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2022

TRENDS IMPACTING



Directors & Officers Liability

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2022 will continue to present a challenging landscape for Directors and Officers in all sectors. While organizations navigate through a lasting pandemic and the operational challenges that come with it, boards will see not only existing exposures such as adherence to securities laws and scrutiny of corporate governance practices, but also emerging risks that include environmental and social factors, as well as vaccine mandates. Consider how your Directors and Officers Liability Insurance program (D&O) would respond to the trends as outlined below.

1. SECURITIES CLASS ACTIONS

Securities Class Actions continue to carry severity of risk for publicly traded companies in Canada and the United States. Since the personal liability of directors and officers can attach to securities laws, it is important to understand the current legal landscape and the importance of a corporation's D&O Liability Insurance Program. The 2021 NERA data suggests that both Canada and the US recorded a reduction in Securities Class Action filings in 2021, after having posted record filings from 2017-2020 ¹. There were a number of contributing factors pointing to a lower number of filings, including a reduction of Merger Objection lawsuits in the US, and a more stringent test for certification in Ontario, however the longtail nature of these lawsuits leaves an unknown in terms of future total costs to D&O Liability insurers. In the US, "Event Driven" lawsuits resulting from COVID-19 related issues and Cybersecurity Breaches are still being filed, and the Electronic Technology and Health Technology and Services sectors lead the percentage of filings. The top two allegations of all filings in the US were Misled Future Performance (40% of all filings) and Misled Future Guidance (24% of all filings). The historically elevated case counts combined with increasing defense costs have left most D&O Insurance buyers absorbing significant premium and deductible increases over the past two years along with restrictions in coverage in some cases.

2. ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG)

Strong Corporate Governance at the board level is a basic expectation of public corporations, and the focus has now shifted from the G to include an awareness of the E and the S, and the integration of a comprehensive ESG platform into a corporation's overall strategy. The balance between ESG matters and financial objectives is top of mind for boards

in 2022 and equally important is the compliance with public disclosure requirements, including those surrounding Climate that are proposed or have been published for comment by securities regulators in Canada. Regulatory focus is likely to include material disclosure of risks and opportunities while avoiding "Greenwashing." It is clear in today's environment that corporations must now consider ESG matters and the interests of all Stakeholders when making decisions, particularly as ESG matters are influencing investors, lending criteria, and now insurer decisions, becoming a key underwriting factor in Directors and Officers Liability Insurance. Public companies that score high in ESG Rankings and include strong public disclosure on matters such as Diversity, Equity and Inclusion, Compensation (Say on Pay), and have a robust Whistleblower Policy, are going to see this reflected in the results of their D&O Insurance programs.

3. EMPLOYMENT PRACTICES LIABILITY (EPL) AND VACCINE MANDATES

As the pandemic persists, employers continue to amend their HR policies and roll out vaccine mandates that impact existing and new unvaccinated employees. Labour and Employment lawyers report a significant rise in terminations and litigation that are the result of imposed vaccine mandates in the private sector. While terminated employees engage counsel and pursue severance pay, these actions may be costly to a corporation, and corporations should consider whether purchasing a separate Employment Practices Liability Insurance policy would be an appropriate risk management tool to transfer the cost of defending these cases to an insurer. In addition to allegations of Wrongful Termination, most traditional EPL policies also respond to allegations of Constructive Dismissal, Harassment (sexual or other), and Failure to Promote. The effects of the pandemic have made the purchase of an EPL Policy a priority.



4. TRANSACTIONS (IPOS, RTOS, de-SPAC TRANSACTIONS, M&A)

Where a private company is considering going public via an IPO or merger with a Special Purpose Acquisition Corporation (SPAC), transactions, in general, create a heightened exposure for Directors and Officers and continue to be difficult D&O Insurance placements in the market. The steady IPO litigation and drastic increase in SPAC/de-SPAC litigation in the US has been particularly concerning for D&O Liability insurers and as such, the placement of insurance is complex and costly, with several insurers limiting the capacity they deploy on these transactions or choosing not to participate altogether. Similarly, the cost of D&O Tail (Runoff) Coverage for Merger and Acquisitions (M&A) deals has also risen significantly in the hard market, and therefore boards should speak to their D&O Insurance Broker well in advance of a deal closing to factor in Tail premiums. It is customary to secure a six-year pre-paid Tail Policy for a company being acquired to protect the exiting board members and any future liability they may face while having served as a Director or Officer.

5. DIRECTORS AND OFFICERS LIABILITY INSURANCE MARKET UPDATE

Extreme hard market conditions characterized by significant rate increases, restricted capacity, and retention changes have persisted for the past two years. In 2022 D&O buyers should anticipate a transitional market. We will likely see moderate rate increases of 10-15% or greater during the first half of the year, followed by a more unpredictable second half as competition returns to the market and D&O insurer portfolios secure a more stable and profitable position. Recent higher pricing has attracted new entrants into the D&O insurer space, both domestically and internationally, which may provide benefits of competition in the latter half of 2022, particularly on “Excess” layers of coverage. For certain buyers

such as IPO transactions, RTOs, SPACs/de-SPACs, and financially distressed companies, pricing and retention will remain elevated. Buyers should begin their D&O Insurance renewal process well in advance of key dates and expect a thorough underwriting review to take place. Potential calls or virtual meetings with insurers are still highly recommended as the pandemic and other secondary exposures such as labour, supply chain issues, and inflation are continuing to hamper many corporations’ results.

6. CYBER LIABILITY AT THE BOARD

The increase of cybersecurity incidents has raised concerns not just about the costs of a cybersecurity breach but also the personal liability of Directors and Officers and their fiduciary duty to the company and its shareholders. Simply put, the Board should have oversight over cybersecurity infrastructure and the response plan to a cybersecurity breach – it is not just an IT issue any longer. While the United States has experienced a number of Securities Class Actions and Derivative Suits against the Organization and its Directors and Officers arising from a cybersecurity breach, the legal landscape in Canada is still developing and is relatively untested. There is an expectation that Canada will see similar securities class action lawsuits in the near future, and companies should understand how their D&O Insurance Program interplays with a separate Cyber Policy, if purchased, for actual breach costs. Public companies must also be aware of the securities laws and public disclosure obligations regarding cybersecurity risks within the organization. Disclosure controls and procedures should be robust enough to ensure accurate and timely disclosure of material cybersecurity-related events and information to investors.

(1) McIntosh, JM. Starykh, SS. 2022. Recent Trends in Securities Class Action Litigation: 2021 Full-Year Review. National Economic Research Associates, Inc (NERA).



About Danielle Gorst

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Danielle brings more than twenty years of financial lines insurance experience with over thirteen years in Executive Protection Underwriting with a leading global insurer, in addition to 9 years as a specialty broker in the placement of Directors and Officers Liability and ancillary lines of coverage.

Danielle works directly with Account teams and provides consultative advice to Navacord clients on strategy and placement of coverage, claims advocacy, in addition to thought leadership and white papers on current trends impacting Directors and Officers Liability. Danielle is often a presenter at Board Governance and Audit Committee Meetings, and a speaker at industry events discussing topics specific to Directors and Officers Liability.

Danielle has a Bachelor of Commerce Degree completed with a concentration in Insurance and Risk Management from the University of Calgary.

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Contact a member of your Service Team with any questions you have regarding your D&O coverage.

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