



DIRECTORS AND OFFICERS (D&O) INSURANCE INSIGHTS 2021

In what has been a volatile year for global markets and corporate officers – from the pandemic to business lockdowns to political upheaval to unprecedented warnings of forthcoming insolvencies – boards of management, more than ever, are vulnerable to a litany of business exposures, any of which could potentially derail the financial health and continued service of any company. Following are five D&O mega trends companies should watch for and guard against in 2021, according to AGCS financial lines and D&O experts.

5 D&O INSURANCE MEGA TRENDS TO WATCH IN 2021



GLOBAL ECONOMIC DEVELOPMENTS AND INSOLVENCY EXPOSURE

As the world continues in the throes of an economic downturn amid a disruptive coronavirus pandemic, the 2021 economic and political outlook is highly volatile. While the International Monetary Fund (IMF) expects the global economy to shrink 4.9% in 2020, on the one hand, it projects a 5.4% global growth in 2021 on the other – far below its pre-pandemic projections¹.

“The impact of a gradual phasing out of temporary policy measures designed to support companies is one of the key concerns for D&O underwriters for 2021,” says **David Van den Berghe, Global Head of Financial Institutions at AGCS**.

Historically, insolvency is a key cause of D&O claims as insolvency practitioners look to recoup losses from directors. There are many ways that stakeholders could go after directors following insolvency, such as alleging that boards failed to prepare adequately for a pandemic or for prolonged periods of reduced income.

There were six “mega” bankruptcy filings involving businesses with at least \$1bn in reported assets during the first quarter of 2020, 31 in the second, and 15 in the third, for a total of 52, compared with a 2005 to 2019 quarterly average of five, according to Cornerstone Research².

According to Euler Hermes³, the bulk of insolvencies is still to come – largely through the first half of 2021 – with its global insolvency index likely to hit a record high for bankruptcies, up 35% by the end of next year, cumulated over a two-year period, with half of countries recording a new high since the 2009 financial crisis. The top increases are expected to be recorded in the US (up 57% by 2021, compared to 2019), Brazil (up 45%), China (up 40%) and core European countries such as the UK (up 43%), Spain (up 41%), Italy (up 27%), Belgium (up 26%) and France (up 25%).

Covid-19 translates to longer payment delays and rising inventories among large corporates. Global firms’ liquidity needs will increase by five days to 74 days in 2020, or \$8trn (up \$140bn)⁴. Monetary policy and the successful search of a vaccine are the remaining safety nets for growth and the avoidance of substantially more insolvencies and probable recession.

“We expect markets to remain fragile in view of the recent extreme bullish reaction to positive Covid-19 vaccine news,” adds Van den Berghe. “Further, the tech war between the US and China, and the end of the Brexit transition period, will remain top of mind as well, and adds to an overall high level of economic uncertainty.”

¹ New York Times, IMF predicts deeper global downturn even as economies reopen, June 24, 2020

² Cornerstone Research, Trends In Large Corporate Bankruptcy And Financial Distress, 2005-Q3 2020

³ Euler Hermes, Calm before the storm: Covid-19 and the business insolvency time bomb, July 16, 2020

⁴ Euler Hermes, Covid-19 to increase firms’ liquidity needs to a record USD8trn as payment delays and inventories surge, July 27, 2020



SECURITIES CLASS ACTION ACTIVITY AND COVID-19 IMPACT

Through the first half of 2020, new US securities class action filings were pacing approximately 18% behind rates seen in 2019⁵. Undoubtedly, this downturn was due in part to the disruption to businesses and court activity caused by the Covid-19 pandemic. Nonetheless, the frequency of federal court filings is on track to match rates in 2017 and 2018 and will be well in excess of every year prior to those.

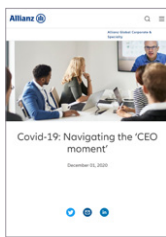
“Of note, the percentage of new filings in 2020 targeting foreign-domiciled issuers has been nearly twice the average rate in recent years,” says **David Ackerman, Global Claims, Key Case Management, at AGCS**. “Underscoring the increased risk, this frequency rate is also nearly twice the percentage that foreign-domiciled issuers represent among all US-listed companies.”

