

# High-Profile Cases How They Have Changed the D&O Game



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# Speakers

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# Directors & Officers Liability

Litigation and Legal Environment



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# Today's Hot Topics

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- ✓ Macro View of Legal Landscape for D&Os
  - ✓ What will a Fee Shifting Rule Mean for D&Os
  - ✓ Department of Justice's Yates Memo – More Individual Pursuit and Liability?
  - ✓ Mega Derivative Litigation – a Trend or Anomaly?
  - ✓ Department of Labor's New Fiduciary Rule
  - ✓ Impact of All of the Above on the D&O Insurance Market
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## Directors and Officers Liability Trends

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- **Securities Class Actions Suit Filings** – Increase over last year (Source: Cornerstone)
- **Relativity** – 8,884 public companies in 1997; 4,916 by 2012 (44% decline); 5,209 by the end of 2014 with IPO activity. (Source: Cornerstone)
- **IPO Litigation** – increase in IPO activity in 2013-2014 -2015
- **Litigation Trends** – Mix of Corporate and Securities Litigation – more diverse plaintiff bar; total corporate and securities lawsuits and enforcement actions stable to slight increase (Source: Advisen)

## Directors and Officers Liability Trends

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- **Derivative litigation** – paralleling shareholder class action lawsuits; large settlements – News Corp. \$139M; Activision Blizzard \$275M; Freeport McMoran \$137.5M. Cyber shareholder derivative suits Wyndham (dismissed) and Target (on-going). (Source: Advisen)
- **Merger Objection suits** – 97.8% of M&A deals above \$100M saw litigation associated with them. Historically these percentages were in the 30-50% range. Approx. 18% of SCA in 2014 were merger objection cases
- **Opt-Out Suits** – class action opt-out litigation – Institution (public pension plans/mutual funds) by passing class and suing individuals
- **Whistleblower** – Increasing steadily - 3,620 whistleblower tips in 2014 vs. 3,238 in 2013

## Directors and Officers Liability Trends

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- **Forum Selection - Delaware Venue** – Delaware venue for state law (e.g. derivative) claims to counter rise in multi-jurisdiction litigation
- **Fee Shifting Rules** – Running counter to typical US rules
- **DOJ Yates Memo** – Leaving D&Os vulnerable with cooperation incentives
- **Minimum stake-to-sue bylaw** - requires shareholders to deliver written consents representing at least three percent of the company's outstanding shares in order to bring a class action or derivative suit (Imperial Holdings Group)

## Directors and Officers Liability Trends

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- **DOL Rule** – Fiduciary definition expanded, mostly impacting Broker Dealers
- **Halliburton Supreme Court Decision** – maintained fraud on market theory; can challenge class certification post motion to dismiss stage . 73% of cases are settled/dismitted prior to class action certification motion. 3 post-Halliburton cases opposing SCA certification with price impact evidence were not successful (Source: NERA)
- **Compensation Clawback**- 7/1/2015 proposal seeks to expand Dodd Frank triggers for executive officer clawbacks. Additionally, seeks to broaden affected roles to those involved in “policy making functions” vs CFOs and chief executives.

