PRIVATE MANAGEMENT LIABILITY MARKET UPDATE

SECOND QUARTER 2024

Contact your local RT ProExec Broker at RTSpecialty.com

The management liability market for private companies can generally be categorized as competitive. Capacity has increased (carriers are more active in the marketplace), and as such, rates have fallen. With the right strategy, companies can leverage the current market to secure robust coverage and favorable terms and conditions.

MANAGEMENT LIABILITY RATES AND CAPACITY

The private management liability market began to soften in early 2023 – a welcome change to clients after the steep increases that took hold back in 2020. Newer entrants are deploying additional capacity which has helped create a more competitive environment. Unlike previous years, incumbent carriers have been seeking flat renewals (per expiring), and accounts with a clean claims' history and a strong financial position are often able to obtain premium decreases.

Although prices are trending flat-to-downward, insurers are not offering discounted rates on all accounts. Those with high-risk exposures or a history of claims will continue to have a more challenging time securing favorable pricing.

While insurance carriers may be willing to offer lower prices and broader coverage to avoid losing business, they remain wary of rising claims. Both economic and social inflation have resulted in greater claim severity. According to Swiss Re, U.S. liability claims costs have risen by 16% on average over the past five years.

ECONOMIC FACTORS COULD SPELL TROUBLE

Macroeconomic concerns impact the private management liability market. For example, rising interest rates create obstacles for companies looking to raise funds. According to The Wall Street Journal, rising loan costs are especially problematic for financially stressed companies. Investors worry that a wave of bank loan defaults could be on the horizon.

For many development-stage and emerging technology companies, the IPO market has historically been a logical next step for funding growth. Unfortunately, the IPO market, has been experiencing a noticeable slump the past two years. According to Ernst & Young, the number of IPOs surged to 416 in 2021 (up from 224 in 2020) before plummeting to 90 in 2022. In 2023, the number of IPOs rose to 128, but this is still far below 2021, 2020, and even 2019 numbers. IPO proceeds have followed a similar pattern – rising from $86.2 billion in 2020 to $155.8 billion in 2021 before crashing to $8.6 billion in 2022 and then recovering slightly to $22.6 billion in 2023.

Taken together, higher interest rates and reduced IPO activity could spell trouble for private companies that need capital to grow. If a company can't secure funds through an affordable loan or IPO, bankruptcy looms as a real possibility. Indeed, bankruptcies for small private companies are on the rise. S&P Global says bankruptcy filings by private equity and venture capital-backed companies increased from 38 in 2022 to 104 in 2023, a new record. Bankruptcy filings by companies that are not private equity and venture capital backed also increased – from 334 in 2022 to 538 in 2023.

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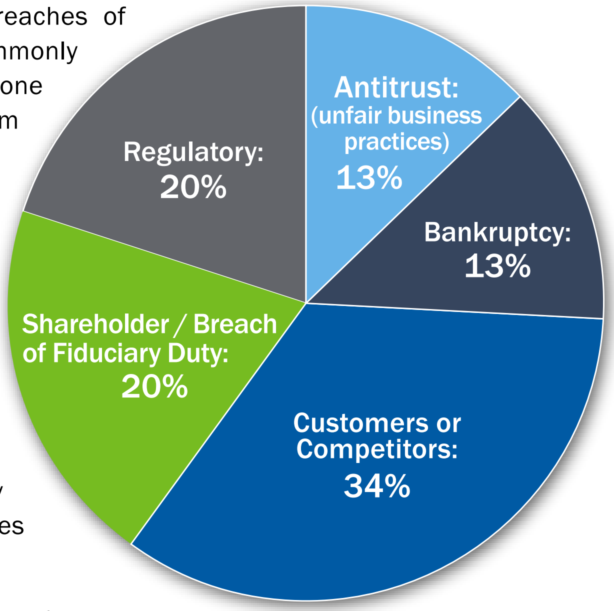
PRIVATE COMPANIES FACE RISKS TYPICALLY ASSOCIATED WITH PUBLIC COMPANIES

AIG analyzed private company D&O claims data from 2016 through 2020 to assess claim drivers and trends. Interestingly, the report shows that regulatory actions, which are generally assumed to be a problem for public companies, can also impact private companies. In one example, a company's founder and former CEO was accused of entering a quid pro quo relationship with a state government official.

Private companies can face claims involving shareholder complaints and alleged breaches of fiduciary duty, types of claims more commonly associated with public companies. In one example of a breach of fiduciary duty claim against a private company, a lender sued a private company's board alleging a breach of fiduciary duties in connection with the refinancing of a loan.

Private D&O Claims



"Antitrust" is the shorthand used by D&O underwriters for claims alleging unfair business practices. Antitrust and bankruptcy claims are infrequent but severe. Such claims accounted for a combined 26% of private company D&O cases, however these two categories accounted for 37% of paid losses.

Below are the average claims payments by category, according to the AIG study:

- Antitrust: $7,142,900
- Bankruptcy: $3,713,020
- Customers / Competitors: $2,695,191
- Regulatory: $2,882,325
- Shareholder / Breach of Fiduciary Duty: $4,324,326

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TIPS FOR MAKING THE MOST OF THE CURRENT CONDITIONS

The favorable conditions of 2023 were a welcome relief for many clients. However, the months ahead could also bring new risks and less favorable conditions. Private companies with funding issues or high-risk exposures could face a particularly challenging market. It's important to be prepared for anything. Below are some observations from our Private Management Liability brokers:

- This is a good opportunity to seek broader coverage terms. In a "buyer's market, policyholders may succeed in obtaining broader coverage through the negotiation of enhancement endorsements from carriers.
- Excess coverage continues to be very competitive with a downward pricing trend.
- Private company D&O is a subset of the wider D&O marketplace and is impacted by overall profitability within the sector. In other words, the soft market won't last forever. D&O losses can take time to materialize. The trends we are already seeing – such as higher bankruptcies and securities class action filings –eventually lead to higher losses and pave the way for a return to a "harder" market.
- Going forward, some lines of coverage will likely be more favorable than others. While D&O rates are declining, standalone EPLI may be a more challenging market in high-exposure areas such as California.
- Even in a softer market, loss history remains an important factor on renewal negotiations. Certain exposures continue to be considered risky, such as employee stock ownership plans (ESOPs) and organizations in the healthcare, cryptocurrency and cannabis segments.
- While it is beneficial to have additional capacity fostering competition in the marketplace, it is important to choose carriers wisely. Understanding a carrier's financial rating, expertise and claims handling experience is an important part of the equation.