

D&O Update

Jardine Lloyd Thompson Limited

March 2008



MARKET CONDITIONS CORRUPTION EXTRADITION

Jardine Lloyd Thompson's (JLT) briefings on issues affecting the Directors' and Officers' Liability (D&O) insurance and updates on conditions in the D&O market are attracting a growing audience. The latest, held at the end of February, offered those attending a detailed analysis of how the subprime issue and resulting credit crunch will affect D&O coverage and its cost. Michael Lea, Head of JLT's D&O Liability Practice, provided an action plan for directors and officers to ensure that their policies are as comprehensive as possible ahead of the more turbulent times to come.

The session also focused on the issue of bribery and corrupt practices, which in the global economy is becoming of vital importance for companies doing business abroad. John Burbidge-King, Chief Executive of Interchange Solutions, explained how companies can inadvertently become embroiled and gave guidance on developing an effective anti-corruption programme. And Nigel Potter, former Chief Executive of Wembley plc, offered first-hand experience of the increasingly hazardous business climate for executives with exposures in the US. One of the first white collar victims of the Extradition Act voluntarily agreed by the UK with the US, he was unable to gain the protection of D&O cover and suffered a criminal conviction.

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FASTEN YOUR SEAT BELTS

The cost of Directors' and Officers' Liability (D&O) insurance has fallen in recent years. But we now face a changing market and more challenging times. That was the message from group chief executive Dominic Burke, who introduced JLT's latest briefing on D&O – a session that focused on the US authorities' increasing propensity for bringing bribery and corruption charges.

“...we now face a changing market and more challenging times...”

Why should we expect more turbulent times ahead?

Reasons include:

- the likely increased duties in prospect for directors from legislation such as the Corporate Manslaughter Act;
- the credit crunch and a possible recession in western economies that combines with a bear market for investors;
- the increasing volume of class actions, with Northern Rock's failure likely to generate more.

The subprime crisis threatens to result in losses upwards of \$3.6bn for D&O insurers in the US and will undoubtedly have repercussions for buyers. The financial sector has already experienced a 20% rate increase during the fourth quarter of 2007.

Michael Lea, head of JLT's D&O liability practice, attended the 2008 D&O Symposium held by the US Professional Liability Underwriting Society (PLUS) in February. He reports that the issue of subprime dominated sessions, with expectations of a 250% rise in class actions, and already 47 subprime filings to date.



Michael Lea

The main culprit is stock market volatility. One in 50 companies is named each year in a US securities class action. For foreign issuers on a US exchange the odds narrow to around one in six, while of 16 Chinese companies with US listings seven have been named in class actions.

A noticeable trend is the predilection of US courts for judgments arising from alleged violations of Section 11 and Section 12 of the 1933 Securities Act. They are replacing Section 10b-5 and are significantly more punitive, involving personal awards against directors who are expected to meet from their own resources.

Some D&O insurers regard Section 11 and Section 12 claims as uninsurable – companies should check whether their policy would respond.



“Secure higher limits now and you may not have to accept a Prior Acts Exclusion...”

The direct effect of the subprime crisis on D&O may well be limited to relatively few companies and their insurers. The wider fallout will be felt by the many D&O insurers in the UK that have a US parent, while the tougher conditions for raising capital will limit the ability of new players to enter the D&O market.

Also on the agenda is the topic of excess D&O, thanks to the case of Allmerica Financial Corp, whose excess D&O insurer rejected a claim payment by excluding pending and prior litigation. The case came to court, where it was ruled that the excess insurer was not obliged to follow the coverage position adopted by the primary carrier.

Comerica Inc also faced a rejected excess claim. A \$21m loss saw the primary carrier AIG pay \$14m and the company contribute \$6m. The excess insurer claimed that AIG hadn't paid the primary \$20m limit in full, so it wasn't liable for the remaining \$1m.

Predicting ahead is tough as legal trends are unpredictable. We believe any short-term hardening in the market will be restricted to financial institutions. The crunch will arrive in this year's fourth quarter or quarter 1 of 2009, when the reporting season will reflect fallout from subprime. Some D&O carriers will exit the market; others will add restrictions to their policy forms.

