Marsh Pty Ltd
ABN 86 004 651 512
One International Towers Sydney
100 Barangaroo Avenue
Sydney, NSW Australia 2000
PO Box H176
AUSTRALIA SQUARE NSW 1215
+61 2 8864 8888
Fax +61 2 8864 8811
www.marsh.com.au

11 June 2020

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By Email:

Dear Parliamentary Joint Committee on Corporations and Financial Services (the Committee)

Re: Public Submission into the Inquiry into Litigation Funding and the Regulation of the Class Action Industry (the 'Inquiry').

Thank you for the opportunity to provide comment to the Committee in respect of your Inquiry.

We hope to assist the Committee in its inquiry and report on '*Whether the present level of regulation applying to Australia's growing class action industry is impacting fair and equitable outcomes for plaintiffs*' by focusing our submission on your Terms of Reference (numbered 9, 12 and 13) in the context of securities class actions[1], litigation funders and the Directors and Officers (D&O) Liability insurance market; the combination of which has created an unprecedented and in our opinion unsustainable shift in this market segment based on our local and global experience and empirical data. It is a shift disproportional to other classes of insurance[2] and one with serious implications for corporate Australia and the Australian economy.

Insurance as history has shown is essential to financial and economic stability as well as growth. We outline below the sobering current state of play for those stakeholders.

A. Evidence of any other developments in Australia's rapidly evolving class action industry since the Australian Law Reform Commission's inquiry into class action proceedings and third-party litigation funders (Term of Reference No 13)

In our submission to the Australian Law Reform Commission's (ALRC) Inquiry into Class Action Proceedings and Third Party Litigation Funders ('ALRC Submission'), Marsh provided empirical evidence of the impact of securities class actions (and by implication litigation funding) on the availability and affordability of D&O Liability Insurance[3] as at July 2018.

[1] Also referred to as shareholder class actions.
[2] Marsh Insights May 2020 Global Insurance Prices Rise for Tenth Consecutive Quarter.
[3] Marsh ALRC Submission Paper 27 July 2018

As a major D&O insurance broker to the ASX200, our data suggested that the rising cost of D&O insurance and the withdrawal of several major insurers from that market, was closely correlated to an increase in the number and size of securities class actions since 2011. Relevantly, we note that all securities class actions filed in the period 2013–2018 were funded[4].

According to Marsh's data, between 2011 and 2018, companies in the ASX200 typically saw the cost of their D&O insurance increase by over 250%. Companies were also forced to retain more risk, with ASX200 companies (then) typically increasing the amount four-fold to over $10 million per loss.

Since 2011, the number of insurers serving the D&O insurance market in Australia has decreased as research has shown that they have contributed over A$1 billion to ASX securities class action settlements (excluding defence costs) in that time[5]. Data over that period illustrates an insufficient premium pool and a gross loss ratio exceeding 100% for insurers[6].

In our ALRC Submission, we opined that the D&O insurance market was at a tipping point and that securities class actions and litigation funders were contributing to increases in premiums and retentions, which were unsustainable in the long term.

We note the year to 30 June 2019 was another big year for securities class actions with 16 new filings, many of which had a funder involved[7]. The year also included the settlement of a number of securities class actions for large sums (one in excess of $130 million) and with many settlement sums not being disclosed. The ALRC noted in its Final Report that the litigation funding market in Australia has been growing and industry revenue is forecast to grow at an annualised 7.8% over the five years through to 2022–2023[8].

Since our ALRC Submission, according to Marsh's data, the average increase in premium for the ASX200 in 2019 was 118% with extreme cases at a staggering 600%; and there are no signs of these increases slowing. Rising premiums would normally attract more insurers to enter a market. However, insurers are now so concerned about the potential size and scope of securities class actions that many are either cutting back their offering or no longer writing the coverage at all.

The list of insurers that have withdrawn from providing D&O insurance to ASX listed companies includes WR Berkley, AAI Ltd trading as Vero Insurance (part of the Suncorp Group), Allianz, Talbot Australia and Lloyd's of London syndicates Novae, Neon, Canopius, Pioneer, Axis and Acapella. Other insurers including AXAXL, Zurich, Chubb and Liberty in addition to Underwriting Agencies, Dual Australia and London Australia Underwriting have reassessed their exposures and have become more discriminating about purchasers to whom they will offer D&O coverage. In some cases, the restrictions imposed are so onerous that they amount to a de facto withdrawal.

