

10 MARCH 2021

Marsh Limited's Submission to

# Te Aka Matua o te Ture | Law Commission's Inquiry into Class Actions and Litigation Funding

Issue Paper 45



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# Executive Summary

In New Zealand, the average insurance rate per million for listed clients increased by 157% between 2018 and 2020. Increases in retention levels mainly impacted on companies securities cover (Side C) where the average increase over the same period was 473% with minimum retentions increasing from as low as NZ\$10,000 to NZ\$250,000.

Marsh Australia reports that the average rate per million increase for directors and officers (D&O) insurance for ASX250 clients in 2020, was 182% above 2019; the average retention increased for the same period by 211%.

This is on top of the previously reported years where between 2011 and 2018, the cost of D&O insurance for Marsh's ASX200 clients increased 250%. Over the same period, clients were forced to retain more risk, with ASX200 companies typically increasing the amount of retention levels four-fold to over AU\$10 million per loss.

- Marsh New Zealand's submission on the Law Commission's Paper on class actions and litigation funding supports the preliminary view that a regime would be desirable "provided that appropriate mitigation of disadvantages" is developed on a fair and reasonable basis which balances the interests of the class plaintiffs against the potential implications on the availability of Insurance for New Zealand businesses and the individuals who govern them.
- We are advocating for a stronger focus on the disadvantages and the resultant impact that these disadvantages could have on Directors and Officers and the business community in New Zealand.
- Our response addresses the continued deterioration of the Directors and Officers insurance market, operating in unbalanced regimes in other countries, with a particular focus on Australia and the direct impact this is already having on the New Zealand Directors and Officers insurance market. We will also discuss the potential impact on Professional Indemnity insurance.
- New Zealand is in the enviable position of being able to take the lessons learned from the Australian experience and ensure the design of the class action regime and litigation funding regulation is fit for purpose from the outset.



## LIST OF QUESTIONS

In developing our submission, we have taken into consideration the following questions raised in the Law Commission's Issues Paper 45, Dec 2020:

### CHAPTER 6:

Disadvantages of class actions (Q4 (b,c))

### CHAPTER 7:

Statutory class actions regime for Aotearoa New Zealand (Q5)

### CHAPTER 9:

Principals for a statutory class action regime (Q11, Q16, Q18)

### CHAPTER 12:

Membership of the class (Q32)

### CHAPTER 13:

Disadvantages of class actions (Q36)

### CHAPTER 17:

Advantages and disadvantages of litigation funding (Q37)

### CHAPTER 23:

Regulation and oversight (Q60)

