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RISK SERVICES LTD.

Increased Limit Factors (ILFs): Hidden drivers of cyclical volatility in D&O Insurance?

What is an ILF?

An Increased Limit Factor (ILF) is a method used by insurers to price each additional layer of coverage in a Directors & Officers (D&O) Liability program. The ILF acts as a “discount” applied to the preceding layer in the insurance tower (see Exhibit A for a visual).

For example: if the first \$10M of coverage costs \$250,000 and the next \$10M layer is priced with a 75% ILF, that excess layer would cost \$187,500. This reflects the assumption that higher layers are less likely to be triggered than lower ones, provided the underlying layers are appropriately priced to absorb defense and settlement costs.

However, insurers can rely too heavily on ILFs. In “hard markets”, when capacity is restricted, ILFs can invert, meaning an excess layer may cost more than the layer beneath it. In “soft markets”, abundant capacity and competition drive ILFs down, sometimes resulting in identical ILFs applied across many layers. This practice raises questions: how can the same factor apply across multiple layers if pricing is meant to reflect portfolio and risk views? In Exhibit B, we demonstrate how this approach can be more cost efficient for a D&O tower build, while providing enough premium for excess layers accounting for the severity exposure.

Why This Matters

If pricing practices fail to adapt, the market risks another correction, similar to 2019–2022, bringing volatility in pricing and coverage. A better alternative to ILFs is exposure-based pricing, independent of underlying layers, using claims frequency and severity analytics. **This is Banyan’s approach: we set sustainable premiums based on modeled risk, building resilient portfolios for the benefit of insureds.**

The ILF Compounding Trap

ILFs often misprice certain layers. In some cases, premiums are inflated above market levels; in others, they are compressed too low. This distortion is most pronounced for large market-cap companies in higher layers of coverage.

- Example 1: A \$50B market cap company may secure a \$10M layer attaching above \$80M of coverage for under \$14,000. Our data suggests the premium should exceed \$50,000, —over 275% higher, —to reflect severity risk adequately.
- Example 2: A \$250M market cap company might have a \$5M primary layer priced at \$50,000. Given the low frequency and contained severity, the next \$5M excess layer could reasonably be \$20,000 (a 40% ILF), rather than \$35,000 based on the traditional 70% ILF approach.

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The Longer-Term Challenge

Our analysis of thirty years of securities class action data confirms that loss probabilities vary significantly across attachment points. Yet, when carriers apply uniform ILFs across a tower, some layers are systematically underpriced, particularly where severity risk is greatest, while others are overpriced relative to their actual exposure.

Data: The Growing Severity Is Real

Data consistently shows that exposures and defense costs are rising. Yet, despite academic research and loss statistics, terms and conditions continue to broaden, while premiums shrink due to ILF compression.

Recent findings include:

- SAR's securities class action litigation report highlights growing severity in U.S. cases.[1]
- NERA's H1 2025 report shows average settlement values up 27% compared to 2024 (inflation-adjusted).[2]
- AM Best warns that D&O premiums "fell too far, too quickly," undermining reserves for future claims.[3]

Despite these warnings, ILF pricing continues to erode premium pools even as exposures grow, setting the stage for another sharp correction. This reflects the industry's recurring "cyclical amnesia."

Banyan's analytics isolate the drivers of historical claims and model expected frequency and severity across segments and market caps. This supports our practice of setting premiums independently of underlying layers, rather than relying on compounding ILFs.

The Core Concern

ILFs amplify swings in D&O premiums, destabilizing the market. Excess layers, in particular, lack sufficient premium to absorb severity exposures. Eventually, prices spike to restore adequacy, straining relationships between carriers, brokers, and clients.

By contrast, Banyan's risk-rated pricing builds stability, transparency, and trust.

Key Takeaways for D&O Buyers

Ask your carrier:

- How do you derive premiums?
- How do you price our risk?
- How do we fit into your overall portfolio strategy?

Understanding these answers helps ensure sustainable partnerships and more stable premiums.

[1] sarlit.com/thought-leadership

[2] <https://www.nera.com/insights/publications/2025/recent-trends-in-securities-class-action-litigation--h1-2025-upd.html?lang=en>

[3] <https://news.ambest.com/newscontent.aspx?refnum=266149&altsrc=17>



Exhibit A - Visual of a D&O Tower using standard ILFs

	Limit	Attachment	ILF	Premium
5th Excess	\$10,000,000	\$50,000,000	75%	\$ 59,326
4th Excess	\$10,000,000	\$40,000,000	75%	\$ 79,102
3rd Excess	\$10,000,000	\$30,000,000	75%	\$105,469
2nd Excess	\$10,000,000	\$20,000,000	75%	\$140,625
1st Excess	\$10,000,000	\$10,000,000	75%	\$187,500
Primary	\$10,000,000	\$100,000 (SIR)	-	<u>\$250,000</u>
				\$822,021

Exhibit B - Visual of a D&O Tower not built on ILFs and using Banyan pricing model

Inputs:

Market Cap: \$100M

Industry: Technology

Listing: US Listed

	Limit	Attachment	Premium
5th Excess	\$10,000,000	\$50,000,000	\$ 48,000
4th Excess	\$10,000,000	\$40,000,000	\$ 53,000
3rd Excess	\$10,000,000	\$30,000,000	\$ 64,000
2nd Excess	\$10,000,000	\$20,000,000	\$ 88,000
1st Excess	\$10,000,000	\$10,000,000	\$155,000
Primary	\$10,000,000	\$100,000 (SIR)	<u>\$266,000</u>
			\$ 674,000

[1] sarlit.com/thought-leadership

[2] <https://www.nera.com/insights/publications/2025/recent-trends-in-securities-class-action-litigation--h1-2025-upd.html?lang=en>

[3] <https://news.ambest.com/newscontent.aspx?refnum=266149&altsrc=17>