MARSH JLT SPECIALTY

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Directors and Officers Liability Insurance Update for the Energy Market

Our directors and officers liability (D&O) insurance update focuses on recent trends, COVID-19's impact, and D&O-related challenges that will affect the energy sector. Over the past year, the local and international D&O market has dramatically contracted, with the London market showing signs of change as early as mid-2018. The London market has traditionally been a long-term global D&O marketplace for international energy companies, with attractive capacity and innovative products. Currently, the D&O market is characterised by rising rates, contracting capacity, and increasing claims frequency and severity. It shows no signs of easing in 2020 or early 2021.

1. Rising Premium Rates

It is increasingly common to see double- or even triple-digit percentage increases in D&O pricing. Marsh JLT Specialty's energy clients saw an average premium increase of 63.8% in 2019, with an increase of 87.8% in the last quarter of 2019 alone. In comparison, the premium increase for US-listed companies (all industries) was 96.7% in 2019 (122% in the last quarter of 2019).

The D&O insurance market for FTSE 100 companies saw average premium increases of 74.8% in 2019 (with an average premium increase of 77% in the fourth quarter). Premium change for all UK companies was slightly higher at just over 80%.

January and February 2020 delivered increases in excess of 300% for the most exposed risks. Energy, mining, and power risks were particularly affected. These severe increases were before the full effects of COVID-19, which has increased volatility in the D&O marketplace.

Premiums are unlikely to stabilise in 2020, due to further prior-year adverse developments, increasing claims frequency and severity on current years, and the challenging economic outlook.

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2. Contracting Market Capacity

We estimate the maximum market capacity for energy risks in the first quarter of 2020 to be around US$300 million, a sharp decline from the almost US$900 million available at the peak of the 2016 and 2017. According to Insurance Insider, approximately US$1.3 billion of capacity left the Lloyd's of London market for all lines of insurance, since the second half of 2019, following market exits and portfolio run-offs. Furthermore, 2019 saw various D&O providers in London close. The contraction's impact is increased by traditional D&O insurers being cautious of the sector and reducing their overall capacity deployed in this class.

Capacity is contracting with all providers, putting further pressure on rates. Marsh JLT Specialty energy clients are particularly affected, primarily those with US or dual US/Australian listings. Energy companies' average limit purchased declined by 2.9% in 2019, compared with a general reduction of 1.1%.

3. Changing Claims Landscape

Insurers have faced increased claims frequency and severity for some years and are counting their losses. In 2018, the two most common types of D&O insurance claims our D&O clients notified were:

1. Investigations (internal and regulatory) – accounting for 36% of all claims.

2. US securities claims – accounting for 28%.

In the energy sector in 2019, noticeable claims drivers were pollution events and bribery and corruption allegations. Claims have also been more frequent outside the traditional hotspots (that is, Europe, Australia, and North America), and exploration and production risks and miners were particularly affected following a series of high-profile losses. Consequently, D&O insurers' appetite for the broader energy sector has reduced materially.

Impact of COVID-19

As the COVID-19 pandemic continues to develop, UK and global businesses are feeling the impact on production and/or service capabilities. This is likely to lead to fluctuations in their financial performance over coming months.

A D&O policy can be triggered by allegations that a director or officer has committed a "wrongful act" in carrying out their duties as directors or officers. In the case of COVID-19, a director or officer could face a claim alleging their contingency planning was unsatisfactory or that inappropriate management decisions were made in response to the pandemic. The specific terms and conditions of any D&O policy should be considered, to determine whether any claim against a director or officer relating to management decisions arising from COVID-19 may be covered under the policy.

Where there appear to be gaps or failings in contingency plans, disclosures to capital markets, or management response, a company's stakeholders, including employees, clients, and investors, may question whether senior executives failed to plan and respond adequately. Any of these failings, and more, could expose directors and officers to investigations or other claims arising from COVID-19.

Examples of possible alleged failings may include:

- Poor communication to staff globally, such as an inconsistent and potentially disruptive approach to managing ongoing pandemic risks, affecting the workforce's health and safety.
- Not having adequate systems in place to allow access to company servers and systems and maintain business as usual while some staff self-isolate.
- Dependence on "just-in-time" manufacturing, which has left businesses with no back-up supply, thereby slowing or halting production.
- Lack of planning on how to monitor systems and controls adequately during increased remote working, possibly allowing for fraud, corruption, or other violations to occur within the company.
- Lack of cyber resilience capabilities to ensure data security during very high levels of remote access.
- Inadequate disclosures to capital markets about supply chain or operational resilience.

Future D&O Challenges In the Energy Market

Bribery and Corruption Risks

Bribery and corruption remains a significant risk influencing capacity for companies in the energy sector. Outside of the supermajor space, some insurers have requested limitations around bribery and corruption, such an increased retentions, sub-limits, or even exclusions.

Health and Safety

High-profile claims relating to safety have focused insurers' underwriting around health and safety measures. Increased questioning during underwriting, and coverage and capacity restrictions are now common for some operations. For example, mining companies have to provide detailed tailings dam information to avoid blanket exclusions.

Insolvency

Growing pressure on oil and gas pricing, and sector consolidation, has resulted in significantly more insolvencies and led to more D&O claims. Given the high levels of cheap corporate debt, this could possibly become a significant issue for D&O insurers.

Environmental, Social, and Governance (ESG) Related Claims

Traditionally, the largest source of D&O claims for public companies related to misleading or fraudulent financial statements. However, the last few years have seen a rise in what has become known as "event-driven" litigation – that is, securities class actions based on the alleged failure of the company and board to properly or fully disclose a risk factor. The trend for increased filing of event-driven suits has raised the profile of ESG in the D&O community, as many of the triggers for such lawsuits have ESG components. Claims can arise out of events such as sexual harassment allegations, product failure, cyber beaches, and environmental violations.

Climate-Change-Related Claims

Litigation alleging responsibility for climate impacts could be about to escalate, thus triggering additional D&O and product liability claims, according to a report by Clyde & Co, which states that more than 1,100 climate change lawsuits have been filed to date in the US.

D&O Renewals: How to Prepare

The challenging market conditions of 2020 will likely continue well into 2021. In order to make a material difference to both capacity and rates at your D&O renewal, we recommend proactive early engagement with your D&O adviser, managing senior management expectations, and challenging historical purchasing decisions to revalidate ongoing priorities.

With contraction in full swing and insurers increasingly risk-adverse, preparing thoroughly for a D&O renewal is even more critical. We recommend including the following steps:

- Start your renewal process early and prepare your internal stakeholders for the most challenging market conditions since the early years of 2000.
- Differentiate your risk – dedicate time and resources to your D&O renewal. Involve senior management, volunteer internal experts to speak with underwriters (including finance, compliance, sanctions, ESG), and pre-empt insurers' questions (for example, on COVID-19).
- Be proactive – subjectivities abound, so address them early on.
- Budget for material costs increases.
- Consider your limits, as you may not be able to purchase the same amount as before, and consider marketing your risk globally, not just in your domestic insurance market or London, if you prioritise capacity.
- Consider structure and the combination of ABC and Side A only limits in your D&O programme.
- Consider alternatives to the commercial insurance market, such as group-owned captives for your Side B and Side C risk, or use of a protected cell captive.

Please get in touch with any of your Marsh JLT Specialty representatives if you need further advice and guidance on the D&O insurance market and how to best prepare for a D&O renewal.

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