About half of the new filings have been against Asia-domiciled companies – 13 from China and three from Singapore in the first half of 2020. As in the previous year, Canadian companies have also been a frequent target (particularly cannabis companies). Financial services, technology and healthcare/ pharmaceutical firms have been impacted most frequently.

Meanwhile, new merger-objection suits have been fewer this year than recent past years, as

the pandemic appears to have depressed merger activity during the middle part of this year, as well. On the other hand, new initial public offerings (IPO) have dramatically increased as we approach the end of 2020, suggesting the potential for a wave of new IPO-related securities litigation in the not too distant future. Approximately 20% of US IPOs launched between 2009 and 2018 gave rise to securities class action suits within four years of the offering, and more than 30% within eight years⁶. Companies whose share price drops below the initial offering price have a measurable risk of drawing securities class action litigation.

Shareholders have filed more than 20 US securities class action lawsuits related to Covid-19 through October 2020 although observers differ on whether or not certain actions are related to Covid-19⁷. Examples of suits to date include against cruise ship lines that suffered Covid-19 outbreaks, as well as litigation regarding the business impact of the pandemic on companies’ financial performance or operations. Investors have also filed claims against firms that have made misrepresentations about coronavirus-related therapies, testing, or equipment, while there has also been a number of consumer class actions as a result of a failure to reimburse customers.



[For more about Covid-19 D&O risks and how to manage them](#)

⁵ Cornerstone Research, 2020 Securities Class Action Filings: 2020 Midyear Assessment, August 2020

⁶ Cornerstone Research, Securities Class Action Filings: 2019 Year in Review, 2020

⁷ National Law Review, Class action litigation related to Covid-19: Filed and anticipated cases, November 9, 2020

While this may be a smaller figure than might have been anticipated near the outset of the pandemic, the current increase of new bankruptcy filings (see page 2) likely will add to the number of securities holder (any party owning an interest – debt or equity – in an organization) lawsuits stemming from the pandemic.

Another threat looming on the horizon comes from the return to work steps taken by businesses, which will ramp up in the near future. The return to office is fraught with peril, with particular regard to shareholder derivative actions, but also in relation to other forms of litigation. Employers can be in a tough spot when asking employees to return, and in particular, on deciding which ones to choose and can be restricted by regulations regarding what they can ask and how they can act, which could bring problems.

In addition, those companies which are slower to recover from the pandemic compared to industry competitors could leave themselves open for litigation from shareholders and consumers alike resulting from perceived underperformance.

Outside of Covid-19, 2020 has given rise to some positive legal developments. Both the US State of Delaware Supreme Court and a trial level court in Northern California have upheld forum selection provisions in corporate charters, which require shareholders to bring actions exclusively in federal court for alleged violations of the Securities Act of 1933 related to shares offered in IPOs. Corporations began to adopt such provisions in reaction to the US Supreme Court’s

2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, which affirmed the concurrent jurisdiction of federal and state courts over ‘33 Act claims. While a significant percentage of companies publicly traded on US exchanges are incorporated in Delaware (whose corporate law therefore is broadly influential), it remains to be seen whether states other than Delaware and California, as well as non-US jurisdictions, will uphold such forum selection provisions.

“Still, it would seem prudent for directors of companies planning IPOs to adopt such provisions where possible,” notes Ackerman, “in the hope of avoiding the unfortunate risk of defending claims in one or more state courts or, simultaneously, in state and federal courts.”