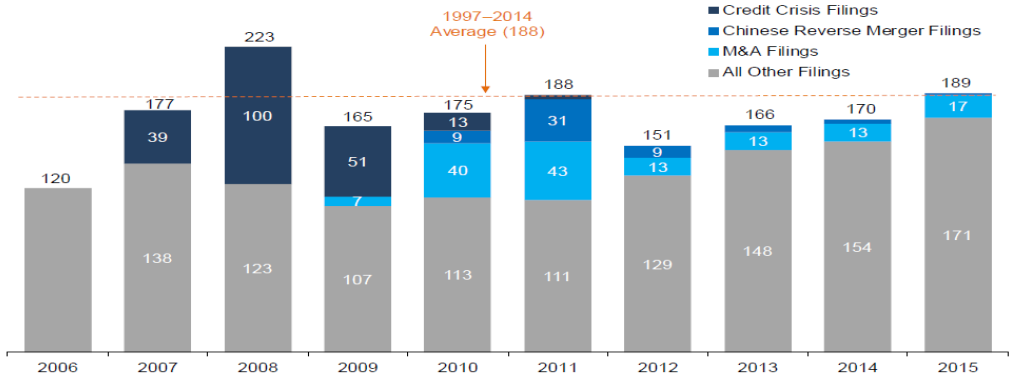


# D&O Market Securities Class Action Frequency

## Classic Filings

2006 – 2015

FIGURE 2: CLASS ACTION FILINGS (CAF) INDEX™  
ANNUAL NUMBER OF CLASS ACTION FILINGS  
2006–2015



Note: There were two cases in 2011 that were both an M&A filing and a Chinese reverse merger company. These filings were classified as M&A filings in order to avoid double counting.

## Key Filing Trends

- The 189 filings in 2015 represent an 11% increase from 2014, and are in line with the 1997-2014 annual average of 188 filings
- 2015 was the first time since 2008 in which the number of filings was above the historical average
- Filings related to Mergers and Acquisitions have remained fairly constant over the past four years

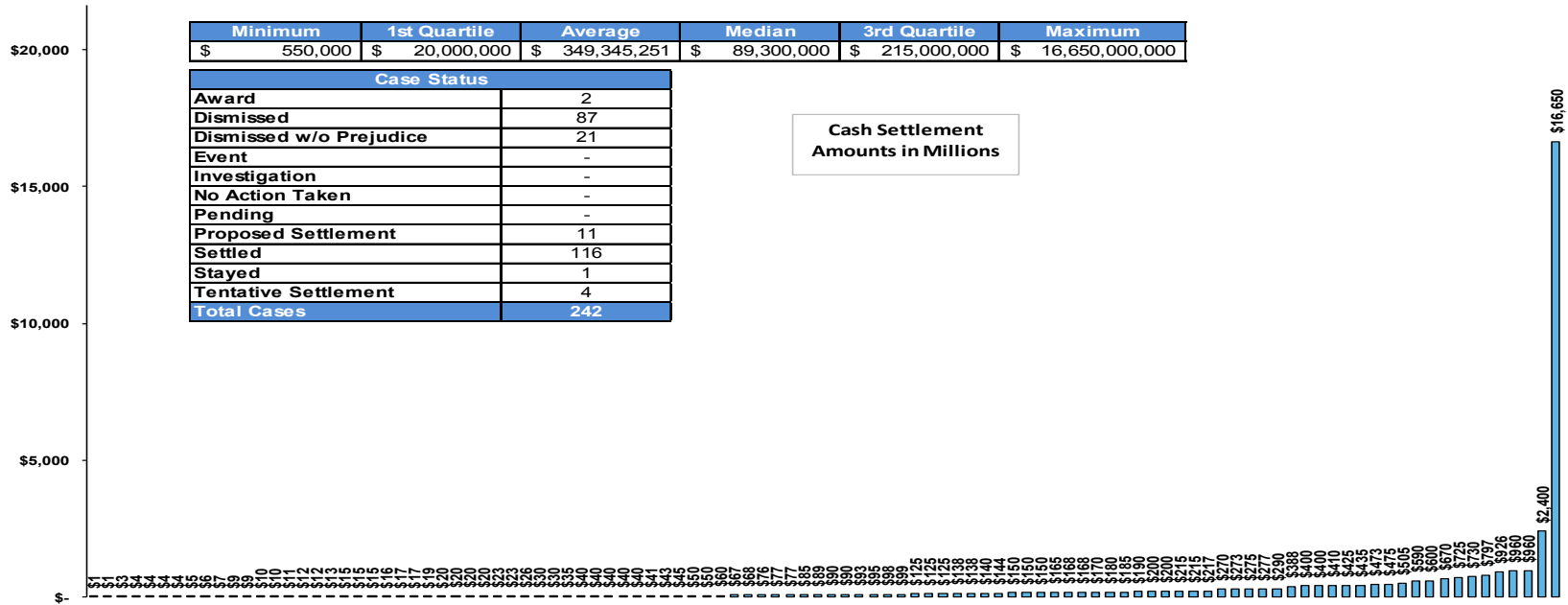
### Box Score 1996 – YTD

- Most Active District Court – **S.D. New York**
- Total Settlement amount for this period - **\$87.13B**
- Total Number of Defendants – **30,130**
- Total Number of Filings – **4,113**
- Number of settled filings – **2,076**
- Total number of Dismissed Filings – **1,516**
- Number of filings ongoing - **521**
- Most frequently Sued Sector – **Technology**
- Most frequently sued Industry – **Software and Programming**
- Exchange of most frequently sued issuers – **NASDAQ**

