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'The D&O market is facing an increasingly complex regulatory and political landscape'

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The risk environment has become increasingly complex in the last few years for board members and company executives, who can be held liable for a widening range of scenarios. The actions and culture of organizations and their directors and officers are coming under heightened scrutiny from a broad range of stakeholders.

Even prior to events in Ukraine, we had been seeing a complex combination of economic and political tensions across the globe – not just related to COVID-19 but also driven by ongoing renegotiation of US-Asia and Europe-UK trade relations. We can also add to the mix an increase in regulatory complexity, shifting sanctions regimes, rising legal focus on bribery and corruption matters, major scandals and more frequent and higher stakes litigation in the US and Europe. Claims being brought against directors and officers have been on a rising trend and the insurance industry market has been through a significant re-set in terms of pricing.

Insolvencies set to rise

Against this backdrop, insurers across Europe are monitoring the situation with bankruptcies. This includes keeping a close eye on the quality of banks' lending books for any signs of deterioration in terms of the number of non-performing loans. Most banks have been playing it very conservatively – they have significant capital buffers on their balance sheet. These will probably stay in place for some time as it's probably too early to start thinking about releasing those reserves.

Insolvencies have been at a record low in the last couple of years. If we just look at France as an example, there were 28,000 in 2019. This figure dropped to 17,700 in 2020 and fell further to just 14,600 in 2021. That is almost a 50% drop in two years. Of course, these have been exceptional times and we will not see the true picture until the widespread government financial support that has been in place for companies through the pandemic is lifted. But there is clearly a large number of zombie companies still trading that will likely go under this year or next, prompting a wave of claims.

Tighter regulation

Meanwhile, there is a continuing trend of heightened regulatory risk – more and more investigations are taking place. This is especially an issue for European companies with securities in the US who remain more prone to being targeted by litigation funders or activist shareholders than their US counterparts.

Although there were actually fewer US securities class actions in 2021 than in previous years, it may be the case that we are simply seeing a reservoir of cases building up that have been out on hold due to the pandemic. This may result in a breaking of the dam in the coming year with a wave of actions being brought.

ESG in focus

Environmental, social and governance (ESG) risk is also moving up the D&O agenda; there is increased scrutiny in this area, from shareholders, the public and regulators. Companies have to make sure they not only meet their compliance responsibilities but also manage their company's reputation. This is a complex and evolving area that will bring new liabilities for directors & officers.

But it is important to remember that this is not just about the environment, it is about company culture too; directors and officers in Europe as elsewhere have to be increasingly wary of charges brought by employees alleging workplace harassment, sexual harassment or gender discrimination, for example, which could result in negative publicity and reputational damage and a lasting negative impact on the share price.

Market outlook

Although the D&O market in Europe hardened later than in the UK and the US, it is already showing signs of stabilization in some countries. This is the general picture, but Europe is a big continent and the situation varies by country depending on the national economic and political outlook, as well as the legal system, with some markets remaining underpriced in our view. For example, Southern Europe is particularly dependent on tourism and has been hit hard by COVID-19 and we may see claims start to increase there in the coming year.

At the 1st of January renewals we started to see a bit more competition in the market. There is definitely more capacity than there was this time last year. Across Europe, we still saw rate rises average out at about 11%. Insurers are maintaining underwriting discipline and if all things remain equal, we could expect a slowdown in rate rises this year.

Ukraine uncertainty

However, the Russian invasion of Ukraine has brought another level of uncertainty. This is a rapidly moving situation and while it is difficult to foresee with clarity the impact on the global insurance industry and the D&O market in particular, there has already been significant fallout in the capital markets. Stock market volatility is likely to continue with a knock-on effect on efforts to contain inflation. Oil and commodity prices have soared. Companies around the world are having to ensure they keep abreast of compliance with changing sanctions against Russia. Clients which have presence in Russia are either *retreating from this market completely, thereby forfeiting income and or weighing the risk associated with the potential of their assets in the country. Meanwhile, the escalating conflict may increase the risk of a systemic cyber attack that would cause substantial economic and insured losses. Director and officers of companies across Europe and beyond, as well as their insurers, are watching developments with concern.*

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