D&O Underwriters Focusing More on Diversity, ESG Issues As Litigation Rises

"Event-driven" securities litigation is on the rise, with directors and officers seeing class action lawsuits over how their organizations have addressed COVID-19, racial and social justice issues, and climate change. And D&O underwriters are paying closer attention, too.

The underwriting process may give organizations guidance on how to avoid lawsuits over environmental, social and governance (ESG) issues, according to Heather Fong-Quade, regional head of product development, North America, for Allianz Global Corporate & Specialty (AGCS). D&O underwriters need to know If organizations are having the right conversations internally on diversity and inclusion, for example.

"We'll look and see what they've signed on to," Fong-Quade said. "What are your values? What's your data on the diversity within your organizations? Have you hired a chief diversity officer? That's the first question and it can segue into others. It's becoming more of a conversation and less, 'here's your application' and you're done."

If an organization frames itself as a "socially aware, cognizant company" in its public statements, those statements need to be carried out throughout the organization. More and more, businesses have been called out for supporting Black Lives Matter on social media, committing to gender equality or celebrating Pride Month while having poor track records on diversity and inclusion. Much like the public, underwriters are Googling prospective insureds more to see if organizations represent the type of values they want to support.

"We're looking at the type of image the insured is trying to present," Fong-Quade said. "That's what is happening and what has to happen. We have to look at companies as a whole. We need to be aware of what's happening throughout the entire company."

Companies now need to be more thoughtful about how they approach ESG issues, and that could be a positive development.

"We are achieving the aims of the social justice movement," Fong-Quade told Advisen. "They are having these conversations at the C-suite level."

These changes make it more essential than ever to craft effective D&O programs," Fong-Quade said. In response to the litigation developments, directors and officers and their firms have focused on ensuring they have adequate insurance protection for non-indemnifiable, or Side A coverage.

"We're seeing more insureds change their programs," Fong-Quade said. Some of that change reflects the heightened risk of directors and officers being sued for not only social issues but bankruptcy risk. The shift may also be due to price. Side A towers have historically been less expensive, prompting some organizations to cut back on entity coverage. Fong-Quade added that AGCS has seen a "return to coinsurance that we haven't seen in the past."

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While D&O capacity is not likely to tighten further, carriers will be more stringent about limit-deployment, seeking higher attachment points on towers. Buyers should expect to take higher retention on securities claims and could see some sublimits on excessive-fee litigation, another area of rising risk.

Whether D&O rates will continue to rise remains to be seen, at least for the next year, given the pandemic and the ongoing economic crisis, according to Fong-Quade.

“It’s unclear if we’ve reached rate adequacy,” Fong-Quade said. “Carriers are getting a better sense of how to underwrite those first-wave risks. At renewal and inception, we’re looking at what’s happening right now and that’s different from the past when we’d be looking at historical losses.”

Securities claims were down in 2020, but they remain high. And while the first eight months of the pandemic offered some insight, insurers are still trying to determine long-term impact.

“All we can say is that we see this next year going forward as a harder market,” Fong-Quade said.

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