The state of Private Management Liability insurance

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Introduction

In the post-pandemic era, the private company management liability insurance market has become more competitive as premiums have decreased and coverage has expanded. Management liability insurance rates were already increasing prior to the COVID-19 pandemic due to claim activity, but economic uncertainty and lockdowns accelerated these rates during that time. Insurers anticipated an uptick in claims related to the financial losses and layoffs caused by the pandemic, but claim activity was not as high as anticipated. New capacity entered the management liability space, and coupled with the lower-than-expected claim activity, caused rates to decrease.

In the post-pandemic era, this scenario has changed once again. There are a few factors that could lead to a shift in the private management liability market. With most companies now requiring a return-to-office "hybrid" work policy and with government pandemic-related subsidies no longer available, the corporate environment is facing new challenges when it comes to Private Management Liability insurance.

There are four key trends that may affect the private management liability market in 2024: **a challenging market environment, potential regulatory enforcement changes, return-to-office mandates, and a cultural and societal shift in the workforce.** This report will review those trends and how they might affect the market.

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Economic struggles can lead to D&O risk

For Directors & Officers insurance, public companies tend to draw more attention and scrutiny, but private companies still face significant risks for their directors and officers. While they are less likely to face securities class actions lawsuits and hefty Securities and Exchange Commission (SEC) fines, private companies, along with their directors and officers are still subject to business litigation, regulatory investigations, and disgruntled investors. As such, private companies still need to ensure they are properly protecting their directors and officers to allow them to effectively function as leaders and advisors without risking their personal assets.

Through the early days of the COVID-19 pandemic, federal, state, and local governments poured billions of dollars into supporting struggling businesses. These took the form of grants, loans and tax subsidies to help businesses whose revenue model was upended by lockdowns and cancellations. This extra financial support helped many businesses weather the economic upheaval of the pandemic. But four years after COVID-19 shutdowns first impacted the United States, these financial support programs have ended.

Some companies have recovered from the pandemic shutdowns and will not be materially affected by the pullback of this support. Other companies, however, may not have rebounded post-pandemic or had other underlying business model problems that were ignored while receiving pandemic financial support. Additionally, some companies still have significant debt from the pandemic that is impacting their profitability. Company debt has jumped 18% since 2020 as businesses took advantage of low interest rates early in the pandemic. These companies may now be facing financial problems that can lead to missed profitability targets, failed strategy goals, falling behind on debt payments or other management problems.

As these governmental support plans expire and the overall economy continues to shift, a few sectors are especially vulnerable. This includes commercial real estate companies, hospitality and retail sectors, and the electric vehicle market.

Commercial real estate

Private commercial real estate companies may face especially strong pressures this year as occupancy rates have not returned to pre-pandemic levels for many cities. The national vacancy rate of 18.2% is 60% higher than Q4 2019 (11.4%). This is forcing companies to compete for rates to attract and retain tenants. The national average full-service equivalent listing rate was $37.74 in March 2024 — down 1.3% in the last 12 months.

This combination of lower demand and falling rents is especially concerning as mortgage rates remain high. Mortgage interest rates are close to 7%, nearly three times the rates from early 2020. For those buildings with mortgages coming due in the next couple of years, it will be difficult to renegotiate the loans due to vacancy rates, falling building valuations and higher interest rates.

Retail and hospitality

Continued high interest rates combined with rising cost pressures in housing and energy may drive down consumer discretionary spending in the coming months — a worrying trend for retail and hospitality companies. A recent study shows that spending on clothing and footwear is down 36% year-over-year as of April 2024. Leisure travel spending has dipped just 3.1%, an encouraging sign for hospitality companies, but if housing and utilities cost continue to rise at their 11.8% year-over-year rate, problems could lie ahead.

