Howden Re

D&O in the AI buildout: preparing for a major correction

Impact of an AI-bubble burst scenario on D&O insurers: quantification and preparation

March 2026

HOWDEN

Executive summary

Artificial intelligence has become the most powerful economic narrative of the decade and foreseeable future.

Public markets, private capital, and corporate boards have embraced AI as a transformative force capable of reshaping productivity, profitability, and competitive advantage. At the same time, financial stability authorities have begun warning that AI linked valuations may be "disconnected from fundamentals" (Bank of England, Financial Stability Report 2024), while global regulators have expressed concern about misleading AI related disclosures, or "AI washing" (SEC Chair Gensler, 2023).

A sudden AI bubble burst and the resulting market correction could trigger a wave of litigation against corporate directors and officers. The typical claims may allege misrepresentation such as AI-Washing (overstating the impact to the company's earnings from AI initiatives) or failure to timely disclose material facts that cause earnings guidance to become unachievable. Other claims may allege inadequate governance, operational failures tied to AI systems, and regulatory violations. For D&O insurers, the risk is not limited to technology companies. AI is now embedded across industries, creating correlated exposures that are starting to resemble — and in some ways exceed — the systemic characteristics of the dot com bubble of 2000.

While current indicators suggest we are not in a bubble quite yet, this white paper provides an analysis of the emerging AI bubble, the potential triggers for a market correction, the likely D&O claim patterns, and the strategic steps insurers should take to prepare.

The emerging AI bubble risk landscape

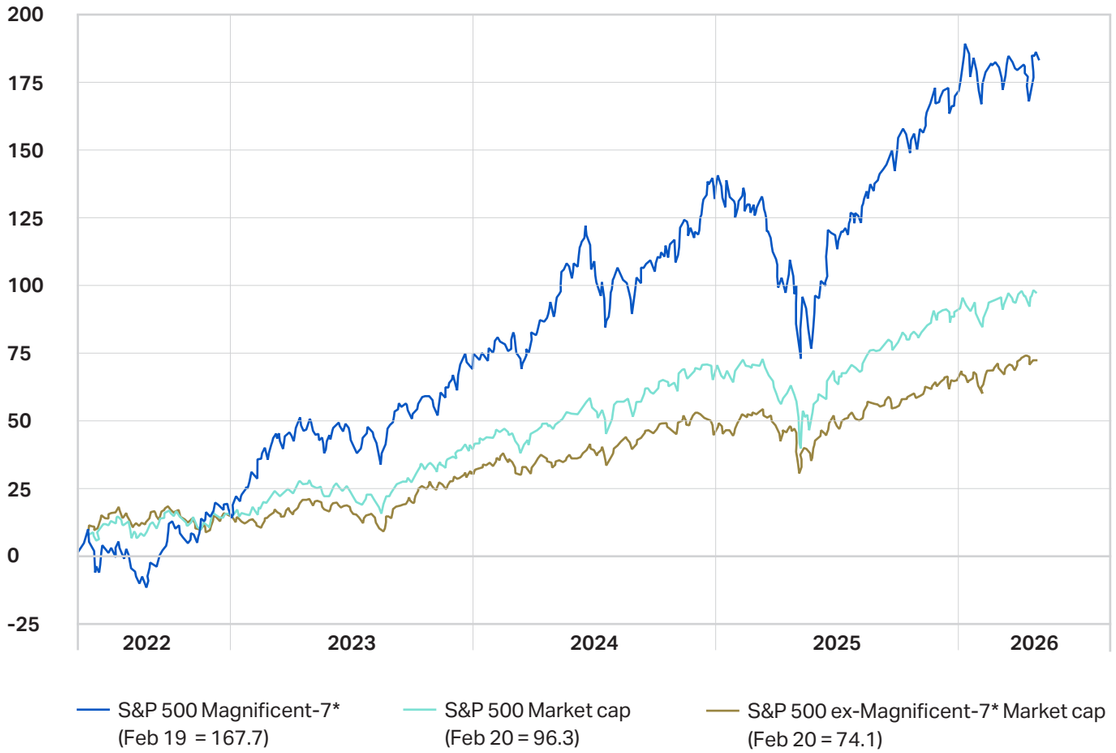
Macroeconomic and Market Context

AI has become a central driver of recent equity market performance. As depicted in Chart 1, a small number of key AI firms account for a disproportionate share of S&P 500 gains over the past few years, contributing to historically high levels of market concentration.

