Navigating the New and Rising Risks for Directors and Officers in 2011

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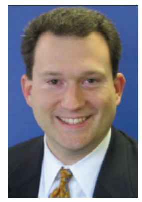
Navigating the New and Rising Risks for Directors and Officers in 2011

Today's Presenters

- **Aaron DiRusso**
  Senior Vice President, Equity Capital Markets
  Raymond James

- **Ethan Lenz**
  Partner
  Foley & Lardner LLP

- **Mike Matthews**
  Partner
  Foley & Lardner LLP



- **Ryan Collier**
  Area President, Executive Lines
  Arthur J. Gallagher & Co.

Navigating the New and Rising Risks for Directors and Officers in 2011

Agenda

- Overview of the Financial Crisis
- Potential Exposure and Implications for Directors and Officers
- Types of Coverage and Claims
- Myths of D&O Liability
- Panel Discussion

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Overview of the Financial Crisis

Aaron C. DiRusso
Senior Vice President

April 14, 2011

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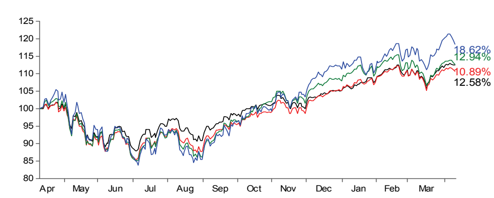
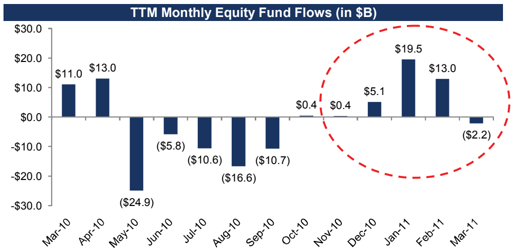
Economic Observations and Equity Market Performance

TTM Market Performance



TTM Monthly Equity Fund Flows (in $B)



Key Market Drivers

- Macro-economic issues:
  - The economy continued to advance in the first quarter, although at a slower pace
    - Consumer spending (70% of GDP) rose at about a 1.5% annual rate in the 1st quarter, down from 4.0% in the 4th quarter 2010
  - Unemployment continued to fall in March (to 8.8%)
  - Long term concerns remain regarding federal debt and state/local municipality financial health
  - Renewed concerns regarding higher rates / inflation
- Equity capital markets observations:
  - Major indices have experienced strong performance since August of 2010
  - First quarter bank earnings are generally expected to be positive
  - Heightened investor confidence in the banking sector in light of higher capital requirements
  - Substantially positive equity fund flows in 2011 but trend is negative for past two months

Source: Dealogic Equidesk. Data includes IPOs, Initial ADRs, and Initial Units raising more than $10M. Data excludes Closed-end Funds.

Market Price Performance

The BKX, NASDAQ Bank, and S&P 500

Three Year Market Performance Trends

The major bank indices have declined substantially over the past three years but have rallied since March 2009 lows

Source: SNL DataSource; Market data as of April 11, 2011

Market Price Performance

The BKX, NASDAQ Bank, and S&P 500

Market Performance Trends Since March 6, 2009

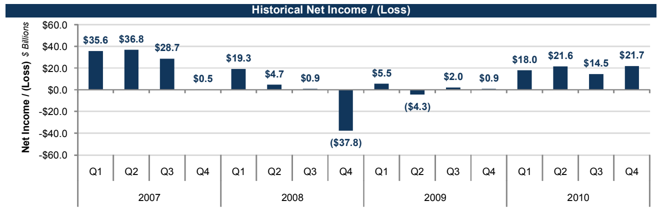
The BKX, an index of large publicly traded banks, has recovered significantly in comparison to the S&P 500 and the NASDAQ Bank Index since March 6, 2009

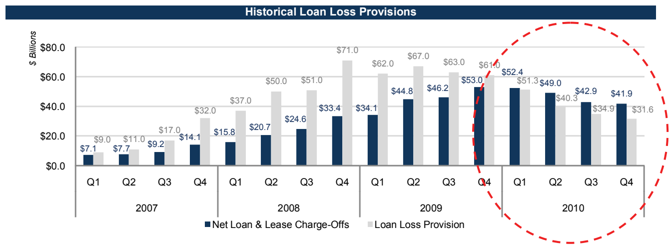
Source: SNL DataSource; Market data as of April 11, 2011