# Securities Class Actions Settlements

## Securities Class Action Cash Settlement Amounts

Fortune 1 to 250 as of Class Period End Date | Settlement Year: 10 Years



Source: Advisen, Ltd. Master Significant Cases and Action Database (MSCAd) January 31, 2016  
 Dataset includes cases filed during the past 10 Years.  
 Settlement values exclude settlements from outside defendants. **Defense costs not included.**

- Average defense costs: 25% of settlement (est.)
- Settled cases greater than \$250M: 28 (24.1%)
- Cases Dismissed: 44.6%
- Bank of America Home Loans – \$16.7B (8/21/14)
- Household International, Inc. – \$2.5B (11/5/15)
- Time Warner Inc. – \$2.4B (4/6/06)

# D&O Market SEC Enforcement Activity

## Increased SEC Actions

- Fueled by a record level of independent actions, SEC enforcement actions rose 19% from 681 since FY 2010 to 807 in FY 2015.

## Classification of Allegations

- In FY 2015, Issuer Reporting and Disclosure and FCPA allegations comprised the vast majority of actions against public company defendants accounting for 85% of actions.

## Enforcement Venue

- The past two years saw a dramatic shift in the enforcement venue for public company defendants – the SEC’s venue of choice became its administrative court. At the same time, scrutiny surrounding the constitutionality of the SEC’s in-house court increased.

## Timing of Settlement

- 82 percent of public company defendants resolved SEC actions on the same day that they were initiated (concurrent settlements). Concurrent settlements are often the result of SEC investigations that last months or years before the Commission initiates an enforcement action.

## Monetary Penalties and Disgorgements

- Total monetary penalties and disgorgements imposed on public company defendants dropped from a five year record high of \$1.25 billion in FY 2014 to \$547 million in FY 2015

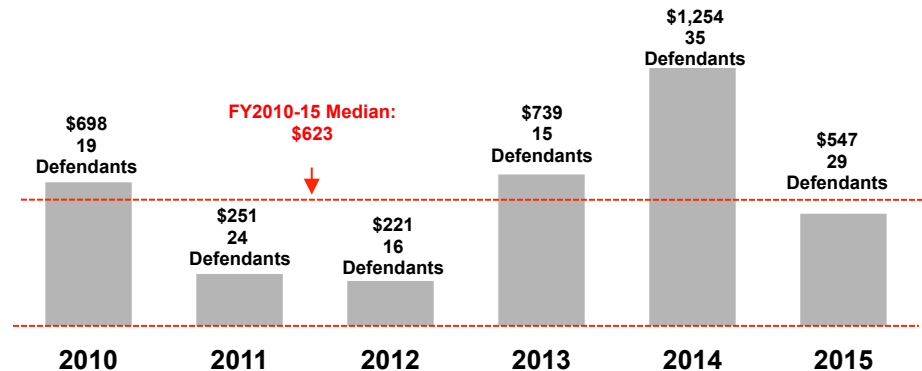
Source: Cornerstone Research;  
NYU Pollack Center for Law & Business 2015 Report

## Heat Map of Allegations Against Public Company Defendants FY 2010 – FY 2015

Allegation Type	Average 2010 - 2014	2010	2011	2012	2013	2014	2015
Issuer Reporting and Disclosure	57%	47%	44%	48%	73%	74%	52%
Foreign Corrupt Practices Act	33%	32%	53%	40%	19%	21%	33%
Other	2%	5%	0%	4%	0%	0%	6%
Investment Advisor/ Investment Companies	2%	11%	0%	0%	0%	0%	3%
Market Manipulation	1%	0%	3%	4%	0%	0%	3%
Broker Dealer	1%	0%	0%	0%	4%	3%	3%
Securities Offering	3%	5%	0%	4%	4%	0%	0%
Municipal Securities/ Public Pensions	1%	0%	0%	0%	0%	3%	0%
Insider Trading	0%	0%	0%	0%	0%	0%	0%
<b>Number of Actions</b>	<b>31</b>	<b>38</b>	<b>32</b>	<b>25</b>	<b>26</b>	<b>34</b>	<b>33</b>