# Main Response – Directors and Officers

## Overview and evolution of Directors & Officers Liability Insurance

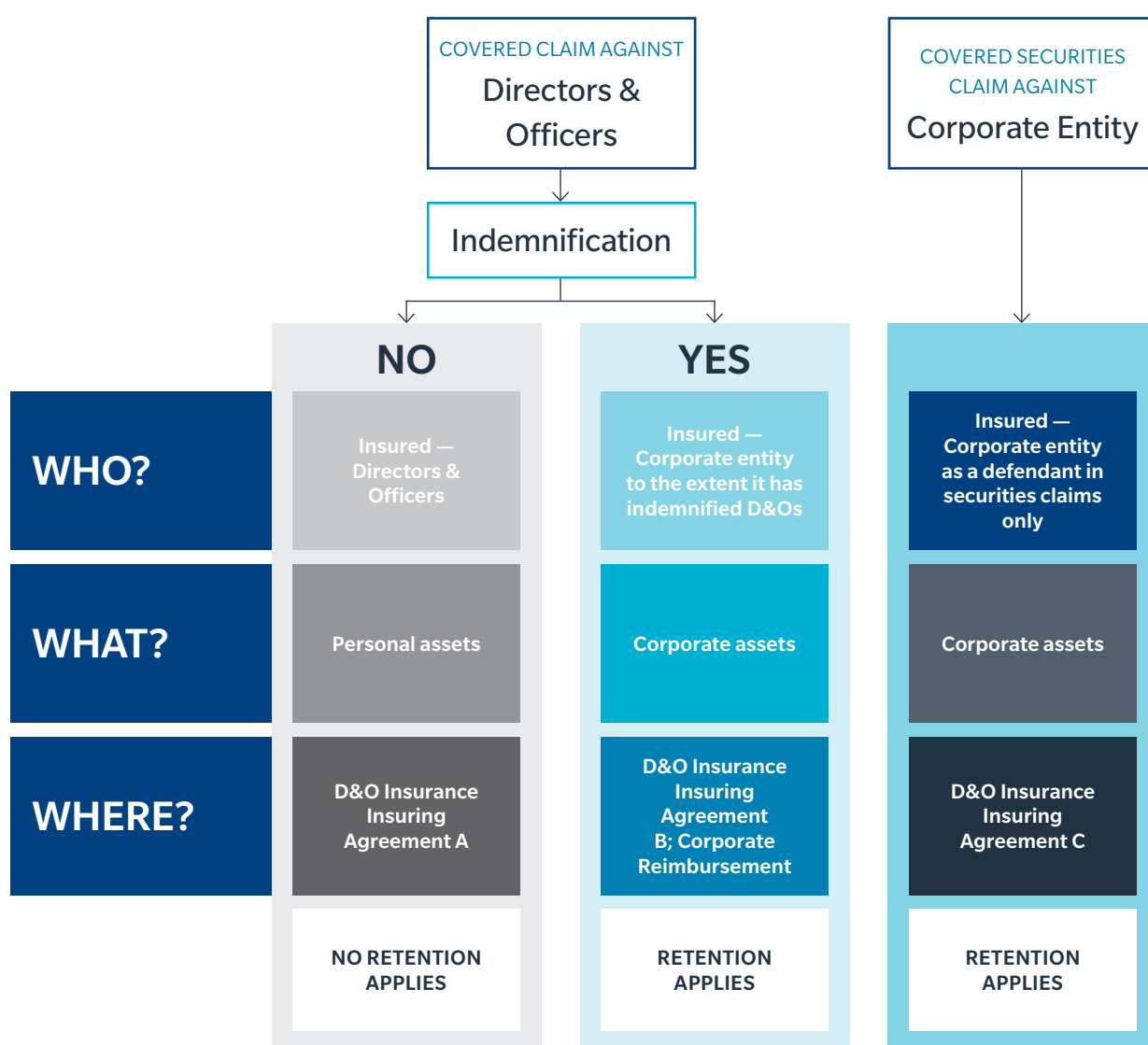
As shown in the illustration (Figure 1), a D&O policy can be made up of three types of coverage:

1. For individual directors and officers;
2. For the company where it grants indemnity to a director; and
3. For the company's own liability for securities class actions.

The limits of indemnity for D&O policies are commonly shared across the above three coverage types.

FIGURE  
1

The Make-up of a D&O Insurance Policy



In today's regulatory environment, the personal assets of directors and officers are increasingly at risk. While most companies will provide directors with some form of indemnity (whether in its constitution and/or by a deeds of indemnity granted to individual directors), there are, certain claims for which it is unlawful for a company to indemnify a director. This is one of the reasons why many deeds of indemnity typically require a company to procure and maintain D&O insurance to protect an individual director or officer from personal liability in the event of a claim or investigation against the director or officer.

A D&O policy provides cover for liabilities incurred by directors and officers in the performance of their duties; otherwise, the personal assets of directors or officers may be exposed.

Traditionally, Directors & Officers (D&O) Liability Insurance contained two separate insuring clauses. The first (popularly referred to as Side A cover), pays on behalf of the individual directors and officers for losses which are not indemnified by the company. The second insuring clause (known as Side B cover), reimburses the company for amounts it pays to its directors and officers as indemnification. Both sides of cover apply only to loss incurred by the directors and officers in claims against the directors and officers. Neither side of cover insures loss incurred by the company for claims against the company.

In the mid to late 1990s, entity coverage (referred to as Side C cover) for securities claims became a popular feature in D&O policies, in response to the difficult allocation issues which accompanied an increase in securities claims made against both directors and officers, who were insured under the policy, and the uninsured company.