Historical Industry Profitability and Charge-Off Trends

FDIC Insured Institutions – 1st Quarter 2007 to 4th Quarter 2010

- Year-end 2010 net income levels strongest in two years
- Third and fourth quarters of 2008 marked with large securities losses on GSE / Others
- October 14, 2008 – Treasury announces $250B capital injection program (what will become TARP)
- May 7, 2009 – Bank "stress test" results are released
- Industry reduction in reserve build projected to lead to double digit earnings growth

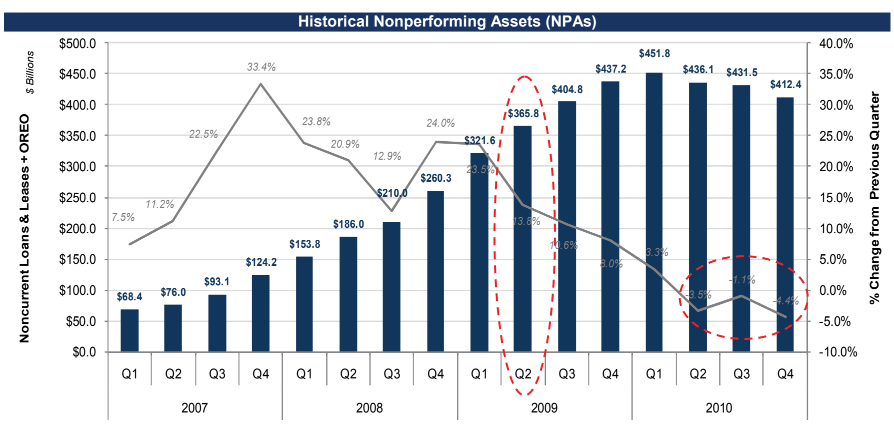




Source: FDIC Historical Statistics on Banking; Includes all insured institutions regulated by the FDIC

Historical Industry Nonperforming Asset Trends

FDIC Insured Institutions – 1st Quarter 2007 to 4th Quarter 2010

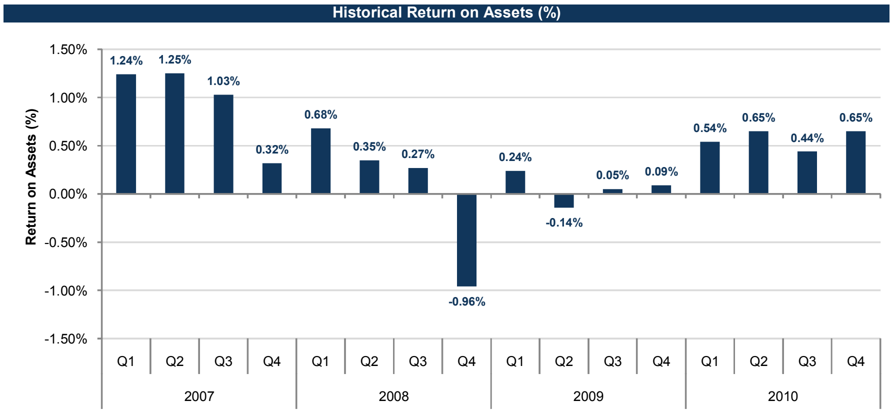


March 6, 2009 (second quarter 2009) marked a recent low for bank stocks

Source: FDIC Historical Statistics on Banking; Includes all insured institutions regulated by the FDIC

Historical Industry Return on Assets

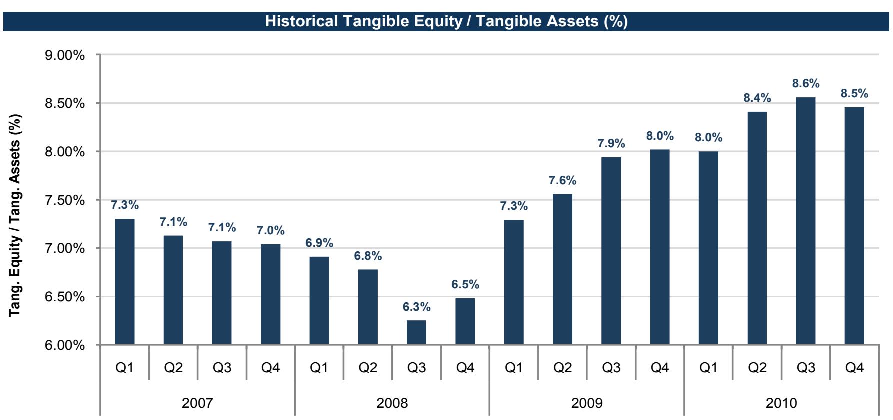
FDIC Insured Institutions – 1st Quarter 2007 to 4th Quarter 2010