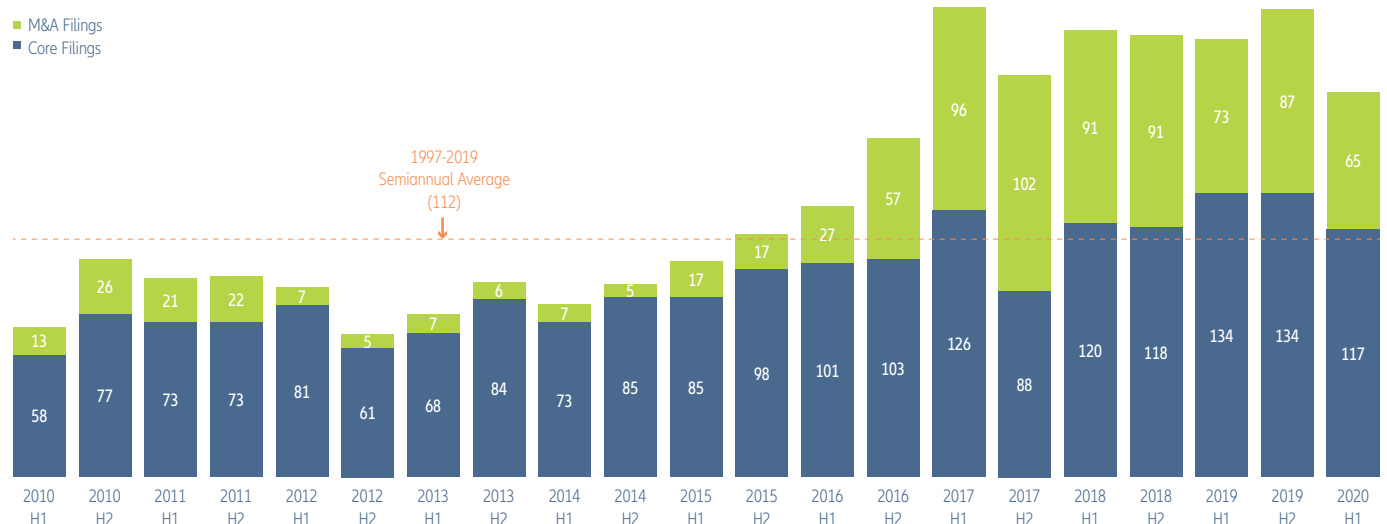
Outside the US, securities class actions are being filed in record numbers and the threat of facing an action has increased in many jurisdictions – notably in Australia and Canada – and in consumer-facing sectors such as retail, automotive, insurance, pharmaceutical and financial services.

The landscape for collective redress in Europe has evolved over the last few years and collective action is a growing exposure. Many countries now offer some form of collective action mechanism, even if it is just a process for consolidating linked actions rather than a true procedure, and in recent years such tools have been utilized for collective shareholder actions in increasing numbers.



➤ [For more on the global outlook for securities class actions](#)

Class Action Filings Index (CAF Index) Semiannual Number of Class Action Filings 2010-2020 H1



Note: This figure begins including state 1933 Act filings in the semiannual counts in 2010. Parallel class actions are only reflected as a single filing. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year.

Source: Cornerstone Research, Securities Class Action Filings 2020 Midyear Assessment, 2020



CYBER ATTACKS THE BOARDROOM

Companies face an evolving landscape of cyber security threats – including potential vulnerabilities caused by the increase in remote working due to Covid-19 – and investors view cyber security risk management as a critical component of the board’s risk oversight responsibilities. Recent years have seen a dramatic increase in the number of incidents and significant numbers of data breaches have occurred in the health/medical, corporate, government/military, educational and financial services sectors.

Often the aftermath of data breaches has been devastating to the companies affected, including fines, costly breach notification procedures, business interruption and intensely negative publicity.

Globally, directors have been called to account, including in derivative and direct litigation, for this adverse impact due to their alleged failures to

institute appropriate corporate governance to protect against cyber security risk. Moreover, major breaches experienced by publicly-traded firms have damaged investor confidence, causing rapid share price drops, and, thereby, becoming “events” which give rise to costly class action securities litigation.

“As cyber security threats evolve and risks become more complex and widespread, focus on corporate disclosures in the form of public filings related to cyber is likely to also intensify,” says Van den Berghe. “Many companies already include additional cyber security disclosure in the form of risk factors and have established controls and procedures that should enable them to make accurate and timely disclosures of material events.”

Ackerman adds: “We expect that the focus on enhanced communication will continue to grow as the challenges continue to evolve.”

“MAJOR BREACHES EXPERIENCED BY PUBLICLY-TRADED FIRMS HAVE CAUSED RAPID SHARE PRICE DROPS, BECOMING ‘EVENTS’ WHICH GIVE RISE TO COSTLY CLASS ACTION SECURITIES LITIGATION”



DIVERSITY, CLIMATE CHANGE AND ESG FACTORS IMPACT ON DIRECTORS AND OFFICERS

Oracle, Facebook, Qualcomm and Norton LifeLock – all technology companies which recently, have been subjected to board diversity derivative suits – specifically, allegations that their boards lack black directors⁸.

