



Casualty Actuarial Society – Spring Meeting
“Sub-Prime Issues for D&O”

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**Le Chateau Frontenac
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Canada**



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- 1995 to 2005: President, Genesis Professional Liability Managers, Inc. (a Berkshire Hathaway company)
- Previously, Partner, Ross, Dixon & Bell, Washington, D.C.
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- Co-Chair, PLUS D & O Symposium, 2007 and 2008
- Author, *The D & O Diary* (Internet weblog)

Subprime-Related Litigation

- Subprime-Related Securities Class Actions
 - Auction Rate Securities investor action
 - Against Securitizers
 - Against Mutual Funds
 - Public Company Shareholder Actions
- Shareholders' Derivative Lawsuits:
- ERISA Lawsuits
- The War of All Against All



Subprime-Related Securities Class Action

Defendants

- Industry Sectors [21 different SIC Codes]:
 - Banking/Mortgage Lending
 - Residential Home Builders
 - REITs
 - Bond Insurers
 - Credit Rating Agencies
 - Reinsurance Companies
 - Savings & Loan Companies
 - Online Brokerage Firms
 - Private Equity Firms
- 5 Foreign Countries:
 - Switzerland (UBS, Swiss Re, Credit Suisse); Bermuda (Security Capital Assurance); Japan (Nomura); Germany (Deutsche Bank); Canada (Oppenheimer, Royal Bank of Canada)

The War of All Against All

- Hedge Funds
- Investment Banks
- Pension Funds
- Investors
- Debtholders

“Subprime?” No, *Credit Crisis* Related

- Student Lending:
 - SLM Corporation (“Sallie Mae”)
 - The First Marblehead Corporation
- Corporate Debt
 - iStar Financial
- Balance Sheet/Investment Assets:
 - Moneygram

The Spreading Credit Crisis-Related Litigation Wave

- Types of Companies
 - E.g., SLM Corporation (student loan company)
- Geographic Spread
 - Initial complaints concentrated in NY, CA and FL
 - Recent Complaints more diverse: e.g., Huntington Bank (Ohio), National City Corporation (Ohio)
- Additional Defendants
 - E.g., recently revised Countrywide Complaint (adding two accounting firms and 26 offering underwriters)
 - Also consider Cadwalader lawsuit (1997 commercial real estate loan securitization transaction)

Closer Look: MBIA Securities Litigation

- Case Based on Alleged Misrepresentations re: company's financial guarantees of "CDOs Squared" securities
- Key Points:
 - Complex Transactions
 - Company's role is complex
 - Company's disclosure is complex
 - Cases likely to be challenging, expensive to prosecute and to defend

Closer Look: State Street lawsuits

- 1/3/08: Company announced \$618 million pre-tax litigation expense reserve
- Six lawsuits against the company by pension or other fund managers, now consolidated into single action
- Legal theories: ERISA, breach of fiduciary duty breach of contract, misrepresentation
 - Houston police fund lawsuit also raises alleged breach of Texas securities laws
- Key Points:
 - No individual defendants
 - No securities claims against company (other than Houston)
 - Cases (other than Houston case) do not trigger D & O insurance

Other Claims: Priority Disputes Between Investors

- *Deutsche Bank Trust Company vs. LaCrosse Financial Products Holding Company* (New York County NY Supreme Court)
 - Interpleader Action brought by Indenture Trustee on Sagittarius CDO
 - Super Senior counterparty (LaCrosse) sought accelerated payment of interest proceeds and principal payments due to “event of default”
 - Dispute arose as to priority of payments under “Waterfall Provisions” and “Subordination Provisions”
 - Action joined holder of record for Secured Notes (Cede & Co.) and 100 “Does” on whose behalf Cede held the Notes (who contend LaCrosse’s position is “neither reasonable or correct”)
 - Action seeks to “interplead and settle all claims between the parties” and to establish appropriate basis for funds distribution
- Key Points
 - Disputes between sophisticated institutional investors
 - Disputes over seniority, subordination, acceleration rights, priorities

Possible Future Directions?

- Additional Disclosure or Suitability Actions in the Financial Sector
 - Insurance companies, mutual funds, hedge funds, pension funds
- Additional Disclosure Actions Against Companies Outside the Financial Sector
 - Investments in asset-backed securities (e.g., Bristol-Myers Squibb)
- Actions against the Securitizers for Securitization flaws
 - disclosures/misrepresentations
 - subordination or seniority claims
 - documentation flaws

Possible Future Directions (continued)

- Individual Investor State Court Actions
 - Avoids Potential Hurdles of Federal Court Class Actions
 - Particularly interesting to European investors
- Lawsuits Against the Rating Agencies?
- Lawsuits Arising From Other Securitized Credit Exposures
 - Credit cards, auto loans, commercial mortgages, student loans



Credit Crisis Litigation: Who Will Pay for All This?

- Different Lines of Insurance Potentially Triggered
 - D & O Liability Insurance
 - Fiduciary Liability Insurance
 - Investment Management E & O
- Complication #1: Large Bank's Insurance Structures
- Complication #2: Bankruptcy
- Complication #3: Simultaneous Civil Litigation, Regulator Action
- Complication #4: Criminal Prosecutions?
- Complication #5: Massive Defense Expense, Low Limits
- Complication #6: State Court Claims May not Trigger Entity Coverage

THE D&O DIARY

A PERIODIC JOURNAL CONTAINING ITEMS OF INTEREST FROM THE WORLD OF DIRECTORS & OFFICERS LIABILITY, WITH OCCASIONAL COMMENTARY

About Those Subprime D & O Loss Estimates

Posted on February 10, 2008 by **Kevin LaCroix**

Over the past several weeks, several industry observers and analysts have tried to put a number on the insurance industry's aggregate subprime-related loss exposure. At one end, Bear Stearns on January 24, 2008 estimated the industry's exposure at \$8.9 billion (refer [here](#)). By contrast, on February 8, 2008, Lehman Brothers estimated ([here](#)) that the insurance industry's losses might range up to \$3 billion, and on February 6, 2008, Advisen announced ([here](#)) that it will be releasing a report estimating that the industry's ultimate losses at \$3.6 billion.

I don't envy these experts whose job it is to try to quantify something as big, amorphous and evolving as the subprime-related litigation wave. Nor do I profess to have any particular insight into whose estimate is more accurate or what the ultimate number will be. I do have some observations about some considerations that are or should be being taken into account in making these kinds of estimates, in light of the circumstances surrounding the evolving subprime meltdown. (I should add that in making these observations, I have not had the benefit of reading the entire Advisen report, which as of this writing is not yet available; I have only had an opportunity to review the press release summary.)

In general, I think the various estimates have correctly noted that a potentially large portion of the amounts to be paid in settlements or judgments in the subprime litigation may not represent insured loss. In particular, the observers have correctly noted that many of the largest commercial and investment banks that are involved in the subprime-related litigation carry very large self-insured retentions and also often carry only Side A insurance programs (covering only nonindemnifiable loss, unlikely to occur here for these entities) or in some cases no insurance at all for certain exposures. These various observers have made a number of other valid observations concerning other factors that could restrict the impact of subprime losses for D & O insurers.

But at the same time, it seems to me that there are a number of other considerations that these observers have undervalued or even overlooked in assessing the possible impact of the subprime meltdown on insurers.

First and foremost, I think it is important to stress that we are only at the very earliest stages of the



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