Source: FDIC Historical Statistics on Banking; Includes all commercial banks regulated by the FDIC

Historical Industry Capital Trends

FDIC Insured Institutions – 1st Quarter 2007 to 4th Quarter 2010



Source: FDIC Historical Statistics on Banking; Includes all commercial banks regulated by the FDIC

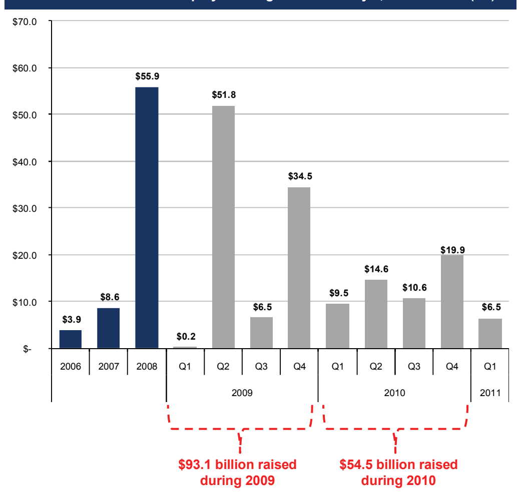
Equity Offering Themes and New Capital Standards

Observations and Considerations

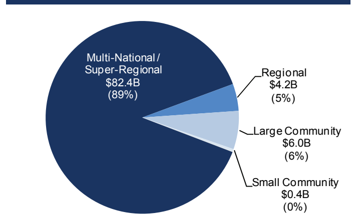
- ❑ TARP redemption
  - Small Business Lending Fund
- ❑ Basel Committee proposes new capital standards (“Basel III”)
  - Leverage Ratio minimum of 7%, Tier 1 Capital Ratio minimum of 8.5%, and Total Capital Ratio minimum of 10.5%
  - Extended phase-in period beginning on January 1, 2013 with transition required by January 1, 2019
  - New “counter-cyclical” buffer of additional 2.5%
- ❑ Recently enacted federal legislation (“Dodd-Frank”) will begin the phase-out of TruPS inclusion in Tier 1 capital for banking companies with greater than $15 billion in total assets

Five-Year Bank and Thrift Equity Offering History

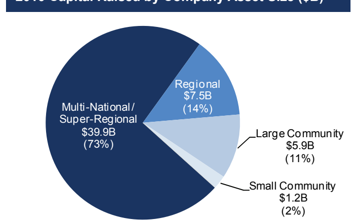
Bank and Thrift Common Equity Offerings from January 1, 2006 to Date ($B)



2009 Capital Raised by Company Asset Size ($B)



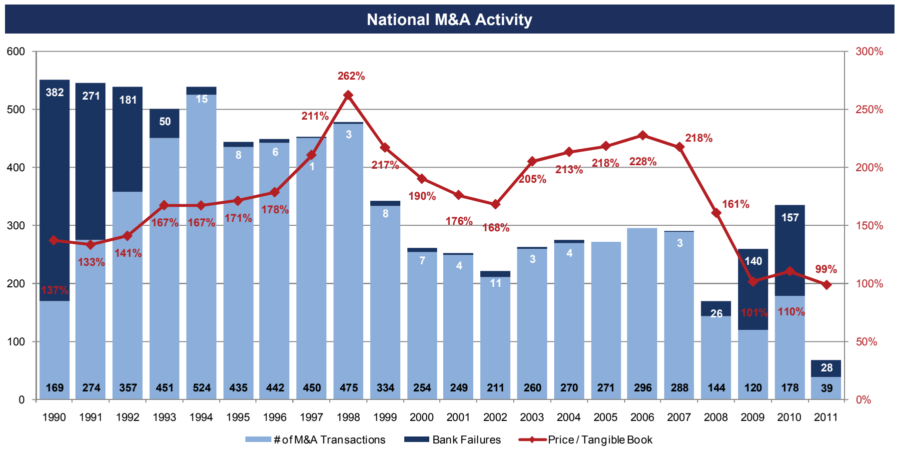
2010 Capital Raised by Company Asset Size ($B)



Source: SNL Financial as of 4/12/2011; Banks and thrifts categorized by Multi-National/Super-Regional (greater than $50 billion in assets), Regional (between $10 billion and $50 billion in assets), Large Community (between $1 billion and $10 billion in assets), Small Community (less than $1 billion in assets).

