2022 Management and Professional Liability Market Outlook

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After a couple of challenging years, the Management Liability (ML) and Professional Liability (PL) insurance markets appear to have turned a corner. While that doesn't necessarily mean smooth sailing across every class of business or coverage line, there are reasons to be cautiously optimistic about the prospects for these markets in 2022.

Tough but stable are the words that Manny Cho, executive vice president, Executive Lines, at Risk Placement Services (RPS), uses when asked to describe the current state of these markets.

"In the latter part of 2021, we saw all the classic signs that a challenging market was in its final stages," said Cho. "New entrants, both insurance companies and managing general agents (MGAs), came into most ML and PL markets. And while capacity and limits may continue to tighten, it won't be to the same degree that we saw during the height of COVID."

Indeed, it seems that the COVID-19 cloud may start to lift from these markets in 2022, with regard to policy terms and conditions. However, the uncertainty around pandemic-related claims and litigation, which have haunted the ML and PL markets since March 2020, remains.

Approximately 4,500 COVID-19 workplace-related class action lawsuits were filed between January 2020 and mid-February 2022. More than one-quarter of these cases are based in California.

Healthcare, retail, hospitality and manufacturing are among the most vulnerable classes of business.

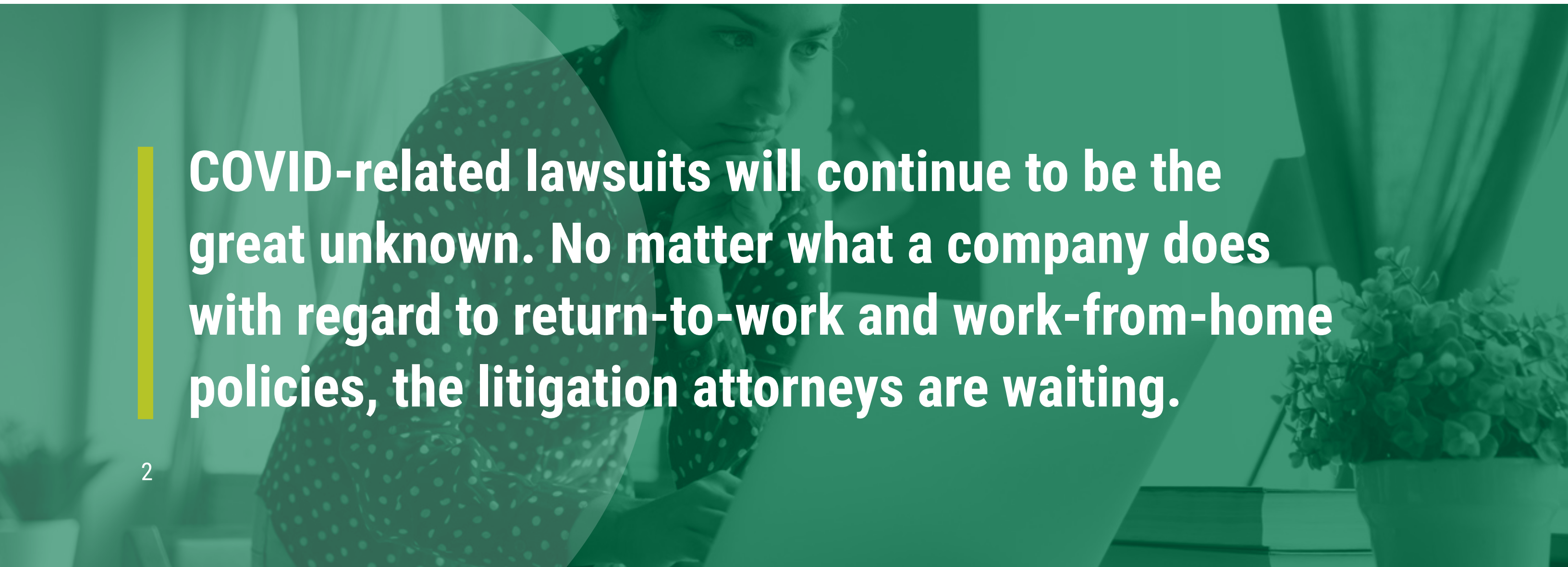
"COVID-related lawsuits will continue to be the great unknown," Cho observed. "No matter what a company does with regard to return-to-office and work-from-home policies, the litigation attorneys are waiting."