So consider a 'flight to quality' – that means away from heavily reinsured primary carriers, managing agents and underwriting agents, which are likely to be the first casualties.

Instead, consider D&O cover as a 10- to 15-year spend. This means offsetting savings from years when the soft market prevails against those when conditions get tougher. Secure higher limits now and you may not have to accept a Prior Acts Exclusion or sign a warranty statement. Both conditions are likely to apply from 2009.

Another recommendation: if your company moves from a layered D&O programme to a quota share, ensure that participants agree a common defence strategy from the outset. This means having the same cover on your excess policy(ies) through a 'follow form' cover. The only way to secure this is to use a broker's or Lloyd's form. Also, use fewer layers in your overall D&O programme if you can.

Right now there is a variety of primary D&O carriers, all with differing coverage enhancements. Liberty and Allianz are among those that joined the UK market last year.

JLT has monitored the various enhancements offered by each carrier and from it compiled a 'wish list' of the improvements available.

“...use fewer layers in your overall D&O programme if you can.”



A HIDDEN THREAT

‘Are corrupting practices widespread?’, asked John Burbidge-King, chief executive of Interchange Solutions. The hard answer is ‘yes’, and as Warren Buffett has observed they take minutes to destroy a business that has taken years to build.

Bribery and corrupt practices are holistic issues, mainly concentrated in the commercial arm of a business. As the cases



BAE Systems, Compass and Siemens prove, they can have far wider repercussions. Siemens spent €1.4bn in the fourth quarter of 2007 on its defence against fraud allegations.

Corruption is subtle; it’s an asymmetrical attack that can remain concealed until it’s too late. Directors and executives are inherently honest, but today’s companies often work in areas where practices are corrupt. While trust is taken for granted, the global business community includes ‘wild frontiers’ where companies are vulnerable, such as parts of China and Russia.

Bribery and corruption touches upon organised crime and terrorism, finding new ways to tap into companies and obtain advantage. Evidence suggests that companies with a weak compliance system are drawn into fraud and anti-competitive behaviour such as cartels.

An interesting report published by KPMG found that 40% of FTSE 350 companies believe they are not subject to the Fraud and Corrupt Practices Act (FCPA); 65% either weren’t sure if they had an FCPA compliance programme or didn’t have one. It’s possible to identify corporate discontent, which breeds corruption. How much attention does the board pay to a high value contract? PwC’s most recent survey found that fraud and corruption is a particular hazard in the E7 countries of China, Russia, Brazil, India, Indonesia, Turkey and Mexico.

“...companies need a comprehensive corruption programme...”

How high is awareness of anti-corruption laws? In the UK it is 72% of companies, in France 64%. Companies familiar with the law in their country of domicile can forget that it applies to other regions where they operate.

- Commissions or bribes to ‘oil’ a contract represent a crime, whether at home country or abroad.
- Malpractice commonly involves hiking the commission rate to clinch a deal
- Demands for ‘payment in kind’ are common, including school fees, entertainment and even charitable donations.

So how can you mitigate the exposure? Basically by adopting a joined-up business approach that doesn’t separate corruption from other corporate risk.



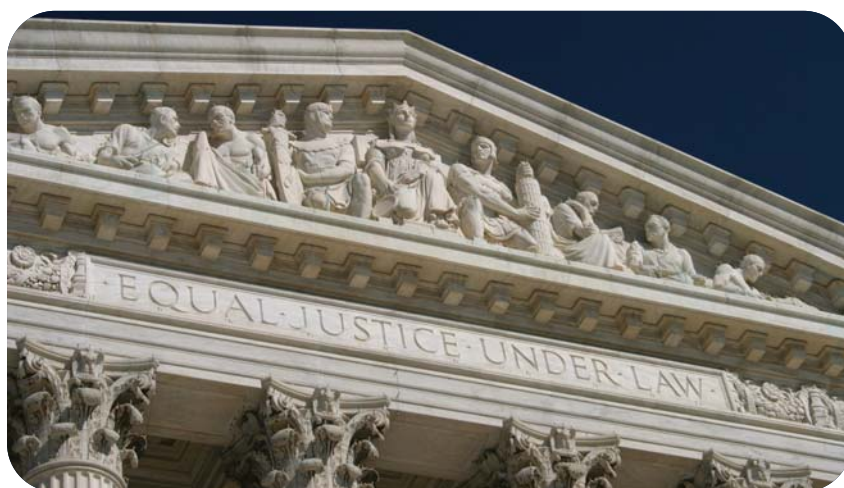
It's blind faith to simply tick boxes – companies need a comprehensive corruption programme, with reputational due diligence carried out on all the parties in a contract. It should include:

