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## The D&O Insurance Market and Liability Trends

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## Summary of Presentation

- D&O Litigation and Enforcement Update
- D&O Market Overview: Pricing, Capacity and Claims

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## D&O Litigation and Enforcement Update

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### Litigation and Enforcement: 2011 Highlights

- n Increase in securities class actions, notable increase in M&A and foreign company litigation.
- n SEC Specialized Units signal likely direction of enforcement.
- n Undetermined impact of Dodd-Frank on private litigation and enforcement: whistleblowers and new rules.
- n Economic conditions driving suits against private company officers and directors: customers, employees...now M&A.
- n Coverage disputes regarding company responses to potential wrongdoing.

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### Frequency: Federal Securities Class Action Litigation

What is happening with claims frequency and how is this impacting my terms?  
1995 - 2011

Year	Number of Suits
1995	188
1996	111
1997	174
1998	242
1999	209
2000	216
2001	497
2002	266
2003	238
2004	239
2005	182
2006	119
2007	177
2008	223
2009	168
2010	176
2011	103

- n 2006 - filings decreased 35% from 2005
- n 2007 - filings increased 49% from 2006
- n 2008 - filings increased 26% from 2007  
filings increased 87% from 2006
- n 2009 - filings decreased 25% from 2008
- n 2010 - filings increased 5% from 2009  
filings decreased 21% from 2008

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### Severity: Federal Securities Class Action Litigation

#### Settlements

2000 - 2011 YTD (dollars in millions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 YTD
Number of Settlements	148	134	160	171	118	146	111	114	107	102	104	28
Number of \$100M <sup>+</sup>	4	6	7	11	11	15	13	8	6	8	6	1
Median <sup>**</sup>	\$4.60	\$6.43	\$6.63	\$6.73	\$7.00	\$8.76	\$7.76	\$7.73	\$8.88	\$8.50	\$10.05	\$6.35
Mean <sup>***</sup>	\$14.04	\$19.69	\$20.94	\$22.06	\$31.70	\$27.47	\$52.89	\$26.26	\$34.58	\$30.81	\$28.40	\$19.66
Q1 (Q4) <sup>***</sup>	\$11.07	\$48.46	\$69.09	\$66.60	\$70.92	\$61.27	\$133.82	\$70.36	\$117.85	\$76.21	\$71.26	\$39.33

<sup>\*</sup> Includes settlements of \$10 or greater  
<sup>\*\*</sup> Excludes settlements of \$10 or greater

Source: Aon PSG, Risklines Group Securities Class Action Services as of 09/29/2011

Note: Past settlement values are subject to change. While settlement information generally reflects settlements of the date a settlement is announced, as additional parties reach settlements and they become final, the past settlement value and date occasionally change. Aon PSG indicates settlement figures in this chart to reflect the change.

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**Developments: Federal Securities Class Action Litigation**

- n Reduced pace of suits relating to credit crisis.
- n Overall increase in number of suits.
- n Supreme Court cases of interest:
  - Merck v. Reynolds
  - Morrison v. National Australia Bank
  - Erica P. John Fund v. Halliburton
  - Matrixx Initiatives v. Siracusano
  - Janus Capital Group, Inc. v. First Derivative Traders
  - Wal-Mart Stores, Inc. v. Dukes

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**Trends: Federal Securities Class Action Litigation**

- n Increase in M&A activity portends continued increase in suits based on merger disclosures.
- n Impact of Dodd-Frank:
  - Whistleblower provisions and new rules
- n Increase in suits involving foreign based companies, particularly China

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**Breach of Fiduciary Duty/Derivative Litigation**

- n Notable increase in number of suits filed in federal and state courts.
- n M&A objection suits based on acquisitions, going private, management buyouts and proxy violations.