With many ML and PL markets having experienced double-digit rate increases in 2021, Cho said the market has "right sized" with regard to premiums. Insurance companies will be more aggressive in the classes of business where they want to grow.

Overall, insureds that are a good risk can anticipate rate increases in the 5%–10% range in 2022, though Cho cautioned that renewals experienced in Q1 and renewals in Q2 may be higher.

And there will be outliers, such as Private Company Directors and Officers (D&O) liability insurance and Fiduciary liability for defined contribution plans with $100 million in assets or greater.

One unfavorable market trend that will continue in 2022 is restrictive policy limits. With $5 million the maximum that most insurance companies will offer for the majority of coverage lines, it could take more carriers and layers to reach an insured's desired coverage level. This will be especially challenging in industries where individuals or companies are contractually obligated to carry a large limit of PL coverage.



CYBER LIABILITY

While cyber liability is neither a ML nor a PL policy, it is imperative that retail agents consider their client's cyber coverage, especially for those involved in professional services, such as consulting and legal services, where the insured could be housing client's proprietary information, personal data and/or assets.

"Was it a privacy or security breach (cyber loss) when the client's proprietary data was hacked from a professional services firm's network?" Cho asked. "Or was it a professional services breach? That's the grey area."

The fiduciary liability market also faces this issue.

"Claims that trigger both a fiduciary liability and a cyber liability policy create their own challenges," said Jack Rosen, area assistant vice president at RPS. "If policies are silent on these matters, or they are not properly addressed, it will be up to the courts to see how coverage applies."

Another area of concern is ensuring retirement plans qualify as insured's on the plan sponsor's cyber liability program.

"Does a retirement plan meet a cyber policy's definition of a subsidiary if it's not being scheduled as an insured?" Rosen questioned.

As market demand for cyber liability coverage grew, ML carriers considered adding cyber to their coverage bundle. However, the uptick in the frequency and severity of claims, which began in 2020, particularly those related to ransomware, caused them to change course.

Technology Errors and Omissions (E&O) coverage does include broad cyber coverage, similar to what is available in a standalone policy. Many Lawyers Professional Liability (LPL) coverages now include coverage related to data breach.

Carriers are introducing 30%-150% premium increases, and sometimes higher, as one of many measures to solidify loss ratios for standalone cyber insurance. Insureds should anticipate large increases in their retentions. Business Interruption coverage may be sublimited or even excluded.

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In the Excess and Surplus (E&S) market, some insurance companies may stop writing new cyber business in 2022.

For those that remain in the market, their cyber underwriting process has become more strategic with questions for insureds that reflect current cyber exposures. Network security questions will typically include topics such as:

- Data backup, segregation, testing and recovery
- Storage of biometric information for companies that use fingerprint scans
- IT vendor vetting process and management controls
- Employee cybersecurity training
- Remote desktop protocol (RDP)
- Endpoint detection and response (EDR)
- Email security
- Log-in security and user authentication

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FIDUCIARY LIABILITY

Rosen believes fiduciary liability is a misunderstood management exposure and has been for years.

"Plan sponsors and trustees think they're covered by their organization's D&O or EPL policy," he said. "Yet almost all of those policies have an ERISA exclusion. They don't realize their personal assets are on the line in the event of a claim."

Until recently, fiduciary was a "throw-in coverage," part of a ML package along with D&O and EPL, Rosen explained. And for the least-risky segment of the market, qualified retirement plans with less than $50 million, it still is.

The small end of the market will also see the smallest premium rate increases in 2022, ranging from flat to 10%. A larger plan, with a clean claims history, will be in the 10%–50% range while those with a less pristine track record could be looking at 100% in 2022.

As insurance companies exit the fiduciary liability market for certain classes, there could be capacity issues in this market in 2022. Plans will also find it harder to obtain their desired limits in the admitted market.

"For fiduciary, you'll need to be best in class to obtain a $10 million primary limit," Rosen stated. "And plan sponsors may have trouble building towers in increments of $10 million."

