

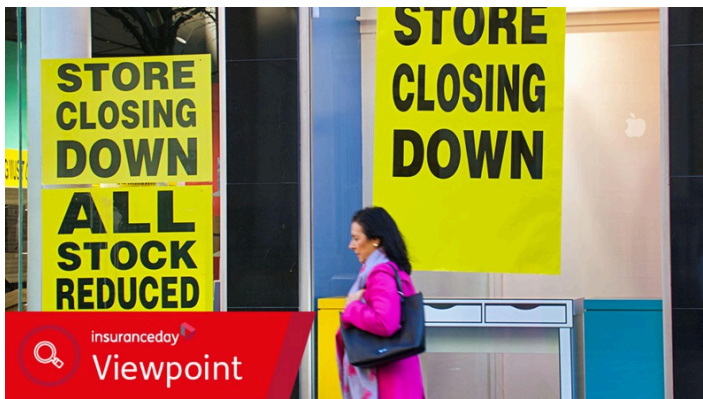
Plugging the management liability risk gap

Brokers and carriers have to overcome the perception among insureds that D&O claims will never happen to them

11 Jun 2024 | **OPINION**

by **Craig Watson** |

Large corporates may be familiar with D&O cover, but many smaller organisations are unaware of the risks or mistakenly believe they have little or no exposure to them



Source: *gerard ferry/Alamy*
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Corporate executives have had plenty to worry about in recent years.

Regulatory changes have highlighted exposures in relation to client and consumer data, while the pandemic raised issues in relation to employee wellbeing during lockdown and cyber risks to company systems with the workforce working remotely.

At the same time, accelerating social change is driving new workplace policies and procedures – diversity, equity and inclusion initiatives; environmental, social and governance strategies; and recruitment and retention policies. These, alongside regulatory developments, are driving up the compliance burden for businesses.

From the directors' and officers' (D&O) liability market perspective, amid all the pressures on businesses and their executive teams, it can be difficult to make the case for adding another discretionary purchase to their annual insurance spend to cover risks that can seem relatively remote.

In addition, the economic climate of high interest rates, high energy costs and the rising cost of goods and services is pushing up the rate of claims being made against companies and their directors – particularly in those sectors hit hardest by the cost of living crisis, such as hospitality and construction.

Such economic pressures directly correlate with the rigorous demands of the Insolvency Act 1986. Over the past 15 years, the credit crunch, austerity, Brexit, the pandemic and the end of Covid-19 support schemes have sounded a steady drumbeat of insolvencies. Under the act, directors and officers are vulnerable to personal liability claims if they are held accountable for creditors' losses following their company's liquidation.

The education challenge

One of the biggest challenges facing D&O underwriters and intermediaries is educating insurance buyers, particularly smaller and mid-sized private limited companies, about the potential scope of uninsured management liability exposures for their organisation and the protection available in the D&O market.

While there is no hard data to confirm the number of businesses that do not have this insurance cover, our conversations with many brokers suggest less than half of the private limited company businesses in the UK purchase this cover. With the UK business community hosting almost five million private limited companies, this suggests nearly three million businesses could and should be considering purchasing.

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Many simply balk at the need for the purchase. A commonly held misconception is a limited number of shareholders and/or directors means a business has very little exposure to D&O risks. This endures even where they have seen a similar-sized local company suffer a business issue or legal action – the default response tends to be “well, that won't happen to me”.

There is a clear knowledge gap to be addressed, which is made more difficult if a broker is juggling priorities – for example, if the client has issues with its core commercial programme. At the moment, it is rare to see a broker placing D&O cover with more than half of the private limited companies it works with, leaving a large number of businesses at risk.

Changing buying habits

When I began writing D&O in the late 1990s, the sentiment among D&O underwriters was every business in the UK would be buying the coverage within a decade. The reality is, while the market has become more

competitive as new capacity has entered the class, the number of businesses choosing not to purchase remains high.

Changing insurance buying habits is the key to closing the management liability insurance gap. The ultimate driver for whether or not a business buys D&O cover continues to be its existing insurance budget. No client is keen to increase its insurance spend and with businesses across many sectors looking to cut costs, additional purchases are one of the first things to go.

Brokers and carriers, therefore, have to overcome the perception among insureds that D&O claims will never happen to them. For example, health and safety went to the top of the list of concerns for directors and officers last year, according to a recent survey. But how many small and medium-sized businesses or small charities are aware of the implications of a health and safety incident investigation, have access to expert legal counsel to defend against any resulting claims and can afford to take the hit of rapidly mounting legal costs on their balance sheet?

It is our job as an industry not only to articulate the scale of exposures even the smallest client could face and the level of indemnity the market can provide, but also to emphasise the access to expert advice available to guide them through any potential investigations and litigation.

Closing the risk gap

D&O coverage provides protection against a wide range of possible outcomes: business failures leading to insolvency, the threat of being sued by a competitor or other third party, the risk of being taken to a tribunal by an employee, shareholder disputes and government interventions or regulatory investigations.

Well-run organisations with a strong focus on compliance, rigorous accounting and robust governance may think they have minimal D&O exposures, but spurious allegations can always engulf the business in legal action.

From the perspective of individual directors, there is also a need to guard against the possibility their personal net worth is in the mix for covering the balance of payments if a company goes insolvent and the quantity of debt exceeds the value of assets in the business.

An effective D&O market is first about ensuring the end client can make an informed decision about whether or not they need the cover. Ensuring they have access to robust and appropriate advice when facing a claim is as important a part of the coverage as appropriate indemnity limits to cover the cost of defending against legal action.

Growing this market is not just a win for insurers and their brokers: it is a win for the end customer who is not buying the cover yet, by informing them about a cost-efficient means of transferring balance sheet risk to the insurance markets rather than discovering too late D&O claims can and will happen to them.

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