Legend	0%	1% - 10%	11% - 20%	21% - 50%	51% - 100%
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## Total Monetary Penalties and Disgorgements Imposed on Public Company Defendants FY 2010 – FY 2015 (Dollars in Millions)



# Delaware Fee Shifting Rule

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- Delaware - Corporate haven, “mecca” with its favorable tax laws, preeminent business court and unified body of corporate law
- June 11, 2015, Delaware enacted a controversial statute that may call the state’s corporation-friendly reputation
- Delaware General Assembly approved legislation to effectively prohibit fee shifting bylaw provisions in the context of stockholder litigation related to corporate governance and merger and acquisition transactions.
- Effectively thwarts efforts to curb unwarranted and frivolous stockholder litigation.
- Block any attempts to quell the large runaway verdicts in D&O matters
- **QUERY:** Will this statute—which will undoubtedly encourage derivative class action lawsuits against corporate management— incentivize companies to reconsider Delaware as the state of their incorporation?

# DOJ Yates Memo: Background

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In September 2015, Deputy AG Sally Quillian Yates issued a directive which represents a renewed and intensified focus by the Department of Justice (“DOJ”) to hold Directors and Officers personally accountable for corporate wrongdoing.



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# DOJ Yates Memo: Key Mandates

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1. To qualify for any cooperation credit, companies must provide DOJ with all relevant fact relating to the individuals involved in the corporate misconduct;
2. Criminal and civil investigations should focus on individuals from their inception;
3. Criminal and civil DOJ attorneys handling corporate investigations should be in routine communication with one another;



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# DOJ Yates Memo: Key Mandates

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4. Absent extraordinary circumstances or approved Departmental policy, DOJ will not release individuals from civil or criminal liability when resolving a matter with a corporation;
5. DOJ attorneys should not resolve matters with a corporation unless there is a clear path to resolve related individual cases, and they should memorialize any declinations as to individuals in such cases;
6. Civil DOJ attorneys consistently should focus on individuals, and should evaluate whether to bring suit against an individual based on considerations beyond ability to pay.

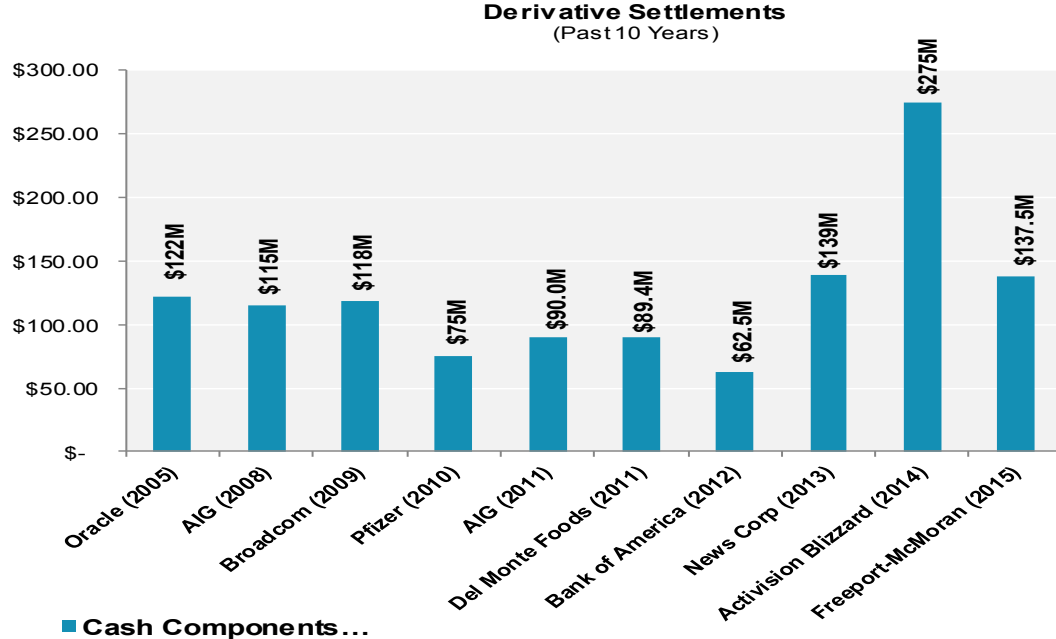
# DOJ Yates Memo: D&O Insurance Considerations

