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Investor Suits Drive Up Cost of Insurance For Company Leaders

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By Alice Uribe and Leslie Scism

(Wall Street Journal) --

Many companies in the U.S. and Australia are paying steeply higher rates for insurance that covers costs for directors and top executives when they or the company are sued.

Driving the increases is the rise in shareholder litigation, both in the number of cases and size of jury awards and settlements, brokers said. Another connected factor is the growth of litigation-finance firms, which invest in corporate legal disputes.

In the U.S., premium rates for directors-and-officers insurance jumped 44% to 104% in the first quarter compared with the year-earlier period, based on different indexes of corporations that are published by brokerage firms at AON PLC and Marsh & McLennan Cos. The average increase for directors-and-officers insurance in Australia was 225% for the first quarter of 2020, Marsh data shows.

To hold down the rising costs, some companies are raising their deductibles -- the portion they pay before insurance kicks in -- while others are reducing maximum payout amounts and setting up self-insurance arrangements.

The decision puts them on the hook for more of the expense of fighting lawsuits. It is an especially difficult decision as many lawyers are anticipating a wave of shareholder litigation tied to alleged shortcomings by managers and boards in regards to their handling of Covid-19 matters.

"It's a real Catch-22. . .some of our clients say that, 'If we didn't take out a higher limit, we wouldn't be a target for litigation funders,'" said Scott Curley, a director at GSA Insurance Brokers in Sydney.

So-called D&O insurance is one of the core products bought by publicly traded companies. It is designed to pay out when claims are filed against directors, officers and other employees, if the corporation doesn't cover the costs. It also will reimburse the company when it pays claims on directors' behalf, and covers a company's liabilities when it is sued by shareholders.

The premium increases have been stiffest in the U.S. and Australia given they have legal systems in which lawsuits against companies are more common.

Australia's largest grain handler, GrainCorp Ltd., is among the companies that has overhauled its insurance arrangements in the face of eye-popping rate rises. In February, its brokers quoted a 567% year-over-year increase.

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"We did not accept those numbers because the price was crippling," said Graham Bradley, who was chairman of GrainCorp at the time of the policy-renewal discussions. He is now chairman at United Malt Group Ltd. after its spinoff from GrainCorp in March.

The board made a "material reduction" in the total extent of the cover and raised deductibles across the two Australian Securities Exchange-listed companies, he said.

The agribusiness paid 1 million Australian dollars ($685,000) for its D&O insurance in 2018, before D&O prices began rising, and in 2019 the cost jumped to $1.03 million. This year, brokers said the price would jump to more than $6.86 million for a policy covering GrainCorp and United Malt.

The pain is being felt almost everywhere.

According to AON, no primary policies that renewed in the first quarter with the same limits and deductibles fetched a lower price. To contain the increases, nearly half of the clients changed their deductibles or policy limits, and sometimes both.

In a June 10 report, A.M. Best Co. said a spike in litigation caused by specific events, such as cyberattacks, the #MeToo movement and wildfires was driving the increases. Companies also face potential litigation over "emerging exposures" such as environmental, social and governance issues, it says.

A total of 428 new class-action securities cases were filed across U.S. state and federal courts in 2019, the highest number on record and nearly double the 1997-2018 average, according to Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse.

Some legal scholars and insurance executives say the increase traces partly to financiers who bankroll litigation. In May, an inquiry into Australia's litigation-funding sector, which gives advances to plaintiffs and gains rights to a portion of any settlement or award, was referred to the Parliamentary Joint Committee on Corporations and Financial Services.

The first hearing will be held on July 13, and the committee has been asked to hand down a report by Dec. 7.

The trends are creating worry in C-suites throughout the U.S. and Australia.

Soubhagya Parija, chief risk officer of the quasigovernmental New York Power Authority and a board director at the Risk and Insurance Management Society in the U.S., said there is widespread concern among his colleagues "about the legal situation. . .and the pandemic has only made it worse."

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