News from the PLUS D&O Symposium

I attended the PLUS D&O Symposium in New York, February 8th and 9th. If you ever have an opportunity to go to this event, you will definitely want to take advantage of it. Not only is it in a great venue (Marriott Marquis at Times Square), the content is always cutting edge and valuable.

Although much of the content is driven by publicly-traded D&O issues, most of them extrapolate to privately-held business, or trickle down over time. Learning about these current issues is certainly a way to get ahead of the curve. I wish the Symposium were longer so they could have more sessions!

Below are highlights from some of the sessions:

The first session I attended pertained to financial institution business. There was a lot of review of failed banks and FDIC actions, but the attention-getter there was that the FDIC has brought claims against the Ds & Os of 21 banks to date, seeking damages in excess of 1 billion dollars. But they have more on the slate and are seeking a total (so far) of 7.68 billion dollars, so there is a lot of litigation still to come. The moderator indicated that some of the banks likely targeted are getting near the end of the statute of limitations for action, so he expects a spike in activity this year.

It remains to be seen what impact this litigation will have on the resources of the financial industry and on the insurance carriers that were writing D&O for these banks.

Further discussion touched on investment bankers, which have been problematic for the last several years. Echoing a comment I heard at one of the 2011 sessions, the panel was universally negative on E&O and D&O for the class, agreeing basically that there is no profitable way to write them. My experience with them has been that most don't think they need coverage, and they're not willing to pay the needed premium, if a carrier will quote them. And then there are the few who buy a policy written by a carrier that excludes....wait for it.... Investment Banking! from the coverage. Yes, I have seen those policies. They cost less than a 10th what a real policy costs. I wouldn't want to be the agent who placed that policy when a claim occurs, but you've really got to wonder about the carriers who will quote and bind that way. It's like insuring a doctor for med mal and excluding bodily injury.

Last notable topic in this session had to do with hedge funds. I had just received an inquiry on one, and didn't want my agent to get too excited about the potential opportunity, because this class of business has not turned out to be a happy hunting ground for me. Turns out I"m not alone. The reasons for the lack of traction I've seen were exactly what the panel commented on.

Hedge funds are (still) unregulated, hard to get sufficient information on, especially when there are feeder funds or funds of funds involved, and the principals tend to just not want to deal with the insurance process. And they tend to have the same perspective as investment bankers with

regard to the necessity of coverage and the pricing therefor. What investment vehicles they're involved in and how they raise capital is exceedingly important, as well as their ongoing performance, controls and information provided to investors.

These bits of information will make or break the ability of a carrier to quote, and of course will have a strong influence on pricing for those who do quote, so it's nearly impossible to do anything with them if one cannot get the needed information.

I worked with one agent last year on a group of funds. It took us over 9 months to get the information from them, and it still wasn't everything we needed. I finally strong-armed a carrier into indicating, and the insured took exception to some parts of the indication, then fired my agent for it taking so long for him to get the terms. And we Still didn't have all the information requested. This is not an unusual treatment circumstance for this class

The next session was on Developments in D&O. A lot of it really focused on topics pertinent to publicly-traded D&O, and if you would like to have that information, email me separately, and I'll share it with you. There was an interesting discussion about the insurability of fines and penalties. One panelist posited the theory that there are several regulations that provide for the assessment of fines or penalties where those assessments really serve as a form of damages. She suggested that if the amount is really damages but just happens to be called a "fine" or "penalty" due to the regulation, it should be insurable (subject to jurisdictional limitations).

The third session was about claims activity in private company and non-profit D&O. Seven pages of notes I took on that one! Here are just the highest of the highlights. If you want more detail, let me know, and if I get enough interest, I'll put it in a future Knugget.

1. Mergers/Acquisitions exposures. The SEC is reaching down into private transactions. When the transaction is challenged, the court is throwing out the "business judgment rule" that was relied upon as a defense in the past. The new standard is "entire fairness." i.e., was the transaction fair across the entire spectrum of constituencies affected by it. The burden of proof under this standard shifts over to the Ds & Os to prove that their decisions were fair.

2. There is a general trend in the bankruptcy courts to look at the Ds & Os from the creditors' perspective. I'm sure any erosion of the business judgment rule here does not bode well, either.

3. Private company investment and growth is coming to regulators' attention and coming under more scrutiny. A relatively new law called the Private Company Investment and Growth Act will give rise to claims. (I need to look it up!)

There is a secondary market for private company shares. You can actually buy and sell shares of privately-held companies online. Who knew!? As long as the number of shareholders stays under the SEC's threshhold (500), these transactions are not regulated. Considering the lack of disclosures and information investors can review to make decisions, this seems to be a sure recipe for disaster. And the regulators don't really appreciate that all this activity is going on "off the books", as it were. There is an increased focus on this trading, and that will no doubt lead to increased claims.

4. Non-profits. The volunteer immunity and charitable statutes are being eroded. That has been a long, incremental slide which continues. There are a lot of claims recently regarding executive compensation.

Some states are considering legislation limiting the compensation of the executives and perhaps barring entirely compensation for the directors. The panel didn't mention whether "compensation" is defined in these regulations. I'd hate to think that a director couldn't get a free lunch when attending a board meeting, but it could come to that.

So, you can see that there's nothing boring in the private/non-profit D&O world, and your insureds need this coverage more than ever before.

I noted that there was a special issue of Business Insurance focusing on private/non-profit D&O. I haven't read much of it yet, but was reviewing one article that had done a survey on the purchase of these coverages. They pegged the purchasers at 70%+ of the potential buying population for both. No offense to the publication, but I'm finding that a wee bit challenging to accept. Of all the risks I see in a year, those that are not specifically seeking D&O rarely have it, and I have plenty of new buyers that are not startup companies. I see somewhere in the vicinity of 2,000 submissions a year, so that's certainly a statistically significant sampling.

I'm curious if all y'all have any statistics or a rough feel for what percentage of your clients have D&O. When I speak to my agents about this line of coverage, it turns out that many do not actively promote it, and those who do don't have anywhere near 75% penetration. I don't know who the survey-takers were, or how big the sample was, but I'm hard-pressed to believe we've penetrated anywhere near a significant percentage of this market.

I moderated a panel on private/non-profit D&O a couple of years ago, and one of our topics pertained to this issue of total number of businesses versus how many have coverage. With only anecdotal evidence, we calculated that about 20% of privately held companies have the coverage and perhaps close to 50% of the non-profits. I'd love any feedback you can provide.

Since different constituencies will have different priorities and opinions, determining that any action was fair to all could be impossible. Some chilling examples were given, and there is a lot of rear view mirror driving going on in these cases.

2. Insolvent/bankrupt companies. I learned that when a company becomes insolvent, the duties of the Ds & Os shifts. Normally the number one duty is to the shareholders. Second is the creditors, Third would be the remainder of the constituencies. But once a company is deemed insolvent, the creditors jump to the number one spot, and the shareholders become number two. How many of your insureds know that, do you think?

Then came the definition of "insolvent". It can be as simple as the breach of any debt covenant. But more importantly, there is a trend for experts to be brought in by the bankruptcy court to determine the date of insolvency. They may well fix a date that was far in the past compared to when the owners of the company felt it became insolvent. This will generally happen due to the recognition of good will, which the court may disregard. There could also be

decisions made that lead to the downfall of the company that in retrospect will be fixed as the time the company became insolvent. If the Ds & Os couldn't even tell the company was insolvent, what are the odds they were executing their number one duty to the creditors?

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