

## DIRECTOR AND OFFICER LIABILITY TRENDS

8:30 AM

Gordon (Chip) Davenport, Foley & Lardner LLP

Daniel Fortin, CAN Financial Corporation

Michael Rice, Aon Financial Services Group



**GORDON (CHIP)  
DAVENPORT III**  
PARTNER  
Foley & Lardner LLP

Gordon Davenport III, a partner with Foley & Lardner LLP, is an experienced litigator who has counseled and represented clients in complex commercial litigation and insurance matters, including product liability cases, distribution litigation, national class actions, insurance coverage disputes, and insurance distribution and sales practices matters. Mr. Davenport is also a leader in the field of Directors and Officers Insurance. He is chair of the firm's Insurance & Reinsurance Litigation Practice, and a member of the Distribution & Franchise Practice as well as the Insurance Industry Team.

Mr. Davenport is admitted to practice before the U.S. Supreme Court, the U.S. Court of Appeals, Seventh Circuit, and the Eastern and Western Districts of Wisconsin. He is a member of the Dane County Bar Association, State Bar of Wisconsin and American Bar Association (Litigation and Tort and Insurance Practice Sections).

Mr. Davenport is a graduate of the University of Wisconsin, where he received his business administration degree in 1980 and his J.D. degree (*cum laude*) in 1983. He was a member of the *University of Wisconsin Law Review* and was elected to the Order of the Coif.

Mr. Davenport was named to the 2007 list of Wisconsin Super Lawyers by *Law & Politics Media, Inc.* for his business litigation work.



Dan has been with CNA for 16 years and is responsible for leading a number of underwriting areas within CNA's Specialty Lines segment that provide management liability professional liability insurance products to large commercial firms, financial firms and law firms. At CNA, he is charged with developing and executing underwriting strategies, establishing broker and insured relations, and leading a team of 75 underwriting professionals. In addition to overseeing underwriting operations he is involved in the actuarial and claim functions. Dan started his career at CNA in 1991 as an underwriter focusing on directors and officers liability insurance provided to publicly traded commercial firms. He also serves as a director on the board of CNA's European insurance company. Dan received his undergraduate degree from Villanova University and his graduate degree from Northwestern University's Kellogg Business School.

**DANIEL FORTIN**  
SENIOR VICE PRESIDENT  
CNA Financial  
Corporation



**MICHAEL D. RICE II**  
CHIEF EXECUTIVE  
OFFICER  
Aon Financial Services  
Group

Mike currently serves as Chairman for the Aon Risk Services Chicago and Chief Executive Officer of Aon Financial Service Group (FSG). Aon FSG is a national practice group for executive liability coverages that places approximately \$3 billion in premium yearly. He is also a member of the Aon Risk Services US Executive Committee. His specialty is Executive Liability (D&O) Insurance for Fortune 500, Tech & Telecom and Initial Public Offerings.

Mike is the architect and original Managing Director of Aon Technology Group which specializes in the insurance needs of Technology & Telecommunication companies as well as an original founder of Aon's online insurance market submission process known as Aon Market Exchange (AMe). Mike was selected as a double winner in the inaugural 2006 Risk and Insurance Magazine Power Broker Survey in Computer Hardware and Telecommunications. He received his Bachelor of Science - Finance from Boston College, 1989.

Director and Officer Liability  
Trends

Gordon Davenport III  
Daniel Fortin  
Michael Rice

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Director and Officer Liability  
Overview and Trends