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Electric vehicles

Around the globe, 14 million electric vehicles (EVs) were registered in 2023, accounting for 18% of all car sales. This tremendous growth — just 3% of new car sales were electric in 2018 — drove many companies to invest in the infrastructure to support EVs. From mining the rare minerals for the batteries, to building manufacturing facilities for EV components to developing a national network of charging stations, a large economic ecosystem has risen to support electric vehicle production.

And while the demand for EVs is expected to continue, the rate of increase may be slowing down. Ford, GM, Mercedes-Benz, Volkswagen, Jaguar, Land Rover and Aston Martin have all announced plans to delay or scale back EV launches. The transition to a fully electric global automotive fleet may take longer than initial estimates.

Consumers may be shying away from EVs as recent events have shown that the automotive ecosystem isn't quite ready for an all-electric future. The recent extreme wintry weather snap in the Midwest that prevented batteries from charging, cars running out of charge during lengthy traffic jams, and difficulty finding available charging stations all played a role in the slowdown of EV growth.

The ancillary businesses are feeling the impact as well. Slower growth in EVs means lower than expected demands for batteries and components. This could lead to D&O claims because many of these businesses had received large investments to ramp up quickly but are now having to reduce or even halt operations.

Any private company that faces a potential economic downturn may face additional D&O risk, regardless of their sector. As companies try to turn around their businesses, they may face lawsuits related to their tactics. These may include:

- **Merger objection lawsuits:** These are lawsuits filed by shareholders who are unhappy when a company is (or is about to be) acquired.
- **Freeze out mergers:** A scenario where minority shareholders are forced to sell their stock for less than fair market value.
- **Breach of fiduciary duty:** This scenario includes self-dealing and conflicts of interest.
- **General business mismanagement lawsuits:** These involve allegations of poor management practices or negligence by company executives or directors.
- **Bankruptcy lawsuits:** These arise when a company or individual files for bankruptcy protection, leading to legal proceedings related to debt repayment, restructuring, or asset liquidation.

Regulatory changes

Private businesses should pay close attention to elections and key court cases in 2024 as they monitor the ever-shifting regulatory landscape. The 2024 presidential election as well as key Congressional races may determine how stringently regulations are enforced, if new regulations are enacted, or if some regulations are rolled back or eliminated.

Business leaders should pay close attention to the recent *Supreme Court ruling in Relentless, Inc. vs the Department of Commerce*, which eliminated the Chevron deference doctrine. Previously, the Chevron deference guided courts to generally accept a regulatory agency's interpretation of its own regulations when disputes arose. Without this doctrine, future regulations may face increased legal challenges, potentially leading to a more lenient regulatory environment.

The regulatory environment can be a key factor in D&O risk. Companies that have regulatory fines or penalties levied against them can face negative publicity as well as financial troubles if the fines are significant. Similar to the risks during an economic downturn, this could result in increased scrutiny of companies' operations and the possibility of lawsuits.

Additional regulations or stricter enforcement could lead to more claims and higher D&O premiums. Business leaders should continue to monitor potential regulation enforcement changes as they plan for renewals.

Office mandates drive D&O and Employment Practices Liability risk

While just 51% of employers had implemented a return-to-office mandate in 2023, a recent survey indicates that 90% of employers intend to enforce return-to-office mandates in 2024. Some employers may push for a five-day in-office culture while others will expect just one or two days, but overall, the era of 100% remote work that defined the pandemic period seems to be ending for most companies. In a PWC report, more than two-thirds of managers prefer at least three days in the office.

The financial benefits for return to office are clear for most companies — 72% report that revenue increased after return-to-office mandates were implemented. And even without potential financial benefits from in-office mandates, many leaders point to improved communication, teamwork, and culture as critical components of in-office work.

Observations of badge swipes indicate these in-office mandates are leading to more in-office work. National occupancy rates on Tuesdays at the end of April 2024 were at 60%, which is 20% higher than the same weeks in 2022.