Bank and Thrift M&A Overview

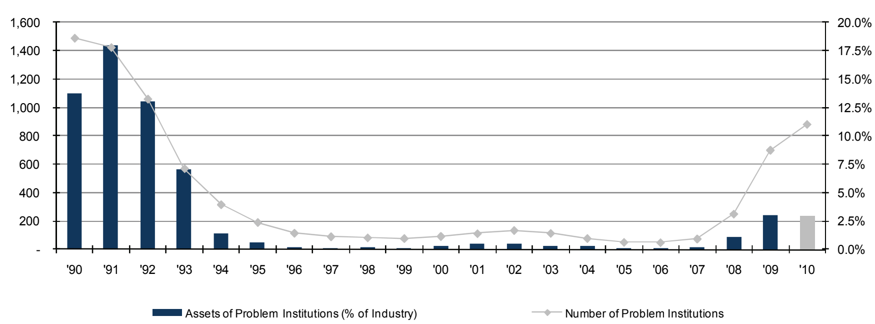
Median National Bank & Thrift Transaction Multiples



Source: SNL DataSource; Data as of April 11, 2011

Problem Institutions

Number of FDIC Problem Institutions and Percentage of Industry Assets Represented

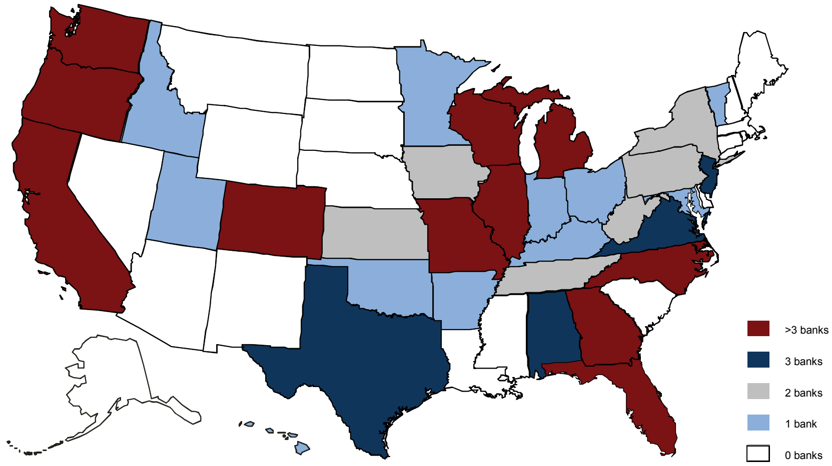


- At December 31, 2010, there were 884 institutions on the FDIC's problem list, representing approximately $390.0 billion in assets (2.93% of the industry's assets)
- The average size of an institution on the FDIC's problem list was $441 million in 4Q2010 versus $574 million in 4Q2009

Source: FDIC Quarterly Banking Profile
Data as of 12/31/2010

Potential Problem Banks(1) – Greater than $1 Billion in Assets

101 Potential Problem Banks in the U.S. with Greater Than $1 Billion in Total Assets
(Assets Totaling $330 Billion in Potential Problem Companies)



Source: SNL DataSource as of December 31, 2010 (1) Source: Raymond James internal analysis

Observations and Considerations

Discussion Points

- The near to medium-term macroeconomic outlook remains uncertain
  - Consensus shift on how robust the economic recovery may be
  - Yield curve signaling inflation / higher rates?
  - Credit quality remaining a concern
- Challenging regulatory environment and outlook
  - New capital standards?
- M&A activity projected to pick up
  - Limited organic growth opportunities
  - Increased operational/fixed costs
    - Tech/consumer/regulatory compliance
  - Interim strategic step/need to create critical mass
  - Board/management fatigue
    - Succession issues
  - Increased focus on branch transaction activity

Potential Exposure and Implications for Directors and Officers

Mike Matthews
Foley & Lardner LLP

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Overview:

- Litigation/liability risks
- Recent developments in the law
- Some sources of increasing risk:
  - FDIC
  - SEC
  - Private plaintiffs
- Protections for directors and officers

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FDIC:

- What's on the horizon
- The first wave of FDIC lawsuits against directors and officers
- What factors FDIC is considering
- What FDIC does when an FDIC-insured institution fails
- D & O insurance implications

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SEC Enforcement:

- Current status/recent developments
- Dodd-Frank Act
- Expanded use of SOX and other tools
- Insider trading
- Aiding and abetting
- Cooperation initiative
- Use of administrative proceedings

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<u>Private plaintiffs:</u>

- Shareholder derivative actions
- Securities class actions
- False Claims Act
- Targeting of officers and directors

