EPIC
Alternative Asset Management Services

Market Review: Executive Risk

An update for Alternative Asset Managers // SECOND EDITION

The Executive Risk insurance market has been steadily firming since the middle of 2019. Nearly all Executive Risk products (e.g., Directors and Officers (D&O), Employment Practices Liability (EPL), Fiduciary, and Crime) are feeling the impact, with other industry verticals and product lines experiencing the effects to a greater degree. The Executive Risk market has undergone even more transformation since our previous Executive Risk Market review in May due to the unexpected and unprecedented risk, economic uncertainty, legal environment, social change and corporate transformation caused by the pandemic. All these factors, coupled with insurance companies increased losses due to poor investment performance and sub-par underwriting results from prior years, are contributing to the **hardening market**.

Significant premium increases are being seen on all products, in all industry verticals, regardless of business size or geography. D&O rates jumped 44 percent in the first quarter of 2020, according to an A.M. Best report, that also warned of possible triple digit rate increases in the future. Alternative asset managers will experience a hardening market for the rest of 2020 and into 2021.

Economic and Legal Uncertainty

Earlier this year, EPIC's Executive Risk Market Review highlighted these additional key factors impacting the market:

- Increased regulatory/legislative activity and shareholder activism
- Increased frequency in securities class action lawsuits
- Event Driven Litigation: Increase in claim frequency/severity is expected

These factors have held true as the year has progressed; creating an undesirable legal environment accelerating the hardening market. For example:

- Experts claim there are currently up to 16 "COVID-19 related" ongoing security class action lawsuits
- Companies are being more proactive in their communications with investors which in turn can open the door for potential unintentional misrepresentations

The onset of COVID-19 brought predictions that the pandemic would cause a wave of bankruptcies across many industries. This prediction has largely been true as 424 U.S. companies have gone bankrupt through August 9th, surpassing the number of filings during any period since 2010, according to S&P Global. Retailers and energy companies have been hit the hardest and a "second wave" could have a devastating effect on the travel, hospitality and transportation industries.

Experts are predicting another wave of U.S. bankruptcies for the latter half of 2020 and are on track to hit a 10 year high. This will likely lead to an increase in the number of bankruptcy-related litigation claims against directors and officers of the bankrupt companies, which in turn could lead to increased claims activity and increased losses under the companies' D&O insurance policies.

Market Reaction

Many carriers are significantly cutting back on capacity; reducing limits or shying away from primary or low excess positions on large tower programs. For example, insurers that previously offered $20 million in capacity are reducing the amount offered to $10 million and cutting $10 million limits to $5 million. Furthermore, some carriers have issued a moratorium, stopped writing new business or are pulling away from specific industry classes, such as retail, hospitality and transportation.

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Most insurers have introduced COVID-Questionnaires for policyholders to complete at renewal or in connection with a new business application. The questions posed relate to the expected impact of the crisis on business operations and financials, business continuity planning, remote work environment and return to office policies. Additionally, many underwriters are being more conservative and detailed in their processes, which has lengthened the underwriting timeline.

Some insurers have introduced broad COVID-19 exclusions or other terms or conditions intended to limit exposure on specific insurance policies. For example, D&O carriers are proposing bankruptcy-related exclusions and trustee/creditor exclusions. Furthermore, carriers offering Employment Practices Liability are tightening terms and conditions related to reduction in force activity and privacy exposures.

D&O excess layer rates are continuing to rise due to increased limit factors so the ultimate increase on the total premium spend is higher than the primary rate increases. Increased limit factors are multiplicative factors that are applied to rates or premiums for "basic" limits of coverage to determine premiums for higher limits of coverage.

Retentions and deductibles are significantly increasing across most classes of business; in some instances, doubling or even tripling.

What does this all mean for Alternative Asset Managers?

For the foreseeable future, the 'new normal' for the Executive Risk lines of business will involve steep price increases, capacity decreases, enhanced underwriting and coverage restrictions. We have revised our estimates to reflect the percentage increases alternative asset managers should expect around renewal time based on the current market conditions.

LINE OF COVERAGE	PERCENT CHANGE
Private Equity D&O primary layers	+10% - +25%
Private portfolio companies D&O	+15% - +25% with some industries seeing +25%
Hedge Fund and Venture Capital D&O	+10% - +15%
Public company D&O	+25% - +50%
Employment Practices Liability	+5% - +25%

Planning for the 'New Normal'

Alternative asset managers should brace for these new market conditions to effect themselves and their portfolio companies.

In this new underwriting environment, all alternative asset managers should be prepared for increased scrutiny and underwriting questions — especially questions related to COVID-19. AAM's must be prepared to start the renewal process earlier than normal in order to give underwriters and insurers more time.

Insurers will continue to push for higher retentions in situations where they feel they previously acquiesced and offered lower retentions than normal.