

Directors & Officers Liability Market Update

Market Summary

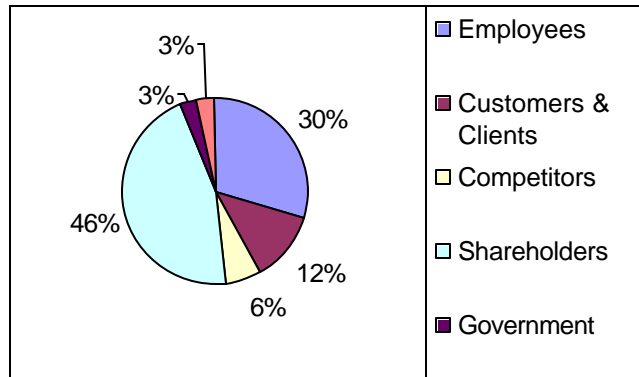
Not unlike the rest of the insurance marketplace, the market for Directors & Officers Liability (D&O) is undergoing significant change. Over the last decade, the market for D&O Insurance grew at an unprecedented rate. In addition, insured's experienced annual rate decreases, increased capacity, lower retentions and broader coverage. In the last few years, there have been trends in the D&O marketplace that have begun to turn the tide, particularly due to recent events such as Sept. 11th, Enron, WorldCom and the IPO/Laddering Claims. Below are some comments about the current state of the D&O market:

Insights: Litigation Trends

Over the last 10 years, in spite of the competitive market and the Private Securities Litigation and Reform Act of 1995, Directors & Officers of Public Companies have seen a sharp increase in the number and severity of Securities Class Action Lawsuits. Last year, the number of lawsuits filed has hit record levels. Recent trends include:

- ✍ New litigation in the area of recent IPO's has spawned a new form of lawsuit called "Laddering or Tie-In Transaction". (number of suits 309 complaints)
- ✍ Year End 2001 total number of Class Action Lawsuits stands at 485 (inclusive of the IPO Laddering cases)
- ✍ Accounting issues now represent over 50% of all cases!
- ✍ An increase in regulatory actions and investigations. The SEC has increased their activity in investigating companies for corporate fraud.

✍ Distribution of Claims by Claimant: (according to the 2001 Tillinghast Towers Perrin D&O Survey)



✍ Looking at the numbers:

- ✍ Average cost of defending a D&O claim: \$540,000
 - ✍ Average payment: \$5,650,000
 - ✍ Average cost of defending a shareholder claims: \$1,048,127
 - ✍ Average size of a shareholder liability claim award: \$17,180,000
- (According to the 2001 Tillinghast Towers Perrin D&O Survey)

✍ According to the “National Economic Research Associates”, the likelihood of being sued has increased by 58% since 1995:

	1995	1999	Change
# Of Publicly Traded Companies	11,688	12,149	3.9%
Market-Adjusted Annual Filings	194	314	61.5%
Increased Likelihood of Being Sued			57.5%

✍ Record settlements over \$100 million!

1. Cendant - \$3.525 Billion
2. Bank of America - \$490 Million
3. Waste Management II - \$457 Million
4. 3Com - \$259 Million
5. Waste Management I - \$220 Million
6. Rite Aid - \$193.0 Million
7. MicroStrategy - \$192.5 Million
8. Informix - \$136.5 Million
9. Sunbeam - \$125.0 Million
10. Conesco - \$120.0 Million
11. Ikon - \$110.0 Million
12. Prison Realty - \$104.1 Million

✍ According to the National Economic Research Associates’ “Trends in Securities Litigation and the Impact of PSLRA” the average Securities Class Action Settlement before and after the PSLRA are as follows:

	Filed Pre-Reform	Filed Post-Reform
Average Settlement	\$8.4 million	\$38.5 million
Average Settlement (Excluding Cendant)	\$8.4 million	\$12.2 million
Median Settlement	\$4.2 million	\$5.2 million