Many D&O policies now include this third insuring clause which insures loss incurred by the company, resulting from certain claims, for its own wrongful acts even if directors and officers are not named as defendants. This coverage typically applies only to "securities claims," and provides cover to corporations for their liability in claims made against them in relation to their securities.

The diagram (Figure 1) may assist in understanding the structure and matrix of a D&O policy.

The limits of indemnity for D&O policies are commonly shared across three coverage types. For a number of years, directors and officers were concerned about the erosion of limits under D&O policies caused by a Side C claim, but now concern has shifted to the cost and availability of D&O coverage generally.

## Implications for Directors and Officers Liability Insurance

We appreciate that the Law Commission's Issues Paper 45 has taken into consideration the implications on the D&O insurance market in Chapter 17, with particular reference to Marsh statistics in relation to the trends in the D&O insurance market both in New Zealand and in Australia.

The figures contained in this chapter remain relevant to our purpose of providing input on the potential ramifications of an unbalanced regime and we have provided a further update on them.

We are in agreement that New Zealand does not currently have an opportunistic class action culture like that experienced in other more litigious jurisdictions, however we are advocating taking the lessons from those experiences to avoid creating an environment that encourages this behaviour in the future for New Zealand.

We perceive the release of the Law Commission's paper and the potential to develop a balanced and well regulated regime as an opportunity to once again provide the insurance industry with reason to view the New Zealand jurisdiction in a positive light against some of the more litigious environments.

Unique to New Zealand is our size in comparison with other countries with class action regimes. This has a major impact on the availability of insurance capacity where the premium pool is likely to be insufficient to sustain multiple class actions in an annual period.



Litigation funding is common in both consumer and shareholder collective redress actions. In a number of jurisdictions it has acted as a catalyst for the use of collective actions.

Source – Allianz Global Corporate & Specialty SE COLLECTIVE ACTIONS AND LITIGATION FUNDING AND THE IMPACT ON SECURITIES CLAIMS: A GLOBAL SNAPSHOT.

## Impact of Litigation funding on Directors & Officers Insurance

A matter of note in reading the Law Commission's paper was in relation to the comment "we have not yet seen robust evidence that the increase in funded litigation across Australia has caused a hardening in the D&O Insurance market."

Addressing this issue as separate to the impact of having a class action regime is challenging, as noted in Chapter 17 (17.50) there is no easy way to separate out the direct impact of litigation funding from other factors contributing to class actions.

In Marsh Australia's 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 as at July 2018.

There are also a number of sources that point to the impact of litigation funding in class action filings. See examples below.

*"Litigation funding is common in both consumer and shareholder collective redress actions. In a number of jurisdictions it has acted as a catalyst for the use of collective actions."*<sup>1</sup>

*"Class action filings have continued to rise. More class actions have been filed in 2017 and 2018 than ever before. The primary driver for this trend is more and more plaintiff lawyers and third party funders bringing class actions in the hopes of sharing in the spoils of a substantial settlement (or, very occasionally, a judgment)."*<sup>2</sup>

## Impact of Class Actions on Directors & Officers Insurance

We have included in this response details of the market conditions that are currently in play in Australia and New Zealand. Any suggestion that this has not been largely driven by the increase in class actions is contrary to the vast amount of publications on the subject which point to this as a major factor in the tougher conditions of the D&O insurance market globally and specifically in Australasia. Refer to below examples:

- <https://axaxl.com/-/media/axaxl/files/pdfs/insurance/professional-liability/directors-and-officers/white-papers/xlcatlindo-securities-class-actionswp2.pdf>
- <https://www.chubb.com/content/dam/chubb-sites/chubb-com/au-en/business/large-multinational-businesses-insurance/documents/pdf/chubb-clyde-security-classactions-white-paper-for-apac.pdf>

The recently released, Australian Parliamentary Joint Committee on Corporations and Financial Services Litigation Funding and the Regulation of the Class Action Industry Report, further supports this view in recommendations designed to bring the system under control and back to its purpose.

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<sup>1</sup> Allianz Global Corporate & Specialty SE COLLECTIVE ACTIONS AND LITIGATION FUNDING AND THE IMPACT ON SECURITIES CLAIMS: A GLOBAL SNAPSHOT.

