Head of Financial Lines & Cyber.

A surge of directors and officers liability claims expected in a post-COVID 19 world is prompting companies and their insurers to look more closely at managing and underwriting the exposure that was evolving even before the crisis arrived.

The 2008 global financial crisis marked a point where the D&O market began to look differently, said Sierra Signorelli, Zurich Insurance Group's CEO Commercial Insurance. "More is expected of directors and officers than in the past," she pointed out, as global regulations have been tightened to prevent a repeat of the crisis, litigation funding has taken hold and corporate officers have increasingly been held responsible in cases not traditionally brought as D&O claims.

Ms. Signorelli was among the Zurich experts who outlined the changing D&O liability risk during a recent webinar, "Current Trends & Exposures in the D&O Market." The webinar, moderated by Ron Davis, Global Head of Customer Management, Commercial Insurance, was the latest in an ongoing series of discussions aimed at helping companies manage their commercial risks.

Businesses are finding themselves under more intense scrutiny from regulators and other stakeholders as the COVID-19 crisis eases, the panelists pointed out, and should be aware of the broad exposures related to environmental, social and governance risks as well as event-driven litigation. At the same time, insurers are working to better-understand the risks to help them properly price and underwrite D&O coverage.

Cases loom as pandemic wanes

"Everything points to a big surge in D&O legal proceedings in coming years," said Tom Ripp, Zurich's Global Head of Specialty Claims. Cases became stalled during the pandemic as courts closed and mediation hearings were postponed. This has created a "pent-up demand" for pending D&O claims.

Companies that were alleged to have been unprepared for the impact of the pandemic are often the focus of litigation, Mr. Ripp pointed out. "Other actions will be brought for failure to disclose – (alleging that) they didn't disclose the impact of COVID on their business until it was too late."

There is also speculation that some companies supported by government stimulus programs could fail when those funds are exhausted. Financially troubled companies and those that become insolvent may find plaintiffs' attorneys and regulators coming after them, Mr. Ripp said. "We will see a lot of creative ideas from plaintiffs' attorneys from the problems that COVID has created."

"Directors are under pressure from all stakeholders, driven by the public perception – correctly – that they should be held accountable for their activities," said Timothy Powell, Global Head of Financial Lines & Cyber at Zurich. "It is now a global concern for directors."

Investors and events fuel cases

Litigation funding is driving an increase in D&O cases, the panelists pointed out. "This is a characteristic of the legal system that is well established now," said Mr. Powell.

With the backing of investors who expect a return in exchange for funding litigation, more litigants are able to have their cases heard, Mr. Powell explained. "While the economics might not have made litigation feasible for them in the past, now it lowers the bar and allows them access to that litigation through these funding arrangements, so that they can take that action."

Cases funded by investors can be more difficult for the litigants to settle, Mr. Ripp said. The investors have a budget for the litigation and aim to receive an amount they feel is justified by the case. "They've done the analysis, they're good at that, and they know what the case is worth."

Event-driven litigation, meanwhile, is attracting a lot of attention in boardrooms. While complaints against directors traditionally focused on such matters as financial disclosures, accounting errors, or inaccurate projections or other matters causing a drop in stock prices, today directors and officers are exposed to nearly any event that affects the value of the company, the panelists noted.

In the past, most event-driven cases were dismissed because directors were not expected to be responsible for "seeing into the future" and knowing that an event would occur for which they would be liable, Mr. Ripp said. "That's changed. Today there is a duty of care and a duty to foresee these events and prepare for them."

Companies have to be prepared for a wide range of events that could attract litigation - data breaches, sexual harassment allegations, natural catastrophes and others could spark D&O suits, said Mr. Ripp. Twenty years ago, it was "unthinkable" that an event such as a dam breach would result in a D&O claim, he added.

Regulators looking closely at commitments
Mr. Powell said he expects regulatory activity to ramp up as the pandemic fades, similar to the way it did in the wake of the 2008 financial crisis. "What is clear is that regulators everywhere are becoming more powerful and more involved in companies' business."

Mr. Ripp agreed. Regulators are better-funded and legislation has given them stronger enforcement tools, he pointed out. "COVID will be another point in time when the globalization of regulation becomes stronger."

Company directors now find environmental and social issues are on "equal footing" with the traditional governance concerns they have always faced, said Mr. Powell. "Investors, regulators, customers and the public are demanding that directors take account of these issues when carrying out their duties," he added. "While it is fair to say that these obligations of directors have always been there, it is now true that the attention on these matters has been amplified."

As a result, companies are striving to "not only do well, but to do good," Mr. Powell explained. Directors are increasingly being held to account for driving that philosophy in their organizations, he said.

Adoption of environmental, social and governance strategies began to surge in 2010, according to Mr. Ripp. "In the 2020s we are going to see the impact of this adoption," he noted, as regulators and others look at whether companies have held true to sustainability promises, pledges to invest in "green funds" or other ESG commitments.

"Many companies are using this to enhance their standing in the community. If you talk about it, but you don't do it…then the impact is going to be a lot different than in the past" when scrutiny was not as intense, Mr. Ripp warned.

Insurers take a hard look at the risk
As regulatory demands increase and D&O exposures expand, insurers are reevaluating their risk assessment models and risk paradigms, Mr. Powell remarked. "Risk is increasing, so insurers will need to respond to that to stay in the game."

D&O coverage prices have risen, he noted, but are at levels seen 20 years ago when the risks faced by directors were not nearly as extensive as today. Prices are not expected to fall unless the risk to directors is somehow reduced, Mr. Powell said.

It is vital for insurers to control the limits they write for the D&O exposure, he said, if they are to maintain a sustainable risk portfolio. "Reducing or controlling limits protects insurers from outsized losses that create volatility in a portfolio and impact the insurer's ability to continue to provide the coverage on an ongoing basis."

"Coverage will continue to be a focus, to ensure that the core protection available to directors is not eroded by alternative coverages that might get thrown into a D&O policy," Mr. Powell said. "Directors need to be confident that the policy they buy will respond to their personal liabilities in the event that they get sued. That concentration on coverage to make sure that those directors are protected is something that we are going to see some impetus on in the next few years, I'm sure."

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