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### Developments: Enforcement Proceedings

- n Significant matters:
  - High profile proceedings, e.g. Goldman Sachs, J.P. Morgan, Citigroup, Bank of America, Carters, Inc.: Non-prosecution agreement
- n SEC Speaks:
  - Cooperation initiatives
  - Areas of focus: insider trading and FCPA
  - National Specialized Units: FCPA, Market Abuse, Municipal Securities and Public Pensions, Asset Management and Structured and New Products
  - Budgetary constraints: Added Dodd-Frank responsibilities

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### Trends: Enforcement Proceedings

- n Impact of Dodd-Frank
  - New rules
  - Whistleblower provisions
  - International reach of SEC and DOJ powers
  - Expanded aider and abettor powers
  - Executive compensation clawbacks
- n Activities of Specialized Units: Insider trading and FCPA
- n Cooperation with Department of Justice:
  - FCPA
  - Dodd-Frank privilege protection

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### Developments: Private Company Litigation

- n Steady flow of actions against officers and directors.
- n Economic conditions explain trends: cases brought by customers and employees (reductions in force).
- n Potential for claims based on M&A activity.
- n Companies entering into government contracts under scrutiny.
- n According to Chubb Private Company Survey: 12% of private companies experienced a D&O suit in last five years.

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**Developments: Coverage Litigation**

- Informal SEC inquiries.
- Internal investigations.
- Special Bond committees.

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## Directors & Officers Liability Market Overview

November 7, 2011  
 Jacqueline Urban, Esq., Senior Vice President  
 Aon Risk Solutions | Financial Services Group | Legal & Claims Practice  
 A Division of Aon Risk Services Central, Inc.

Presented to the Casualty Actuarial Society  
 Prepared by Aon Risk Solutions  
 Financial Services Group




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### Topics For Discussion

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- § This is still a soft market.
  - But, is it changing?
- § What do Insureds purchase?
- § Carrier Relationships – do they matter?
- § Coverage Enhancements Available in the Market
  - For Individuals
    - Pre-Claim Inquiry Costs/Personal Protection Suite
  - For the Entity
    - SEC Investigation Entity Coverage
  - Improvements to Terms & Conditions
  - International D&O

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### Macro Market Update – D&O Overview

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<b>Capacity</b>	<b>Stable &amp; Significant</b> <ul style="list-style-type: none"> <li>• Majority of markets maintain A.M. Best Ratings of A or better</li> <li>• \$123B in "theoretical" capacity available in the market</li> </ul>
<b>Coverage</b>	<b>Very broad for all insureds</b> <ul style="list-style-type: none"> <li>• Insurers remain willing to provide coverage improvements (if requested)</li> <li>• Primary terms &amp; conditions are very broad and heavily reinsured</li> <li>• Excess layers are much improved, however we continue to push for "true" follow-form coverage</li> <li>• Several new coverages have been introduced (Executive Edge, Investigation Edge, other insurers, etc.)</li> </ul>
<b>Limits</b>	<b>Strategic purchasing behavior</b> <ul style="list-style-type: none"> <li>• Some insureds are re-investing premium savings in additional limits</li> <li>• Some insurers seeking to expand their limits in order to capture more or maintain premium, in particular A-Side layers</li> </ul>
<b>Retentions</b>	<b>Remain stable for most insureds</b> <ul style="list-style-type: none"> <li>• However, certain insurers are seeking higher retentions in light of recent high frequency / low severity events (i.e. M&amp;A, hung up claims)</li> <li>• Higher retentions do not always equate to meaningful savings</li> </ul>
<b>Pricing</b>	<b>How low can it go?</b> <ul style="list-style-type: none"> <li>• Pricing below 2000 levels despite frequency and severity trends</li> <li>• Primary pricing is still competitive for most insureds and Excess pricing is extremely competitive, although beginning to see some insurers walk away or seek an alternative layer (incumbents vs. non-incumbents)</li> <li>• In particular on primary layers we are seeing one carrier starting to firm faster than the market. It is looking for rate on some large accounts as well as higher retentions to address the "hump up" claims.</li> <li>• Underwriters are pointing towards modest price decreases as they reach minimum pricing thresholds and fear CAT losses on non-D&amp;O lines may lead to all PAC pricing.</li> <li>• Anticipate a competitive pricing environment through the remainder of 2011, although certain insurers are seeking to drive rate and/or retention increases on primary policies.</li> <li>• Industry &amp; individual results do matter – be prepared and continue to <u>differentiate your company</u>.</li> </ul>