Michael D. Rice II  
Aon Corporation

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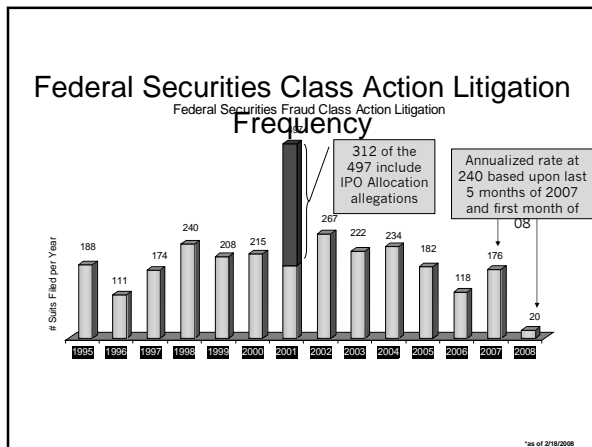
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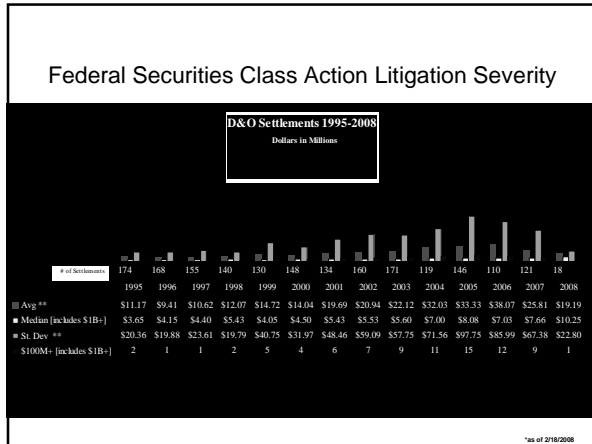
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# FOLEY'S SEVENTH ANNUAL NATIONAL DIRECTORS INSTITUTE CULTURE OF TRANSPARENCY




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- ### Subprime issues of note
- 181 subprime lawsuits to date (many E&O)
  - Since August 2007 – 35 subprime securities class action suits against D's & O's
  - Subprime D&O losses projected to be anywhere between \$3.6B and \$9.0B
  - Total annual US D&O insurance premium – approximately \$10.0B
  - Impact on premiums & coverage
    - Only FI's thus far
    - Watch company investment portfolios
- \*\*\*\*CAUTION\*\*\*\*
- Subprime & other economic forces have led to a volatile (some would say) BEAR stock market
  - Current annualized SCA D&O claims activity – 240 (196 - 10 year average)

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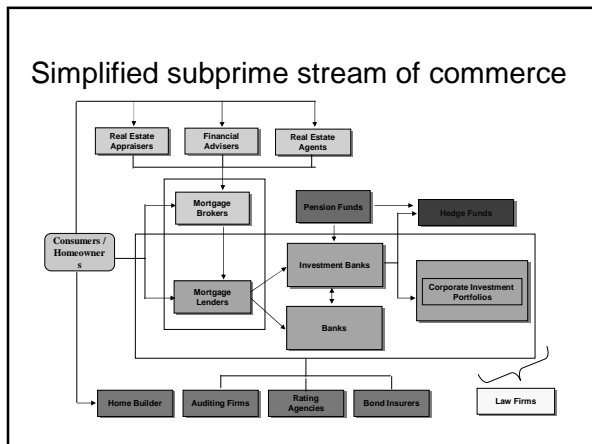
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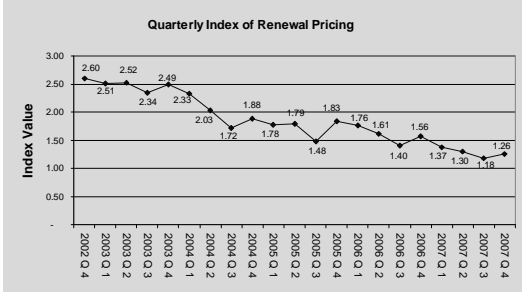
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# FOLEY'S SEVENTH ANNUAL NATIONAL DIRECTORS INSTITUTE CULTURE OF TRANSPARENCY

## Quarterly Index of Renewal Pricing



Source: Aon's D&O Index 120187

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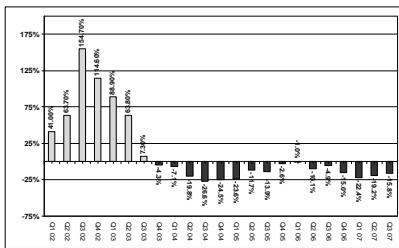
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## Quarterly D&O Pricing Trends



- Q4 data
- All industries down 18.9%
- Banks & Securities firms up 18.6%
- Fortune 500 down 22.9%

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## D&O Insurance Marketplace Overview

- Observations
  - Approximately 40 insurers with public & private company D&O insurance appetites
  - No two carriers utilize the same form
  - No AAA S&P rated insurers
  - A market of "leaders" & "followers"
  - Carriers reporting record profits
  - Carriers keeping more risk – bypassing reinsurance
- Implications
  - The product is NOT a commodity
  - Carrier relationships / positions should be chosen strategically
  - Financial strength needs to be considered
  - Analysis of policy forms is key
  - Carriers will change pricing quickly as losses increase