The common background of all these derivative suits seems to be a reaction to recent racial justice protests such as **'Black Lives Matter'** and the complaints in the lawsuits are similar. Shareholders allege that the company's board of directors violated their fiduciary duties by their inaction on diversity issues. Some of the complaints seek a number of actions by the respective defendant companies by way of relief, such as return of board members' remuneration, nomination of new black board directors, creation of a company fund to hire black talent or aiming to tie executive compensation to diversity-related goals.

While the financial impact of such lawsuits remains to be seen, there will be substantial legal defense costs involved in their settlement. This growing D&O liability threat may further drive the increase in frequency and severity of US securities class actions noted over recent years.

In future, more and more D&O claims are likely to be driven by environmental, social and governance (ESG) factors, which have the

potential to substantially impact the reputation of a company.

This trend can to a certain extent be seen as a continuation of the rise of D&O "event-driven litigation" which has become established in recent years, with plaintiff law firms ready to seize almost any opportunity to bring class actions or force a settlement. The "event" itself can be caused by different triggers – be it the #MeToo movement, Covid-19, California wildfires, or an airplane crash – and ESG factors are increasingly contributing.

Issues resulting from climate change, water management, biodiversity degradation, exploitation in supply chains and corporate governance issues are some of the main ESG trends to watch in 2021. From a D&O liability perspective, these are topics which companies and boards will be expected to focus on with regards to disclosure and internal risk management. The accountability of risk managers keeps rapidly evolving in this context, for example, through proper identification of the key risks to the company and the most impactful mitigation measures.

In particular, climate change is a key challenge. Since the 1980s, the frequency of natural



[For more on diversity-related D&O risks and how to manage them](#)

⁸ Business Insurance, More firms may be exposed to D&O suits over diversity, September 14, 2020

catastrophes worldwide has tripled and the economic impact of extreme weather events in G20 economies alone is estimated to be \$142bn⁹ annually. Climate change cases targeting “carbon majors” have already been brought in more than 30 countries, although most cases are filed in the US, where an increasing number allege that companies have failed to adjust business practices in line with changing climate conditions. Climate-linked activism against corporates is a developing trend – particularly in Europe – and boards are increasingly challenged by investors and stakeholders. To understand the real impact of climate change, companies and their boards have to look beyond the usual two- to five-year horizon and anticipate and prepare for various future scenarios.

“In response to the fact that corporations around the world find themselves under increasing public scrutiny regarding their ESG performance, AGCS has partnered with (investment and risk consultant) The Value Group to develop a new data-driven D&O scoring methodology driven by ESG and recognized quality metrics,” says **Joana Moniz, Global Head of Commercial Financial Lines at AGCS**. “The new underwriting approach will help AGCS and its customers to assess and mitigate these types of risks through improved risk dialogues.”

The new modelling approach focuses on ESG-related metrics such as corporate governance and other quality parameters, including compliance standards. The data shows that there are specific ESG key performance indicators with strong predictive power about future D&O litigation.

“Current and future D&O underwriters need to be aware of ongoing global ESG matters – from activist investor campaigns to social justice protests or money laundering schemes – in order to adequately assess potential perils.

“Ultimately, underwriters must assess how these matters may develop into a litigation trend and/or impact a company’s risk management practices,” notes Moniz.



⁹ Climate Transparency, Brown To Green, The G20 Transition Towards A Net-Zero Emissions Economy, 2019



PRIVATE COMPANY EXPOSURES CONTINUE TO CHALLENGE

The importance of D&O insurance to private companies seems to be generally understated. This is true even if the D&O litigation scenarios against private companies and/or their executives are well known.

The majority of private company lawsuits are employee-related matters. However, a private company's officers can be sued for breaching their fiduciary duties – such as in the context of the sale of a company for an alleged inadequate price. Other examples of why private companies should have D&O coverage include to combat anti-trust claims and regulatory actions. Private companies and their senior management also need to be aware of the potential liability risk under federal securities regulations for alleged misrepresentations to prospective investors and others.

While these settlements can be relatively small when compared to public companies, they may have a huge impact for executives who are made personally liable and who lack D&O insurance protection. This is even more concerning in the context of a bankruptcy scenario, where executives are made liable at a point in time when the company itself is unable to indemnify them.

Generally, D&Os of privately-held companies are more closely involved in all of the company's operational topics and business decisions, which may more easily translate into the direct, personal impact of different types of litigation impacting them.

