Market Review: Executive Risk

An update for Alternative Asset Managers

Insurance markets are cyclical. After several years of very competitive pricing and coverage terms as well as an abundance of market capacity, 2019 was the beginning of a shift in the marketplace with carriers seeking rate increases on executive risks with no real changes in operating exposure. This trend continued into 2020 and has now been exacerbated because of COVID-19 and the ongoing pandemic. With the insurance industry still trying to understand the financial impact of the virus; increased losses coupled with poor investment performance has driven insurance carriers to re-evaluate their underwriting guidelines in a number of areas. Moreover, for specific lines of coverage and some industry specific classes, the shift has been more dramatic.

Public company Directors and Officers Liability Insurance ("D&O"), private company D&O and companies in the Energy, Oil & Gas, Hospitality and Retail/Restaurant sectors are seeing the worst of this new market trend with primary carriers looking for 20%-40%+ premium increases at renewal. While this difficult insurance market cycle is impacting the entire P&C sector, not all lines of business or industry segments are experiencing rate changes to the same degree. Alternative Asset Managers for example, are seeing rate increases on average in the range of 10%-20% and underwriting criteria remains in line with their specific business structure, investment strategy and investment performance.

Factors Impacting the Market

In Q3 of 2019, the insurance marketplace began adjusting to correct for deteriorating underwriting results and depressed premiums. These conditions were due in part to a plethora of competition and the influx of new niche insurance carriers which helped drive down premium rates and expand coverage terms. This competition was further supported by positive investment returns and controlled losses for a period of time.

Increased Market Capacity, Positive Investment Returns, Positive Loss Ratios, Lower Premiums = **Soft Market**

Reduced Market Capacity, Poor Investment Returns, Negative Loss Ratios, Rising Premiums = **Hard Market**

Public company commercial D&O insurance has experienced the most pronounced impact of the hardening market given the continued increase in securities class action lawsuits and regulatory scrutiny.

Major Global multi-line insurance companies, who underwrite many lines of coverage from Property and Casualty to D&O risks in a multitude of industry segments, are more sensitive to systemic risk and large catastrophic losses. When losses happen in certain areas of their business; they have a way of trickling down and impacting rates in other areas. For example, insurance companies may adjust rates across their entire executive risk book of business to help offset the losses experienced in other lines of coverage.

ADDITIONAL KEY FACTORS IMPACTING THE MARKET:

- Taken as a whole, top D&O insurers' underwriting results are deteriorating. This means that these insurers are generally not making an underwriting profit and must look to investment returns for their profits.
- Insurers are currently making significantly lower investment returns.
- Increased regulatory/legislative activity and shareholder activism.
- Increased frequency in security class actions.
- COVID-19 pandemic and potential catastrophic losses.
- Event Driven Litigation: Increase in claim frequency/severity is expected.

EPIC Alternative Asset Management Services

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What to Expect and How to Plan For It

Although insurance capacity remains generally available; some insurers are reducing exposure by lowering limits, tightening underwriting standards, and narrowing coverage terms. All Alternative Asset Managers should be prepared for increased scrutiny and underwriting questions — especially questions related to COVID-19.

- How has/will COVID-19 impact the Alternative Asset Manager's funding commitments, employees, portfolio companies (including those companies that require additional funding) and transactions?
- Has the Alternative Asset Manager stress tested its portfolio?
- Are any portfolio companies at risk of debt covenant breaches or bankruptcy?
- Has the Alternative Asset Manager utilized dividend recapitalizations, etc.?

Insurers on excess program layers continue to increase their rate on line (ROL) factor subsequently resulting in premium increases that move up the insurance tower. Additionally, to be more in line with their underwriting guidelines, insurers are pushing for higher retentions in situations where they feel they previously acquiesced and offered lower retentions than normal.

Given the new workforce challenges, it is imperative to allow for more time as insurers are moving slower and have become hesitant in the new post COVID-19 underwriting environment.

EXPECTED PREMIUM INCREASES

- Private Equity firms primary layer premiums are seeing an average increase of 10%-20%.
- Hedge Funds and Venture Capital firms are less affected by the current market conditions with average premium increases of 10%-15%.
- Certain industries are facing even stricter underwriting and while subject to change, there is currently an overall lack of interest from "new" carriers to participate on programs. More specifically, Alternative Asset Managers investing in the following industries are likely to see 20%-40% primary premium increases and limited insurer appetite:
    - Energy
    - Healthcare
    - Hospitality/Tourism
    - Real Estate/Development/Rental
    - Retail/Restaurants

For **Portfolio Companies**, carriers are extremely focused on potential bankruptcies which has driven a focus on reducing capacity and narrowing available coverage in some cases (e.g. preset runoff terms, removing the additional Side A limit, etc.).

As always, we will continue to keep all of our clients, business partners and friends abreast of the changing market conditions.