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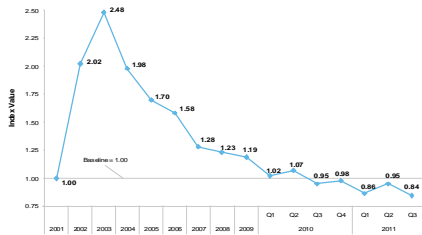
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Quarterly Index of D&O Pricing

D&O Pricing

Q1 2002 – Q3 2011 | Base year: 2001 = 1.00



Source: Aon FSG Quarterly D&O Pricing Index  
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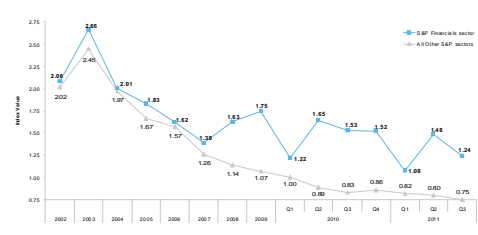
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Quarterly Index of D&O Pricing

S&P Financials sector vs. All Other S&P sectors

Q1 2002 – Q3 2011 | Base year: 2001 = 1.00



Source: Aon FSG Quarterly D&O Pricing Index  
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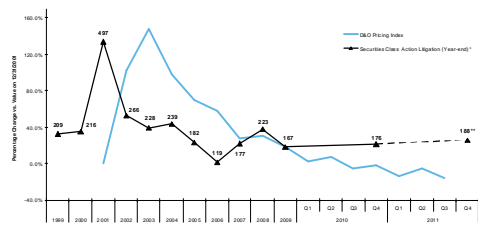
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D&O Pricing vs. Claims Frequency vs. Market Indices

D&O Pricing vs. Claims Frequency

Q1 2002 – Q3 2011 | Base year: 2001 = 1.00



Source: Aon FSG Quarterly D&O Pricing Index  
\* Standard & Poor's Securities Class Action Clearinghouse as of October 11, 2011. These totals include IPO Allocation, Analyst, and Mutual Fund Filings.  
† Financials plus all other S&P sectors except Energy for 2011.  
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**Market Capacity**

**Insurer Financial Strength**

Insurer	AM Best	S&P	Capacity	Insurer	AM Best	S&P	Capacity
Aon Bermuda	A+	A+	\$50	CV Starr	A	NR	\$15
Aon US	A+	A+	\$25	Evanscoie Bermuda	A	A	\$25
Aon Westchester	A+	A+	\$25	Evanscoie US	A	A	\$25
Affinity	A	A	\$25	Flagship Specialty (Berkley)	A+	A	\$25
Affinity Bermuda	A	A+	\$25	Great American	A	A+	\$25
Acip US	A	A+	\$25	Hartford	A	A	\$25
Aero Pw	A	NR	\$25	IFC	A+	A+	\$25
Allstate-Cambridge	A	NR	\$10	Indeco	A	NR	\$15
Allstate-Bermuda	A	A	\$25	Inspiration	A	NR	\$25
AVALON US	A	A	\$25	Liberty	A	A	\$25
Avon Bermuda	A	A+	\$25	Morgan's London	A	A+	\$25
Avon US	A	A+	\$25	Morgan's US (Berkley)	A+	A+	\$25
Berkley US	A	NR	\$10	Nationals	A	A	\$25
Berkley Pro (W.R. Berkley)	A+	A+	\$15	Old Republic	A+	A+	\$15
CBP	A	A	\$15	Pl Energy	A+	A+	\$25
Charles Process Liability Bermuda	A	A	\$25	PSJ	A	NR	\$15
Charles Process Liability US	A	A	\$25	Seas Pw	A	A+	\$25
Charm	A	A	\$25	Texas	A	NR	\$10
Chubb	A+	A+	\$25	Travelers	B+	A+	\$25
Chubb Atlantic	A++	A+	\$25	Unicoi	A	NR	\$15
CNA	A	A	\$25	VA Bermuda	A	A	\$25
CNA	A	A+	\$25	W US	A	A	\$25
Cross & Forward	A	A	\$15	Zurich	A+	A+	\$25

