

D&O Insurance:

Best Practices and Keys to Success

NACD New England

June 9, 2009



Panelists & Moderator

Moderator

- ◆ **Jordan D. Hershman, Esq.**
 - ◆ Co-chair of the Securities Litigation Practice Group at Bingham McCutchen LLP
 - ◆ Practice focuses on securities litigation defense, complex business litigation and intellectual property matters
 - ◆ Currently serving as lead counsel to Freddie Mac in several high profile securities class action and derivative action cases, among other matters

Panelists

- ◆ **Nancy Hawthorne**
 - ◆ Lead director at Avid Technology, Inc.
 - ◆ Director of the Metropolitan Series Fund, Inc.
 - ◆ Chair and CEO of Clerestory LLC, a financial advisory and investment firm
- ◆ **Stephen F. Maggiacomo**
 - ◆ Senior Vice President at the Executive Liability Division of AIU Holdings
 - ◆ 15 years of experience in the commercial insurance industry
 - ◆ Currently manages AIU's Commercial and National Accounts - Directors and Officers Liability business in the Northeast Region
- ◆ **John Graham**
 - ◆ Senior Vice President and team leader at Aon Risk Services
 - ◆ 25 years of industry experience, including 21 years on the brokerage side of the business and 4 years underwriting
 - ◆ Special areas of expertise include directors and officers liability

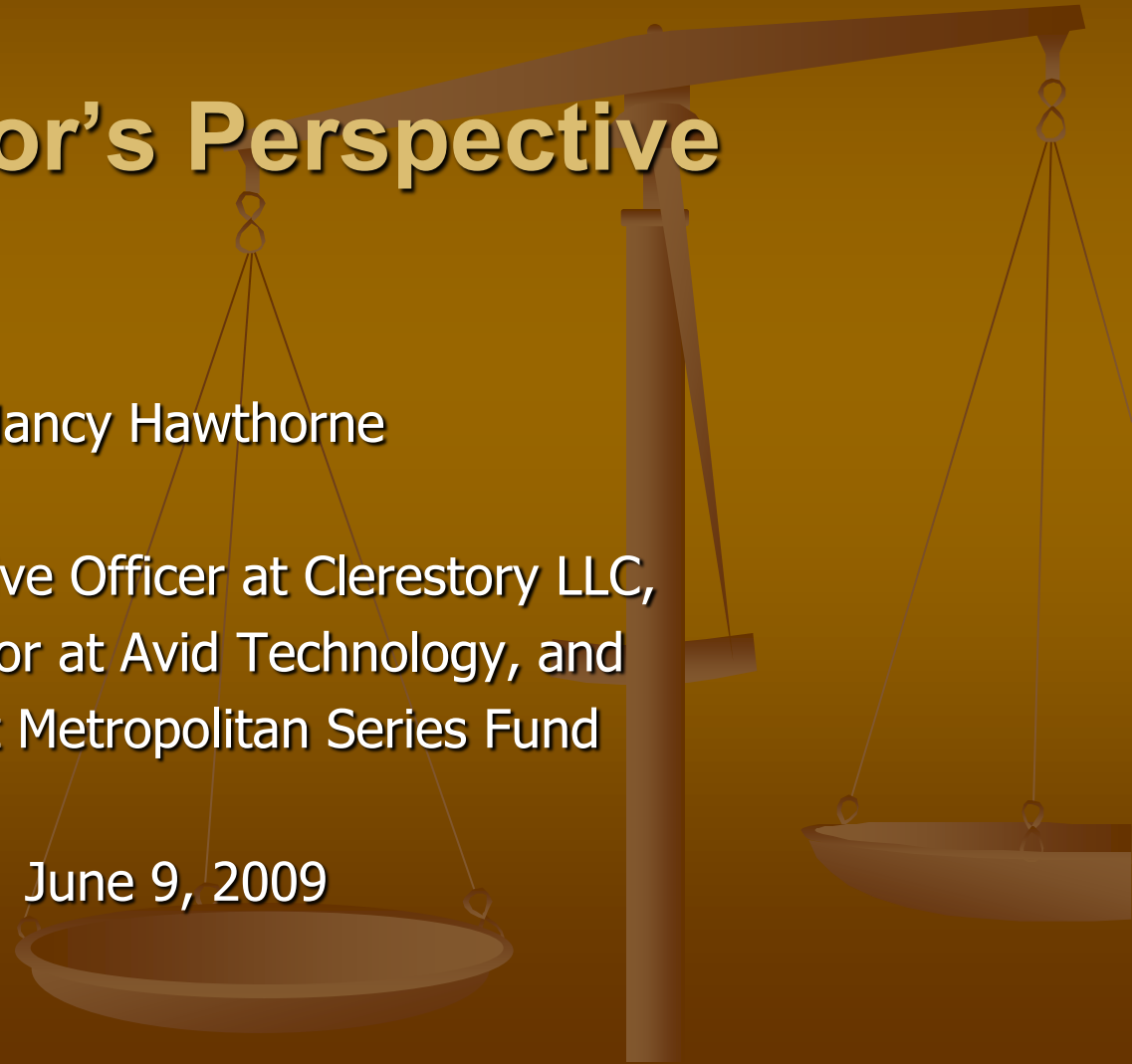
Directors & Officers Liability Insurance:

A Director's Perspective

Nancy Hawthorne

Chief Executive Officer at Clerestory LLC,
Lead Director at Avid Technology, and
Director at Metropolitan Series Fund

June 9, 2009



Glossary of Terms

Side A - When Corporate Indemnification for Individuals Is Not Permitted

Side B - Indemnification from the Corporation

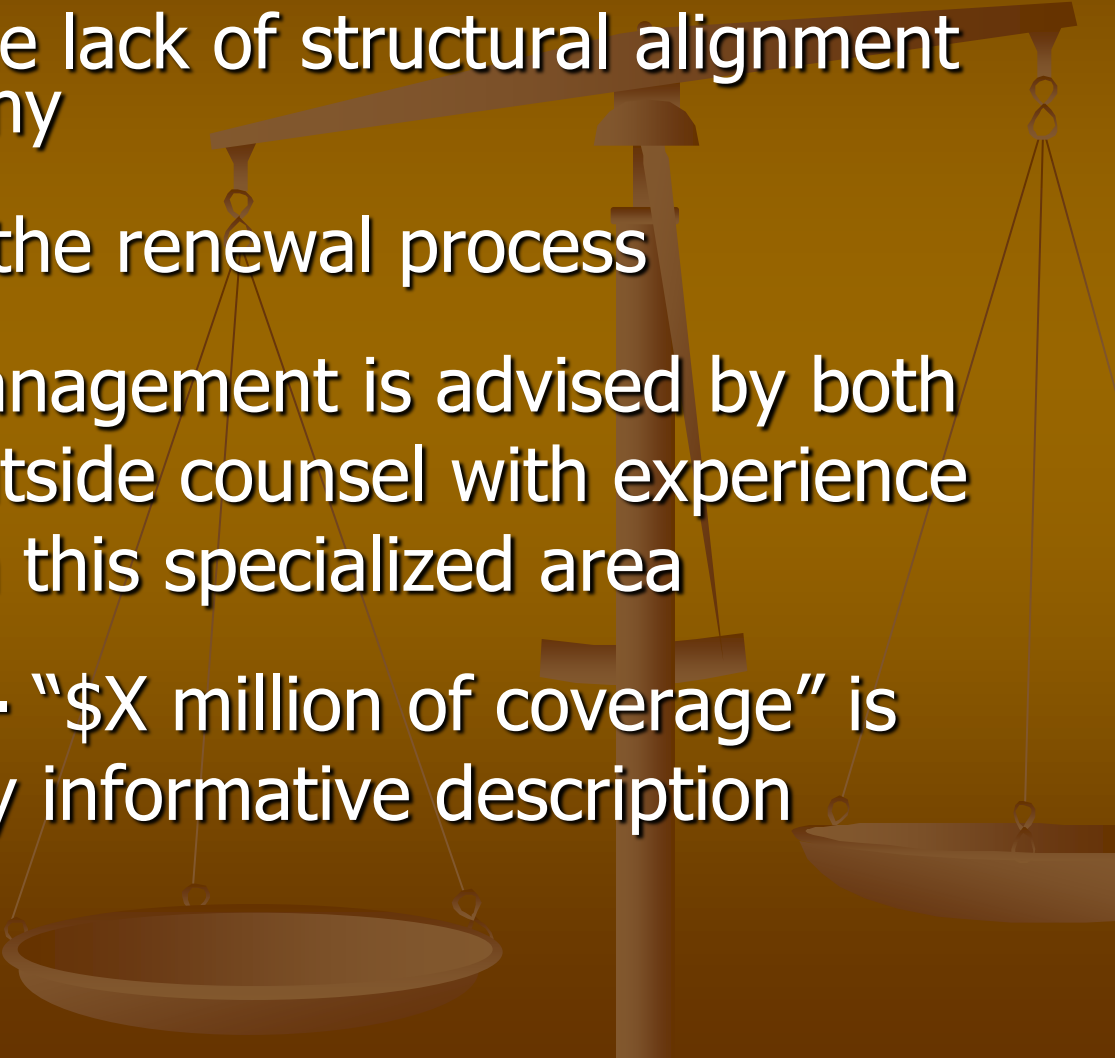
Side C - Entity Coverage

Side A DIC - Side A Difference in Conditions

Severability - Knowledge of the Guilty is Not Imputed to Innocent Insureds

Final Adjudication - Language in a Fraud Exclusion that Provides that the Insurer Must Cover Claims until such Time as There is a Final Adjudication of Fraud

Directors' Role in the Renewal Process

- **Understand** the lack of structural alignment with the company
 - **Participate** in the renewal process
 - **Ensure** that management is advised by both a broker and outside counsel with experience and expertise in this specialized area
 - **Ask** for detail -- "\$X million of coverage" is not a sufficiently informative description
- 

Where the Company's Interests and the Directors' Diverge



- Dollar Amount of Coverage
- Quality of Insurer vs. Rate Tradeoff
- Sharing Coverage with the Company: Is it a Zero-Sum Situation when a Claim Occurs?
 - How does limited coverage get divvied up between the company and the board?
 - How entity coverage, Side A coverage, and the indemnity interrelate

“What Could Go Wrong???”, or, What Keeps This Director Awake at Night