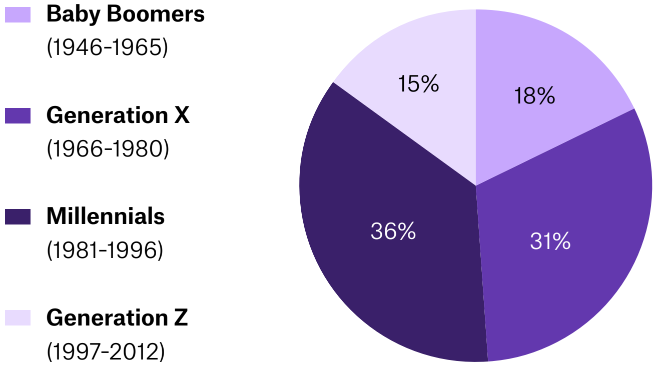
But the return to office also drives risks for managers. The possibility of potential lawsuits based on return-to-work exemptions — who gets them, who doesn't, how many times one employee must come into the office as compared to another employee, and so on — poses an entirely new dynamic. Managers will attempt to balance health, safety and personal needs while also pushing for more time in the office. Perceptions of bias, inconsistent enforcement, or unequal standards can drive legal action, especially if employees perceive gender, racial, or disability bias.

The Equal Employment Opportunity Commission tracking of individual charges shows a significant drop in charges in 2020 and 2021 — down 15% compared to 2019 charges. In 2022, those charges jumped back up above 2019 levels as workers started to return to the office. These complaints may be partially driven by the start of return to office mandates but may also be driven by other cultural shifts that return-to-office mandates may exacerbate.

New awareness of office behaviors

In many ways, there has been a significant shift of national culture in the post-pandemic United States. In 2017, #MeToo started driving increased awareness of sexual harassment, sexual assault and inappropriate behavior in the workplace. Since 2020, there have been numerous protests and cultural movements related to race, sexual identity, and international disputes that have led to a greater focus on personal identity and launched contentious debates in society. As workers return to the office, they will bring these political shifts and debates with them, which will impact office culture.

2024 workforce by generation



Source:

The workforce coming back to the office is younger than the one that moved to remote work in March 2020. Generation Z, those born between 1997 and 2012, make up 15% of the US workforce in 2024 and will overtake the baby boomers (1946-1964) this year as more than 11,000 baby boomers are expected to retire each day in 2024. Generation Z is less religious and more focused on social issues than previous generations — creating potential clashes of opinions with older generations within the office.

In-office work can lead to more casual conversations around the office, greater potential for inappropriate or misunderstood remarks, and the chance for increased lawsuits and claims. What was once shrugged aside or ignored in pre-pandemic office culture may be less tolerated by younger and more socially aware workers. This may lead to an increase in employment practices claims (sexual harassment, racial discrimination, ageism, and more) now that more workers are back in the office. Workers are increasingly sensitive to micro-aggressions and discriminatory behavior within the workplace, which also could lead to an increase in employment practices claims.

Leaders who are viewed as allowing an intolerant or discriminatory culture to fester could be susceptible to D&O claims. When employment practices lawsuits result in negative publicity and large settlements, this can impact a company's financial performance and valuation. Shareholders who see a drop in their investment value may seek legal recourse from the executive team that ignored the workplace environment.

Companies have also been under pressure to increase diversity on the board of directors. Recent attempts to enforce board diversity have not always been successful, but they have increased attention on the topic and create another potential basis for shareholder lawsuits.

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How Munich Re Specialty can help

The risk to directors and officers in today's unpredictable, complex, and litigious business environment represents clear and present danger. You may have questions about Private D&O insurance for your company. What is Private D&O insurance? How much does it cost? Do we as an organization need it? If so, what is the right coverage option for us? Munich Re Specialty is here to help, answer your questions and provide you with the Private D&O solution your business requires. Our executive risk experts offer cost-effective programs tailored to your organization's risk management needs, helping you confidently lead your company.

Learn more about
Munich Re Specialty's Private Management Liability solutions.

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