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- Are your corporation's bylaws triggered automatically? Do they indemnify individuals to the maximum extent of the law?
- Consider the following policy provisions
  - Scope of Conduct Exclusions
  - Adequacy of Side A limits
  - Severability language / imputation limits



# Derivative Litigation and Settlements



## Additional notable cases:

**HealthSouth (2009)** – Judgment – \$2.876B

**Southern Peru Copper Corporation (2011)** – Judgment – \$1.262B

**UnitedHealth Group (2007)** – Settlement – \$900M (settlement consisted of individual defendants' surrender of certain rights, interests and stock option awards, not cash.)

## Implications

- An increase in the frequency and severity of derivative litigation has resulted in coverage challenges regarding the amount of plaintiff attorneys fees covered in settlements.
- The entity is only named as nominal defendant in derivative litigation, which could result in uncovered defense costs for the entity.
- M&A litigation is not only involving the target company, but also "aiding and abetting" allegations against the acquiring company (not a "Securities Claim" since not the acquirer's shareholders or securities).
- Regulatory Investigations against the entity and the resulting expenses have both increased.
- While not yet a "claims trend," the topic of compensation clawback is one that is of great importance to the officers of the company.
- Cyber breaches have resulted in D&O litigation (e.g., Target and Wyndham Worldwide). Although not a "trend" this issue is top of mind for Boards of Directors and management teams. The SEC has issued guidance that cyber security must be discussed in the Boardroom and that public disclosures are receiving increased scrutiny.

# DOL Rule on Fiduciary Definition

## Proposed Expansion of the Definition of Fiduciary

- The Department of Labor recently proposed substantial revisions to the regulation governing at what point a person who provides “investment advice” to a benefit plan regulated by ERISA becomes a “fiduciary”
- The existing regulation, in place since 1975, includes several provisions that prevented certain financial services firms from becoming “fiduciaries” of their clients’ plans. Historically, to be a fiduciary, “investment advice” must be
  - Ongoing
  - Individualized in light of the plan’s needs and
  - Pursuant to an agreement that it will constitute a primary basis for investment decisions
- The revised-definition would treat virtually anyone who receives compensation for making investment-related recommendations to an ERISA plan, IRA, plan participant, or beneficiary as a fiduciary
- Impact of the New Definition:
  - This proposed change could expose investment advisors to more litigation
    - The ERISA Exclusion within an investment management professional liability policy should be limited to the Insureds’ plans sponsored for their own employees
  - While not directly impacting plan sponsors and in-house fiduciaries, some experts suggest that the proposed rule will place both under increased scrutiny to monitor their investment advisors/managers for any breaches of duty and that the change may increase the plan sponsor’s exposure to co-fiduciary liability
- Following a 90-day window for commentary on the new definition, public hearings were held in August 2015; the DOL’s issuance of final rules in April 2016.

# Directors & Officers Liability Insurance State of the Marketplace



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# D&O Market Snapshot

## Capacity

**Abundant in the commercial space (excess), smaller universe of primary markets**

- Majority of markets maintain A.M. Best Ratings of A or better.
- Newer capacity in the marketplace continues to put pressure on excess pricing. Markets such as Berkshire, Endurance, QBE and Allianz (most recently) are now quoting primary D&O.
- Mergers and Acquisitions continue - Tokio Marine & HCC; XL & Catlin; Endurance & Montpelier Re; ACE & Chubb

## Coverage

**Insurers are willing to negotiate coverage improvements**

- Primary and excess terms & conditions continue to remain very broad.
- Broadened Side-A DIC provisions available
- Carriers offering endorsements in response to Halliburton Supreme Court ruling- Class Certification expenses retention free