Insights: D&O Market Trends

- ✍ The competitive market for D&O insurance is beginning to change. High-tech and biotech companies and recent IPO's continue to experience higher premiums. Universally much higher shareholder claim settlements, the average amount at an all-time high of over \$17 million, suggest that higher limits should be looked at closely.
- ✍ Recent Securities Class Action settlements have reached record levels. There were several settlements in recent years exceeding \$100 million.[such as Cendant, Waste Management, Rite Aid, MicroStrategy and Sunbeam Corporation] This trend suggests that publicly traded companies have never been more at risk.
- ✍ Over the last decade, insureds have enjoyed unprecedented expansion of coverage. The introduction of Entity Coverage, Retention Waivers, Bankruptcy Coverages, Lower Retentions, and very Low Rates, has had an adverse impact on overall loss trends.
- ✍ Some adverse loss trends suggest tougher times may be ahead for the D&O insurance industry. Current premium, loss and coverage trends suggest that corporate insurance purchasers should maintain a longer-term view of appropriate coverage. The financial strength and reputation of the D&O insurer(s) on an insured's program will be critical.
- ✍ Due to the loss trends, D&O carriers have begun restricting coverage terms, such as:
 - ✍ Increases in Premiums (in the range of 20% to 50% to start and in some cases 100% to 300% of the expiring premium, especially for Telecommunications, Technology & Bio-Tech Companies, companies with weak financials and Insureds coming off multi-year policies).
 - ✍ Decreases in Limits offered either at renewal or new business. Carriers are attempting to keep exposure limited in response to the record settlement amounts.
 - ✍ In some cases, Securities Entity Coverage is being deleted and replaced with Pre-Determined Allocation Options.
 - ✍ Addition of Co-Insurance Participation at renewal. (Anywhere from 10% to 30% Co-Insurance)
 - ✍ Significant increases in Retentions (both for Securities and Non-Securities Claims).
 - ✍ Deletion of the Bi-Lateral Discovery Provision and increases in the premium associated with the Discovery Provision. (such as One Year Discovery in the range of 100% to 200%)
 - ✍ Deletion of Punitive Damages Coverage from the Definition of Wrongful Act.
 - ✍ Deletion of the Bankruptcy Carve-back within the Insured vs. Insured Exclusion.
 - ✍ Bankruptcy and Insolvency Exclusions are being utilized on accounts that are highly leveraged or in tough financial condition.
 - ✍ Restatement of Earnings Exclusions are beginning to be introduced
 - ✍ Deletion of the Waiver of Retention Enhancement.
 - ✍ Failure to Effect and Maintain Insurance Exclusions have begun to be re-introduced, especially post Sept. 11th.
 - ✍ War & Terrorism Exclusions have been introduced post Sept. 11th.
 - ✍ Prior Acts Exclusions are being utilized on tough to place accounts.
- ✍ Continued increase in employment related claims is a major force driving D&O liability losses.

- ✍ In addition to changes in policy forms, D&O carriers have begun to require significantly more underwriting documentation in order to provide a quotation. Some of the underwriting requirements are, as follows:
 - ✍ Fully completed, signed & dated applications and all supplemental questionnaires.
 - ✍ A current list of the Directors and Officers, including their business affiliations and other Board Seats.
 - ✍ Hard copies of recently filed SEC documents, such as, 10-K's, 10-Q's, Proxy Statements, 8-K's, Registration Statements for Securities Offerings.
 - ✍ Hard copies of the most recent annual CPA Audit, including the Management Letter and Management's Response.
 - ✍ A copy of the Insured's written Insider Trading Policy.
 - ✍ A copy of the Insured's written Revenue Recognition Policy.
 - ✍ A copy of the Insured's written Audit Committee Charter.
 - ✍ A written schedule of any pending litigation.
 - ✍ A copy of the Insured's current Schedule of Insurance. [for consideration of deleting the failure to maintain insurance exclusion.]
 - ✍ Completion of a Financial Risk Questionnaire, pertaining to current debt levels, other key financial ratios and internal control issues.
 - ✍ Conference Calls and Client meetings have become important for obtaining in-depth underwriting information and in some cases may be conditions of binding coverage.

Conclusion

With the rapid change in the regulatory environment, intensity of litigation and erosion of the insurance marketplace, it is crucial for corporate boards to play a more active role in their organization. Increased scrutiny over audit committees, director independence and financial statement certification have made corporate governance priority number one for most organizations. Corporate governance, sound risk management and a comprehensive insurance program will mitigate the exposure of corporate executives to costly lawsuits.

Based upon the trends mentioned above, it is important for corporate boards to be more aware of the insurance program being offered to them. When possible, the board should have their agent/broker present the renewal terms at one of their meetings.

Corporate risk managers should consider the following with respect to their upcoming D&O renewal:

- 1) ***Financial strength of the carrier.***
- 2) ***Breadth of coverage offered by the carrier.***
- 3) ***Long-term commitment of the carrier in writing D&O coverage.***
- 4) ***Claims Handling Philosophy of the carrier.***
- 5) ***Layering the coverage to have several carriers participate in the program. This may also provide future options if any one carrier were to non-renew.***
- 6) ***Experience of the agent/broker (including their wholesale broker) placing the coverage.***
- 7) ***Consider higher limits to protect Directors & Officers from increases in settlement amounts.***

- 8) *Consider Side-A DIC Coverage (Difference-In-Conditions) to cover potential gaps due to potential changes in coverage. (Such as loss of coverage for Bankruptcy circumstances)*

Presentations and Articles

1. "Falling Markets, Rising Risks", Best Review (May 2001)
2. "Trends in Securities Litigation and the Impact of PSRA", National Economic Research Group
3. Cornerstone Research "2001: A Year in Review"