While larger plans with more than $100 million in assets have borne the brunt of ERISA litigation and claim activity, midsize and even smaller plans aren't necessarily immune.

"At this point most large, qualified plans have been the target of excessive fee litigation," he explained. "So now plaintiff's attorneys are looking for opportunities in the $50–$100 million in assets part of the market, which is considerably larger."

Rosen advised that plan sponsors and trustees take a closer look at their plan's investment options, share classes and record-keeping fees, in accordance with their fiduciary responsibilities. He also recommended that they document their meetings, keep minutes and vote in order to demonstrate that they're actively managing their plan in the best interest of participants.

UNIVERSITIES AND ERISA CLAIMS

For several years, larger 403(b) plans at educational institutions and nonprofit organizations have been an especially troubled part of the fiduciary liability market. Claims typically cite excess plan fees, often stemming from higher-priced, actively managed funds or the use of retail, rather than institutional, share classes.

In one high-profile case, in January 2022, in a unanimous ruling, the U.S. Supreme Court revived a class-action suit brought by Northwestern University employees who participated in the school's retirement plan.

They accused the school of placing high-fee, poor-performing investment options in their 403(b) plan.

"If the fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty," Justice Sonia Sotomayor said in the court's opinion.[2]

PUBLIC COMPANY D&O

The expression, "What a difference a year makes," is a clichéd but accurate way to describe the Public Company D&O market in 2022. After rising by 25%–30% in Q1 2021, premium rate increases consistently fell throughout the remainder of last year, landing in the single-digit range by the end of December.

Rodney Choo, senior vice president RPS, is even more optimistic about the rate outlook for 2022.

"With new capacity leading to greater competition in the Public Company D&O market, rates should continue to ease in 2022," Choo predicted. "Depending on the risk and the size of the program, rate increases should be in the single digits. Well-performing, high-quality risks may be flat or even experience a rate decrease."

In 2022, the Public Company D&O market will continue to improve. Competition may be more muted on the primary layer for most risks. However, greater competition for the excess layers will potentially mitigate any continuing rate pressure on the primary.

There will continue to be challenging sectors, particularly for companies going public as well as for those that trade for over-the-counter (OTC), rather than on an exchange, or micro-cap companies, but at least for the latter, new competition may provide a better environment than has been seen for some time.

"Insurance is an efficient market in terms of capacity," Choo explained. "With new insurers entering the Public D&O market, there is real competition for incumbent players. That may lead to a widening of underwriter appetite to include OTC and micro-cap companies."

One area that will continue to see difficult times are Special Purpose Acquisition Companies (SPACs). Despite some backlash against SPACs, they continue to be a popular alternative to an initial public offering (IPO) for companies looking to go public.

SPACs are not new. What is though, is the sheer number that have occurred in the past few years and the use of private financing to allow them to complete larger and more complex transactions.

GROWTH OF U.S. SPAC ACTIVITY

Year	SPAC IPOs	IPOs	SPAC %
2022	41	52	79%
2021	613	968	63%
2020	248	450	55%
2019	59	213	28%
2018	46	225	20%

Source: SPAC Analytics, accessed February 22, 2022.

SPACs have two years to acquire a private company and take them public via the acquisition (what is referred to as a de-SPAC) or the money raised by the IPO goes back to shareholders. That does not include founder shares, which creates a strong incentive to complete a deal in that window, even if the target company may not be ready to handle the rigors of being public. That, fundamentally, is the risk that is starting to play out in the courts.

"SPACs are a target of the plaintiffs' bar. We saw a large uptick in SPAC-related litigation last year. There was also a shift in the nature of the allegations to more classic fraud actions and a sharp drop in the lag between close of the de-SPAC and time the cases are brought." Choo stated. "Add in enhanced regulatory scrutiny and everything suggests these concerning trends will continue."

Adding to the challenge, is the litigation risk can hit the SPAC, as well as the target company being acquired. This raises complex insurance issues, as there are cases that implicate three policies—the SPAC runoff, the private company runoff and the go-forward public company program. In these situations, how the D&O programs were structured to work together is critical.

Another market trend that Choo has observed is push back on defense counsel fee inflation. D&O policies cover "reasonable" defense costs, which leaves room for interpretation.