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### Hot D&O Underwriting Topics

- Public companies
  - Exposure to subprime
  - Stock options – though diminishing
  - M&A plans/procedures
  - Financial performance/analyst expectations
  - SOX/ERM
  - Board/senior management turnover
  - Existing litigation / SEC investigations
  - Stock price volatility / industry volatility
- Private companies
  - Financials (audited)
  - Employee count / growth
  - "Securities" exposure
  - IPO plans
  - Quality / independence of board & senior management

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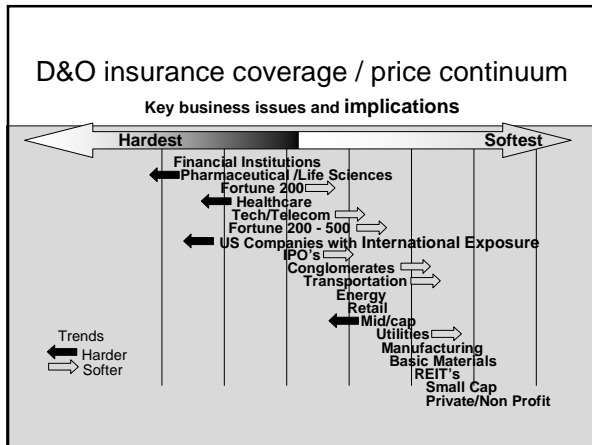
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### D&O international risks – checklist

- What should a company consider when analyzing its international exposures?
  - In which countries do we operate? Do we have multiple subsidiary holding companies in the country?
  - Of the countries in which we operate, which are considered "problematic" jurisdictions for non-admitted insurance?
  - Of the problematic countries, which are of greatest financial or strategic importance to (Client)?
  - Of the problematic countries, where do we have local national Directors and Officers? (in the case of D&O insurance)
  - What is the citizenship for the directors and executive officers?
  - In the problematic countries where we have Directors and Officers, what corporate indemnification protection is permissible or available, if any? Do indemnification agreements exist?
  - Claim and litigation environment in country
  - Claim and litigation environment for industry/Regulatory oversight
  - Is Subsidiary publicly traded or privately held (fully or partially)
  - Complicating factors of purchasing locally admitted policies: contract language, local claims handling, additional costs, etc.

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D&O international risks – checklist continued...

- What are the risks and exposures of purchasing non-admitted insurance in a foreign jurisdictions?
  - Some countries require locally admitted insurance policies
  - Some countries are unclear or silent on the acceptability of non-admitted policies
  - Increased sophistication of international regulatory bodies and legal systems
  - Tax implications
  - Indemnification protections are typically NOT as extensive, or non-existent, versus U.S. norms
  - Claims activity is growing outside of the U.S. (but remains very limited for subsidiaries of U.S. parent companies to date)

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International risk – decision dashboard

Country (Reporting Admitted Revenues)	Dishonest (Level of Risk)	Estimated Revenues Assets	Reputational / Strategic Risk	Regulatory Risk / Ability to Indemnify D&Os	Comments
Brazil		\$282M	• Significant Growth potential	• Government active • Indemnification not specifically addressed	• No tie-in with master policy is permitted
Mexico		\$301M	• Significant growth potential and existing manufacturing operations	• Indemnification not specifically addressed • Civil suits can be brought by shareholders representing 3.3% of capital stock	• Tie-in with master policy is allowed
Australia		\$553	• Large presence in APAC region	• Indemnification permitted • Legal environment expanding	
China		\$710M	• Intellectual property rights not well	• Government reach can be significant	• No tie-in with master policy is permitted
India		\$386M	• Headquarters for APAC	• Indemnification permitted	• No tie-in with master policy is permitted
Germany		\$1,025M	• Largest single operation in EU	• Indemnification is generally not permitted	• FOB permitted
Japan		\$505M	• Significant potential for growth	• Indemnification not addressed but exceptions of liability may be granted under certain circumstances	• Tie-in with master policy is allowed

**SAMPLE**

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D&O international risks – insurance solutions

- What are the potential insurance solutions in those countries where you wish to pursue admitted policies?
  - Purchase separate Limit, locally admitted policies in each of those jurisdictions, or
  - Work with your “master” policy primary (or low excess) insurer to purchase locally admitted policies in each of those jurisdictions and tie-in the Limits where permissible. Where separate Limits are required, purchase a separate Limit, locally admitted policy; and/or
  - Where the Freedom of Services Act applies (EU/EEA), purchase one policy to address those jurisdictions.