<sup>2</sup> Allens Linklaters, CLASS ACTIONS RISK 2018, <https://www.allens.com.au/globalassets/pdfs/insights/disputes-investigations/classactionrisk.pdf>

From a New Zealand broker's perspective, we are continuously involved in insurer negotiations for listed companies that are centred around the markets view of the increase in this type of litigation and the potential for an increase in activity following the development of class action regimes that have been experienced in Australia and other jurisdictions.

Regardless of published numbers, which in themselves include some significant evidence of the problem, insurers are looking at the potential future exposures and adapting their rating models and availability of capacity in anticipation of meeting the much larger scale claims that are the product of multiple plaintiff actions.

Whilst comparing ourselves to other overseas jurisdictions is useful as we do not currently have the level of claims experience here in New Zealand, it is equally important to consider New Zealand specific aspects such as the size of New Zealand market from an insurance premium pool perspective.

In New Zealand it is difficult to obtain the level of statistical information on specific premium by type as the Insurance Council of New Zealand (ICNZ) only publish this information in clusters to non-members. This is complicated by the fact that providers of D&O Insurance in New Zealand are offshore branches or subsidiaries of international insurers.

By extrapolation we estimate the annual premium pool for New Zealand Directors and Officers insurance at the end of 2019 was approximately NZ\$50 million.

Using the NZ\$50 million figure as a starting point, even if we estimated a tripling in that premium pool, following the current tougher market conditions, a small increase in the claims experience resulting from class actions has the potential to exceed the entire current annual premium pool.

Insurer perception around the potential alteration in risk profile due to the nature of a class action regime and litigation funders should not be underestimated. This is important to consider when developing the class action regime and litigation funding regulation as insurers will exit markets where they perceive a deterioration in the litigation environment.

If we were to experience a material increase in class actions following implementation of a new regime, the market would not currently be in a position to sustain multiple class actions within a single policy period. The result of this would likely include, even higher retention levels, lower limits, increased premiums and potentially more insurers exiting the D&O insurance market in the region.

The impact of that kind of insurer portfolio remediation is felt directly by New Zealand businesses, and if we follow the overseas trends this will result in clients having to sacrifice cover which has the following flow on effects:

- Reduction in limits and removal of additional layers of protection or full withdrawal of insurer capital from the New Zealand market.
- Quality directors and officers may resign from positions where they are not comfortable with the level of insurance protection.
- Companies with substantial balance sheets removing premium income from the market through alternative risk financing – depleting the premium pool which will drive rates up even further.

Ultimately these will be detrimental to claimants who would otherwise have been able to access restitution under much larger insurance limits.

## Relevance of Global Insurance

It is important to understand the connectivity of the global insurance market and the impact this has on New Zealand.

Historically New Zealand benefited from lower litigation activity compared with other jurisdictions and although New Zealand market conditions are tougher than previously, they are still in their infancy compared with more litigious jurisdictions such as the US and Australia.

The local insurance market in the D&O space is dominated by US and Australian owned insurers, as well as a number of UK based insurers and agencies.

To date there have been a number of D&O insurers who have withdrawn from writing D&O in New Zealand and Australia.

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, Canopus, 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.



## Australian D&O Market at a glance



**229%**  
increase in average rate per million  
for **public companies**



**279%**  
increase in average retention  
for **public companies**



New securities entity claims  
estimated quantum:

**\$1 billion**  
per year



**70-100%**  
increase in premium for  
**private companies and NPOs**



Reduced/removal of  
**Side C and  
Side B cover**



**6 insurers**  
have **exited** the  
D&O market in 2020

## Australian D&O Market

SOURCE – DIRECTORS AND OFFICERS LIABILITY  
(D&O) 2020 AUSTRALIAN INSURANCE MARKET  
RECAP SERIES

### Shareholder class actions and claims remain as key drivers behind D&O hard market

Unprecedented average D&O insurance cost – Increases of  
over 200%.