## Retentions

**Dependent on the underlying risk; insurers may look to seek increased retentions**

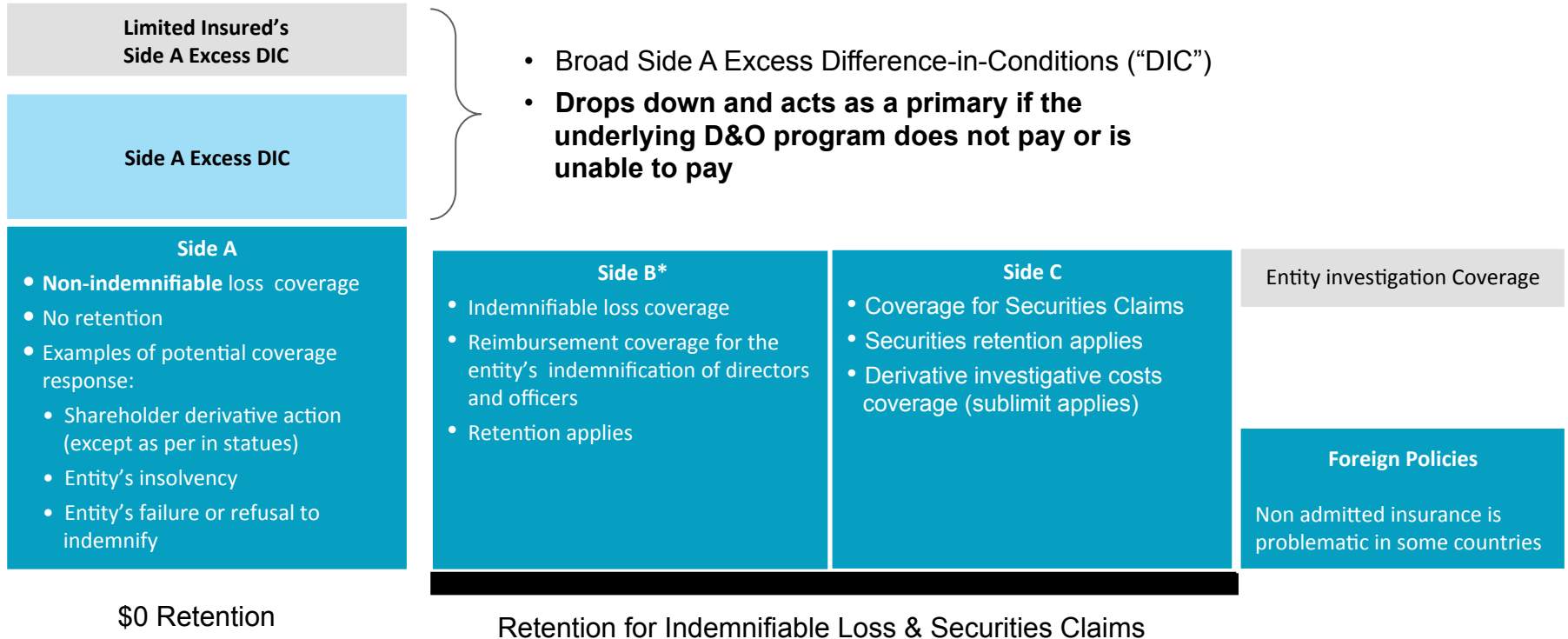
- Insurers are imposing higher M&A retentions for Insureds who have chosen to purchase programs with below-market retentions and acquisitive risks.
- Insureds are exploring higher retentions to mitigate premium increases, however, the cost-benefit is not always beneficial.

## Pricing












**Stabilization; some primary D&O rates continue to rise but excess remains soft given supply/demand dynamics**

- Primary underwriting concerns are generally frequent M&A activity, stock volatility, equity offerings, balance sheet strength, business and industry outlook.

