The Mag 7, consisting of Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla, all of which are significant players in the AI space, have gained 175% over the past 3 years and now combine for a market cap of $22 trillion or 38% of the S&P 500 market cap. Private companies in the AI Space contemplating IPO's in 2026, such as SpaceX, Open AI, Anthropic, and Databricks, may contribute another $2 trillion of market capitalization to this concentration.

Chart 1:

Market cap of S&P 500 with and without magnificent-7*
(percent change since Oct 12, 2022, daily)



Source: LSEG Datastream and Yardeni research. Standard & Poor's.
*Magnificent-7 stocks include Alphabet (Google), Amazon, Apple, Meta (Facebook), Microsoft, NVIDIA and Tesla. Both classes of Alphabet are included.

A realization, if true, by the market that demand for AI computing services will not support the massive buildout, could send markets tumbling with infrastructure stocks and their backers hit hardest.

Corporate adoption of AI has accelerated rapidly. Over 60% of S&P 500 companies mentioned AI in their 2025 Q2 earnings calls, a figure that is on the rise. Companies across sectors — from financial services to healthcare to logistics — are announcing AI initiatives, often before demonstrating clear return on investment. This enthusiasm has fuelled expectations of significant productivity gains. Investment in data centre buildouts to support these initiatives is expected to cost several trillion dollars through 2030. The risk of an oversupply of AI computing capacity is at the heart of the bubble talk we hear so much of.

A realization, if true, by the market that demand for AI computing services will not support the massive buildout, could send markets tumbling with infrastructure stocks and their backers hit hardest. Other triggers could come from advancements in technology. For example, the 2025 launch of DeepSeek R1 (a new AI model needing far less computing power) drained over $500B of market cap from NVDA in a single day. More recently (February 3, 2026), UBS issued a report warning that off-the-shelf AI offerings pose a threat to companies engaged in Software as a Service "SaaS". The report triggered a sharp market reaction, with major SaaS company stocks as well as the stocks of the large Private Equity firms falling 5-15% in a single day.

Indicators of a potential AI bubble

While there are many metrics and signals leading some to believe that an AI bubble may be forming, there are also some fundamental characteristics of this market that suggest that we are not yet there.

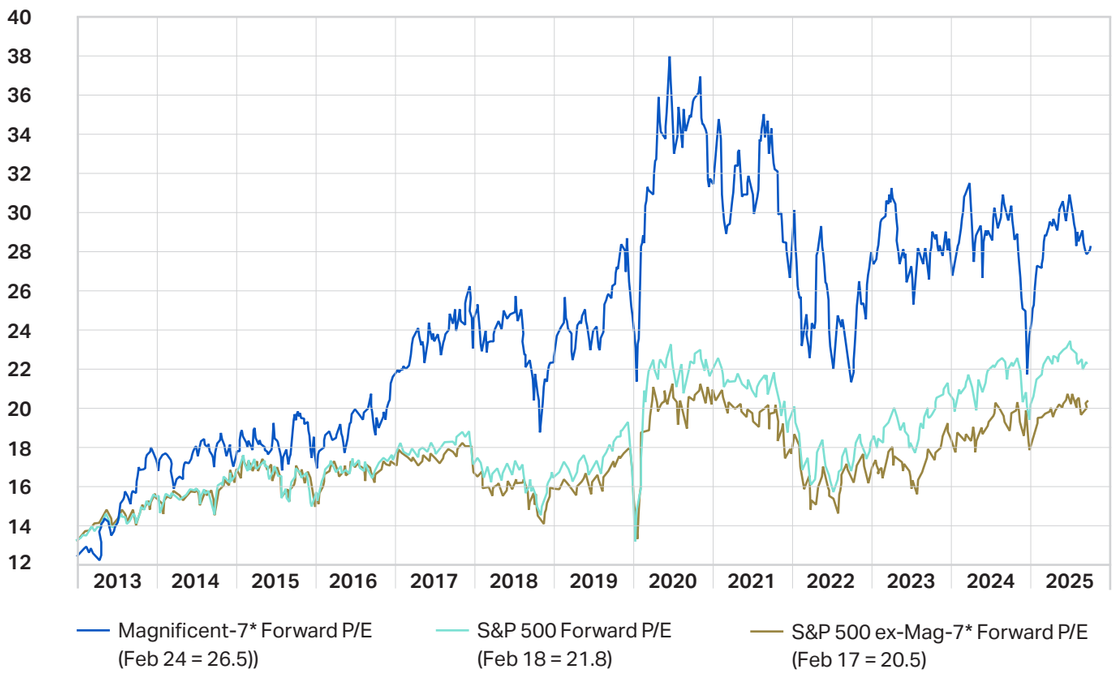
Valuations vs Fundamentals:

Much of the concern from those pointing to a bubble stem mainly with these headline metrics: the meteoric price appreciation of the Mag 7, market caps reaching incredibly new heights, and the large amount of capex being spent on the AI buildout.

As seen in Chart 2 below, however, the Mag 7 trade at a P/E ratio of ~28x, which is less than half the level for large tech companies leading up to the 2000 Dot Com Bubble burst. Further, these companies generate significant free cash-flow, engage in stock buybacks, and pay dividends; comforting metrics that have even attracted value investors like Warren Buffet, who has major stakes in AAPL and GOOGL.

Chart 2:

Forward P/E ratios* of S&P 500 with and without magnificent-7** (weekly)



Source: LSEG Datastream and Yardeni research. IBES
*Price divided by consensus forward earnings forecase
** Magnificent-7 stocks include Alphabet (Google), Amazon, Apple, Meta (Facebook), Microsoft, NVIDIA and Tesla. Both classes of Alphabet are included.

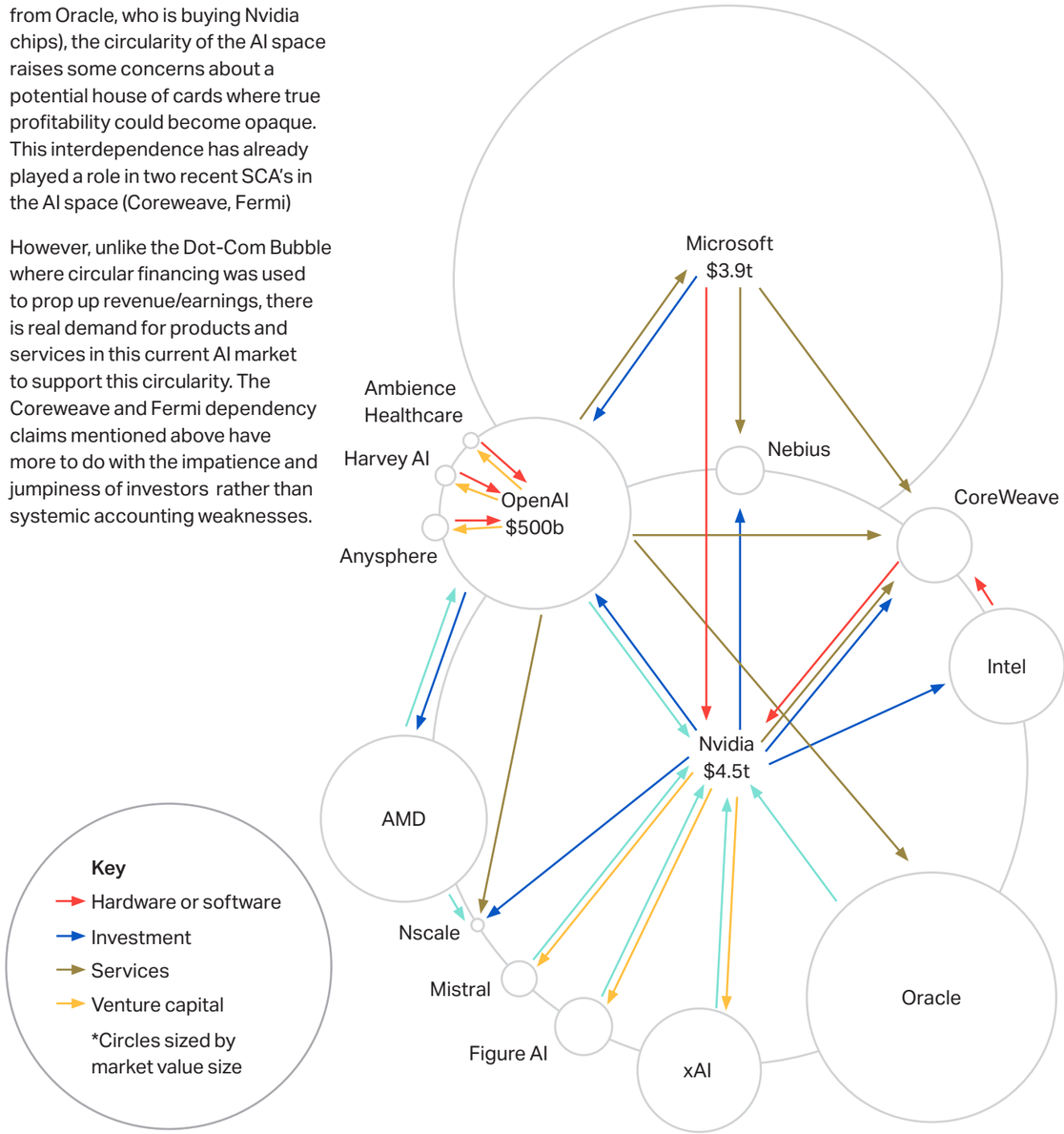
Circular Financing:

With the largest AI companies' consistency in investing in one another (as seen in Chart 3 below, Nvidia has invested in Open AI, who is purchasing computing capacity from Oracle, who is buying Nvidia chips), the circularity of the AI space raises some concerns about a potential house of cards where true profitability could become opaque. This interdependence has already played a role in two recent SCA's in the AI space (Coreweave, Fermi)

However, unlike the Dot-Com Bubble where circular financing was used to prop up revenue/earnings, there is real demand for products and services in this current AI market to support this circularity. The Coreweave and Fermi dependency claims mentioned above have more to do with the impatience and jumpiness of investors rather than systemic accounting weaknesses.

Chart 3:

How Nvidia and Open AI fuel the AI money machine



Source: Bloomberg

Other Accounting Risks to Watch:

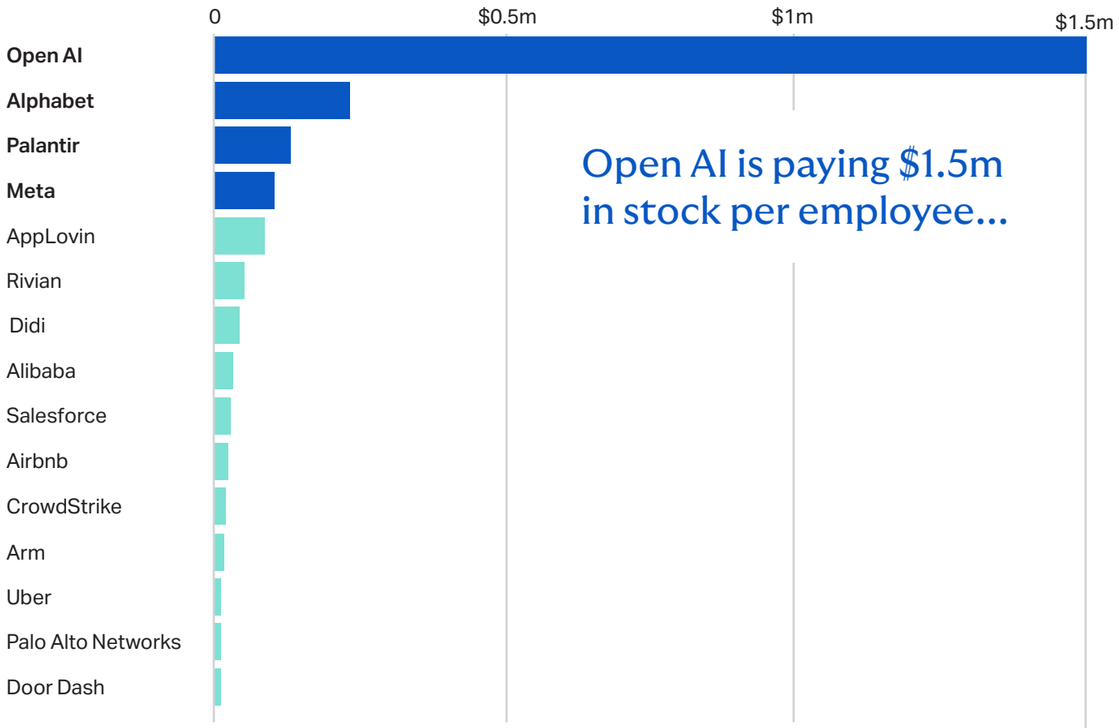
Sceptics like The Big Short legend, Michael Burry, argue that the typical depreciation schedule for GPU's of 4-6 years is too long for AI chips and is a ticking time bomb of future write-downs. This may be true, but depreciation rates are ascertainable to investors and follow GAAP, thus are less likely to sneak up on the market.

