Financial lines: Position and trends 2021-2022

A general overview on the Spanish, Italian, German and French insurance markets

Prepared for Alta Signa

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General overview of the European Financial Lines market

After a long period of soft market conditions, in the last couple of years the European Financial Lines market has experienced some significant changes, which led to a phase of transitioning market characterised by:

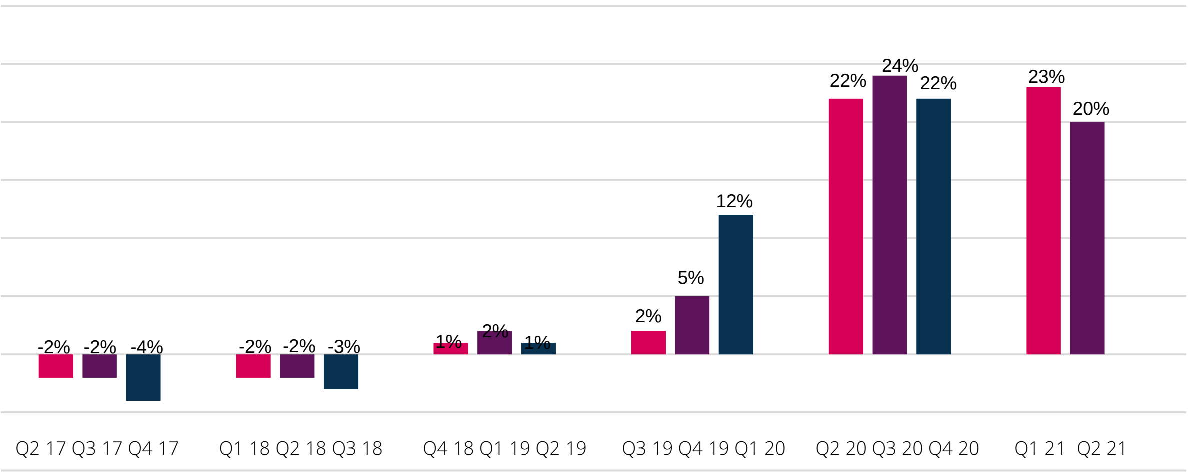
- Significant contractions in capacity and risk appetite.
- Increase in rates and premiums.
- Reduction in the number of provided guarantees.

This trend has undergone a further acceleration with the spread of the Covid 19 pandemic emergency.

According to the quarterly Global Insurance Market Index issued by Marsh for Q2 2021, pricing related to financial and professional lines showed the highest rate of increase among those concerning the main insurance product categories.
In particular, prices for Financial Lines coverages increased by 20%.

In Italy, France and Germany, the average increases in prices for D&O coverages ranged between 10% and over 30%, especially impacting insurance programmes covering distressed business sectors with significant exposure on the U.S. market.

CONTINENTAL EUROPE - Financial Lines price trends



Source: Marsh Specialty and Global Placement (with kind permission from Marsh)

DWF Spain

D&O: Position and trends 2021-2022

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Spanish Market: D&O

Recent position

During recent years, premium increase caused by:

- The continual tightening of the system of responsibility that face Directors & Officers (reform Spanish criminal code, article 236 of Companies Act).
- Important increase in corporate crimes, such as fraud, improper management, misappropriation with considerable media impact.
- Not only for huge organisations, also SMEs.

Other Emerging D&O risks have come to stay long: environmental, social and governance (ESG). (i.e. Pandemic crisis, cases of harassment or discrimination at work).

70-80% of this product is sold through brokers:

- The insured (companies & managers) needs professional and technical advice.
- The insured requires novel and specific coverages.

Legal defense and bail cover represents the highest cost to the insurer.

Spanish Market: D&O

Trends I

Post pandemic crisis + prolonged Record of Temporary Employment Regulation (ERTEs) may be masking an insolvency situation for lots of companies:

- Fast Increase in accident rates and claims.
- “Hard market”, reducing capacity and complicating underwriting for insurers. In some cases, they may decide to exit the business.

Progressive Shift Towards Criminal Liability Coverage:

- Uncertainty over the judgment in the *Abengoa* case although expressly provided for in the policy, guarantee or bail cover could not be used in criminal proceedings to guarantee the civil liability of the accused insured parties of D&O insurance policies in cases in which the company itself could be considered an injured party due to the actions of its administrators and directors.

D&O insurance used as an Alternative Solvency Instrument:

- Increasingly used as an alternative solvency instrument for certain financial intermediaries, such as closed collective investment institution management companies (sociedades gestoras de entidades de inversión colectiva de tipo cerrado) (SGEIC) and investment companies (sociedad gestionar de instituciones de inversion colectiva) (SGIIC).