"I encourage companies to manage their legal fees in the same manner that they manage other vendor costs."

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PRIVATE COMPANY D&O

After a tumultuous two years for the Private Company D&O market, it appears a return to normal is finally on the horizon and a flurry of new entrants provide stability once again.

Amidst 2020 uncertainty, insurance companies entirely lost their appetite for classes of business seen as high exposure during the lockdowns, such as restaurants and hospitality. Reactions ranged from a complete pause on all underwriting to muted terms with restrictive conditions and premiums significantly higher than pre-pandemic, despite a clean loss history. In California, a notoriously plaintiff-friendly state, insureds faced renewals with a 50%–100% rate increase.

Historically, standalone D&O policies always provided full prior acts, barring a recent acquisition (change in control) or exceedingly poor loss history. However, during the pandemic, Bryan Dobes, area senior vice president at RPS, reported that he saw more than a fivefold increase in quotes issued with a prior acts exclusion.

“There was so much uncertainty and fear, carriers assumed the worst-case scenarios and stripped all continuity of coverage for what would have previously been minor underwriting concerns,” said Dobes.

These underwriting exclusions were part of an overall trend toward tighter underwriting standards in the face of financial uncertainty. According to Dobes, underwriters are now asking more questions and requesting more detailed financials.

“The days of D&O renewals quoted off the expiring financial exposure and an updated headcount are long gone and probably not coming back,” he said.

Insurance companies have become extremely particular about which insureds they’ll offer $5 million in limits to. Many new MGA market entrants will only deploy $2–$3 million in limits on a primary basis for favorable classes. For riskier classes, such as media, entertainment and auto dealerships, limits are in the $1–$2 million range.

In 2022, a claims-free account with strong financials should anticipate renewal increases of 7%–25%, depending on the industry and jurisdiction. Most markets will consider a rate increase of 5%–10% or less to be a “flat renewal.”

Even in the face of higher premiums and lingering restricted appetites from legacy carriers Dobes said that private companies have reason to be hopeful. In the last year there have been more than a dozen new carriers and MGAs that have entered the D&O space with optimistic 2022 new business targets.

“As we shift from the pandemic to endemic phase, the renewed sense of eagerness and optimism among insurance carriers is palpable,” Dobes stated. “The supply side cavalry has arrived and they’re open for business.”

D&O AND CRYPTOCURRENCY FIRMS

Even with new entrants and capacity in the Private Company D&O market in 2022, cryptocurrency firms will find it rough going obtaining coverage. According to Dobes, the appetite for crypto is “extremely limited.” For these companies, limits are low while premiums and retentions are high. “Premiums and retentions for this industry class more closely resemble those of OTC public companies than traditional private companies due to the perceived heightened exposure and fluid regulatory environment,” explained Dobes.

Public companies in the cryptocurrency market did not fare well in 2021 from a D&O perspective. According to Cornerstone Research, there were 11 federal securities class action lawsuits filed that year against cryptocurrency firms.[3]

NONPROFIT D&O

Compared to its public and private company siblings, the Nonprofit D&O market is relatively staid. Directors and officers at nonprofits deal with stakeholders who typically don't yield the same clout as a shareholder or investor.

In 2022, Nonprofit D&O insureds can look forward to rate increases of 10% or less. However, as with any ML coverage, insurance companies will favor certain types of nonprofit organizations over others.

According to Dobes, nonprofits with a political connection are seen as a high-hazard risk as are those with a celebrity exposure. He also stated that underwriters have concerns about the financial stability of organizations that rely on certain types of funding, for example, a scientific venture that relies heavily on crowd funding.

Many insurance companies have also lost their appetite for nonprofits that rely heavily on the generosity of a handful of donors or federal government funding as that money could easily dry up.

EMPLOYMENT PRACTICES LIABILITY (EPL)

While it appears that the worst of the COVID-19 pandemic has passed, the Employment Practices Liability (EPL) market isn't ready to breathe a sigh of relief. Many are concerned that the threat of claims related to vaccine mandates and employers' work-from-home/return-to-office policies, could test this ML market.

With that in mind, insurance companies will be taking a cautious approach in 2022.