Stock-based Compensation schemes for start-up companies can rise to proportions that blur the financial statements and/or dilute shareholder value. As the race for top talent becomes increasingly competitive, many AI companies are offering large stock compensation packages to the best researchers and engineers. This was problematic in the Dot-Com Bubble and is a growing concern in the AI space as highlighted below in Chart 4.

Chart 4:

Stock-based compensation prior to IPO, in inflation-adjusted 2025 dollars, among major technology companies that have gone public since 2000

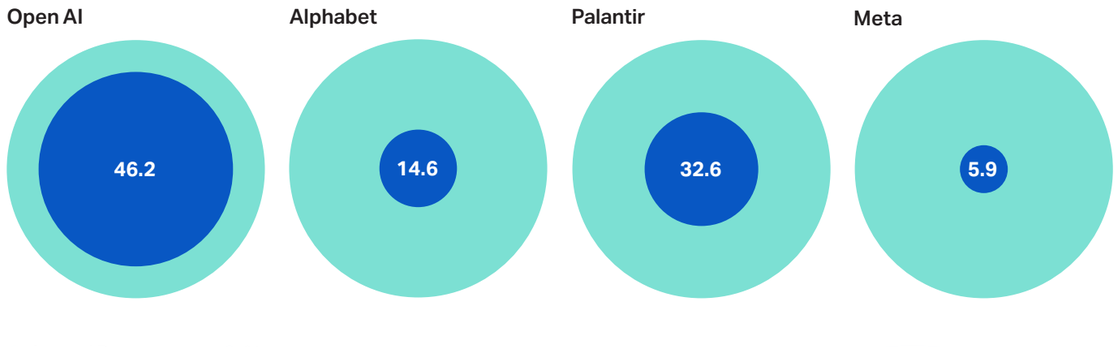
Stock-based compensation per employee



Source: Wall Street Journal

...which represents nearly half of the company's revenue.

Overall stock-based compensation as a share of annual revenue*



*Share for OpenAI uses a 2025 compensation and revenue projection shown to investors this summer; shares for other companies use figures for the most recently concluded year before their IPO, per securities filings.

Note: Figures for companies other than OpenAI are based on an Equilar analysis of company disclosures. Alphabet is the parent company of Google, which went public in 2004. Meta changed its name from Facebook in 2021.

Sources: Company information shared with investors (OpenAI figures); Equilar (all others)

The large private equity firms have poured tens of billions of dollars into private companies in the AI space putting them at increasingly greater risk of a slow-down or correction.

Some sceptics see private companies in the AI space overvalued relative to comparable public companies. This may lead to disappointing IPO or post-IPO performance as well as underperformance of the big private equity firms.

Legal climate impact on a potential bubble vent

Accounting Regulations

The Dot-Com Bubble burst of 2000 resulted in sweeping changes in the form of the Sarbanes-Oxley Act of 2002, criminal convictions (executives from Enron, Worldcom, Tyco and more), and the shutdown of Arthur Andersen (formerly one of the Big 5 Accounting Firms). While this was a quarter century ago, these controls and deterrents remain effective and would likely reduce the breadth and severity of a similar event were it to happen today.

Securities Class Action Trends (Frequency)

It has been a roller coaster ride in terms of the number of SCA's since 2000. We are currently in an elevated state, not due to an increase in bad behaviour or heightened regulatory scrutiny, but instead due to a rise in nuisance claims turning any missed earnings report into allegations of failure to disclose. Recent trends have begun to decline, driven in part by the adoption of federal forum provisions and a less assertive SEC.

Derivative and Direct Action Suits

Plaintiff firms have had growing success bringing non-SCA suits in state court by way of Derivative and Direct-Action suits. Failure of oversight claims on mission critical operational failures and large merger claims are leading to historically large settlements impacting severity rather than frequency.