Spanish Market: D&O

Trends II

Increased Litigation deriving from “new” risks.

- The pandemic has introduced factors that will have an impact on companies and their D&O liability, such as dramatic revenue and profit losses, business interruption coverage (or lack of it), government measures like ERTEs causing delayed decision-making, bankruptcy proceedings and increasingly challenging regulations: lead to an arrival of claims against companies and their directors and officers as the economy and businesses reopen.
- Societal and cultural pressures have manifested in movements like #MeToo which brought the subject of harassment and abuse to the forefront of public and media. Eventual liability derived from a lack of adequate actions to promote a culture against sexism, a lack of diversity, racism and bullying. BoD are expected to set the tone and a toxic culture could be a driver for D&O claims mitigate environmental and climate risks.
- Cyber security threats are constantly evolving.: data breaches (RGPD), cyber and ransomware attacks.
- The increase of Mergers & Acquisitions.

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Financial lines trends in Italy

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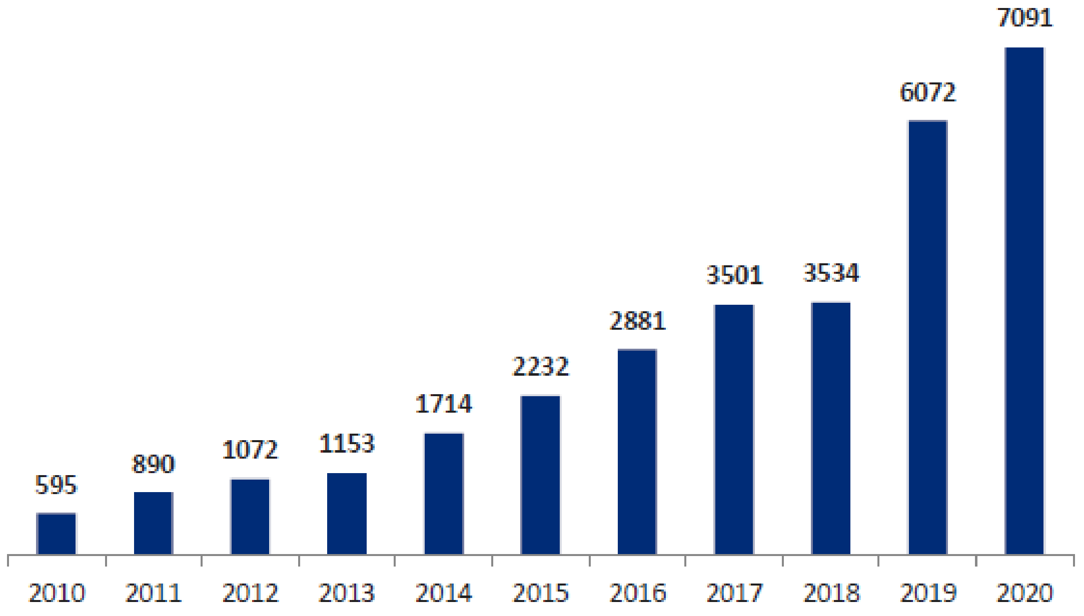
The Italian Financial Lines market: current trends

Since 2019 the Italian market has experienced a contraction in the capacity provided, as well as a sharp increase in rates and a tightening in the types of coverages granted under D&O/PI policies.

The main reasons for this trend are:

- A continuous increase in claims, with particularly unfavourable loss ratios (over 100%) against earned premiums constantly below the technical trends.
- The reduction of market players and the small number of insurers providing efficient international programmes, as well as the closing of many Lloyd's syndicates previously operating on the Italian market (especially in the Financial Institutions or Professional Indemnity areas).
- Strategic decisions by Insurers' headquarters to reduce capacity and focus on portfolio profitability.

Claims notified between 2010 - 2020



Source: Market survey - Marsh Italia 2020 (with kind permission from Marsh)

D&O Insurance market in Italy

The Italian current legislation provides for:

- Stricter legal requirements to be met by corporate directors, statutory and executive managers.
- A wider range of responsibilities that these subjects must take on when serving their offices, which in turn translate into a significant increase of their exposure to the risk of being targeted by third-party claims for damages.

Despite rising claim frequency and severity, the D&O industry has laboured under a persistent and deepening soft market for well over a decade before seeing some recent hardening.

In the next years we may face the risk of catastrophic losses for possible post-Covid 19 D&O claims related to the management of the emergency and its impact on companies' bottom line.