Some ASX200 companies have seen average D&O insurance  
cost increases in excess of 200% and deductibles climbing as  
high as AU\$250 million on their renewals. With no demonstrable  
sign of these increases slowing down, some are finding it difficult  
to obtain the desired level of D&O insurance cover.

Towards the end of 2019, insurers in the Australian D&O market  
warned that despite the magnitude of premium increases  
experienced during 2018 and 2019 (that had already reached  
above 100%), further and higher increases in the following  
year should be expected. 2020 saw these projections come  
into fruition.

The chart (Figure 2) demonstrates the magnitude of what we  
have seen in Australia through the first three quarters of 2020.  
This summary shows the average year-on-year change between  
the end of third quarter in 2020 compared to 2019, based on  
Marsh's ASX200 client data.

FIGURE  
**2**

YTD 2020 at Q3 vs YTD 2019  
at Q3 (Marsh ASX200 clients)

SOURCE: MARSH ASX200 D&O  
BENCHMARKING REPORT

|                                  | Change            |
|----------------------------------|-------------------|
| Average Rate per Million         | + 229 %           |
| Average D&O Premium Spend        | + 173%            |
| Side C Limit                     | - 28%             |
| Average Side C Limit             | AU\$92.02 million |
| Retention                        | + 279%            |
| Average Retention                | AU\$12.96 million |
| Total D&O Limit (ABC, AB, A)     | - 16%             |
| Average Total Limit (ABC, AB, A) | AU\$189.4 million |

# New Zealand D&O Market

## Insurance Market

There is no doubt that we have been experiencing tougher insurance market conditions over the past two annual renewal cycles in relation to D&O insurance.

At this stage major adjustments to renewal premium, retentions and terms have largely impacted listed companies and some other large organisations who purchase substantial limits.

Given the nature of the clients impacted by the market adjustment it is clear that the securities class action environment is playing a major part in this. It has become increasingly difficult to purchase Side C cover and this is also the area experiencing the major adjustments in self-insured retention levels.

Initially, increases and stricter terms were more severe in dual listed companies, however increasingly this appears to be spreading to all listed companies.

The result of the market shift over the past two years is an increase in the rate per million by over 150% in the listed company category with some dual listed companies experiencing increases in excess of 200%.

## Comment on impact on future and New Zealand specific issues

Although there are similarities to the Australian commentary in respect of additional implications from COVID-19, from a New Zealand perspective it would be reasonable to say that insurers are looking to price the risk here to avoid under-pricing of potential future securities class action activity.

The level of premium increases seen in New Zealand are well below countries with the type of claims experience as seen in Australia. While we have seen uplifts in self-insured retentions, we are not yet experiencing the drastic remediation actions occurring elsewhere other than in respect of Side C retentions.

Early indications for the 2021 renewal period point to further premium increases and retention level adjustment. Clients who avoided substantial changes in the 2020 period are likely to experience the full effect of this in 2021.

There are no signs of confidence from the insurance market that New Zealand will benefit from its previously stable representative "class action" claims environment and there is clearly some nervousness around regulatory changes and the unknown impact of COVID-19 on businesses in New Zealand.