# D&O Program Coverage Overview



















# Insurer Updates - Significant Changes

Insurer	Updates and Significant Developments	Primary Market
	<ul style="list-style-type: none"> <li>▪ Acquisition closed on January 14, 2016</li> <li>▪ Management / leadership sorting out</li> <li>▪ Capacity management</li> </ul>	<ul style="list-style-type: none"> <li>▪ Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Continued pressure from Icahn – break up the company in light of SIFI designation</li> <li>▪ Management shakeup; layoffs, I</li> <li>▪ Active divestiture program; 19.9% IPO of mortgage insurance operation and sale of AIG Advisor Group</li> <li>▪ Very commercial</li> </ul>	<ul style="list-style-type: none"> <li>▪ Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Failed transaction with PartnerRe; rumors surrounding merger with Arch have generally gone quiet</li> </ul>	<ul style="list-style-type: none"> <li>• Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Continued ramp up; robust hiring</li> </ul>	<ul style="list-style-type: none"> <li>▪ Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Significant leadership hires</li> </ul>	<ul style="list-style-type: none"> <li>▪ Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Aggressive underwriting appetite expected to continue in 2016</li> </ul>	<ul style="list-style-type: none"> <li>• Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Many hires from Zurich; new strategy going forward</li> </ul>	
	<ul style="list-style-type: none"> <li>▪ Tokio Marine Transaction</li> </ul>	<ul style="list-style-type: none"> <li>• Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Purchase by Fosun International and China's probe of CEO</li> </ul>	
	<ul style="list-style-type: none"> <li>▪ Merger closed; Catlin team has generally left to work for Validus</li> <li>▪ International platform continues to grow, given Catlin's European platform</li> </ul>	<ul style="list-style-type: none"> <li>▪ Yes</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Departures in management team, including D&amp;O leadership</li> <li>▪ Solid name branding and international platform</li> </ul>	<ul style="list-style-type: none"> <li>• Yes</li> </ul>

# D&O Insurer Key Statistics Q1 2016

Insurance Company	AM Best Rating	S&P Rating	5-Year CDS Spreads		
			2/2/2016	01/05/2015	12/31/2015
 AIG	A XV	A+	76.01	48.811	48.454
 Allianz	A+ XV	AA	47.42	36.974	35.951
 Allied World Assurance Company	A XV	A	--	--	--
 Arch Insurance Group	A+ XV	A+	--	--	--
 Argo RE	A XII	A-	--	--	--
 Aspen	A XV	A	--	--	--
 Axis AXI	A+ XV	A+	--	--	--
 Beazley	A VIII	NR	--	--	--
 Berkshire Hathaway Specialty Insurance	A++ XV	AA	96.63	67.16	67.512
 Chubb	A++ XV	AA	15.59	13.537	13.492
 CNA	A XV	A	--	57.67	57.67
 Endurance Everest	A XV	A	--	--	--
 Everest Re Group, Ltd.	A+ XV	A+	--	--	--
 Great American Insurance Group	A+ XIV	A+	--	--	--
 The Hartford	A+ XV	A+	52.94	48.171	47.504
 HCC	A+ XV	AA	--	--	--

Insurance Company	AM Best Rating	S&P Rating	5-Year CDS Spreads		
			2/2/2016	01/05/2015	12/31/2015
 Hudson Insurance Group	A XV	NR	--	--	--
 Ironshore	A XIV	NR	--	--	--
 Liberty Mutual Insurance	A XV	A	--	--	--
 Lloyd's of London	A XV	A+	--	--	--
 Markel	A XIV	A	--	--	--
 Nationwide	A+ XV	A+	--	--	--
 Navigators	A X	A	--	--	--
 QBE	A XV	A+	--	--	--
 RLI	A+ XI	A+	--	--	--
 Starr Companies	A XIV	NR	--	--	--
 Swiss Re	A+ XV	AA-	48.00	41.534	39.858
 Travelers	A++ XV	AA	--	--	--
 W. R. Berkley	A+ XV	A+	--	--	--
 Windsor International	A X	A-	--	--	--
 XL Catefin	A XV	A+	--	--	--
 Zurich	A+ XV	AA-	52.51	42.765	41.662

A.M. Best Rating System		S&P Rating System	
Superior	A++, A+	Extremely Strong	AAA
Excellent	A, A-	Very Strong	AA+, AA, AA-
Very Good	B++, B+	Strong	A+, A, A-
Fair	B, B-	Good	BBB-
		NR	Not Rated

