Insurance Buyers' News

BRJ Insurance®

Springfield
PO Box 4207, Springfield, MO 65808
Phone: 800-422-5275
417-887-3550 • Fax: 417-887-3252

Rolla
PO Box 1258, Rolla, MO 65402-1258
Phone: 800-364-2212
573-364-8888 • Fax: 573-341-2257

West Plains
PO Box 964, West Plains, MO 65775
Phone: 800-400-3896
417-256-6162 • Fax: 417-256-6165

River City Insurance
PO Box 127, New Madrid, MO 63869
Phone: 800-899-7392
578-748-5215 • Fax: 573-748-5392

Insurance Costs March/April 2023 Volume 34 • Number 2

What is social inflation?

We know what economic inflation is, which is bad enough, but social inflation can make claims costs rise even more, often well exceeding general economic inflation.

Social inflation is an indicator of how society is shifting its preferences for determining who is best placed to absorb risk, according to a new white paper by the Insurance Information Institute (I.I.I.), "What is third-party litigation funding and how does it affect insurance pricing and affordability."

What is the impact of social inflation?

Social inflation drives higher insurer claim payouts and loss ratios, notes I.I.I. Ultimately, policyholders pay more for coverage. A simple way to think about social inflation and its components is to compare the impact of these factors on claims losses over time with growth in an inflation measure like the Consumer Price Index (CPI). The insurance lines

continued on next page

Buyer's Market for D&O in 2023?

A report from Insurance Brokerage USI predicts a softening in the Directors & Officers insurance market this year. "The overall public company D&O marketplace turned even further toward a true buyer's market in the second half of 2022. A softening market should continue, but much of that depends on the extent of the economic slowdown and the pace of inflation. Overall, we anticipate flat to slight premium decreases for D&O liability placements for most insureds with no significant claims."

Commenting on the insurance market in general the report said, "As we enter 2023, a changing insurance market continues to impact coverage, premium, deductibles, and many other factors that are essential to your organization. Although the insurance market for some property and casualty (P&C) lines stabilized in 2022, organizations with below-average risk profiles or exposures to loss in certain

continued on next page

that tend to bear the brunt are commercial auto, professional liability, product liability, and directors and officers liability.

Drivers of Social Inflation

Unlike general economic inflation, which insurers can mitigate using pricing models and loss reserves, social inflation can arise from factors that are difficult to foresee, such as rising costs from:

- increases in the number of outsized jury awards
- legal proceedings that take longer than reasonably expected
- rollbacks in tort reform that overturn statutory limits on non-economic damages.

Considered to be a growing cost of doing business in the insurance industry, social inflation is influenced by negative public sentiment about larger corporations, litigation funding, and tort reform rollbacks at the state legislative level, all of which have increased liability costs. Shifting public perceptions and attitudes may lead jurors to sympathize with plaintiffs when awarding damages. Jurors may also believe the business, or the insurance company, has unlimited financial resources, leading to what's commonly known as "shock" verdicts. These monetary damage awards are much higher than expected based on the evidence presented at trial, often exceeding $10 million.

Emotional appeals to juries by plaintiff's attorneys are nothing new. Neither are class action lawsuits. But the plaintiff's bar has gone to a new level with tactics like third-party litigation funding and litigation lending, the report notes. Funding of lawsuits by international hedge funds and other financial third parties – with no stake in the outcome other than a share of the settlement – has become a $17 billion global industry, according to Swiss Re. Law firm Brown Rudnick sees the industry as even larger, estimating it as a $39 billion global industry in 2019, according to Bloomberg.

What is third-party litigation funding and how does it drive social inflation?

The impact of these and other issues in the legal landscape can be intensified by third-party litigation funding.

Third-party litigation funding (TPLF) is a form of financing for legal expenses in which an investor provides money to attorneys or clients in exchange for a financial stake in the settlement or winnings of a lawsuit or arbitration. This money is often described as a non-recourse loan because it does not have to be repaid to the investor if the legal case is lost or never resolved. Also known as legal financing, legal funding, third-party litigation finance, or alternative litigation financing (ALF), this booming global industry is valued at $17 billion dollars and may expand to $30 billion by 2028, according to a Swiss RE report.

Research shows TPLF can contribute to social inflation by enabling more lengthy litigation, ultimately making insurance coverage more expensive. There are several other aspects of TLPF which can create concerns.