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D&O Insurer Perspective;  
Implications For Directors

Dan Fortin  
CNA Financial Corporation

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Overview

- Factors Impacting D&O insurance
- Inputs for calculating D&O premium
- Emerging Issues
- Managing Increasing Claim Complexity
- Enhancing D&O Risk Profile

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Factors Impacting D&O

- Frequency and Severity of Claims - Regressing to the mean?
- Recent Legal Decisions – Lower loss costs?
  - Stoneridge
  - Tellabs
  - Dura
- Systemic Events – Sub Prime, Stock Option Backdating
- Increasing Volatility of Debt and Equity Markets
- Recession
- D&O Insurer Profit Landscape
- P&C Insurer Profit Landscape

Increased variability of pricing, still favorable overall from buyer's perspective.

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Inputs For Calculating Premium

- Ownership: Public, Private, Non-Profit
- Market Capitalization, Assets, Revenue, Industry, Location, Beta, Credit Rating
- Governance and Accounting Ratings
- Retention, Attachment
- Legal/Claim Experience
- Scope of Coverage
- Intangibles
- Frequency and Severity Assumptions

**D&O Pricing: More Science Than Art**

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Emerging Issues

- Sub Prime Credit Crisis
- Foreign Corrupt Practices Act (FCPA)
- Global Warming – The next Y2K?
- Increasing Shareholder Activism

**D&O Insurers tend to be more reactive than proactive**

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Managing Claim Complexity

- Reverse Engineer Procurement Process
- Importance of Broker Selection
- Importance of D&O Insurer Selection
- Partner and Communicate
- Leverage Insurer Experience
- Consider a Long-Term Buying Behavior

**Claim experience should be a critical factor in buying decision.**

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### Enhancing Risk Profile

- Develop Insurer Relationships at Executive Level
- Conduct Objective Risk Self-Assessment
- Proactively Address Negative Risk Factors
- Procurement Strategy – Buying Behavior

Relationships can make a difference on pricing, terms and claims.

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### Key Takeaways

- Increased Variability of D&O Pricing and Terms
- D&O Premium Rating Models
- Emerging Issues
- Optimizing Claim Process – Reverse Engineer
- Enhancing Profile – Relationships Matter

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### How to get the Right Insurance Coverage for your Director and Officer Liabilities

Gordon Davenport III  
Foley & Lardner LLP

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1. Evaluate what "Executive Risk" coverages you need.

- D&O
- E&O
- Employment Practice
- Fiduciary Liability
- A-Side-Only
- Intellectual Property

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2. Know the details of your current coverage.

- Key elements:
  - Types of coverage
  - Amounts of coverage
  - Premiums
  - Carriers
  - Coverage terms and conditions

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3. Compare your coverage to current best available

- Executive risk insurance market changes constantly
  - On price
  - On coverage terms and conditions
- Good: detailed review every two years
- Better: every year

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4. Use the right broker

- All brokers are not equal
- Your broker should:
  - Have expertise in executive risk coverages
  - Do many executive risk placements
  - Be knowledgeable about the executive risk markets

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5. Be an active buyer

- Have a game plan
  - Shop the market, or focus on incumbent?
  - Create list of targeted improvements
- Thoroughly analyze renewal proposals (not just price)
- Actively negotiate for improvements to weak spots

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6. Don't buy on price alone. Also consider:

- Details of coverage terms and conditions
- Strength of carriers
- Reputations of carriers for claims handling

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7. Build relationships with your insurance companies

- Greater comfort with you produces better coverage
- But don't stay with same companies at all costs

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8. If you switch carriers, pay attention to continuity-of coverage issues

- Prior acts coverage
- Tail coverage or notice of circumstances under old policy

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9. Address your particular risk exposures

- International exposures ("Worldwide coverage territory" may not be adequate)
- Private placements
- Professional services
- Intellectual property exposures

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10. Pay particular attention to key coverage terms:

- Coverage for SEC proceedings
- Crime/fraud exclusion
- Punitive and multiplied damages
- Insured-vs.-insured exclusion
- Rescindability
- Severability
- Hammer clauses

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