Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 102: D&O Insurance and the Regulatory Environment in Trump 2.0 Administration (Part 2)

By Lynda A. Bennett and Scott H. Moss

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Lynda Bennett: Welcome to the Lowenstein Sandler podcast series. I'm Lynda Bennett, Chair of the Insurance Recovery Group at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts, or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now, let's take a listen.

Welcome to Don't Take No For an Answer. I'm your host, Lynda Bennett, Chair of the Insurance Recovery Group here at Lowenstein Sandler, and I'm very pleased to welcome back a couple of guests. We talked last time about the D&O Insurance market, the regulatory environment on the heels of President Trump taking office for the second time, and I'm very pleased to have back with me today Matt Sabino and John McKenna, managing partners at ARC Excess and Surplus. So, John and Matt, welcome back.

John McKenna: Thank you.

Matthew Sabino: Thanks Lynda.

Lynda Bennett: And Justin Kudler has been patiently waiting. He's the Senior Vice President and Senior Claims Counsel at ARC Excess and Surplus, and today we're going to dive a little more deeply into his world on how to get insurance coverage for these types of risks that we've been talking about on episode one. And also, I'm happy to welcome back my partner, Scott Moss, who is co-chair of the Investment Management Group, and he helps companies avoid claims to the greatest extent possible so that you don't need to get D&O insurance coverage and have the need for Justin's services or ours. So, welcome back Scott and Justin as well.

Justin Kudler: Thank you, thank you.

Lynda Bennett: All right. So, last time we talked about just some of the higher-level risks and changes that we may see coming due to Trump coming back into office. What are some of the risks and concerns that fund managers have, and then the underwriters and policyholders have on crypto issues specifically? Scott, why don't you go ahead and weigh in.

Scott Moss: Thank you. So, I think the main risk is trying to figure out what it is and how it's regulated. I would love actually from my perspective to call crypto

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"crypto", and if it was actually regulated as crypto, rather than trying to figure out is it a security, is it a commodity interest, who has jurisdiction, is it currency, is it none of the above, does it exist at all. Those were very hard questions to answer as counsel, whether somebody was trying to not face a regulator or are already facing a regulator asking hard questions.

So, if regulation comes about, or if non-regulation comes about that better defines what it is and what governs it, that would be very helpful in the new administration. And that's my personal hope. It's been very challenging to advise on it not necessarily knowing where it fell.

Lynda Bennett: Yeah. And so, John and Matt, for a period of time, for the very reasons that Scott just said, it seemed like the insurers weren't super anxious to jump in with both feet into insuring crypto because they didn't know what the heck it was. What's the current mindset on crypto? And again, particularly as Trump has stated his desire to make the US the world capital of crypto.

John McKenna: I'll just tell you from the broker dealer side, I got a call a couple of days ago from one of our long-term clients asking what the coverage was in their policy as to crypto, and there's different ways that it can be addressed. Some policies are silent. Some have an absolute exclusion, and some have an exclusion with a carve back for crypto within an ETF or a mutual fund.

I gave them the answer to their question, but my question to them was: What are you doing about it from your end? They just said the requests to have crypto in the portfolio had been overwhelming, and they're actually limiting each investor to $10,000 in the portfolio. They're not soliciting it. It's unsolicited only, and it has to be within an ETF or mutual fund for them to allow it. Otherwise, go open a Coinbase account.

Matthew Sabino: And I think from the underwriting standpoint, as an example, I worked on a deal last year. It was a crypto-related fund. They were looking for coverage. The marketplace was minimal at best. Fast-forward to a month and a half ago, I went back out to market post-election, people want to quote it, got better terms and conditions, got better rates, got better pricing. From a regulatory standpoint, there wasn't as restrictive of coverage, right?

And I think the hope is that you look at this cyber task force, this crypto task force that was just announced from the SEC's perspective about developing a clear framework in terms of regulation of the crypto market. That's all positive from the underwriter's standpoint, because if we can put that in place, kind of what Scott was getting to earlier, if we can get a framework to get carriers comfortable, to get their reinsurers comfortable, we'll ultimately get to a position where more capacity is available in the marketplace, which is ultimately going to be more beneficial to the insureds that are looking to buy the coverage.