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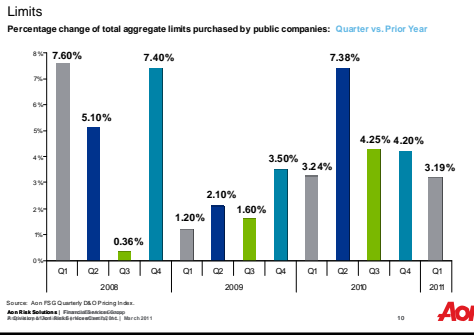
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**Limit Purchasing Decisions**




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**Carrier Relationships**

- § Yes, they still matter.
- § Underwriting meetings can assist in differentiating the risk.
- § Claims relationships matter too.
  - As pricing declines, and terms broaden, important to consider claims handling abilities and experience of carriers.
- § Consistent communication is essential to establishing and maintaining good relations.

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**D&O Coverage Enhancements**

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**§ For Individuals**

- Pre-Claim Inquiry Coverage
- Personal Protection Suite

**§ For the Entity**

- SEC Investigation Entity Coverage
- FCPA Investigation Coverage
- Reputation Protection

**§ Improvements to Terms & Conditions**

**§ International Capacity**

- Stand Alone "foreign" D&O programs

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**The D&O Insurance Market and Liability Trends**

**Actuarial Considerations for D&O Pricing and Reserving**

CAS Annual Meeting – Chicago  
 Carl X. Ashenbrenner  
 November 7, 2011




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**Actuarial Considerations - Pricing**


§ Annual Loss trends:

- Changes in terms and conditions
- Catastrophe exclusions and risk loads
- Attachment points and limits

§ Does past predict future?

- 2001 IPO Allocation
- 2002-03 Brokerage Firm – Analyst
- 2003-04 Mutual Fund – late trading
- 2006 Option Back Dating
- 2007-09 Subprime/credit/Madoff
- 2011 Chinese reverse merger
- Future ??

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**Actuarial Considerations - Pricing**

**Party like it's 1999**

Hypothetical Excess D&O Reported Loss and ALAE Triangle  
 Evaluated as of December 31, 1999

Report Year	Months of Development								
	12	24	36	48	60	72	84	96	108
1993	5.0%	20.0%	26.0%	35.0%	36.0%	35.0%	35.0%		
1994	7.0%	29.0%	44.0%	45.0%	47.0%	40.0%			
1995	7.0%	28.0%	24.0%	26.0%	33.0%				
1996	4.0%	23.0%	46.0%	39.0%					
1997	3.0%	30.0%	42.0%						
1998	6.0%	12.0%							
1999	2.0%								
2000									
2001									

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### Actuarial Considerations - Pricing

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1994	7.0%	29.0%	44.0%	45.0%	47.0%	40.0%	44.0%	45.0%		
1995	7.0%	28.0%	24.0%	26.0%	33.0%	32.0%	41.0%			
1996	4.0%	23.0%	46.0%	39.0%	39.0%	38.0%				
1997	3.0%	30.0%	42.0%	95.0%	108.0%					
1998	6.0%	12.0%	142.0%	224.0%						
1999	2.0%	135.0%	219.0%							
2000	9.0%	112.0%								
2001	15.0%									

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### Actuarial Considerations

**Largest SCA Settlements**

Case	Filing Date	Settlement
Enron	10/22/01	\$7.2B
WorldCom	4/30/02	\$6.1B
Tyco	2/4/02	\$3.2B
Cendant	4/16/98	\$3.2B
Nortel	2/16/01	\$2.9B
WorldCom II	5/14/02	\$2.6B
AOL Time Warner	7/18/02	\$2.5B
Koninklijke Ahold	2/25/03	\$1.1B
McKesson HBOC	4/28/99	\$1.0B
AT&T	10/27/00	\$1.0B