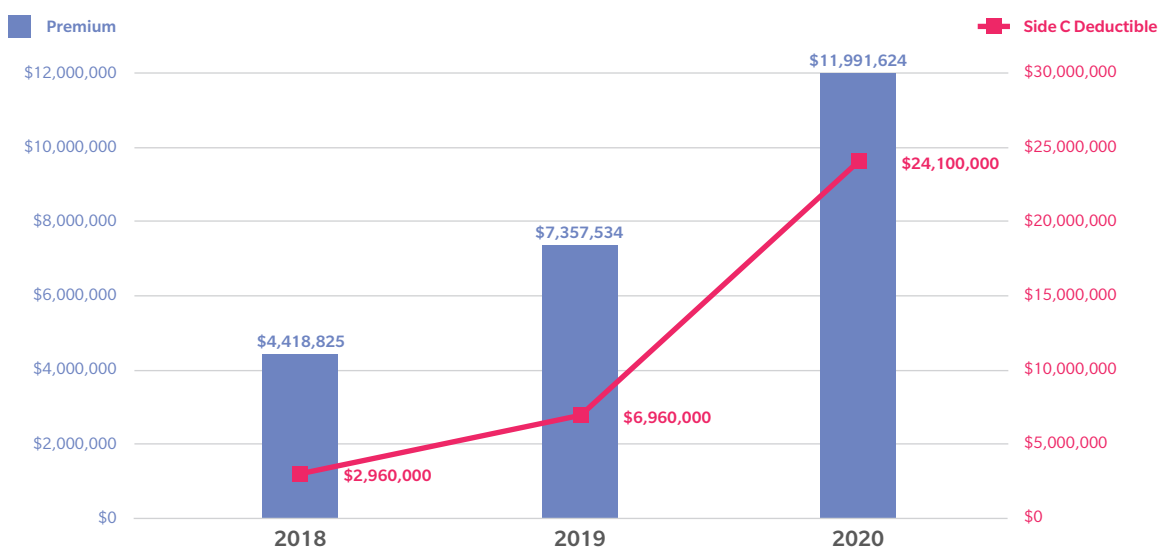
All of this along with a reduction in available capacity has the potential to make lower priced New Zealand risk less attractive and the insurers are likely to be very particular about where they apply their capacity in 2021.

FIGURE  
3

### Side C Deductible and Premium increases 2018 to 2020

SOURCE: MARSH

This graph demonstrates the average impact on a selection of NZX and dual listed New Zealand companies in relation to premium and Side C deductible increases. Figures below are shown in NZ\$.



## Pacific Liability Market

### SOURCE – MARSH GLOBAL INSURANCE MARKET INDEX Q4 2020

Pacific Insurance Pricing Change — By Major Coverage Line:

- Several underwriters have reduced line sizes, contributing to pricing pressure on excess layers.
- Financial and professional lines pricing rose 51%, marking 14 consecutive quarters of double-digit increases.
- The financial and professional lines market continued to deteriorate in the fourth quarter. All major lines — D&O,
- Major claims continued to impact the market, particularly around listed company D&O and construction/engineering PI.
- Listed D&O accounts experienced increases above 100% in many cases, with reduced limits common.

## Impact of Securities Class actions on Liability policies

A large amount of focus has been on the impact on D&O insurance as this line of insurance has already started to produce negative implications relative to the increase in this type of litigation, however there are other insurance classes which can be equally impacted by the structure of a class action regime.

- Professional Indemnity insurance is the policy that responds to professional negligence claims against insureds. Importantly this cover insures both the employer and the individuals who are involved in providing services.
- We already have local experience in class action litigation in relation to Professional Indemnity insurance policies, involving regulatory authorities, professional services firms, financial institutions and the Crown.
- As a result of this liability insurance market participants have indicated that they are reviewing the deployment of their capital in respect of these lines of liability insurance in New Zealand.
- From an insurance market perspective there are already pricing and capacity issues around particular industries and regulatory authorities. The Crown has also been in the spotlight recently with MPI and the kiwifruit industry where the insurance industry contributed NZ\$15 million to the out of court settlement of NZ\$40 million.<sup>3</sup>
- Given the size of these types of actions and the potential for an increase in volume, it is imperative to ensure that there are sufficient defendant protections in the class action regime to retain and attract insurance capital for these risks.



<sup>3</sup> <https://www.mpi.govt.nz/biosecurity/about-biosecurity-in-new-zealand/kiwifruit-claim-litigation-updates/>

# Conclusion

The Marsh submission supports the New Zealand Law Commission's view on the need for a class action regime on the basis that the regime is designed to mitigate potential disadvantages by its design.

The intention of our submission is to advocate for stronger focus on the disadvantages and the resultant impact that these disadvantages could have on directors and officers, the New Zealand business community and the insurance market.

Our views are informed by the current challenges in the D&O and the broader liability market both here and in Australia in terms of lack of insurance capacity, increased self retention levels and premium implications.

Our contribution to this exercise lies in our extensive insurance market and client engagement and ability to provide market insight from an independent intermediary position. Therefore we extend Marsh's offer to contribute further, should the Law Commission proceed to the next step in the development of the class action regime and litigation funding regulation.

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