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Lynda Bennett: It's a pretty innovative idea that the insurers want to know what the risk is before they insure it, right? Fair enough. So, let's just touch briefly also on trade and tariffs. That's something obviously that Trump has been pretty vocal about. We're getting a lot of questions from clients on that. How are the insurance markets feeling about insuring on those issues?

Matthew Sabino: I haven't gotten too many questions, but I feel like the exposure more so to the larger public companies that have multinational exposure, knowing how to deal with those different territories, how tariffs are going to impact their bottom line, and making sure that executives are prepared for when those tariffs and trade wars for lack of a better term, are implemented. Because ultimately to the extent that it hits the stock price, that's where the claims are going to go. I think it's a wait-and-see to see how it's going to come and how companies are going to handle the exposure associated with those tariffs and trade positions.

Lynda Bennett: And prior public disclosures on what they were doing and why, right? All right, and then just briefly before Justin gets to shine the spotlight here on what I care most about, which is getting the carriers to pay claims, what about IPOs and SPAC deals? People, I think, are feeling a bit more optimistic about the economy and the availability of capital as we move into 2025. What are you seeing in that space in D&O? And also, and I'll kick this to Justin, too, some lessons learned perhaps on how to structure these policies a little better and have them interlocking a little more seamlessly so that when we get to claims, we know how that works?

Matthew Sabino: I was just going to say, obviously with the more favorable or perceived favorable regulatory stance of the administration, we may see the FTC will have more flexibility with a lot of these M&A activities. When that goes to policy construction, obviously the extent that we push back on any sort of antitrust limitations or BOP BOP type of limitations in these policies, trust me, I would love to be able to delete the BOP BOP limitation altogether as opposed to just getting the defense cost carved back.

I don't know if that's going to go away, right? Because I don't think carriers ultimately want to be on the hook for a difference of consideration type of matter, but certainly deal-making is back on the table. I'm not so sure about SPACs. I'm kind of a wait-and-see kind of approach there. But from an M&A, from an IPO standpoint, I think certainly the regulatory or expected regulatory framework is going to lead to some expansion in that arena.

Lynda Bennett: Right.

John McKenna: I think the underwriters are certainly hoping that IPOs come back in a real way. I think they have a lot of dry powder to deploy, and I think they had some of their best years when we were in a flurry of IPO activity.

Lynda Bennett: Well said, John. All right, Justin, you've been patient, and we've made a lot of references to pre-existing claims and the potential change in risk profile that may impact future claims. So, I'll start off with you. What is the

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current state of play with respect to existing regulatory claims? What are you seeing from the carriers on the heels of all of that high level of regulation that happened over the last couple of years under the Biden administration?

Justin Kudler: Well, Lynda, regulatory claims are a part of everyone's claim inventory. Yours, mine, and every insurer's. There are always unique issues relating to regulatory coverage, like whether the subpoena meets the definition of "claim," or whether a wrongful act has been alleged. But other than that, I believe that regulatory claims have been proceeding normally.

Lynda Bennett: So, one of the things that I'm seeing in the pre-existing claims is an interesting phenomenon where insurance companies want to point to and rely on SEC documents and regulations, and how the SEC works, and not necessarily living inside what the policy language says. Have you seen that movie, Justin? And how are we dealing with that to get the carriers back to the insurance contract that they sold?

Justin Kudler: I have seen that movie, Lynda, and it's a horror film. As claims advocates, we just drill down on the policy language and hold the insurers to the commitments they made in their contracts with the insureds, irrespective of how the SEC works.

Lynda Bennett: What do you think the main issue is, or the main lines of defense that the carriers are putting out there in terms of payment for defense and indemnity claims on these regulatory matters?

Justin Kudler: Sure. So, hourly defense rates really are skyrocketing past $2,000 an hour in this space. Insurers, not surprisingly, are pushing back on those rates. We see it a few different ways. One of the ways is there can be pressure on the rate itself and a demand for a defense counsel to take a lower rate. Some carriers don't want to go there or don't go there, and they are more likely to push back on the amount of work performed or which level of lawyer performs it. It becomes a question of how your dollars are deployed.