"Carriers are willing to write EPL business as long as they can offer terms that they're comfortable with," said Dave Tardif, area senior vice president, RPS. "They won't just write business to put it on the books."

During the pandemic these terms frequently included exclusions for discrimination related to COVID-19. Reflecting the economic uncertainty of the first months of the pandemic, reduction in force and creditor exclusions were frequently added to EPL policies in 2020 and 2021. These exclusions should largely disappear this year though some underwriters may continue to ask COVID-19 related questions.

Another EPL challenge will be the fallout from the Great Resignation, with underwriters often leaving a long-standing employer in search of new opportunities and greater compensation.

Many MGAs and insurance companies want a certain profile for an EPL insured, such as a minimum number of employees. Other insurers are more opportunistic and willing to go after business others don't want.

Another EPL challenge will be the fallout from the Great Resignation, with underwriters often leaving a long-standing employer in search of new opportunities and greater compensation.

"When senior leadership and underwriters depart, depending on who replaces them or where they're coming from, a carrier's underwriting philosophy could change," Tardif said. "It's our job as brokers to keep track of these changes and evaluate how they affect a company's underwriting and appetite."

Whether a company is public or private also factors into appetite. EPL insurance is typically sold as part of a ML bundle along with D&O. Many insurers don't want to underwrite Public Company D&O and so wouldn't consider a submission for other ML coverages.

Geography is another consideration with insurance companies, treading carefully in areas such as New York City, southern California and the Miami-Dade area. Many will decline to write coverage in those markets. For organizations in those markets that obtain EPL insurance, it will be at a price 10%–15% higher than it would be for a similar profile company in a less litigious location. Insureds should also expect a higher retention than would be offered to a company with the same headcount located elsewhere.

Unless the U.S. is hit with another COVID-19 variant, the number of employees going back to the office should pick up throughout 2022. What remains to be seen is how fair employees judge their company's work-from-home/return-to-office policies. Many see this as a potential area for discrimination claims.

Another variable is a new federal law that bans mandatory binding arbitration for sexual harassment claims. This change could have a significant impact on the EPL market.

REPRESENTATIONS AND WARRANTIES

Following 2021's record year of $2.9 trillion in U.S. mergers and acquisitions (M&A), the outlook is bullish about the level of M&A activity that drives the need for this coverage.[4] Concerns about tightening U.S. and global regulations may even spur deals to occur sooner rather than later.

Choo characterized the current market state as, "Mature and robust with significant capacity having come in over the past few years."

Experienced claims administration and underwriting matter more than a well-known insurance company name or even price in this market. In particular, underwriting expertise and claims experience are crucial as policy language is deal-specific. The underwriting process is so in-depth that it bears a greater resemblance to due diligence than an evaluation of insurance risk.

This flight to quality, as well as an uptick in claims, is why the cost of the insurance has gone up, despite an abundance of capital.

Premiums, which are based on the limit provided, range from 3.5% to 5%+, compared to a few years ago where it was common to see pricing below 3%. Retentions remain 1% of the overall transaction size. Policy periods are typically six years for breaches of fundamental and tax representations and three years for nonfundamental representations.

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LAWYERS PROFESSIONAL LIABILITY

"The E&S market for lawyers is hyper competitive," stated Kevin Merchant, area assistant vice president at RPS. "Cases settle quickly and the odds that a claim will trigger an excess layer are low."

"Micro firms," those with five attorneys or fewer, are finding it challenging to purchase the same limits that they had just a few years before in the admitted market. The E&S market increasingly is providing the coverage answer through an excess layer.

The smaller end of this market could benefit from greater automation of the underwriting process as well as by the right questions.

"Small firm LPL would benefit from fewer but more focused questions," he stated. "You need really specific underwriting questions like, 'What's the attorney-staff ratio?'."

The ability to identify a creative solution can be critical. As an example, Merchant pointed to a situation where an insured was contractually obligated to have limits that were higher than most insurance companies would write—and the policy cost more than the law firm is prepared to pay.

"Our solution was to find a carrier that was willing to write client-specific limits," Merchant said. "Let's say there's a client that accounts for 10% of a firms' billings and requires that the firm carry $10 million in PL coverage. The policy would have $10 million in client-specific limit and $2 million for the rest of the firm's clients."

