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Industry D&O Results

- Schedule P – Other Liability includes many lines
- Securities Class Actions (SCAs) account for most D&O loss costs for Publicly-Traded companies
- Many commentators publish SCA statistics
- Understanding the commentators’ audience is essential

Industry Commentators

- Advisen
- Cornerstone Research
- D&O Diary Blog
- NERA Economic Consulting
The Counting Game

- A publicly-traded company, its law firm and auditor are sued in 7 lawsuits alleging the same violations over a two-year period. What is the relevant "Count"?
- Correct Answers
  - 21 "defendant lawsuits"
  - 1 to 7 "lawsuits"
  - 1 "public company"

Securities Class Action Statistics

SCA Statistics

Source: Cornerstone Research
What’s Next

- Macro-Economic Conditions
  - M&A Activity
  - Bankruptcies

- Dodd/Frank Financial Reform
  - Whistle-Blower Rewards
  - Salary Claw-backs
  - Study on Private Right of Action for Aiding and Abetting
  - Study on F-Cubed Case Resolution

D&O What’s Next?
September 20, 2010
Lake Buena Vista, FL
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Agenda

• Introduction
• Post Crisis Environment
• Trends
• Data
• Modeling
• Q & A
Introduction

- Excellent opportunity to enter a large market at a point of significant change
- A very strong parent with a solid capital base
- A+/$/15M paper
- A very experienced team

Introduction

- Philosophy of writing high excess and A – side business
- Management of limits
- High quality accounts
- Industry diversification
- Good opportunities in a stressed market

Post Crisis Environment

- Number of credit crisis related SCA law suits has decreased
- Recent subprime related settlements, on average, have been encouraging in terms of loss dollars
- Madoff, other Ponzi Schemes, auction rate securities
- Banks and Financial Regulation
- “Mega claims” in the horizon?
Post Crisis Environment
Home Values

A History of Home Values


Post Crisis Environment
Bankruptcies

Business and Non-Business Filings
Years Ended June 30, 2006-2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Non-Business</th>
<th>Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>1,572,597</td>
<td>1,512,989</td>
<td>59,608</td>
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<tr>
<td>2009</td>
<td>1,306,315</td>
<td>1,251,294</td>
<td>55,021</td>
</tr>
<tr>
<td>2008</td>
<td>967,831</td>
<td>934,009</td>
<td>33,822</td>
</tr>
<tr>
<td>2007</td>
<td>751,056</td>
<td>727,167</td>
<td>23,889</td>
</tr>
<tr>
<td>2006</td>
<td>1,484,570</td>
<td>1,453,008</td>
<td>31,562</td>
</tr>
</tbody>
</table>

Source: Bankruptcy.com

Post Crisis Environment
Unemployment

United States - Unemployment Rate (1980 - 2009)

Source: Christina Romer, Robert Coen, and Bureau of Labor Statistics
Post Crisis Environment

Consumer Confidence

Consumer Confidence: Defined as the degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending.

Post Crisis Environment

Federal Budget Deficit

Annual Deficit Federal Government US from FY 2005 to FY 2015

Post Crisis Environment

Dow Jones – 100 Years

Source: Stock Trader's Almanac

Source: US Government Spending.com

Source: Conference Board

Source: Conference Board
Post Crisis Environment

Dow Jones – 100 Years

Source: Stockcharts.com

Post Crisis Environment

S&P 500 – 5 Years

Source: CN Money.com

Regulation/Supreme Court Cases

  - Set a number of non-negotiable deadlines for compliance
  - Cannot be used to plead an inference of scienter
Post Crisis Environment
Regulation/Supreme Court Cases

- Effect of Dura Pharmaceuticals Inc vs. Broudo (2005):
  - A casual connection between the misrepresentation and the economic loss – Causation
  - Rejected plaintiffs “price inflation” theory

Post Crisis Environment
Regulation/Supreme Court Cases

  - An inference of scienter must be more than merely plausible or reasonable
  - A reasonable person could infer that the defendant acted with require intent
  - A strong inference that the defendant acted with the required state of mind

Post Crisis Environment
Regulation/Supreme Court Cases

- Stoneridge Investment Partners, LLC vs. Scientific Atlanta Inc (2008):
  - Parties with some role in fraudulent conduct but do not themselves make a misrepresentation or engage in deceptive conduct cannot be sued under implied private litigation rights of 1934 Act
Post Crisis Environment
Regulation/Supreme Court Cases

  - Application of the federal securities laws to lawsuits brought
  - 1. By foreign investors
  - 2. Against foreign issuers of securities
  - 3. Based on transactions on foreign securities exchanges
  - A “foreign-cubed” or “F³” transaction

SCA Statistics
(from Randy Hein’s Presentation)

Source: NERA Economic Consulting

Trends

- Overall frequency is up again to historical stable averages
- 2006 seems like an anomaly in terms of counts (however loss amounts are increasing for 2006 settlements)
- Emergence of new classes (For-profit educational entities)
- Increased M&A activity
Trends

- Rate changes (so far limited to give backs?)
- Capacity
- Insurance Carriers that were under pressure due to Credit Crisis
- Reinsurance

Trends

- Next bubble in a low interest rate environment?
- Instability in oil prices
- Role of Private Equity

Data

Three key elements to consider when reserving D&O losses
- Data
- Contagion Risk
- Systemic Risk
Data

- Historical data for traditional SCAs (Securities Class Actions) available through commercial vendors
- Requires scrubbing and cleansing
- Manual work

Data

- Use more than one vendor
- Regular updates
- Differentiate data based on appetite (ex. ADRs)

Modeling

Contagion Risk
- Institutions connected through one or more parameters deteriorating at the same time
- Mutual fund cases
- Analysts cases
- Subprime lending cases
  (as of June 2010, 183 open, 10 settled and 33 dismissed)

Source: Reuters
Systemic Risk

- The movement of the entire market in a downward cycle
- Financial Crisis
- Climate change
  - Carbon Disclosure
  - Mandatory climate risk disclosure

Source: Wikimedia Commons

Systemic Risk

- Pollution (Interpretation of the pollution exclusion)
- Energy crisis
- Water

Source: Wikimedia Commons

Systemic Risk

- Double Dip recession
- Unemployment over 10% again
- National home prices dropping further
- Another cycle of law suits? (anyone left to sue?)
Exposure Based Modeling

- Market Cap
- Change in market Cap

Parameters for reserving
- Market Cap loss during class period
  - Plaintiff friendly
  - Carrier friendly
- Maximum dollar loss
- Bounce back effect
- Stock price movement compared to sector movement

Predictive Modeling
- Stock price movement
- Option pricing
  - D&O contract as a put option protecting shareholder value
- Debt markets (CDS Pricing)
- GLM
Pick a loss ratio based on UW experience, judgment and intuition
- Historical loss ratios of similar companies
- Adjustments for market trends, contagion risk and systemic risk

Risk appetite (primary vs. excess, ABC vs. A-side, …)
- Expected loss ratio based on market cycle (as opposed to 3 to 5 previous years)
- Loss ratio indication based on a holistic view

Questions