



HYLANT EXECUTIVE RISK NEWS BRIEF

A 2008 YEAR IN REVIEW

BOTTOM-LINE D&O UPDATE JANUARY, 2009

HAPPY NEW YEAR FROM HYLANT EXECUTIVE RISK

2008 In Review – What a year it was!

For businesses in the U.S. and abroad, 2008 proved to be one of the most challenging years in decades. The litigation effects of the subprime meltdown, credit crisis, housing market decline, global recession and unprecedented government intervention in the financial markets will not be fully known or finalized for years to come.

Market Update

Average year-over-year rate decreases for public company D&O tapered off in the 4th quarter of 2008 to just below 5%. Rates for financial institutions were up 20-25% on average for the same period. Commercial renewals in the 1st quarter of 2009 are trending in the flat to 5% increase range due to underwriting restrictions, firming of reinsurance renewals and budget edicts by insurers. We expect further tightening of pricing in 2009.

Recent Claim Trends

226 Federal Securities Class Action lawsuits were filed in 2008, up 30% from 2007. Approximately 100 of these suits were “subprime” related. Alleged investor losses increased 27% to over \$850 billion indicating increased future severity.

The average public company D&O settlement in calendar year 2008 was \$29 million, down slightly from 2007. The median amount also decreased to \$7.5 million from \$9.5 million and median defense costs remained consistent at \$2.5 million. Notable large settlements since July include:

— Coca-Cola	\$137.5 million
— SCOR Holding AG	\$84.6 million
— Tyco II	\$73 million
— Transkaryotic Therapies, Inc.	\$50 million
— AIG	\$115 million

¹Stanford University Class Action Clearinghouse
²NERA



Continued Subprime Fallout

The litigation floodgates have opened due to the rapid downgrades of \$450 billion (over 80%) of all collateralized debt obligations ('CDO's). The amount of civil litigation, breach of contract allegations against loan originators, securities fraud lawsuits, ERISA claims, lawsuits against Credit Rating Agencies, consumer and regulatory actions as well as criminal investigations led by the Department of Justice and FBI have been shocking.

There are at least 50 ongoing criminal and SEC investigations pending with mortgage originators including **New Century Financial Corp., American Home Mortgage Investment, Countrywide Financial, Golden West Financial** and **Washington Mutual**. **Merrill Lynch** has already announced \$690 million in settlements relating to subprime matters. The impact to the insurance industry (primarily D&O and E&O coverage) is estimated at \$3-\$9.6 billion.

Bank Failures, Fannie & Freddie

There were 22 bank closures and failures through 11/08 including **Indy Mac, Downey Savings & Loan** and **Washington Mutual**, the largest in U.S. history. In September, the U.S. Government took over operation of Fannie Mae and the Freddie Mac. Both companies are subject to significant pending shareholder litigation relating to management statements about their capital positions.

Additional large Financial Institutions now subject to shareholder litigation relating to pre-failure/bailout disclosures include **AIG, Bear Sterns, Merrill Lynch, Countrywide Financial, Lehman Brothers**, and **Wachovia**.

Hedge Fund Problems

Hedge Fund assets are \$1.5 trillion, the lowest level in two years. The massive withdrawal activity by investors (a record \$152 billion in the 4th quarter) has put downward pressure on equities in which these Funds invest. Almost 700 Funds were forced to liquidate through the 3rd quarter of 2008. Litigation has increased against the Funds, their managers and the companies in which the Funds invest.

Return of the Ponzi

The **Bernard Madoff** fraudulent Ponzi scheme will end up costing investors \$37 - \$50 billion. The cost to the insurance industry is estimated at \$750 million - \$6 billion to be funded primarily by D&O and E&O insurance policies written for advisors and funds that invested with Madoff.

Saytam Computer – In January 2009, this Indian Company announced core fraud involving billions of dollars of fictional cash assets. U.S. investors lost virtually all of their money, and have begun multi-jurisdiction litigation against Saytam and its directors and officers.

