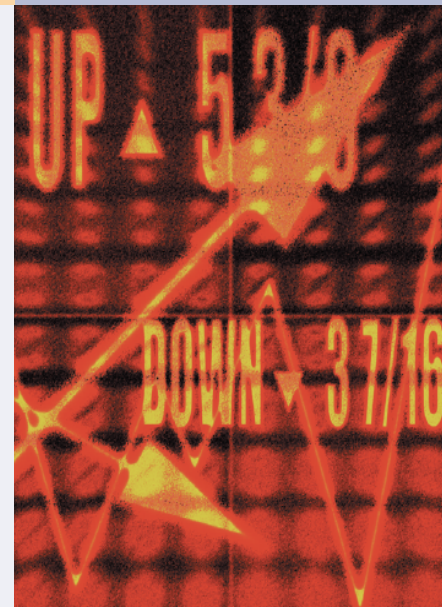


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A Note on Volatility

One of the more elusive metrics in the area of Management Liability – or any insurance sector – is volatility. In recent years we have all certainly witnessed the effects of a volatile insurance marketplace, in terms of both pricing and coverage. The volatility of settlements, always a problem, has never been greater, as demonstrated by some of the high profile settlements thus far in 2004. Despite its impact, volatility is exceedingly difficult to measure and predict, yet it remains one of the principal risks in our marketplace. We view it as a challenge to our Practice to educate ourselves and our constituents on the issues that impact our already volatile market so that we can respond to the evolving environment with appropriate risk management strategies. All of the topics covered in our newsletters reflect on some level our concern with the crucial and timely issue of volatility.

*Todd Jones, National Practice Leader,
Willis Executive Risks Practice*



CaseWatch: *Dura Pharmaceuticals*

The fate of billions of dollars of damages in D&O securities class actions may be decided by the US Supreme Court in its closely watched review of the lower court ruling in *Dura Pharmaceuticals*. The typical starting point for measuring losses in security stock-drop cases has traditionally been the stock price immediately prior to the company's public disclosure of something amiss. An alternative to this, adopted by the Ninth Circuit Court of Appeals in *Dura*, suggests that the stock price has frequently already fallen by the time corrective disclosure is made and that investor losses should be calculated starting at an earlier, higher stock price, leading to larger damage estimates. It should be noted that the Ninth Circuit tends to side with the more liberal assessment of loss. While a decision may not be made until early next year, we will keep this one on our Willis CaseWatch for further developments.

ERISA Fiduciary Challenges

These are certainly trying times for 401(k) fiduciaries, with investigations on the rise in several key areas. As the first wave of investigation into mutual fund conduct subsides, the related probe into the mutual fund selection by 401(k) pension plans continues to grow. Working both sides of the street, the SEC has sent out initial questionnaires to a number of mutual fund managers as well as several large pension plans on the mutual fund selection process. At the same time, the Massachusetts Securities Division and the New York State Attorney General's Office recently subpoenaed information on expense reimbursement between a mutual fund manager and a client's deferred compensation plans. The concern that unites these two probes is whether there are conflicts of interest or kickbacks in the selection of fund managers.

The Department of Labor has also announced plans to investigate 401(k) fee disclosures. Many fiduciaries may take comfort in the belief that they have adequately disclosed their

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current fee structure to plan participants and beneficiaries. However, prior investigations by the IRS and DOL on the use of float within employee contribution plans, such as 401(k) plans, indicate that this may be cold comfort. Recent experience has shown that the “real” fee attributable to an investment option should include the possible interest earned by the money manager if the funds reside in the money manager’s account prior to investment (for example, if monies are forwarded to the money manager on the 15th of the month but not invested until the 30th).

A new survey indicates that 14 percent of large retirement plan sponsors intend to institute rules or procedures to address market timing or excessive trading in the near future while two-thirds (69 percent) have recently taken steps to eliminate excessive trading.

