

# ENTERING FINANCIAL HURRICANE SEASON

WEATHER TURBULENT MARKET CONDITIONS  
BY CREATING A PLAN NOW

The official start of Hurricane Season isn't until June, but it may be more than the Southeast that's facing a storm this summer and fall. With interest rates expected to peak over the next two months<sup>1</sup>, we may start to see the collateral effects of bringing down inflation come through...

When recessions occur, they present unique risk exposures for the banking sector. Some of these present immediately - financial distress, material stock drops and fraud; others lag, like allegations of improper foreclosure, debt collection lawsuits and regulatory investigations. Each risk carries its own coverage considerations that must be contemplated well in advance of a claim. To continue with the hurricane metaphor, the time to check the hatches and fix the roof is when the storm is forming, not when it's overhead. At CAC, we're recommending banking & lending institutions "stress test" their policies today.

## *Here are some of the key questions you should be asking your broker:*

- To what extent does our D&O and E&O policy respond to regulatory matters? What exclusions or limitations to covered loss apply in these actions?
- Does my D&O and E&O policy insure loss that would typically be viewed as restitution or disgorgement?
- To what extent do my policies afford coverage for fines and penalties?
  - Does it only respond for Individuals or is the Entity protected as well?
  - What if we settled the matter before a fine or penalty was determined?
- Does our EPL policy have an exclusion for allegations of third-party discrimination, violations of fair housing laws, or redlining?
- Does our policy include all allegations of discrimination in the definition of third-party wrongful act or claim?
- What carrier relationships do you personally have to achieve the best possible outcomes both at renewal and the time of a claim?
- Does our policy's definition of loss include injunctive relief?

We'd welcome the opportunity to share our views on what the responses to the above questions should be.



## SIGNIFICANT FI MARKET DEVELOPMENTS

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### D&O MARKET TRENDS:

- **Tip Toeing into 2H 2023:** Prior to March 2023, the D&O market for Financial Institutions was stable with ample capacity available in the marketplace. As a result of the bank failures, underwriters have quickly changed course preparing themselves for the worst: a systemic event impacting multiple policies. Expect underwriters to ask a lot more questions specific to capital and liquidity as well as internal controls with regard to lending and servicing. It's too early to determine the impact on rates, but it's fair to say the market has at least moved from softening to stable for most sectors.
- **Carrier Carousel Continues:** Reinvigorated markets, new capacity and competitive veterans keep the market fresh. Markets such as Allianz, Ironshore and QBE have hired experienced underwriters looking to grow their book by competing on lower layers. New capacity continues to compete for excess layers in hopes of building rapport with the insured and dropping down the program in the future.

### ENFORCEMENT TRENDS:

- **DOJ's Combatting Redlining Initiative is Picking Up Steam.** In October 2021, the Justice Department announced the launch of a new Combatting Redlining Initiative. Since the start of the initiative, the DOJ has settled with 6 different firms for a total of \$84M. \$40M of that amount has come in the first 2 months of 2023. Notable allegations in settlements to date are (i) avoidance of providing Home Loans & Other Mortgage Services in Majority-Black and Hispanic neighborhoods and (ii) absence of physical presence/branch in Majority-Black and Hispanic neighborhoods, despite a firm having branches in surrounding areas.

It's also worth highlighting that the CFPB has recently finalized the Dodd-Frank Act Section 1071 rule which requires financial institutions to collect and provide data on lending to small businesses to the Bureau. This rule is intended to create accountability by requiring financial institutions to collect and disclose data about small business loan applicants' race, ethnicity and gender. The data will also include geographic information, lending decisions and credit pricing.

- **DOJ increasing focus on prosecuting PPP Fraud.** The PPP saw more than \$800 billion in loans get issued during the pandemic. Approximately 92% of those loans have been fully or partially forgiven. Recently, multiple Congressional Committees have issued reports highlighting concerns over the amount of fraud that potentially occurred during the time PPP was operational. Most recently, the Pandemic Response Accountability Committee issued a report identifying "\$5.4 Billion in Potentially Fraudulent Pandemic Loans Obtained Using over 69,000 Questionable Social Security Numbers."

Some State Attorneys, including the Palm Beach County Attorneys' office, have recently created a task force to assist the DOJ & FBI in the investigation and prosecution of people who defrauded the PPP.

- **SEC Adopts Compensation Clawback Provisions:** Initially proposed by the SEC in July 2015, the SEC has adopted incentive-based compensation clawback rules requiring publicly traded companies to implement a policy for the recovery of erroneously awarded compensation as a result of an accounting restatement. The final rule extends to both restatements that involve material misstatements as well as those that don't; the latter was



not contemplated in the initially proposed rule. If “Compensation Clawback” sounds familiar in the context of a D&O policy, it’s because most policies have been amended to include coverage for the costs incurred by individuals to facilitate the return of such clawback under Dodd-Frank 954 and SOX 304. Coverage for the compensation amount itself is not covered under most D&O policies, however Bermuda markets have offered coverage for the compensation in the past.

#### GOVERNANCE TRENDS:

- **Shareholder Proposals Heavy on DEI:** Environmental and Social (E&S) shareholder proposals (573) outpaced the number of Governance proposals (332) in 2022 for the sixth year in a row. Environmental proposals (226) addressed a broad range of topics, and social proposals (347) focused on diversity, equity, and inclusion topics. Top governance proposal topics of 2022 included (i) requests to provide for, or make easier, the ability of shareholders to call a special meeting, (ii) calling for an independent chair, and (iii) requests related to adopting or amending proxy access rights.
- **New Delaware Amendment to Officer Exculpation Implemented:** Delaware General Corporation Law was amended in August 2022, permitting officer exculpation with respect to breaches of duty of care. Before the amendment, only directors were permitted exculpation with respect to breaches of duty of care. The inclusion of officers now closes a gap that the plaintiffs bar has been trying to exploit. In order for a company to adopt these changes, its certificates of incorporation must be amended, which will require shareholder approval. The impact on the D&O marketplace of the new amendment remains to be seen, but at least eleven companies have filed for the change to their certificates of incorporation and two D&O lawsuits have been filed against issuers challenging the amendments.

#### SOURCES

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#### CAC Specialty Is Here To Assist

CAC Specialty is a risk solutions company of seasoned and proactive senior industry leaders, operating as a nimble and collaborative partner who puts you and your business first. With a knowledge-driven approach informed by data and decades of honed instinct, CAC Specialty brings an innovative vision to insurance broking and structured solutions to solve your risk challenges – from the simple to the previously unsolvable.

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