Capacity as a result is difficult to fill, meaning some D&O programs have lower limits and a narrower scope of cover (details provided below) at greater cost. For coverage of between $100 million and $200 million, larger corporate entities are paying premium in the order of $5 million – $10 million (or more) where they previously paid $500,000 - $800,000. For some industries or sectors, the premiums are even higher; now on average between $10 million – $15 million. To add a further layer of complexity, disproportional primary pricing versus excess layer pricing from insurers has also been observed.

[4] ALRC Report 134 December 2018 Integrity, Fairness and Efficiency- An Inquiry into Class Action Proceedings and Third-Party Litigation Funders page 77 para 3.24
[5] XL Caitlin/Wotton & Kearney, Show me the money! The impact of securities class actions on the Australian D&O Liability Insurance market page 11.
[6] XL Caitlin/Wotton & Kearney op cit page 12.
[7] King & Wood Mallesons, The Review, Class Actions in Australia 20182019 page 4.
[8] ALRC Report 134 op cit para 2.12, page 49

There has also been pressure on retentions. For ASX listed entities, these are currently typically between $10M[9] to $50M[10] with extreme examples reaching up to around $225M, meaning companies are holding much of the risk insurers used to hold. Is this the most efficient use of capital for encouraging economic growth?

Last year insurers had warned Marsh that steeply rising premiums were still not enough to cover claim payments (and associated costs) in respect of securities class actions and that this year they would be charging premiums to alleviate the costs. Insurers have been true to their word. Our data for the first quarter of 2020 shows the average increase was 225% with some premiums rising by as much as 400% - 500% per cent for the biggest (securities class actions exposed) ASX listed companies.

D&O Insurance is a critical protection mechanism of any strong corporate governance regime that ensures the sustainability of boards and ultimately the organisations they represent. The current state of securities class actions and litigation funding is undermining the stability of that regime by eroding the availability of insurance coverage and contributing to significantly higher pricing for D&O products offered in the Australian and global insurance markets (that write Australian risks).

However and importantly, it is not just publicly listed companies that are experiencing premium and retention increases and reduced capacity. The effects of litigation funded securities class actions have rippled through all D&O policies, as well as the management liability package policies commonly purchased by small to medium-sized businesses and Not-For-Profits. Companies across Australia, regardless of industry and size, are all sustaining the impacts.

B. What evidence is becoming available with respect to the present and potential future impact of class actions on the Australian economy (Term of Reference 9)

We are in the midst of the most volatile and restrictive D&O insurance market in the history of the segment. Insurers today are acutely aware that securities class actions have been one of the largest contributors to D&O insurance losses and that the number of claims (and reported circumstances) are exceeding the total insurance market premium pool by a significant margin. As a result, D&O insurance renewals are being increasingly scrutinised as insurers seek to rebalance their position through premium adjustments to compensate for the claims and related costs.

For those insurers who have remained in the D&O market segment, many are seeking to mitigate their exposures by re-evaluating their underwriting appetites by reducing capacity and elevating attachment points. Coinsurance, retentions and coverage issues are also being closely scrutinised and adjusted to help insurers better mitigate their exposures. Having to maintain increasing policy retentions will no doubt have a negative impact on a company's available capital and shareholder value.

Coverages that have been restricted or removed altogether (at primary and excess levels) include 'Entity Cover for a Securities Claim' (this is an interesting development as far as shareholders are concerned as this aspect of a D&O policy has been classified as an asset of the company), 'Special Excess Limits for Non-Executive Directors', 'Personal Expenses', 'Public Relations Expenses', 'Pre-Investigations including cover for Shareholder Derivative Demands', 'Mitigation Costs', 'Optional Extension Periods', 'Deeming Provisions'[11], 'Continuous Cover', 'Fines and Penalties (for strict liability offences)', 'Lifetime Run-Off for Retired Directors' and 'Insolvency Hearing Costs'.