- When an incident occurs:
 - Will I be able to access funds for defense before I’m exonerated?
 - Will I have to pay it back if the judgment goes against me?
- What are the odds I’d ever be NOT INDEMNIFIED and NOT INSURED even if I’m conscientiously doing my job as a director?

NACD – June 9, 2009
D&O Insurance Best Practices
and Keys to Success

Selecting a Primary Underwriter –
Building from a Strong Foundation

Stephen F. Maggiacomo
SVP / Regional Executive
AIU Holdings Executive Liability Division

Critical Components of a Primary Layer

- Financial Strength
- Market Presence and History
- Coverage Terms and Capacity
- Underwriting & Claims Infrastructure
- Relationship and Commitment

Financial Strength

■ Ratings

- Operating company financial strength
- Investment portfolio
- Parental support
- Franchise value
- Management

■ Regulatory structure

- Recent events have demonstrated that regulatory safeguards function as intended
- P&C industry remains well capitalized despite recession, credit crisis, and beleaguered capital markets

■ Issues in the late 1990s / early 2000s

- Reliance, Kemper, Frontier

Market Presence and History

- Key to understand:
 - Difference between stable capital and capacity
 - Where your primary carrier fits in the market
 - Difference between primary underwriters and excess players
 - Whether your carrier is “built to last” or “riding the wave”
 - The importance to you of your carrier’s underwriting philosophy