This becomes even more challenging in a crisis environment such as Covid-19, under which management capabilities are being tested and challenging business decisions are required – which are mandatory for certain areas of the organization such as personnel, supply chain management, financial stability, refinancing, and the sustainability of internal systems and technologies.

While the Covid-19 pandemic is currently placing private companies and their executives under considerably higher D&O litigation risk, the business decisions will also have a long-term impact on the risk management practices, internal processes and management of labor and IT resources of these organizations.

“Management of privately-held companies need to meet with brokers and insurers to have enhanced risk dialogues in such a way that the inherent and changing D&O risk environment for this business segment is fully understood by all parties,” says Moniz.



MARKET DYNAMICS THE STATE OF THE D&O INSURANCE SECTOR

Although billions of dollars worth of premiums are collected annually for D&O insurance, the profitability of the sector has been hit in recent years due to factors including increasing competition, growth in the number of lawsuits and rising claims frequency and severity. Underwriting results have been negative in many markets around the world, including Australia, the UK, the US and parts of Europe, driven by event-driven litigation, collective redress developments, regulatory investigations and higher defense costs. This has been compounded by a cultural shift that has resulted in more D&O claims being brought in relation to securities around the world.

Although third party data suggests the D&O insurance market continues to harden in terms of pricing, the combination of previous pricing inadequacy and exposure and loss trend increases during the soft market cycle continues to impact.

“In other words, insurers are still digesting profitability assessments from prior-year policies,” says **Shanil Williams, Global Head of**

Financial Lines at AGCS. “This is also at a time of great uncertainty around forward-looking exposure assessments, in particular the impact of Covid-19 on the economy in general and its impact on specific industries. Combined with many ‘known unknowns’ like climate change, cyber risks and ESG, this has created a lot of nervousness in this sector.”

From an insurance-purchasing perspective, companies and brokers are beginning to explore fundamentally different insurance options to try and bring the supply and demand back to equilibrium, including retaining much more risk at the frequency and low severity side via increased self-insured retentions, co-insurance and even alternative risk transfer options.

In addition, companies are focusing more on the Side A part of the coverage and taking more of the Side B and Side C on their own balance sheet (*see graphic*). As companies have increasing budget restrictions in 2021, we may see more of a focus on retention levels and coverage which has a trade off with premium.

“There also is a great opportunity here to improve the risk dialogue so that insurers and customers can close the gap on perception and evaluation of risk. D&O is a boardroom issue and this product is one which requires an elevated level of partnership between customers and carriers,” says Williams.

“At AGCS, we remain committed to being a global D&O insurer and working in partnership with our customers to ensure that we have a sustainable solution for all the parties involved.”

As for the impact of Covid-19 on claims, traditional class action lawsuits – which had decreased as the pandemic settled in from March to May – have picked up and will likely continue into 2021, especially against companies in sectors like

transportation, leisure, biotech and banks. After years of abundant capacity and appealing rates, D&O underwriters anticipated a hardening market in 2020 — then the pandemic hit.

In such a financial climate, it’s unsurprising that the D&O market has been adversely impacted. As the pandemic heads into the close of the year, the market is watching very carefully what happens from here through the coming winter.

“The market was correcting itself, and on top of that came the current economic and financial crisis,” says Williams. “The financial crisis mainly touched financial institutions, but this is touching everybody and every business, and it is just too early to understand its impact.”

D&O INSURANCE STRUCTURE

The structure of a D&O insurance policy depends on which of three insuring agreements are purchased (**ABC** policies are generally chosen, as these are standard form policies for publicly listed companies; for private or non-profit companies, only **AB** policies would be useful).

Cover	Description	Who is the insured?	What is at risk?
Side A	Protects assets of individual directors and officers for claims where the company is not legally or financially able to fund indemnification	Individual officer	His/her personal assets
Side B	Reimburses public or private company to the extent that it grants indemnification and advances legal fees on behalf of directors/officers	Company	Its corporate assets
Side C	Extends cover for public company (the entity, not individuals) for securities claims only	Company	Its corporate assets



CONTACT US

AGCS is committed to D&O insurance as a key strategic product and we will remain a long-term sustainable player. We offer market-leading rated paper, multinational solutions and a dedicated global network of D&O underwriting and claims experts:

www.agcs.allianz.com/solutions/financial-lines-insurance/d-and-o-insurance.html

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