So, the insurer and the insured, all things being equal, should be aligned on this. The insured doesn't want to waste limits. There could be another claim on that policy year. There could be an unexpected turn in an investigation that would cause additional steep defense costs. So, the insured wants to keep this down, too. And the insured also may want to protect its relationship with counsel for future cases and show that it cares about controlling its bills for those other cases where maybe there isn't insurance.

The pushback on work performed that I was mentioning earlier, it works like a rate cut. It's the same thing, really. If you take a 100 percent of the work and the insurer says, "Well, we're only going to pay for 80 percent of that work," instead of going through on a line-by-line analysis that you and I both have seen can be very tedious, time-consuming, and not terribly worthwhile, saying we'll only pay for 80 percent of work, it's really just the same thing as a 20 percent rate reduction. So, it's just hidden in a

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different set of clothes. But that's what insurers are on for, what they're coming on for, in the space of regulated or highly regulated companies, but there are always some recalcitrant insurers.

Lynda Bennett: I agree with everything that you just said. Another trend that I've seen over the last couple of years, and again I think it rolls back a little bit to the level of regulation the government is imposing or not, is I've had a number of claims where individuals are being asked to come in to be interviewed and need separate counsel. And we've had a lot of head-bumping with carriers on that because the defense cost erodes the limits of these policies, as you and I both know quite well.

And when you have six or seven executives that are being investigated, spoken to, interviewed, and they all want separate counsel, we get into limits, constraints. Because as you said, at $2,000 an hour, those limits go by pretty quick, and the carriers I think are looking for ways to put a fence around that. And it's difficult to do because selection of counsel and the right to independent counsel when potentially those individual officers and directors are not necessarily aligned with what's happening with the company, you need to have separate counsel involved.

Justin Kudler: Alignment is key there.

Lynda Bennett: Correct, yeah. And John alluded to another issue, which is whether you get defense costs for the entity or not, and that becomes a very significant issue of: When does the investigation start and end? As we always talk about here on Don't Take No for an Answer, the specific words of your insurance policy always matter. We always need to look at that because the definition of "claim", the definition of "loss" varies.

So, Justin, with the couple of minutes that we've got left here, I wanted to get your view on whether the fact that we may have less regulatory claims in the future, less aggressive investigation on those that are initiated, will that move the needle at all in terms of cleaning up these historic claims where the insurers may be optimistic that not having as many future claims they can kind of clean up and pay the ones that remain on the books?

Justin Kudler: So, I think the short answer here is no, but for the sake of the podcast, I'll add a little more color to it. That I've never heard of anything like this, where fewer claims in the future could impact currently open claims in terms of dollars spent now and later. I don't think that really reflects an accurate sense of how the marketplace works. I do think... And maybe this harkens back to our previous episode. I do think this could affect premium and affect whether a given market is soft or hard. I also think in theory it could affect the staffing of claims departments. But I would make a number of observations about the number of claims.

So, first of all, under a Trump administration, there could be the same number of claims, but a change in mix. Obviously depending on the new administration's enforcement priorities, you don't know whether fewer dollars will need to be spent in the future, as you were suggesting,

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because even if the frequency of the claims goes down, the severity certainly could rise. And as we were talking about earlier, the defense costs could rise.

In turbulent times, I heard one commentator say, "Agencies will protect their turf." So, if agencies try to protect their turf by taking more stringent enforcement positions or getting out ahead of other agencies in terms of certain issues, then you could find that there could be more costs rather than fewer. And as, I think, Matt was referring to earlier, this is an administration that wants to protect individuals and Main Street investors, including on things like privacy concerns, so we don't necessarily see I think any kind of decrease.

Lynda Bennett: All right. Well, great. Thank you all for joining us for both episodes. Matt and John and Scott and Justin, you have shared lots of very interesting insights. It'll be terrific to see whether some of our predictions come true, and we really appreciate the time that you took to join us and have this very interesting conversation.

John McKenna: Thanks, Lynda.

Matthew Sabino: Thanks, Lynda.

Scott Moss: Thank you.

Justin Kudler: Thank you, Lynda.

Lynda Bennett: Thank you for listening to today's episode. Please subscribe to our podcast series at lowenstein.com/podcast or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Lowenstein Sandler podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel.

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