Coverage and Capacity

- Role of the broker
 - Knowing the contract, the market, and your coverage
- Every suit alleges fraud
 - and every contract excludes fraud
- Triggering exclusions, severability, definition of loss, section 11, reporting back corridors
 - The devil is often in the details
- Capacity
 - Relationship between limit proposed and carrier's premium writings

Knowing a Carrier's Claims and Underwriting Capabilities

- Paying Claims
 - Attitude and aptitude
- Extent of the carrier's claims infrastructure
- Reliance on monitoring counsel
- Who would the attorneys who will defend you prefer to work with?

Relationship and Commitment

- Importance of stability
 - Capacity, commitment, and people
- Enduring through market / industry cycles
 - Carrier's ability to stay with you through thick and thin (both yours and theirs)
- Benefits of premium history
 - Having “money in the bank” when a claim hits



Directors & Officers Liability Insurance Trends

John Graham

Senior Vice President
Aon Risk Services
One Federal Street
Boston, MA 02110

AON RISK SERVICES

Marketplace News

Issue

January 12, 2009

Business Insurance

Financial crisis pushes some D&O rates sharply higher

January 5, 2009

ADVISEN

Financial Crisis Trigger More Class-Action Suits

Stanford Law School's Securities Class Action

Clearinghouse has counted 220 of these suits in 2008, up from 173 last year and 115 in 2006.

March 16, 2009

Business Insurance

Prices firming across D&O sector
Other areas following financial services' lead to increased rates

November 5, 2008

ADVISEN

Financial Crisis to Cost D&O and E&O Insurers \$9.6B

November 23, 2008

Financial Week

Warning: premiums to rise

Losses caused by markets, hurricanes mean coverage costs are heading higher

"Ace has already mandated that all premiums for both new and renewal business either stay firm or increase next year." - Ace chief executive Evan Greenberg said during the company's third-quarter earnings call

December 8, 2008

ADVISEN

D&O Underwriters Brace for High-Stakes Litigation

The insurance industry has been one of the hardest-hit sectors in the economy from the financial markets turmoil, with many of the world's top insurers "experiencing significant losses"

Marketplace News

Last update: 5:53 p.m. EST Dec. 10, 2008

Market Watch

XL shares slump on report insurer is for sale
Bermuda-based giant reportedly hires Goldman to help sell itself

November 10, 2008

CNNMoney.com™
A Service of CNN, Fortune & Money

**Federal Government Grants AIG a New
\$150 Billion Bailout Package**

February 27, 2009

Business Insurance

Best Downgrades Swiss Re:

A.M. Best Co. on Friday downgraded Swiss Reinsurance Co. Ltd.
and its subsidiaries' financial strength rating to A from A+.