- Full disclosure; with whistle blowing mechanisms and public reporting to stakeholders on compliance.
- A culture of openness allowing for checks and balances.
- Better management of third parties in the supply and the sales chain.

All of these allow companies to enter new markets with a greater degree of confidence.

A CAUTIONARY TALE

The case of Nigel Potter is fascinating and offers a cautionary tale, said Dominic Burke. Nigel, former chief executive of Wembley plc, served a 656-day sentence in a Pennsylvania prison after The Extradition Act came into force at the start of 2004. Ostensibly a measure to combat terrorism, the act has been used by US authorities to extradite white collar defendants to America on



only a low threshold of evidence and with no duty to prove their alleged offence.

In the past four years, the UK authorities have allowed 46 such extraditions to the US, while only one has been in the other direction.

Nigel Potter was recently released and able to relate his experience at JLT's D&O briefing, but as he observed, the resulting criminal record will remain for the rest of his life and severely restrict potential future business activities.

He recounted the events leading to his imprisonment, which arose from Wembley's US gaming operations on Rhode Island, where a general manager proposed a bonus payment to

the group's outside lawyers. The board openly discussed the proposal, although in the event it was not taken up and no payment was ever made. However, it was entered as a 'just in case' provision in the group's annual budget, which, with the benefit of hindsight turned out to be a major mistake.

“In my experience, the US doesn't recognise UK corporate governance.”



Following the dismissal of another US manager and his deputy for wrongful expropriation of group funds, the individuals took the group to court claiming they had lost their jobs for failing to support the proposed bonus payment.

Local authorities in the US, invited by Wembley to investigate the issue, declined to do so. Instead, charges of attempting to bribe a public official were brought against the group and 15 different charges were brought against Potter.

A further mistake was Wembley's failure to inform their D&O insurer at this stage of the allegations, as directors did not believe that they would develop further. However, although UK counsel ruled that there was no case to answer, Potter was extradited once the Act took effect.

“...mistake was Wembley's failure to inform their D&O insurer at this stage...”

“The general strategy of the US is to jail you the moment that you land on American soil – making it much more difficult to successfully fight your case from jail,” Nigel said.

“Unfortunately, the authorities appear more concerned with achieving convictions than with justice.”

His warning for other British companies with US operations? “In my experience, the US doesn't recognise UK corporate governance. US chief executives are the kingpins of their organisation and don't work as part of a team as they do here.”

As Michael Lea added, the US attitude is also to regard investment as a one-way street. Companies “either make money or get sued”.

This hostile climate has proved too much for some companies. Both 2006 and 2007 saw record levels of delistings from the New York Stock Exchange and Nasdaq, while a growing number of listings of London's Alternative Investment Market (AIM) reflects the flight to less regulated markets. As yet, this hasn't persuaded the US authorities to change their attitude. They regard an AIM listing as “no more than an attempt to evade compliance with the rules”.

SPEAKER PROFILES

MICHAEL LEA

Head of Directors' & Officers' Liability Practice, Jardine Lloyd Thompson Ltd

Michael joined JLT from Marsh Finpro in 2001 as a founder member of the Financial and Professional Risks Business Unit and advises global corporations on their executive liability and crime exposures and designs insurance programmes to meet their coverage requirements utilising international marketplaces.

Michael is a leading figure in the London market and has written articles on corporate governance and Directors' and Officers' Liability insurance. He is a regular speaker at industry conferences and has been frequently quoted on the subject matter in that national and industry press.

Michael has 20 years experience in Financial Lines and is considered as a market leader in these classes of insurance.

JOHN BURBIDGE-KING WB, MCIM

Chief Executive, Interchange Solutions Limited

John is founder and CEO of Interchange Solutions, specialists in business reputation and risk management (www.interchange-solutions.co.uk).