The impact of Covid 19

According to Marsh Global Analytics latest studies, Covid 19 has already had significant consequences on the Financial Lines Italian market:

- Increase in claims and notification of circumstances that may cause a claim.
- Failure to renew coverage.
- Introduction of questionnaires dedicated to the management of the crisis and the operations of companies during the pandemic.
- Increasingly restrictive coverage or no coverage for companies belonging to the most exposed sectors, such as, for example, hotels, tourism and transport.
- Further restrictions in assessing Employment Practice Liability extensions.

However, according to experts, most of the negative effects of the pandemic in terms of increase of Financial Lines insurance claims are yet to come in the next years.

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Financial lines trends in Germany

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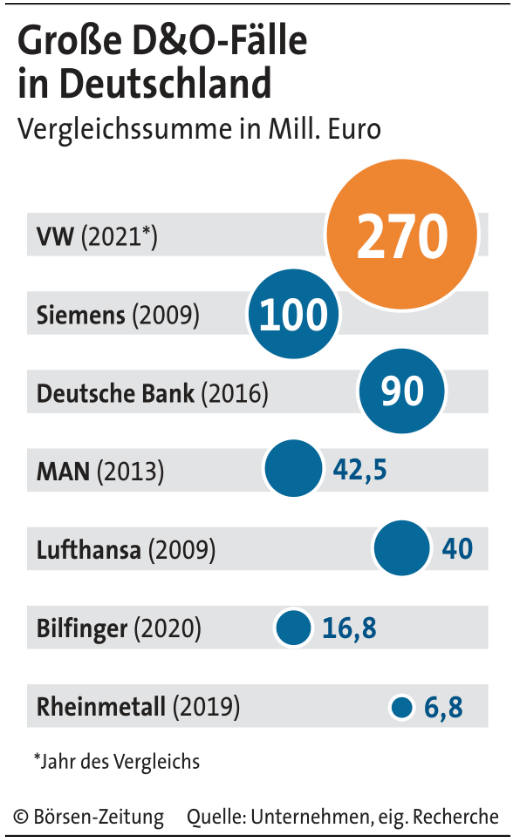
Current developments

Rising risks

Germany is said to be a country with the most D&O claims across the globe

Both the number of claims, and the amount in dispute per case is rising.

Indeed, this year we had the biggest settlement in Germany ever concerning "Diesel-gate" (see box to the right).



Post Covid Insolvency risks

Prediction: Insolvency claims against managers will surge

German law makers have eased strict insolvency requirements, if the insolvency is only triggered by pandemic influences.

The rules are difficult to oversee:

- The rules have changed rapidly.
- What does ‘pandemic influence only’ mean?
- What is the general commercial reason for going bust?
- State aid programmes will end – more insolvency proceedings are predicted; there may be more cases for CEOs to fail applications for insolvency proceedings in due time.

Recent German Federal Court-Ruling: If the D&O policy is silent on insolvency claims, these are covered.

- Insurance coverage is in place unless insolvency claims are explicitly excluded!

Continued cyber risks / cyber attacks

Prediction: We shall still see large-scale internet fraud

In our practice we recently saw 2 cases with damages each of over €1m.

- Fraudsters contacted employee with false emails.
- Employee prepared bank transfer instruction for CEO and money was paid out and lost.

Also for noting:

- Home office working could make it even easier for fraudsters because employees at home do not go to a colleague for a second view.
- New programmes available for identifying fraud emails/emails from unknown senders.
- Worth thinking to make certain programmes mandatory in contract wording.

The next big thing?