Claims Inflation

Ground-up severity trends in D&O have matched or outpaced inflation, with the upward pressure becoming more pronounced in recent years. This increase has been accompanied by rising legal costs. The combined effect is pushing more exposure to the higher excess layers.

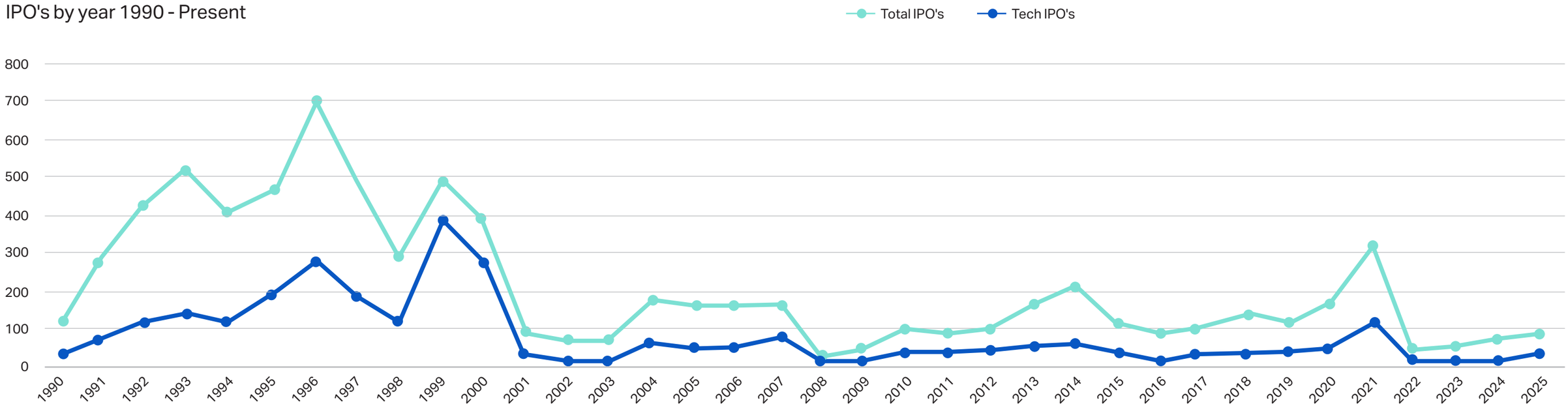
Full Industry Crash vs Sub-Industry Crash

The AI buildout to date has centred around a handful of public companies focused on the infrastructure buildout, including hardware, AI foundational models and data centres. Downstream sectors that include the service providers and the end-users will continue to evolve and broaden the scope of what we consider included in the AI ecosystem. However, this upstream and downstream may work to divide the bubble into two smaller bubbles. For example, a sudden realization of there being a glut of computing resources would hurt the infrastructure side, but it would help the downstream companies that benefit with lower computing costs.

IPO Activity:

In the D&O context, perhaps the biggest difference between the current AI landscape and the Dot-Com Bubble can be seen in the number of tech IPO's. The numbers in recent years have been quite low and nowhere close to the levels seen in the dot-com mania of the late 90's. Chart 5 below illustrates this. The number of IPO's is not just an indication of the irrational exuberance in the stock market but also a strong predictor of D&O performance as '33 Act Section 11 claims have fewer pleading hurdles and are the low-hanging fruit for plaintiff firms.

Chart 5:
IPO's by year 1990 - Present



Portfolio exposure assessment for D&O insurers

D&O carriers can prepare now for the potential scenario of an AI Bubble correction event.

While such an event will impact the entire D&O market, its impact can vary widely amongst individual carrier portfolios. Carriers exercising best practices with respect to managing concentration risk, limit deployment, and attachment point strategy can avoid an outsized market share of a major event.

Concentration Risk

The key benefit of diversification in a D&O portfolio is that it allows a carrier to weather the storm when there is a contagion of claim activity in a particular sector. In prior events with a surge of correlated claim activity, as in Technology in 2000 or Financial Institutions in 2008, the non-offending sectors enjoyed relatively quiet periods of claim activity. The diversification benefit is seen throughout the cycle, not just in the short surge periods. To manage concentration risk, capturing industry codes at the account level is essential.