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<u>Protections for directors and officers</u>

- D & O insurance
- Advancement/indemnification
  - Be aware of bylaws/agreements
  - Recent developments in the law

<u>Conclusion</u>

Types of Coverage and Claims

Ethan Lenz
Foley & Lardner LLP

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Three Types of Coverage/Insuring Agreements

1. Side A
2. Side B
3. Side C / Entity Coverage
   - Private = Always
   - Public = Usually

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<u>Side A</u>

Covers claims against individual directors and officers that are not indemnified by their company

- Statutory Prohibition
- Insolvency

Typically no retention

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<u>Side B</u>

Provides reimbursement to company for amounts it is required to indemnify directors and officers as a result of a claim

- Most coverage is paid under Side B
- Retention typically applies

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<u>Side C / Entity</u>

Coverage when the company itself is a defendant in a claim

- Private = all claims
- Public = securities claims only

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- Claims Made Coverage
- Insured Retains Right to Defend and Settle Claim
  - Subject to Insurer Consent

- Claims for a "Wrongful Act"
  - Any actual or alleged act, error, omission, misstatement, misleading statement or breach of duty by an insured in their capacity as such

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- Exclusions are Key to Coverage
  - Express Exclusions
  - Definitions
  - Conditions

Myths of D&O Insurance

Ryan Collier
Arthur J. Gallagher

Myths of D&O Liability

1. All D&O policies are created equal
   – No two policies are alike. Very esoteric
2. D&O policies are “etched in stone”
   – All policies are very malleable. Clients need an astute broker that focuses exclusively on this coverage – not a generalist
3. The most well known carriers offer the best coverage forms
   – “Last to the dance brings the best gift”

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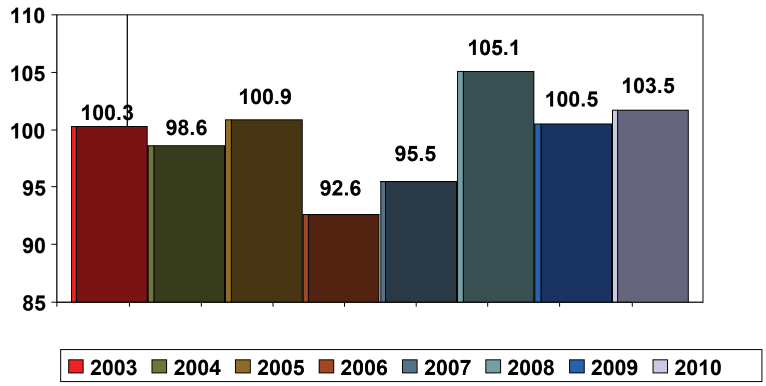
Myths continued…

4. D&O carriers don't pay claims - numbers say otherwise



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Myths continued…

5. Continuity doesn't matter
   – However, continuity of a bad policy is "bad continuity"
6. Directors and/or Officers don't ever pay "out of pocket"
   – Rare..but ask the former outside directors of Just for Feet Inc. Two valuable lessons learned here – adequacy of limits and benefits of Side A DIC policy
7. Private companies don't have D&O claims
   – Recent Chubb survey showed 112 out of 451 companies polled had a claim within past 5 years
8. Public companies are seeing less frequent lawsuits since Class Action Litigation is "down" to 176
   – Record year for securities lawsuits at 1,170 as the shift from tradition continues

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Last of the myths (at least for today)

9. The claim happened so far back that we are safe
   - The average lag time for filing a claim in the public domain is now over 250 days (up from 126 days in 2008). This will increase as the FDIC starts to bring suits and civil actions against the failed banks and the D's & O's as they have announced in the WSJ.

10. Since all D&O insurance is the same, just take the cheapest option (and pray)
    - Premium cost vs value of insurance
    - Many factors well beyond the price (problem is that most of the insurance industry can't decode the difference)

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Panel Discussion
and
Question & Answers

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Contact Information

- Aaron DiRusso
  Senior Vice President, Equity Capital Markets
  Raymond James
  (212) 672-6832
  Aaron.DiRusso@RaymondJames.com

- Mike Matthews
  Partner
  Foley & Lardner LLP
  (813) 225-4131
  mmatthews@foley.com

- Ethan Lenz
  Partner
  Foley & Lardner LLP
  (414) 297-5835
  elenz@foley.com

- Ryan Collier
  Area President, Executive Lines
  Arthur J. Gallagher & Co.
  (312) 803-6360
  ryan_collier@rpsins.com

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