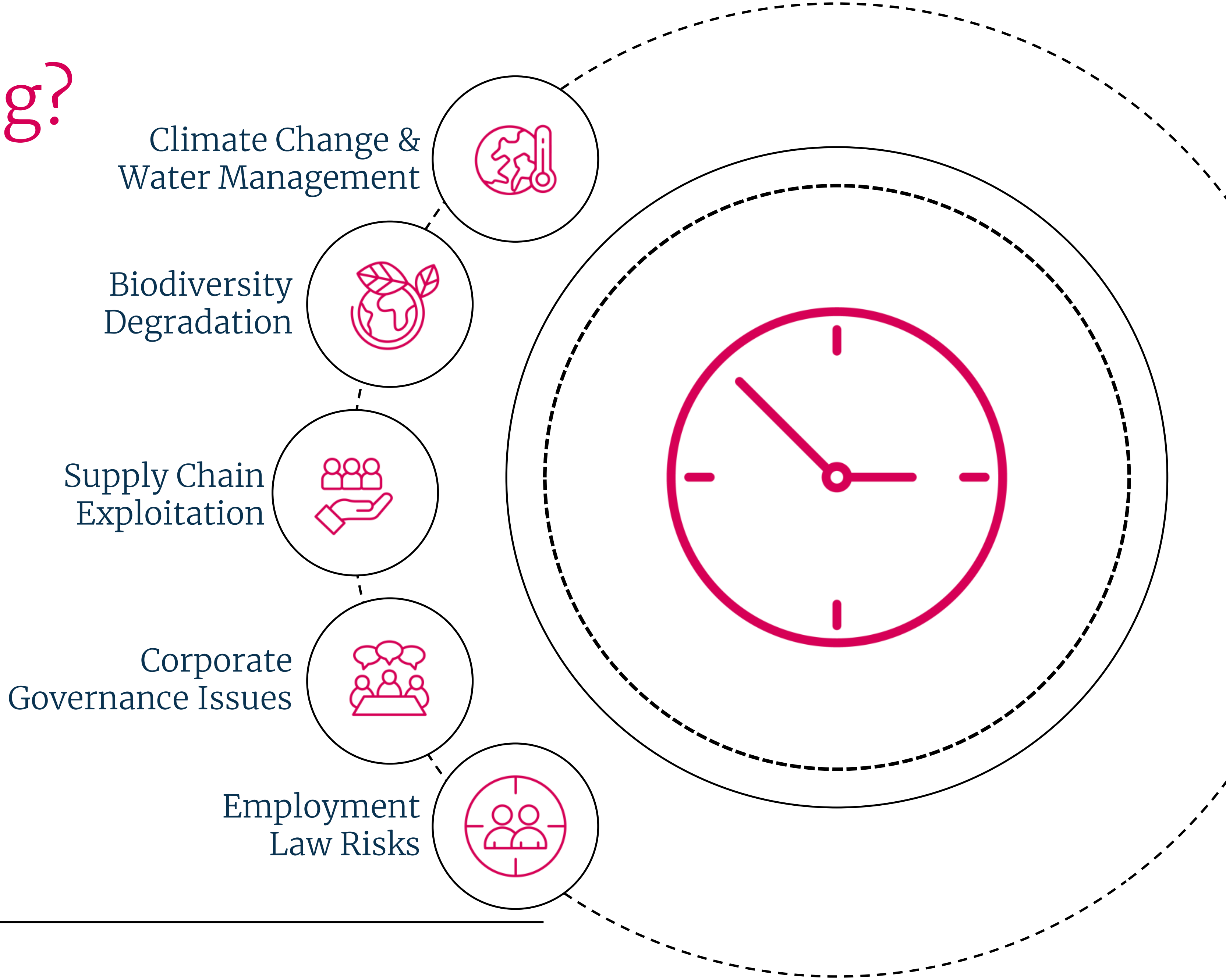
ESG

Increasingly D&O claims are likely to be driven by environmental, social and governance (ESG) factors, which have the potential to substantially impact the reputation of a company

These currently only have a low impact in Germany. German law for damages requires exact proof of causation. Claims connected to climate change are rather unlikely because causation difficult to trace back to one certain company.

Employment law risks

In employment law we expect to see more “job description hoppers”: These are people who apply for a job just intending to sue the company, alleging that rejection happened only because they are old or disabled.



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Financial lines trends in France

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Financial Lines Insurance Market

1. D&O Insurance market in France.
2. PI Insurance market in France.
3. Cyber risks Insurance market in France.

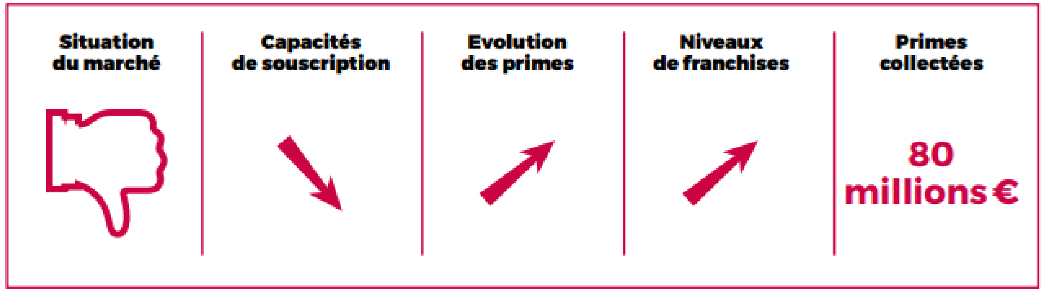
"The market is extremely tough, it hasn't been this tight since 2001 and 2002"

Léopold Larios de Pina, Vice-President of AMRAE (i.e. association of France's risk managers)

D&O Insurance market in France

- After 2 years of drastic capacities reduction, specialists no longer anticipate any significant capacities reductions.
- Remaining capacities reductions may be offset by the arrival of new entrants, already operational in London, which are gradually setting up structures that will enable them to underwrite through FPS.
- The market is therefore likely to stabilise in 2022 and then begin to decline in 2023, as a result of competition.
- Companies which were the most affected by the Covid-19 crisis (i.e. hotels, airlines, travel agencies, residential leisure, airports, etc.) have a lot of difficulty taking out new policies.