Source: Securities Class Action Settlements: 2010 Review and Analysis - Cornerstone Research

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### Actuarial Considerations

**Largest Credit SCA Settlements**

Case	Filing Date	Settlement
Wachovia	2/29/08	\$629M
Countrywide	8/14/07	\$624M
Merrill Lynch	10/30/07	\$475M
Washington Mutual	11/5/07	\$209M
National City	1/24/08	\$168M
New Century	2/08/07	\$125M
Wells Fargo	4/14/08	\$125M
MoneyGram	3/28/08	\$80M

- 207 Credit Cases filed to date
- Many cases are beginning to settle
- Large banks named in many different suits

Source: Securities Class Action Settlements: 2010 Review and Analysis - Cornerstone Research

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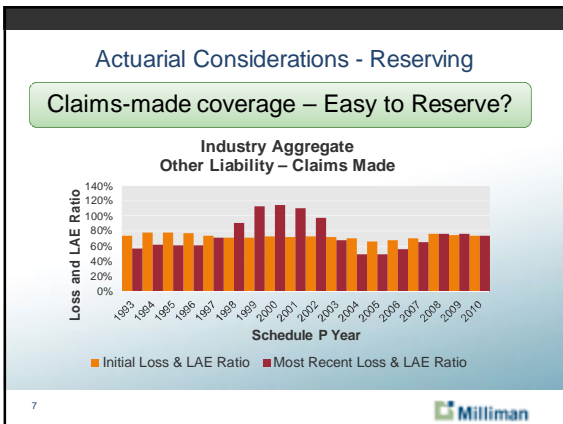
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- ### Actuarial Considerations - Reserving
- § Case reserving philosophy
  - § Changes in attachment points, limits, sectors
  - § Public vs. Private
  - § Catastrophes
  - § Attritional vs. Security Class Action
- 8 Milliman

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- ### Actuarial Considerations - Reserving
- § Shareholder loss = max price during class period minus share price day after class period
  - § Average settlement approximately 3% of shareholder loss
  - § Large variation of shareholder loss by claim
  - § Larger companies tend to settle later and at lower percentage of shareholder loss
- 9 Milliman

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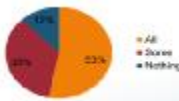
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### Actuarial Considerations - Reserving

§ Review of 724 Security Class Action Cases

§ What do D&O insurers pay from settlements?




§ D&O individuals pay about 5% out of own pocket

§ Larger settlements have lower insurance contributors

- Exceed all insurance limits
- Exclusions of coverage (Deliberate Misconduct)
- Other sources contribute (Accounting Firms, Investment Banks)

Source: "How protective is D&O Insurance in Securities Class Action" - PLUS Journal Reprint, February 2010, Volume XXIII, Number 2, March 2010, Volume XXIII, Number 3

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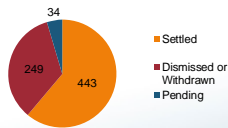
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### Actuarial Considerations - Reserving

How are cases settled:



§ Three went to trial, of these 2 settled during trial and one decided defendants favor

Source: "How protective is D&O Insurance in Securities Class Action" - PLUS Journal Reprint, February 2010, Volume XXIII, Number 2, March 2010, Volume XXIII, Number 3

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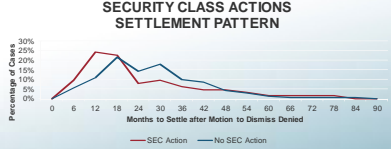
### Actuarial Considerations - Reserving

When do cases settle?


§ Average of 24 months after motion to dismiss is denied

§ SCA with parallel SEC action settle quicker (about 20 months on average)

#### SECURITY CLASS ACTIONS SETTLEMENT PATTERN



Source: "How protective is D&O Insurance in Securities Class Action" - PLUS Journal Reprint, February 2010, Volume XXIII, Number 2, March 2010, Volume XXIII, Number 3

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Questions??

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*Other Considerations*

**Oral Discussion**  
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