However, it will take more than creativity to find coverage for law firms in certain locations.

California, in particular Los Angeles, Orange County and San Diego, continues to be challenged in LPL markets, as the threat of having to go before a plaintiff-friendly judge often leads to quick settlements. As a result, many carriers will no longer underwrite LPL coverage in those jurisdictions.

During the pandemic, the pace of LPL claims frequency slowed. However, the severity didn't, with claims in excess of $50 million becoming more common.[5] Merchant attributes this to multi-district litigation and class action lawsuits, rather than an individual client suing their lawyer for malpractice.

"Large claims are the state of where the market was five years," he explained. "They are not a true reflection of today's market."

ARCHITECTS AND ENGINEERS

Most PL underwriters aren't too concerned about either bodily injury or property damage. The exception are those who underwrite PL for architects who design condominiums and structural engineers, both seen as a high-hazard subsegment of this industry class.

"These catastrophic exposures are part of what make the architects and engineers (A&E) market unique in PL," observed RPS' Ron Kiefer, senior vice president. "If a bridge collapses or a condo building develops mold because of design issues, lives are at stake."

As with any industry, some occupations are riskier than others. Those involved in landscape architecture or interior design are viewed as a lower hazard. For those tamer risks, premium rate increases should be flat-to-10% in 2022. Higher-hazard practices can expect increases north of that range.

Given both the complexity of the work that they perform and the underwriting process, residential architects, structural engineers and geotechnical engineers are often better served in the E&S market in terms of limits and policy language. "E&S carriers can offer more customized coverage than an admitted carrier can do," offered Kiefer.

In addition, Kiefer noted E&S carriers are helpful in building higher coverage limits. "For example, a firm might need $10 million in limits and we can provide them with $5 million primary and a $5 million excess layer."

Firms that do overseas business also need to see if their existing A&E PL coverage will apply if they take a job." A policy needs to include the right language to defend you in foreign jurisdictions," Kiefer stated.

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As with LPL, a limited cyber component has crept into some policies. Kiefer recommended that insureds rely on a separate, standalone cyber policy as it will provide broader coverage. He will often ask the underwriter to remove the cyber component, even if there's not a premium reduction. That way, there won't be confusion if one event triggers two policies.

THE E&S MARKET

The complexities of ML and PL markets make them particularly well-suited for the E&S market. Many of the ML and PL coverages, such as D&O and EPL, originated in E&S.

"New insurance products often start in the E&S market," said Cho. "That's because carriers can be more nimble in making policy language, pricing and retention changes than they can in the admitted market, where making those changes is a slower process."

"Our ability problem solve for ML and PL insureds and their agents during the pandemic speaks to the advantages of this market, particularly as coverages and limits became more restricted," he added.

Retail agents shouldn't underestimate the benefits of working with a wholesaler in these complicated and nuanced markets.

ACCESS TO EXPERTISE

Another significant advantage of the E&S market is the ability to tap into a wholesaler's expertise and the underwriting relationships they bring to the table.

Retail agents shouldn't underestimate the benefits of working with a wholesaler in these complicated and nuanced markets.

"I see my job as more than just placing a D&O policy," said Choo. "I also play a role in helping to educate the insured's board about their exposure and even play a role in assisting with the management of SEC litigation."

This in-depth expertise, can even lead to cost savings for a program, even in the typically more expensive E&S market. Merchant provided such an example.

"I had an aviation firm that needed $4 million in LPL limits and the admitted carrier was willing to provide $2 million," he recalled. "However, it was more cost-effective for the insured to have a $1 million primary layer with $3 million in excess. The firm ended up with the coverage they needed and at a better rate."

In some of the more challenging markets, retail agents shouldn't be as concerned about whether they're working with an admitted or E&S carrier.

"In the Private Company D&O market, whether the insured ends up with an admitted or E&S policy, sometimes it's random," explained Dobes. "What matters most is obtaining the insured's coverage desired limits with the best possible price and terms."

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For more information, visit RPSins.com.

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[3]"Security Class Action Filings: 2021 Year in Review," Cornerstone Research, p 5.

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