

Proliferating Liabilities for Directors & Officers

Sources of liability for directors and officers have grown significantly, and staggering awards – those in excess of \$100 million – have grown right along with them. This year alone, there have been seven such settlements and court awards totaling almost \$1.4 billion. Exposure to regulatory action has surpassed that of shareholder-related suits. In the history of the Securities & Exchange Commission (SEC), there have been 18 penalty payments in excess of \$50 million – and 12 of these have occurred within the past 15 months.



Corporate executives continue to be challenged by new standards that include swifter financial reporting, greater transparency and better execution – all in an environment that is extremely unforgiving. Nowhere is this clearer than in the world of Directors & Officers (D&O) Liability insurance. Here, corporate reputations are made or broken while insurance premiums rise and fall.

Both executives and D&O insurance carriers face some harsh realities in today's litigation environment. Tort reform in securities litigation, via the Private Securities Litigation Reform Act of 1995, has ultimately done little to reduce the number of claims filed or the concentration of litigation in the hands of a few law firms. When combined with the stock market corrections and revelations of corporate scandals and intrigues, the result has actually been an increase in the size and ferocity of D&O litigation.

Changes in enforcement strategy and activity in response to recent corporate wrongdoings add further complications to the mix. When, for example, federal prosecutors execute their new divide and conquer strategy, whereby they seek to discourage companies from indemnifying those individuals being charged, this has obvious and significant D&O insurance implications.

SEC ENFORCEMENT ACTIVITY REPORT¹

Position	Number Charged	Number Charged with Fraud
Chair	75	63
CEO	111	99
President	111	96
CFO	105	79
COO	21	19
CAO	16	14
VP of Finance	27	19
General Counsel	11	8
Controller	47	28

¹ This SEC enforcement activity report was mandated by Section 704 of Sarbanes-Oxley and covers the five-year period ending July 30, 2002.

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An additional element in this complex new world is that the fight takes place in multiple venues in various guises. Today, the traditional federal securities suit is accompanied by an enforcement action (or two) as well as derivative actions and state-based claims; these may be joined by tagalong suits from the company's pension plans, bondholders, bankruptcy trustee and assorted stakeholders.

For the executives working to coordinate the investigation and defense of these matters, there is the further need to manage the various insurance policies and carrier responses to the multiple sources of litigation and regulatory action.

Federal securities class actions, shareholder derivative suits, ERISA-based claims, state and local civil and criminal prosecutions and other actions have broadened the litigation net. While proactive corporate governance continues to be a preeminent imperative, the state of the marketplace for D&O insurance also figures heavily in D&O risk management decisions.

The insurance market is one that is seldom in equilibrium. If there was any silver lining to be found in the recent hard market – one that saw sharply rising prices and tightening terms for D&O insurance – it was the attraction of new capital and new capacity. Fresh markets have created competition in the D&O marketplace and effectively stopped the hard market in its tracks, with prices leveling out, if not decreasing, on many segments. Even so, the D&O market appears to be fairly fragile, with robust claims inventories and growing pipelines of claims impacting both the traditional D&O carriers (who are being hit the hardest) and new capital alike. Whether this heralds a return to hard market conditions remains to be seen.



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