Tuesday December 16, 11:53 am ET

BusinessWire

**A.M. Best Affirms Ratings of CNA
Financial Corporation and its Subsidiaries
– Outlook Remains Stable**

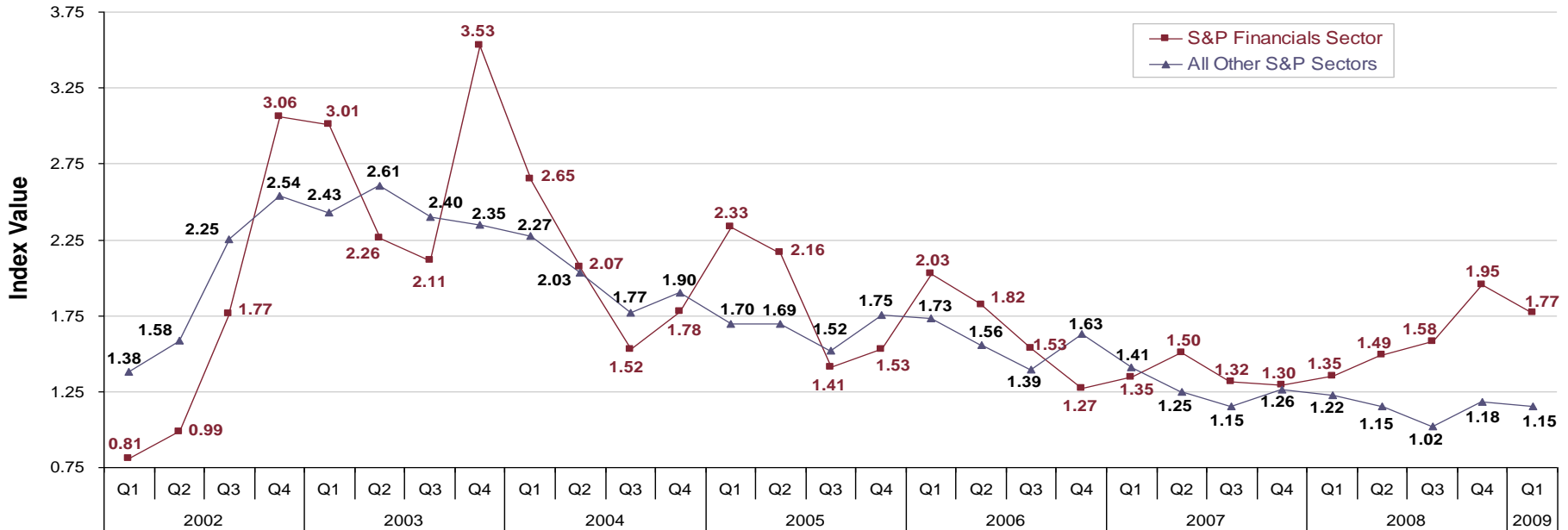
February 9, 2009

REUTERS

S&P downgrades Hartford on earnings, economic worry

AON RISK SERVICES

Quarterly Index of D&O Pricing



- Since D&O policies are typically written for a 12-month term, the year over year comparison provides the most meaningful indicator of results in the quarter
- YOY: Q1 2009 v Q1 2008 ... pricing decreased 2.42%
- **YOY for the S&P Financials sector (Banks, Diversified Financials, Insurance, and Real Estate): Q1 2009 v Q1 2008 ... pricing increased 31.11%**
- YOY for All Other S&P sectors as a group: Q1 2009 v Q1 2008 ... pricing decreased 5.74%
- For 6 straight years premiums have decreased in the non-financial sector

Key D&O Issues / Coverage Considerations

→ Primary Policy

- Severability of the Application and Exclusions
- Definition of a Claim – investigations
- Pollution Exclusion – Climate Change exposures
- Personal Conduct Exclusions – final adjudication
- Bankruptcy – stress test
- International considerations

→ Excess Policies

- Follow Form
- Exhaustion of Underlying Limits
- Side A Difference in Condition

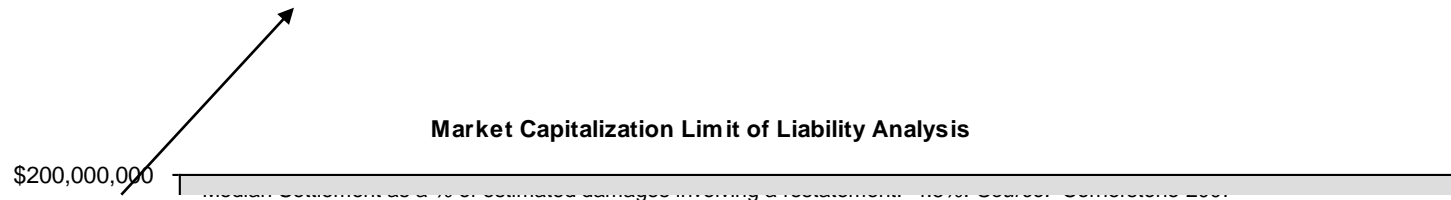
How much D&O coverage should I buy?