The SEC and Department of Justice charged **Mark Dreier**, the head of a 250 person law firm, with securities and wire fraud in the "tens of millions of dollars" range relating to the sale of phony promissory notes. Mr. Dreier is currently in jail without bond.



Record Foreign Corrupt Practices Act (FCPA) Fines/Penalties

Since January of 2006, the SEC has brought 38 FCPA cases against U.S. companies, more than all previous years combined. In December, **Siemens** announced an \$800 million criminal and civil settlement – the largest in history. In the 4th quarter, Halliburton announced a \$559 million settlement related to bribery allegations to Nigerian officials. Other companies with multimillion dollar FCPA fines, penalties and disgorgements in 2008 included **Fiat, AGA Medical Corp., Faro Technologies, Willbros Group, AB Volvo** and **Flowserve Corp.**

Legal Decisions

“Foreign-Cubed” litigation – *Morrison vs National Australia Bank, Ltd.* – the 2nd Circuit decision in October affirmed the dismissal of a shareholder lawsuit brought in the U.S. by Australian shareholders relating to an Australian Bank trading on an Australian Exchange.

In December, the 9th Circuit Court of Appeals finds no private right of action under Sarbanes-Oxley in *Digimarc Corporation Derivative Litigation*. Accordingly, it will be up to the Federal Government (SEC) to enforce disgorgement of executive bonuses and profits under SOX 304.

Other Notable Events in 2008

- SEC Enforcement Activity resulted in over \$1 billion in sanctions including the second highest number (671) of enforcement actions in history
- The SEC has proposed the use of IFRS (International Financial Reporting Standard) beginning universally for companies in 2014
- U.S. business bankruptcies increased 49% to 38,651 leading to additional D&O litigation as creditors seek to preserve their rights
- Liquidity in the Auction Rate market improved with the return of \$50 billion to investors from settlements with the large broker-dealer firms such as Citigroup and UBS
- AIG, Hartford and XL experienced highly publicized AM Best downgrades
- Two additional former Milberg, Weiss partners have been jailed for six months. David Bershard and Steven Schulman must also pay \$8 million and \$2 million in criminal fines and penalties respectively.



For more information regarding this article or any Executive Risk product, please contact one of Hylant Group's Executive Risk experts.

Jim Lash

Vice President and Practice Group Leader
jim.lash@hylant.com
513-354-1611 | Cincinnati Office

J. Scott Stewart

Executive Vice President
scott.stewart@hylant.com
419-259-2752 | Toledo Office

Michelle Lafferty

Vice President, Claims Counsel
michelle.lafferty@hylant.com
216-674-2412 | Cleveland Office

Douglas J. Miller

Vice President
doug.miller@hylant.com
734-662-1359 | Ann Arbor Office

Brian D. Sullivan

Vice President, Risk Management
brian.sullivan@hylant.com
419-259-2716 | Toledo Office

Nick Milanich

Client Executive
nick.milanich@hylant.com
216-674-2431 | Cleveland Office

Spencer Timmel

Client Service Executive
spencer.timmel@hylant.com
513-354-1656 | Cincinnati Office

Melissa R. Laine

Client Service Manager
melissa.laine@hylant.com
734-662-1699 | Ann Arbor Office

Emerging D&O Issues

- Increased Executive Compensation disclosure issues, scrutiny and regulations
- Increased litigation from business bankruptcies
- FIN 48 – FASB Interpretation Bulletin – Accounting for uncertainty in income taxes and disclosures surrounding loss contingencies is expected to greatly impact the pharmaceutical, financial services and telecom industries
- Litigation relating to volatility in commodities and currency markets
- Predicted increase in SEC investigative activity against U.S. public companies

Article written by Doug Miller



Leave nothing to risk. Choose the best.

hylantexecutiverisk.com

Illinois | Chicago
Indiana | Bloomington, Fort Wayne, Indianapolis
Michigan | Ann Arbor, Detroit, Grand Rapids
Ohio | Cleveland, Cincinnati, Columbus, Toledo
Tennessee | Nashville