What can be done about social inflation?

Some states have implemented rules requiring disclosure of third-party litigation funding in lawsuits, which would give defense attorneys and juries insight into the entities other than the plaintiff who are financing the legal fees of plaintiff's attorneys. Such efforts predictably meet resistance from third-party litigation funders. In 2020, the 13 largest commercial litigation funders in the world formed the International Legal Finance Association (ILFA) to advocate for litigation funding and oppose blanket disclosure requirements.

More frequent lawsuits and costlier jury verdicts can lead to increased insurance costs as rates are adjusted to reflect the changing risk profile. It can even force insurers to stop writing certain forms of coverage. Higher claim costs tend to be passed along to policyholders in the form of higher premiums. In extreme cases, climbing claim costs can ripple through the entire economy, creating conditions analogous to the 1980s liability crisis, where liability claims were adversely impacting the U.S. insurance industry to the point where some insurers faced insolvency.

This Just In

states or industries faced severe upward rate pressure." In other words, underwriting controls were more stringent and pricing could be higher for less-than-ideal risks.

"In addition to the universal and ever-present need to effectively manage risk, several other challenges are affecting virtually all insureds across all insurance lines. In late 2022, Hurricane Ian had and will continue to have an extreme effect on the insurance industry with many insurers expected to pay out billions in losses. The impact of Ian, as well as continued severe weather events, supply chain challenges, an increased focused on ESG risks and inflationary pressures will continue to affect market capacity, available coverage and premium costs. These factors reinforce the need for a comprehensive risk management strategy."

What is D&O Coverage

Decisions made by the boards of private companies are not immune from public scrutiny. Securityholders, employees, customers, suppliers, competitors, and even the government can sue a privately-owned company and its board of directors.

Additionally, as leaders of the company, the directors and officers can be found personally liable for their management decisions.

D&O policies will pay legal defense costs and settlements for directors' and officers' personal liability for actual or alleged "wrongful acts" committed in the course of their official duties. Policy definitions vary, but "wrongful acts" usually include actual or alleged acts, errors, omissions, neglect or breaches of duty, misstatements or misleading statements. Even if you have D&O coverage, it's important to know what it doesn't cover, so look at details carefully.

- Exclusions. Typically, policies exclude: 1) claims for bodily injury, property damage and personal injury, such as libel, slander and emotional distress. Your general liability policy covers these risks, 2) "prior incidents" and "prior litigation," or incidents reported in earlier coverage periods and litigation begun before the policy period, 3) ERISA liability, which results from administering pension and welfare plans, 4) pollution or environmental impairment liability, and 5) coverage for punitive damages.

Some policies may also specifically exclude securities actions, such as coverage for fraudulent, dishonest or criminal acts. Publicly traded firms buy D&O coverage, in part, to protect directors and officers from these types of claims. If your policy contains these exclusions, you will want to negotiate with your insurer to have them removed.

- Coverage for regulatory actions, such as a regulatory agency investigating the organization for some types of wrongdoing. However, some policies exclude coverage for specific activities, particularly in the financial services field. And some policies might specify coverage for regulatory activities by named agencies.
- "Preclaim" costs. D&O policies traditionally do not cover costs an organization incurs when investigated as a "party of interest" or in an informal inquiry, as opposed to when it is the target of an investigation. Some insurers now offer coverage for preclaim costs in certain situations.
- Securities suits brought outside the U.S. Will your policy cover investigation and defense costs incurred in a foreign jurisdiction, as well as any potential settlements? This coverage could prove important to multinational firms, as other countries beef up their securities regulation.
- Advancement of loss. Whether a policy actually covers a claim can remain undecided until the case is resolved. For example, many

continued on next page

claims against directors and officers allege fraud, which many policies exclude. Meanwhile, defense and investigation costs accrue. If your insurer reimburses insureds for legal defense costs before settlement, it might stipulate that the insured reimburse the insurer if the claim turns out to be uncovered.

- Severability. Wrongful acts can void coverage, so you will want your policy to have a severability clause, which clearly states that the wrongful act of one director or officer will not be imputed to any other director or officer.
- Entity vs. insured exclusion. Older D&O policies often have an "insured vs. insured" exclusion, which excludes coverage for claims brought by one insured against another. This could include suits brought by the corporation against insured directors and officers (or ex-directors and officers), if your policy covers the corporate entity. The newer wording specifically eliminates coverage for suits by the corporate entity against its own officers and directors.
- Coverage for bankruptcies. Chapter 11 filings often trigger shareholder suits against the corporation's directors for breach of duty or fraud. When a company goes into receivership, ownership of the D&O policy and its proceeds can come into question. Entity coverage under the policy can also reduce the limits available to defend directors and officers. Policies can be amended to fix these coverage gaps.