Identification/Classification

- NAICS or GICS are standard and allow you to measure market share across major segments. These codes are updated every 5 years or so.
- Custom industry codes may be more nimble but harder to compare against industry without an up-to-date mapping.
- The standard industry coding systems, however, do not identify AI companies specifically nor the type of AI Company (e.g. foundational model, infrastructure, applications). If you want to go deeper into concentration risk, you could manually establish AI identifiers, or you can let Howden Re do it for you. We have added an AI identifier to all U.S. traded companies in the latest update to Howden Re's D&O Model, which we use to quantify a client's exposure to an AI Bubble Event.

Market Share Analysis

- Review and compare portfolio mix of business by industry with the mix of the overall market regularly to uncover any major concentrations above average.
- Mix of business by size of firm is also very important, especially when trying to manage the underwriting cycle. Know that pricing swings over time fluctuate to a greater degree for the larger and riskier accounts, and given that we are in a soft market, pricing for these accounts, many of which are squarely in the AI space, is less than adequate in the short term.

To manage concentration risk, capturing industry codes at the account level is essential.

Limit Deployment

It may be too obvious a point to recommend disciplined limit deployment, whereby the overall premium to max limit balance affords a portfolio an acceptable level of loss ratio volatility. But even the best underwriters can sometimes get out over their skis or need to make accommodations to support their key clients or partners. Having a good monitoring process can go a long way, especially in Financial Lines where there may be less than obvious accumulations of limit.

- Monitor per policy maximum limits as well as stacked limits per insured
  - Stack limits, if applicable, per insured across multiple platforms (e.g. U.S., Bermuda, London teams, etc.).
  - Link policies and stack limits across correlated products (e.g. Full D&O/Side A/Fiduciary or SPAC/DeSPAC/Runoff) for individual insureds. Frankly, the above stacking should be a standard procedure in a Financial Lines unit, since they are underwritten by the same unit. Perhaps less standard, stacking the above products with Tech E&O/Cyber policy limits would be useful here as a catastrophic cyber event involving an AI system could very well be the trigger for a Bubble bursting.
- Scrutinize outliers both in terms of total limits deployed but also focus on where the reward may be insufficient for the risk. Take, for example, a high excess Side A layer on a multi-trillion-dollar market cap company at around $5K per mil of limit. You should ask the questions, "Is it really a 1-in-200-year likelihood of a tower-busting claim for this company"? and "Is my portfolio better without this?"

Attachment Point Strategy

Another way to benefit from diversification is in terms of attachment point strategy. Claim trends, both the inflationary type as well as litigation trends, can and do impact primary and excess layers differently and sometimes unexpectedly. Furthermore, rate adequacy across the spectrum of attachment points vary from time to time, so it is important to not be stuck in one place for too long. Best practice is to be as diversified and opportunistic as possible.

- Full-service carriers should maintain a balance of primary/excess and be flexible enough to capitalize on market inefficiencies.
- Carriers who write only excess policies should avoid falling into narrow band of attachment points and instead consider deploying limits across ventilated excess layers to gain the diversification benefit.

Conclusion

The AI boom presents both opportunity and systemic risk.

Booming economic activity and resulting rise in market caps plus some mega IPO's will give the public D&O market a boost in demand and hopefully help turn the tide on the soft market. On the other hand, bubble like expansion of valuations demands careful attention to portfolio construction.

Proactive preparation today will determine which insurers weather the storm and which are overwhelmed by it. Those supported by best-in-class risk transfer expertise are well positioned to not only navigate volatility but also seize opportunities in a rapidly evolving landscape. Howden Re built its D&O Model with this in mind and it's letting us do our part in helping the industry build sustainably profitable portfolios.

Every business faces unique exposures, let's talk about yours.

Report Author

Brian Turner
Managing Director, FCAS, MAAA, CPCU

brian.turner@howdenre.com
+1 (646) 709 7018

The Team

Carrie Byler
Head of US General Casualty

carrie.byler@howdenre.com
+1 (646) 960 2422

Steve Hanke
Managing Director

steve.hanke@howdenre.com
+1 (203) 722 4510

Jim Walsh
Managing Director

jim.walsh@howdenre.com
+1 (201) 747 5046

Evan Glisson
Head of Casualty Analytics

evan.glisson@howdenre.com
+1 (718) 406 4912

One Creechurch Place, London EC3A 5AF

+44 (0) 20 7398 4888
howdenreinfo@howdenre.com

howdenre.com