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WHAT'S NEXT: THE FUTURE OF D&O LIABILITY INSURANCE

With extreme market fluctuations quickly becoming the norm of the day, shareholders are being forced to experience a nauseating roller coaster ride watching their investments dwindle away. While shareholders do their best to ride out the lows, the plaintiffs' bar is sharpening their claws preparing to pounce onto the scene. Right now no one can be exactly certain where they will land. Although financial institutions are proving to be a good starting point, few if any companies are immune from their attack. Of course, further fueling the fire is the constant media spotlight on Main Street's outcry for reprisal against those executives who, in their estimation, have been reaping more than their fair share for far too long. Today, it is nearly impossible to pick up a paper or watch the news without seeing some commentary speculating on the reasonableness of certain executive compensation packages in light of the current financial condition of the companies. Several recent corporate failures and government bailouts have resulted in sharp scrutiny on some of these "golden packages". With no immediate end in sight to these tumultuous times, directors and officers need to brace themselves for a bumpy road ahead.

In our current climate with emotions running high and uncertainty as to where and when the claims will start coming in, shareholders may not be inclined to draw distinctions between those directors and officers who may have ill served their boards and companies and those whose service has been above reproach, which certainly can prove to be problematic for the latter group. It would seem that directors and officers have some cause for concern since we have not yet felt the impact from the wild market instability of the past few months. With that in mind, it may be wise for those closest to the fire to take the time now to familiarize themselves with their D&O policies in the event that a claim comes their way.

If the best offense truly is a good defense, then it was very disconcerting to learn at a recent discussion group on "*The New Era of Executive & Director Liability*" co-moderated by Steven Anderson, Executive Managing Director of Beecher Carlson's Executive Liability Practice at Corporate Board Member's Annual Boardroom Summit¹,

¹ Discussion group was held on October, 15, 2008 as part of the program for Corporate Board Member's 5th Annual Boardroom Summit at the Grand Hyatt in New York. Co-presenters included Bruce Vanyo, National Co-Chair of the Securities Litigation Practice and Co-Managing Partner of the Los Angeles Office, Katten Muchin Rosenman LLP., and Kieran Hughes, Assistant Vice President, AIG Domestic Claims.

that very few of the directors and officers in the audience had taken the time to substantively review the terms and conditions of their D&O policies. Even more telling of the disconnect between those tasked to procure the policies and those most effected by them when a claim comes in was the fact that only about a third of the audience was familiar with Side A coverage. An unfortunate conclusion drawn by the moderators from their experiences and further reinforced by these responses is that too many times directors and officers are not aware of what they do not have in terms of coverage. Issues such as the wording of the severability, indemnification, and exclusion provisions were addressed in great detail in addition to some of the newer endorsements offered by the markets to shore up potential loopholes.

Another issue raised by an audience member inquired as to the recent trends in purchasing IDL coverage. Some interesting points debated during this discussion addressed potential internal conflicts that can arise between board members when directors elect to carry different limits damaging the “all for one and one for all” spirit of the board. That aside, it is an important consideration as expenses and fees related to securities claims can easily erode policy limits forcing directors to fund their own defense. It is a real concern for directors to thoroughly vet when purchasing D&O coverage.

Apart from recent market conditions, claim filings this year were already steadily climbing back up to levels not seen in years. Some estimate that filings could soar as high as 280², which would be the highest number of filings since 2002. So far this year it has been reported that one third of the securities filings are attributable to subprime issues and that number is likely to grow as the year progresses. In addition to the fallout from the subprime meltdown, other significant issues plaguing the industry include increased regulation, the full extent of which remains to be seen, the globalization of securities litigation resulting in more foreign companies commencing lawsuits in the U.S., as well as the plaintiffs’ bar making attempts to forge new ground in foreign countries.

Another important issue demonstrating the unwavering strength of the plaintiffs’ bar that was highlighted during the discussion involved the increased activity of upfront private investigative efforts of these firms. Plaintiffs’ firms are seeking to obtain statements from former employees to bolster their allegations of possible fraud in their complaints asserting securities violations. In some instances, firms will even go as far as employing former FBI agents to reach out to as many former employees as possible in an effort to obtain information to try to influence courts in defeating motions to dismiss. As a result of such activities corporations have valid concerns over the safeguards in place to protect confidential information that could be accidentally and intentionally disclosed by these former employees. These efforts signal that plaintiffs’ firms are continuing to find ways to overcome some arguably unfavorable decisions for them of recent years.

In summing up the current climate of the D&O market, Steve advised that financial institutions are seeing, and can likely expect to continue seeing, an increase in premiums,

² Statistic from NERA Economic Consulting

cutbacks in capacity, tightening of policy terms and increases in retentions. One dire prediction from some industry experts is that 1 in 9 banks will fail in the next 24 months.

Putting financial institutions aside, overall D&O renewals thus far have not been viewed as problematic. Steve has not seen any real issues filling out D&O programs although poor 3rd Quarter results by insurers may cause them to pull back on capacity and increase premiums. Some markets have elected to increase limits and some newer markets are emerging onto the scene as well. However, Steve did caution that current market conditions have resulted in some companies seeking to hedge their risk by further diversifying their insurers.

When choosing your D&O insurer it is important that you seek out a partner with a company that values the overall big picture. As an insured, you do not want a partner that haggles over every line item and who essentially nickels and dimes you when trying to navigate through a claim. With the general consensus being that buyers of D&O coverage over the past few years have become more sophisticated, it would seem logical that they would want to know in plain language exactly what coverage their D&O policies provide. In the end, all of the moderators agreed that understanding what you have and comparing it to what is available in the markets will give you a good perspective on any policy enhancements you may be missing.

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