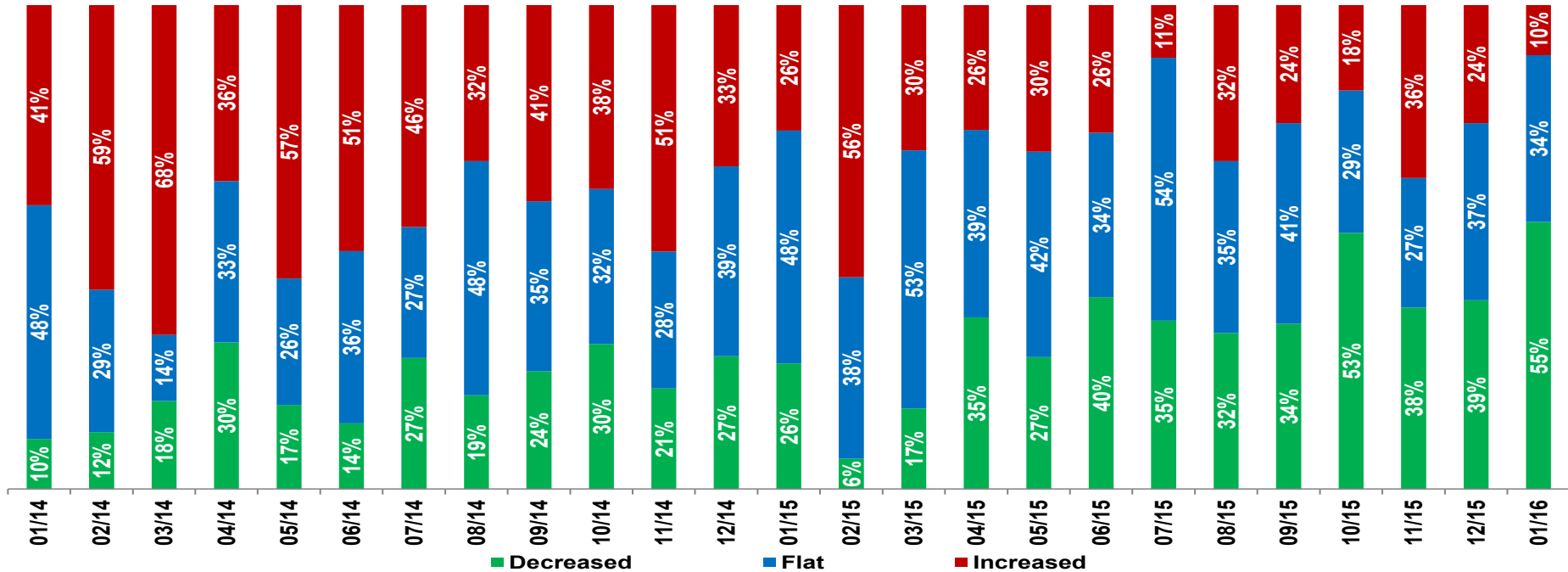
Financial Class Size (ranges in \$ millions)			
I	Less than 1	IX	250 to 500
II	1 to 2	X	500 to 750
III	2 to 5	XI	750 to 1,000
IV	5 to 10	XII	1,000 to 1,250
V	10 to 26	XIII	1,250 to 1,500
VI	25 to 50	XIV	1,500 to 2,000
VII	50 to 100	XV	Greater than 2,000
VIII	100 to 250		

1 CDS Spreads represent the cost (in basis points) to insure \$10,000,000 of corporate debt for a period of 1 year. (e.g., a spread of 100.00 indicates the price of \$100,000 to insure \$10,000,000 of debt per annum).

2 CDS Spreads are on the corporate debt and are not a reflection on the regulated insurance company subsidiaries' claims paying ability.

# D&O Market Monthly Pricing Index

Percentage of Clients with Decreases – Flat – Increases (Primary Layers Only – Same Clients/Limits/Deductibles)



Source: Aon FSG Quarterly D&O Pricing Index  
 Percentages may not add up to 100% due to rounding



# Speakers

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