The complexity of claims against directors and officers makes D&O one of the most challenging areas of coverage. Every corporation's situation and policy require individual analysis. We can help you evaluate your risk exposures and coverage needs. Please contact us for more information.

Why You Might Need Surplus Lines Insurance — Even if You're Not a Celebrity.

You've heard of celebrities who buy insurance on signature body parts — Keith Richard's middle finger ($1.6 million), Dolly Parton's Breasts ($3.8 million), Jennifer Lopez's butt ($27 million) and Mariah Carey's legs ($1 billion).

These transactions take place in what's called the surplus lines market. Lloyd's of London (pictured here) is the most famous entity making transactions in this market. But your business may also need to access the surplus lines market at some point.

According to the Wholesale & Specialty Insurance Association (WSIA), specialty and surplus lines companies are often called the "safety valve" of the insurance industry. They fill the need for coverage in the marketplace by insuring those risks that are declined by the standard underwriting and pricing processes of admitted insurance carriers. With the ability to accommodate a wide variety of risks, the wholesale, specialty and surplus lines market acts as an effective supplement to the admitted market.

Surplus lines premium volume was over $24 billion with more than 2.6 million transactions through June 2021, an increase of 21.9% for premium and 7.2% for transactions year over year, according to the U.S. Surplus Lines Service and Stamping offices. These numbers represent a vast number of insureds who, without the surplus lines market, would have a difficult time obtaining insurance, if they were able to secure it at all.

The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity (i.e., high limit) risks. Surplus lines insurers are able to cover unique and hard-to-place risks because, as non-admitted insurers, they can react to market changes and accommodate the unique needs of insureds who are unable to obtain coverage from admitted carriers.

This results in cost-effective solutions for consumers that are not "one size fits all," but are skillfully tailored to meet specific needs for non-standard risks.

Risks typically written in the surplus lines market fall into three basic categories:

1 non-standard risks, which have unusual

continued on next page

underwriting characteristics;

2 unique risks for which admitted carriers do not offer a filed policy form or rate; and

3 capacity risks where an insured seeks a higher level of coverage than most insurers are willing to provide.

Although surplus lines insurers are "non-admitted," that does not mean they lack regulation. Each surplus lines insurer must be admitted (licensed) in one of the 50 states and must meet that state's financial solvency requirements. The state of domicile becomes that insurer's regulator.

Surplus lines companies are able to offer special coverages because they are largely free of rate and form restrictions that make it difficult for standard companies to write the risk. Their flexibility allows them to design policies that meet unique customer needs.

Talk to Us

Sometimes a small change in your business strategy creates a need to access the surplus lines market. For instance, if a contractor installs kitchen cabinets in rental apartment buildings, he probably buys liability coverage in the standard market. However, if he takes a similar job for condominiums, he may need surplus lines liability coverage. Why? Because his potential liability is greater. If there were a construction defect, the contractor could be sued by each condo owner, rather than just one building owner.

If your business activity has changed, give us a quick call, and we'll let you know if we need to make any adjustments in your insurance program.

Common Misconceptions about Directors and Officers insurance.

One of the major misconceptions about Directors and Officers insurance is that it's only for publicly traded companies or non-profits. Chubb Insurance recently addressed this and other misconceptions:

D&O is unnecessary because your business is privately-owned. Privately-owned companies face virtually the same exposures as publicly traded companies, but private company D&O policies can insure much more than securities litigation.

We don't need D&O insurance because our business is family owned.
Family driven lawsuits can be more contentious and expensive to defend given their personal nature and the fear of exposure to the public.

If my company is sued, the cost to defend the lawsuit will be minimal.
Legal expenses and average settlements have risen significantly over the past 10 years. D&O insurance shields balance sheets and personal assets from expensive litigation costs.

I have D&O coverage under other commercial or personal insurance policies.

There may be limited coverage on other insurance policies, but a dedicated D&O policy can provide a broader breadth of coverage tailored to meet your company's specific needs.