Key business issues and implications



Limit Procurement - Market Capitalization Analysis

Potential Claim Severity for Purchasing Consideration



This model suggests that ABC is adequately protected up to approximately 16% market cap loss involving a class action securities fraud case involving a restatement

Inputs/Assumptions

Current stock price	\$12.08
(104 Week Low/High)	\$4.62 - \$16.33
Approximate number of shares outstanding	162,300,000

40% Stock Drop Example

High Market Cap	\$2.6B
Loss in shareholder value (40%)	\$1.06B
Median settlement (4.5%)	\$47.7M
Defense Costs (25%)	\$11.9M
Total Loss	\$59.6

[1] Based upon a study of 726 post reform act class action securities fraud cases by Cornerstone Research from 1997-2006. These statistics generally apply to D&O Insurance Losses which are normally indemnifiable. This chart is for discussion purposes only.

Insurer Ratings

S&P Rating

	AAA	AA+	AA	AA-	A+	A	A-	BBB+	NR
AM Best Rating	A++	National Indemnity [^] 1	Chubb						
	A+		HCC (XIV)	Munich Re* Travelers	Ace Everest Re Old Republic (XI) 1 2 RLI (X)	Nationwide 2			Ace Westchester (XII)
	A			Zurich 1	AIG 1 2 AIG Cat Excess 1 2 Axis Lloyd's~ Swiss Re* W.R. Berkley*	Arch Endurance Great American~ (XIII) Hartford 1 2 Navigators (X) XL 1	AWAC Catlin* C N A 2 Hudson*	Crum & Forster (XIII)	Darwin* (IX) RSUI (XII)
	A-								Ariel Re (XII) Ironshore (XI) Max Capital* (XIII)

BOLD indicates incumbent insurers

* Infrequent or inconsistent writer of financial institutions

[^] Distressed company market / High minimum premium requirements

~ Generally retreating from financial institutions in current market cycle

(Parenthetical) reflect financial size class only if less than XV

1 S&P negative outlook

2 AM Best negative outlook

History of Personal Payments by Independent Directors

↳ Independent Director Contributions

- Van Gorkom – seminal case (1985)– \$1.35M
- Enron - \$13M (no recourse to insurance/indemnity)
- Worldcom - \$24.8M (no recourse to insurance/indemnity)
- Just for Feet - \$41.5M (lack of insurance)
- Mercury Interactive (9/17/08 settlement) - 3 outside directors paid 100k financial penalty and agreed to permanent injunction -- SEC will pursue enforcement actions

↳ Regulatory Involvement (pursuing a course of no insurance and indemnification)

- Research Analyst conflict of interest cases – Blodget-Grubman – personal contributions
- Chancellor Corporation – Audit Committee Chair banned for serving on a publicly traded board

↳ Rarity of Event

- Circa 13 cases in 25 years in which independent directors made out of pocket (8 settlement; 3 defense; 2 settlement/defense)*
- Largely a reflection of insolvency or unavailability of D&O Insurance
- ID's not typical target of regulators
- Frequency reduced further via appropriate D&O limits and state-of-the-art protections

History of Personal Payments by Inside Directors & Officers

- ↳ Inside Directors and Officers – Payments or Prohibitions

- ↳ Based on securities class action claims filed in 2000-2003
 - Personal payments in approx. 7% of securities class action suits
 - SEC/regulatory actions – more prevalent against Insiders
 - 70% of time inside directors pay penalty, disgorgement or are barred from serving
 - Fines/penalties rather modest – \$200K-\$250K

- ↳ Prosecutions - Jail time – Who me?
 - Joseph Nacchio – Qwest – 6 years
 - Martha Stewart – Imclone stock? – 5 months
 - Bernard Ebbers – Worldcom – 25 years
 - Dennis Kozlowski – Tyco – 25 years
 - Jeff Skilling – Enron – 24 years

- ↳ Other notables?
 - Bill Lerach – Milberg – 2 years
 - Bernie Madoff – not long enough