After operational service in the Royal Marines, he had senior roles gaining experience in a challenging international environment, ranging from banking electronics, biometrics to security printing. He was an active participant of the World Economic Forum and

encouraged the debate on the counterfeiting of goods (paper discussed at Davos 2004) and corruption. He also participated in the ECGD Buyer Credit review in 2004/05.

John has interacted with all levels of government and companies around the world; a member of the UK Fraud Advisory Panel, former director of the European Forum of the Strategic Account Management Association (USA), a consultant on Middle East culture to Canning, and a Court Assistant of the Company of World Traders. Interchange is a member of the Society of British Aerospace Companies.

NIGEL POTTER

Former Chief Executive, Wembley plc

Nigel Potter is the former CEO of Wembley plc. In August 2005 he was convicted of conspiring to bribe a former Rhode Island House Speaker in the United States. Whilst he voluntarily went to the USA to face the charge in September 2003, he is widely seen as one of the first victims of the US-UK extradition treaty that was signed on 31 March 2003 and brought into law in January 2004.

Nigel has always protested his innocence and scores of people, particularly from the business world, have argued that all he was doing was his job: discussing a proposal made by the manager of a US subsidiary and following the instructions of the Wembley board of directors, namely "to proceed with caution" and "to seek legal advice".

EVENTS

Directors' & Officers' Market Update Web Seminar Recorded at the D&O Briefing on 28 February 2008

Listen to Michael Lea's full market update or download the transcript. Go to www.jltgroup.com.

JLT and AXA Breakfast Briefing 10 April 2008 Catastrophe Exposure: The Issues Debated

Globalisation, technological advancements and the economic and political environment are key reasons that the risk of catastrophic loss is increasing.

AXA Corporate Solutions and JLT will debate the issues considering the catastrophe risk outlook and its elements.

The briefing will be held at JLT's offices in Crutched Friars, EC3 commencing at 8.45am with registration and breakfast.

For further information and to register, please visit:

<http://www.eventsforce.net/catastropheexposure>.

JLT Web Seminars

We have held a number of web seminars in recent months:

- **Business Continuity Management** – avoiding common pitfalls and maximising value
- **Supply Chain Risk Assessment** – to help you accurately map your key vulnerabilities
- **Data Privacy** – to help you understand the legislative environment and insurance opportunities
- **Delay in Start-Up** – It's time for a consistent approach

which are available for you to view online or you can download a copy of the transcript.

To register and find out more visit our website: www.jltgroup.com

GIVE YOUR D&O POLICY A FREE HEALTH CHECK

Current market conditions mean now more than ever is the best time to review your D&O policy.

D&O exposures to shareholders, regulators, environmental agencies or the general public have led to a growing trend in the frequency and severity of lawsuits.

Insurers have responded to this by launching many new primary D&O policy forms. With no consistency between insurers each form has different ideas, enhancements and concepts.

Through our unique position at Jardine Lloyd Thompson we work on all UK, US and International forms. This has given us the ability to create a comprehensive database of all available enhancements. We can now negotiate JLT wordings with the highest common factor of improvements for your current D&O policy.

We have a team of D&O specialists who are experienced within the US, Asian, European and London markets. Using our knowledge, expertise and the information we have collated we can now offer you a free no-obligation health check of your current D&O policy.

For more information, please contact: Michael Lea on +44 (0) 20 7558 3686 or micheal_lea@jltgroup.com

ABOUT JARDINE LLOYD THOMPSON

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We provide market leading industry knowledge and expertise in specialist fields to some of the world's largest companies through to SME's, private individuals and public organisations. What sets us apart is the quality of our people and the environment we have created. It allows individuals to work together as a cohesive and focused team without internal boundaries, promoting personal accountability and responsibility for the benefit of our clients and other stakeholders.

It is this different style of approach that has helped us to become a world leader in many sectors, from Construction, Marine, Natural Resources, Communications and Technology and Life Sciences through to Credit and Political Risk, Professional Liability and Claims Management.

Today, the Jardine Lloyd Thompson Group employs 5,000 people worldwide and through JLT Network™ provides our insurance broking services in more than 120 countries.

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