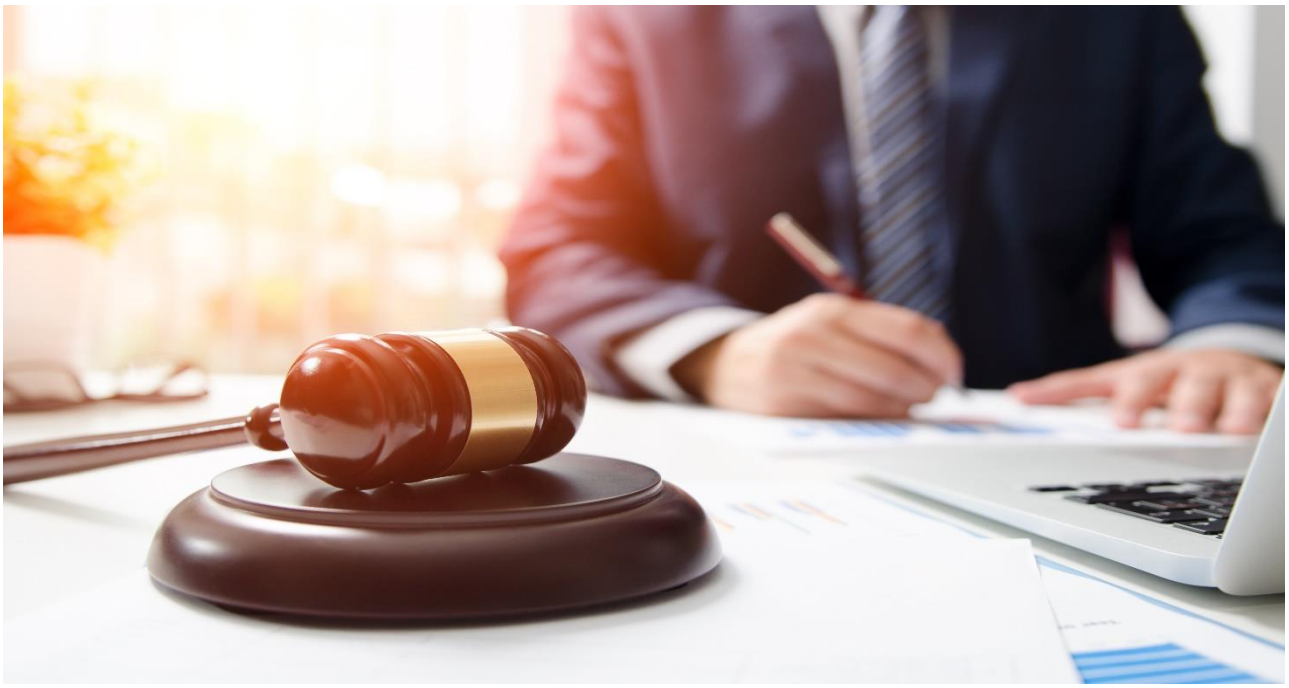
LAWYERLY

Corporate wrongdoing is the real reason D&O premiums in Australia are rising

Class actions



July 3, 2020 Andrew Saker Omni Bridgeway

Part of the sustained attack currently being waged against litigation funders in Australia relates to the impact of funded class actions on the cost of directors' and officers' (D&O) liability insurance.

The argument goes that funded shareholder class actions have been the major cause of recent D&O premium increases and restrictions in cover, which may in turn be discouraging would-be directors from accepting roles and suffocating entrepreneurialism and innovation in our boardrooms.

The background to these attacks is the current Australian federal parliamentary inquiry into litigation funding and class actions. As the largest funder in Australia, and a pioneer of the industry, Omni Bridgeway has welcomed the inquiry, which provides an opportunity to improve an Australian class action system that is almost 30 years old.

However, opponents of litigation funding and class actions are using the inquiry to spread misinformation and inaccuracies, including the claims about the level of impact class actions are having on D&O premiums and, as a consequence, the implications for corporate Australia and the Australian economy.

The truth is that class actions cannot exist without corporate wrongdoing. If a party has done nothing wrong, it need not fear a class action or, when faced with one, it need not settle. There are no known frivolous or vexatious class actions; they are an economic irrationality and legal improbability.