---

[9] For those ASX Companies that still enjoy a $5M retention (which is now the new minimum) this in itself is multiples of what some were incurring only 12 months prior at $1M.

[10] While retentions for Side C cover have been the most impacted, Side B retentions (which apply to Company Reimbursement cover) are now equally under pressure.

[11] A deeming clause provides that a claim, is deemed to have been made during the policy period if it arises from circumstances which were notified during the policy period. If a D&O policy contains a deeming provision some relief may be provided by section 54 of the Insurance Contracts Act 1984 if an insured fails to notify within the policy period, The relief provided by section 54 does not however apply to a failure by an insured to exercise their section 40 statutory rights available under the Insurance Contracts Act 1984.

In addition, we have seen the imposition of a number of new and onerous exclusions added by endorsement. The much publicised Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry not only reportedly attracted foreign litigation funders to set up shop in Australia[12] but further focused insurers' attention to mitigating their exposure from potential securities class actions that may arise out of the Royal Commission by imposing the now infamous Royal Commission Exclusion which was designed to 'ring fence' any perceived Royal Commission exposures to one policy period and not expose any going forward policies.

With fewer insurers providing cover and existing insurers reducing their exposure by reducing limits and/or removing certain covers or adding certain restrictions (albeit at increasing premiums) this has made it difficult for brokers to fill program limits and for clients to find appropriate cover.

An Australian director is now potentially exposed to liability under more than 600 pieces of legislation. In addition, Australia has now become the most likely jurisdiction outside of the United States in which a corporation may face significant securities class action[13]. Australia's D&O premiums are, not surprisingly, beginning to more closely align with D&O premiums charged in the US, which have similarly been driven up by securities class actions increasing in both frequency and severity[14]. We note that 1 in 10 S&P 500 companies was hit with a securities class action in 2018[15]. Without robust coverage in the current landscape, companies and boards will become risk averse, and this will impact the economy.

If companies cannot offer directors sufficient protection for liabilities associated with their directorships there will be a real problem for companies to be able to attract and retain qualified directors. Ultimately, this is not good for anyone – neither corporate Australia, shareholders or for investment in the country.

C. The potential impact of Australia's current class action industry on vulnerable Australian business already suffering the impacts of the COVID-19 pandemic (Term of Reference No 12);

The D&O insurance market was challenging heading into 2020 and has become acutely more so because of COVID-19. The COVID-19 outbreak and its subsequent impacts on the economy and businesses, both known and unknown, has created a very uncertain environment and one where we are seeing companies, their directors and their insurers err on the side of (extreme) caution if not nervousness.

Whilst there have been no COVID-19 related securities class actions lodged in Australia to date as far as we are aware, media reports suggest that litigation funders and law firms in Australia are examining the potential for class actions against various businesses and governments for amongst other things financial performance and COVID-19 related plans and responses. Eleven securities class actions have already reportedly been filed in the US[16].

Recent outcomes have been uneven given early days; however, our general observations on the impact of COVID 19 on vulnerable Australian business are as follows.

COVID-19 will continue to exacerbate the market hardening (with London capacity for Australian risks further withdrawing) and inevitably impact pricing for the balance of 2020. We are once again seeing triple digit pricing increases.

---

[12] Litigation funder sets up shop in Australia to profit from banking royal commission by senior business correspondent Peter Ryan Posted 28 January 2019 ABC News.
[13] Allens, Shareholder Class Actions in Australia, February 2017, page 2.
[14] Marsh Insights May 2020 Global Insurance Prices Rise for Tenth Consecutive Quarter, page 5.
[15] King & Wood Mallesons, op cit page 30
[16] LaCroix, Kevin, "Two Additional Coronavirus Outbreak-Related Securities Suits Filed",The D&O Diary, May 27, 2020. See also LaCroix, Kevin, "COVID 19 - Related Securities Suit Filed Against Animal Supply Company, The D&O Diary, May 25, 2020 and LaCroix, Kevin,"Wells Fargo Hit with First PPP-Related Securities Class Action, The D&O Diary, June 4, 2020.