While the incidence of employees day trading in their 401(k) plans is rare, it is apparently not unknown. Until recently, many larger 401(k) plans allowed daily trading in some or all investment options. This was sometimes true even when an underlying mutual fund option may have discouraged or expressly prohibited such activity as excessive trading. A new survey indicates that 14 percent of large retirement plan sponsors intend to institute rules or procedures to address market timing or excessive trading in the near future while two-thirds (69 percent) have recently taken steps to eliminate excessive trading. To accomplish this, some plans have limited the number of permitted trades, instituted minimum holding periods, imposed redemption fees, imposed lockouts and created warning notices. These are issues that 401(k) plan fiduciaries have not previously had to concern themselves with.

These new developments are commanding the attention of financial institutions, ERISA fiduciaries and plan sponsors, as well as Fiduciary Liability insurance underwriters. The concern is that the focus is not only on possible improprieties involved in the sale of funds to the plans, the disclosure of the resulting fees and the governance of the plans, but on the plan fiduciaries as well. With a very limited number of suits filed on these issues to date, the plaintiffs’ bar appears to be taking a largely wait-and-see approach. These are clearly challenging times already, and are likely to become more so.

Employment Practices Liability (EPL) Class Action Developments

In the Willis 2004 EPL Market Forecast, we indicated that one story to watch was the potential certification of the world’s largest EPL class action in *Wal-Mart*, one of the relatively few class actions of any real size in the area of gender discrimination/glass ceiling. We view this case as important for several reasons:

- Glass ceiling allegations were previously thought by many to be single plaintiff actions, difficult if not impossible to bring as a class.
- Size can matter; if this suit were to settle for a mere \$1,000 per plaintiff, the damages would still exceed \$1 billion.
- Even if the plaintiffs ultimately lose in their efforts to be certified as a class, they have indicated their determination to file as many state-wide class actions as necessary to bring their issues before the court.
- From the insurance carrier standpoint, defendants may spend tens of millions of dollars in fighting class certification only to turn around and begin defending separate classes or individual cases.

In an initial victory for the plaintiffs in late June, a San Francisco court agreed to allow the giant gender discrimination lawsuit to proceed as a class action. While currently on appeal, this decision means the suit could apply to as many as 1.6 million current and former employees.

This move came the month after Boeing reached a \$72.5 million settlement in what would have been the largest gender-bias case to go to trial in the US. The class here included 28,000 current and former workers. The settlement, still to be approved by the class members, covers only the Washington state workers, while a similar, separate, state-wide class action continues in another venue.

Both of these cases dramatically demonstrate the potentially catastrophic nature of Employment Practices litigation and the fact that the law is continuing to evolve. While these cases involve the retail and manufacturing/defense sectors, sizable settlements have been reached in several class actions dealing with financial institutions, indicating that these recent developments are not limited to specific industry groups.

D&O Issues in Brazil

Directors & Officers cover is a particularly hot topic in Brazil, where a marketplace dominated by a local insurance monopoly and recent changes in the law have raised the stakes. The Willis International Practice recently published an Alert on the subject, which can be accessed via the publications page on www.willis.com or by contacting the Willis Executive Risks expert nearest to you.



Executive Risks Regional Contacts

For further information, please contact any of the following:

Glenn Dockery
One Glenlake
1 Glenlake Parkway
Suite 1100
Atlanta, GA 30328
P- 404 224 5123
F- 404 224 5001
dockery_jg@willis.com

Tom Ciano
Three Copley Place
Suite 300
Boston, MA 02116
P- 617 351 7517
F- 617 351 6870
tom.ciano@willis.com

Brian Gauen
10 South LaSalle Street
Suite 3000
Chicago, IL 60603
P- 312 621 4855
F- 312 621 6870
brian.gauen@willis.com

Jim Iacino
1400 16th Street
Suite 400
Denver, CO 80202
P- 720-932-8203
F- 720-932-8138
jim.iacino@willis.com

Todd Jones
5 Corporate Center
100 Mansonford Road
Radnor, PA 19087
P- 610 254 7284
F- 610 254 5600
todd.jones@willis.com

Steve Pincus
7 Hanover Square
7th Floor
New York, NY 10004
P- 212 837 0734
F- 212 509 4912
pincus_st@willis.com

Brenda Shelly
One Bush Street
San Francisco, CA 94104
P- 415 291 1520
F- 415 398 4986
brenda.shelly@willis.com