



HYLANT EXECUTIVE RISK NEWS BRIEF

A 2007 YEAR IN REVIEW

BOTTOM-LINE D&O UPDATE JANUARY, 2008

Market Update

4th quarter premiums for renewals decreased 12% on average compared to the previous year as underwriters tried to make up for budget shortfalls and incumbents fought to maintain their positions on accounts. For the year, pricing was down 8.5% on average. A-Side pricing continues to decrease dramatically.

Recent Claim Trends

- 142 Federal Securities class action suits were filed in 2007 exceeding the 2006 total of 106. This increase was due primarily to the subprime litigation in the 3rd and 4th quarters which included some 26 cases against banking/brokerage and real estate firms. Despite this increase, the 2007 total is still below the 2005 total of 169 cases. (Source: PWC)
- Notable settlements since June include:
 - CIGNA - \$93 million
 - Doral Financial - \$129 million
 - Ameriprise - \$100 million
 - Priceline.com - \$80 million
 - Genzyme - \$64 million
 - Merrill Lynch - \$125 million
- Even with the criminal indictment of Bill Lerach, his former firm, Coughlin Stoia Geller Rudman & Robbins remains the number one plaintiff firm filer followed by Bernstein Litowitz and Grant & Eisenhofer.
- Notable item: the Apollo Group securities litigation that went to trial in November is only the 18th securities class action to actually make it to trial since 1996. On January 16, 2008 a federal jury found certain former directors and officers liable for securities fraud and ordered them to pay \$280 million. Apollo is evaluating options for appeal.



Subprime Implications

Total financial write-downs related to subprime losses may approach \$400 billion. Resulting litigation on D&O and E&O policies are predicted to impact the industry to the tune of \$3 billion, however many believe that the industry should be able to absorb such losses given the availability of additional reinsurance capacity in the market.

Much of the initial litigation has been leveled against public subprime and warehouse lenders, REITS and banking/brokerage institutions. This is starting to expand to other companies such as housing manufacturers and construction companies.

In addition, the ratings agencies are now under scrutiny. The SEC now requires rating agencies such as S&P, Moody's, Fitch, AM Best and DBRS to specifically disclose how they assign ratings. Moody's was recently sued for allegedly assigning excessively high ratings to bonds backed by subprime mortgages.

Stock Option Backdating

Despite the recent \$468 million United Health Group and \$117 million Mercury Interactive settlements, as well as the highly publicized Brocade case where Gregory Reyes recently lost his bid for acquittal, the activity seems to be settling down. This past year only 10% of the total SEC investigations related to stock-options backdating. Furthermore, they have recently dropped investigations into several companies relating to their backdating practices including Electronic Arts, Linear Technology, Nvidia, PMC-Sierra and Zoran. The case against Apple Computer was also dropped on 11/14/07.

SEC and Department of Justice Activity

- The SEC has been much more active in fiscal 2007. There was a 59% increase in enforcement actions brought by the SEC compared to the year before including 220 direct actions- the most since 2001. Orders have been obtained requiring violators to disgorge \$1.1 billion in illegal profits and pay another \$500 million in fines and penalties. 125 people have been personally barred by the SEC from serving as officers and directors of public companies in 2007.
- In contrast, DOJ criminal indictments are down significantly. There were 357 indictments between 2002 and 2005 in major corporate fraud cases. In 2006 there were only 14 and in 2007, only 12.

Supreme Court Rulings

- Tellabs- 6/21/07 ruling sought to clarify the pleading standard over what is required to prove "strong inference" of scienter under the PSLRA (Private Securities Litigation Reform Act). The court held that for a complaint to survive dismissal, an inference of scienter must be more than merely plausible or reasonable; it must be cogent and at least as compelling as any other inference of non-fraudulent intent. Most believe the ruling was a compromise approach, and while generally deemed favorable to corporations, some argue that it did not go far enough.



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- Stoneridge vs. Scientific Atlanta- 1-15-08 ruling appears to have resolved the pending question of whether secondary actors such as outside vendors, accountants, banks and law firms can be held liable under 10(b) of the '34 Act in private action securities claims. The court ruled that plaintiffs must plead and ultimately prove actual reliance by investors of the secondary actors' allegedly deceptive conduct. This requirement creates a higher pleading standard than a fraud-on-the-market presumption, and is seen as a welcome development to companies. The Court did not however bar all private suits against secondary actors under 10(b) noting that they could still be primarily liable if all elements of the claim are met including actual reliance.

Bankruptcy

- In NACEPF vs Gheewalla, the Delaware Court held that creditors have no right as a matter of law to assert direct claims for breach of fiduciary duty against a corporations directors notwithstanding that the corporation is either insolvent or in the "zone of insolvency." Rather, such claims can only be brought derivatively on behalf of the corporation.

Emerging Issues- Climate Change

Climate related issues under Regulation S-K 101 (c) (1) (xii) which require companies to disclose current and anticipated "material effects" of compliance with environmental regulation are being complicated by the current legislative situation. The Supreme Court ruling that greenhouse gases meet the Clean Air Act's definition of air pollution has created a legislative and regulatory impasse with the various States statutory framework. Companies with exposure to State climate change legislation may have a duty to disclose and a coalition of investors, States, and environmental organizations have recently petitioned the SEC for disclosure clarification regarding climate related risk.

- Eight States have already sued five electric utilities claiming that CO2 production has contributed to the nuisance of global warming.
- New York has subpoenaed five energy companies seeking information on their analysis of climate risk.
- Litigation is projected to increase until the regulatory and legislative confusion is settled.

For additional Climate Change information, please see our most recent Hylant Group Large Account Practice newsletter,

Article written by Doug Miller



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