Regulatory investigations and civil and criminal proceedings which are anticipated to follow as a result of COVID-19 are likely to result in cover for investigations being further scrutinised with coverage terms being tightened or in some cases removed. The uncertainty associated with the impacts of COVID-19 has also given rise to the imposition of additional exclusions.

Broad form Insolvency/Financial Mismanagement Exclusions have been foreshadowed for companies without strong balance sheets or comfort being given around debt. This is particularly concerning to directors since D&O insurance was the last line of defence in situations where their corporations were unable to indemnify them due to insolvency. We note some welcome relief has been provided in this regard on:

- 20 March 2020 by ASIC in Guidelines (20-068MR) for public companies in meeting upcoming AGM and financial reporting requirements;
- 25 May 2020 with Treasurer the Hon Josh Frydenberg MP announcing the government would temporarily adjust the Corporations Act to make continuous disclosure requirements less onerous during the extreme uncertainty of the coronavirus crisis; and finally with
- the Australian Government also announcing a suspension on insolvent trading laws, which exempt directors from personal liability for trading whilst insolvent for six month to assist directors to trade through the COVID-19 crisis instead of incurring the costs of placing a business in administration with the resulting social and economic repercussions. This followed the Governments recent announcement that litigation funders would be subject to tighter regulation under the Corporations Act. This brings the regulation of litigation funders in line with that of other financial services providers.

Broad form COVID-19 Exclusions have also been foreshadowed going forward. The majority of the exclusions contain multiple and broad linking terms to exclude claims "*in any* way *caused by or resulting from*", COVID-19, SARS-CoV-2 or mutation or variations thereof. Some go even further seeking to exclude losses "*directly or indirectly arising out of, attributable to, or occurring concurrently or in any sequence with a Communicable Disease*". While the most onerous also include exclusionary language which in addition to the above seek to also capture losses or claims that relate to "*the fear or threat of*" COVID-19/SARS CoV-2 or a Communicable Disease, "*whether actual or perceived*". We anticipate resisting, let alone amending the language of these exclusions will become more challenging and, as was the case with the Royal Commission Exclusion, ultimately non-negotiable.

The myriad of ever changing factors, information and potential losses flowing from COVID-19, has given rise to challenges for companies and their directors in respect of the reporting of claims and more importantly circumstances (that may give rise to a claim) so as to not prejudice cover. This is because when a new policy incepts, the addition of any Insolvency or COVID-19 Exclusions will likely remove any opportunity to recover any future COVID-19 losses.

Appropriate notifications are particularly important in today's market conditions where insurers are either not supporting an existing program going forward or only on more restrictive terms and with new insurers coming on risk. We anticipate that some insurers will (as they did with notifications following the imposition of the Royal Commission Exclusion) seek to reject the notifications made on the basis that they are 'too broad or blanket' or that they 'do not contain sufficient detail'. Uncertainty as to policy response (for both insureds and insurers) has never been so dire.

We are not surprised some directors have chosen to resign from their positions in light of current market conditions, coverage restrictions and the uncertainties associated with COVID-19 related losses and claims.

D. Concluding Remarks

The D&O insurance market finds itself in the midst of a perfect storm: greater (and unprecedented) risk, significantly higher premiums, notably lesser and more onerous coverage, punitive retentions and historically lower limits. The surge in securities class actions has notably made its mark on the D&O insurance market and the management of such insurance programs in Australia.

Over the next 12-18 months, Marsh sees a continuation of the hardening of the Australian (and global) insurance market which will not be easy to overcome. Marsh warns that corporate Australia could face a future in which D&O insurance is no longer available or affordable or provides the coverage expected or required. This will be a most unfortunate outcome as D&O insurance was designed to offer security, piece of mind and financial stability to Corporate Australia. Marsh is concerned that the massive premium increases and restrictions in cover fueled by funded securities class actions will suffocate entrepreneurial and investment and growth focused decisions in Australia, as boards become risk averse.

Yours sincerely,

Craig Claughton
Managing Director and Head of FINPRO,
Marsh JLT Specialty, Pacific

Melita Simic
Head of FINPRO Technical,
Marsh JLT Specialty, Pacific