Unfortunately, however, we are witnessing an increase in corporate misbehavior – from the findings of the Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry to the widespread underpayment of workers.

The appropriate response to increasing evidence of breaches of the law causing losses to Australian investors is not to curtail their ability to access the law by making it more difficult to bring funded class actions, especially at the behest of companies and their insurers.

The profitability of D&O liability insurance would increase if there was broader compliance with corporations laws, including our robust continuous disclosure regime.

There is no doubt that there has been an increase in the cost of D&O insurance in recent years – several hundred per cent in some cases for some companies. Omni Bridgeway accepts that the number of class actions is one contributing factor. However, there are a number of other important factors driving the increase.

These factors have been conveniently overlooked in the recent commentary and include: a correction to years of under-pricing of D&O business; global trends in the commercial insurance market; and evidence of corporate wrongdoing.

In a joint white paper published in 2017, insurer XL Catlin and law firm Wotton + Kearney concluded that one of the principal drivers of the unprofitability of the D&O insurance market in Australia was the "chronic under-pricing of … D&O business by insurers since at least 2011".

More recently, in a submission to the Australian Law Reform Commission (ALRC) inquiry into class action proceedings and litigation funders, law firm Norton Rose Fulbright said that the recent increase in premiums for D&O cover was "an overdue and necessary reaction to the realities of the Australian market" and "the increase in pricing is one which the market can and will absorb". The ALRC referred to these submissions in its final report, delivered in 2019, and that similar views had been expressed by others.

The Australian experience is not unique. The Marsh *Global Insurance Market Index* has tracked rising commercial insurance premiums worldwide in the past year, including in markets where securities class actions cannot be considered the primary driver.

It found that in the first quarter of calendar 2020, financial and professional liability insurance, including D&O, rose 23 per cent in the US, 46 per cent in the UK, 12 per cent in Continental Europe and 33 per cent in the Pacific, including Australia.

Concern about the fall-out from the COVID-19 pandemic – in terms of potential regulatory investigations and civil and criminal proceedings – is also driving premiums higher worldwide. Marsh expects a further 'hardening' of both the Australian *and* global D&O insurance markets in the next 12-18 months.

D&O liability insurance policies do not only cover class actions but respond to a wide range of single and multi-party claims against directors and officers of a company. In Australia, directors and officers are subject to common law and statutory duties and they face a range of claims giving rise to civil and criminal liability for breaching those duties.

Insurers have always used exclusions in their policies in an attempt to ring fence certain exposures – and there is evidence they are applying new exclusions in areas such as any regulatory, civil or criminal actions as a result of the Hayne Royal Commission. But historically, insurers have rarely enforced these exclusions, largely because they fear being dropped from insurance brokers' panels and missing out on future work.

The Hayne Royal Commission uncovered significant and widespread evidence of corporate misconduct. One of the outcomes of the Royal Commission was that ASIC has taken a ‘why not litigate?’ approach to regulation of the financial services law, raising the prospect of action against a number of implicated institutions.

Even before the release of the Royal Commission report, Craig Claughton, head of financial and professional practice at Marsh, said: “The banking royal commission factor was pushing up already rocketing D&O premiums – doubling the cost on average – and increasing the excess payable by several times”.

The reality is that the primary reason for the increase in the cost of D&O liability insurance is the extent of corporate wrongdoing. This has led to successful actions being brought on behalf of aggrieved investors. The quantum of settlements in recent shareholder class actions – tens or hundreds of millions of dollars in many cases – points to meritorious actions for serious instances of misconduct not frivolous litigation against unfair targets.

This trend, with its clear implications for insurance premiums, has been coupled with the correction to years of under-pricing noted by the insurance industry itself.

The claim that funded class actions are the main factor impacting the D&O premium increases and stultifying business in Australia is a specious argument. Even the insurance industry itself admits that evidence of poor corporate behaviour, and the resulting risk of regulatory, civil and criminal actions, are contributing to the rise in D&O premiums.

It is clear that the main problems lie with the corporations and their insurers. It is time to stop looking to the symptom and perhaps turn our collective attention to the cause.

About the author

Andrew Saker is Chief Executive Officer and Managing Director of Omni Bridgeway