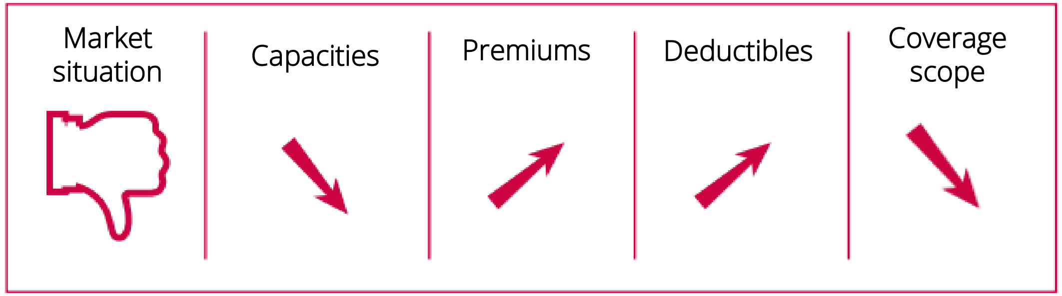
- Capacities are still decreasing due to the lack of risk appetite.
- Coverage scope is identical.
- Premiums are increasing from 10-50%.
- Deductibles are increasing from 10-50%.



In a case dated 25 November 2020, the French Supreme Court held that, contrary to previous case law, the criminal exposure of the company which merges with another one therefore survives the merger operation and is transferred to the new holding (French Supreme Court, 25 November 2020, No 18-86.955).

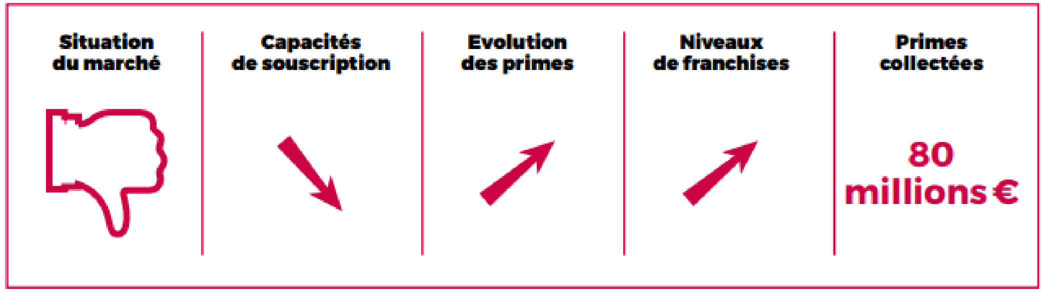
PI Insurance market in France

- The market remains tight and no change is in sight in the continental market for the January 2022 renewals.
- The upward curve could stabilise between the next 12 and 24 months.
- Capacities have decreased after July 2021 from 10-30%.
- The coverage scope has reduced.
- Premiums have increased from 20-30%. One way to decrease premiums is through the use of captive insurance companies. An amendment to the draft Finance Act 2022 could review the tax framework for captives.
- Deductibles have increased by 20-50%.



Cyber risks

- In 2020, almost 50% of companies were targeted by a cyber attack.
- 80% of cyber attacks are ransomware attacks.
- Ransom amounts vary according to the size of the company. Small and medium-sized companies are targeted in a more industrial way with ransoms ranging from several thousand euros to several hundred thousand euros. These amounts can be much higher for large companies (i.e. from one to several tens of millions of euros).
- A recent parliamentary report dated 15 October 2021 recommends to legally ban the payment of cyber ransoms (https://1c578dc4-8f40-4040-88fe-b4d1f38eac50.filesusr.com/ugd/50f22c_361ca4c49de74364b3ff2058441fd0a7.pdf).
- Strong capacities reduction after July 2021 (i.e. more than 50%).
- The scope of coverage is reducing, especially with regards to ransomware attacks.
- Premiums have increased by more than 100%. Specialists expect rates to continue rising in 2022.
- Deductibles have doubled. Primary insurers are increasingly rare; this allows them to drastically increase deductibles (especially on large companies).



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