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In this issue… analyzing securities lawsuits: Clarity can be elusive; and an invitation from the Director of the Federal Insurance Office

SECURITIES LAWSUITS ANALYSIS

Earlier this month the insurance industry analytics company Advisen released its 2011 third-quarter report on securities litigation.

Other monitors of securities lawsuits include the NERA Economic Consulting Group, which released its 2011 mid-year review in July; Cornerstone Research, which also published a half-year review in July; PriceWaterhouseCoopers, whose annual review of 2010 came out in April 2011; and the widely read blog the D&O Diary.

These reports all provide, in their own way, valuable data and insight into the record of securities litigation. However, because they each employ their own categorization techniques it can be hard for the casual reader to obtain a clear, consensus picture of securities litigation trends and experience.

For example, the July 2011 NERA report opens with this sentence: “In the first half of 2011, securities class action lawsuits were filed at the second highest semi-annual rate in the last eight years.” A reasonable inference would be that securities lawsuits are on the rise. However, the Cornerstone Report released on the same day began its review of the same period with this statement: “Federal securities class action filing activity decreased moderately in the first six months of 2011, reversing the increase in filings in the second half of 2010.” This depicts a slowing down, rather than the accelerated pace suggested by NERA.

Who is right? They are both right, within their own framework of categorization. The problem is that the broad heading of “securities lawsuits” embraces many sub-varieties, selected by the monitors themselves. NERA identifies six such variants: Standard cases, Options Backdating cases, “Ponzi scheme” cases, Merger & Acquisition (M&A) Pricing cases, Credit Crisis-related cases and, finally, “Other” cases.

For its part, Cornerstone uses seven categories: Chinese Reverse Merger filings, Merger & Acquisition filings, “Ponzi” flings, Options Backdating filings, Auction Rate Securities filings, All Other Credit Crisis filings and All Other filings.

Some of these overlap, but even then there is no consensus: NERA lists 37 M&A filings while Cornerstone’s M&A tally is 21. In his October 18 posting, D&O Diarist Kevin LaCroix points out the problem with categorization, commenting that different approaches by different published accounts “may be enough to lead to differences of opinion about ... whether or not the number of annual filings is increasing or declining.”

The reports are still relevant
Category inconsistency might make it hard to get an accurate thumbnail impression of the securities litigation landscape, but for the many constituencies affected by securities litigation it is important to understand the past and present state of play. Reading each report in its entirety is probably the best way to gain the useful insights they offer.

Despite definition variations, the notion of a "traditional" securities lawsuit tally is helpful, indicating how federal legislation and regulatory action could have had an impact. It is worth the time to identify particular unique circumstances such as the so-called laddering cases from the early 2000s, or the options backdating cases. More recently, the rapid proliferation in Chinese reverse merger lawsuits can be seen as an underwriting alert.

There's always something
Categorization issues aside, the world of securities litigation is always in flux. Whichever way you count it, merger and acquisition-related litigation has ballooned in the last year or two. The number of derivative lawsuits brought on behalf of the company is not easy to calculate, but few would doubt they are increasing. Opt-out lawsuits, where class members decide to leave the class in order to try their luck alone, also appear to be more prevalent.

This newsletter has talked before about the Securities and Exchange Commission (SEC) flexing its enforcement muscle. The commission's November 9 press release: "SEC Enforcement Division Produces Record Results in Safeguarding Investors and Markets" would seem to back this up. Although many of these actions are taken against individuals and so will likely not spawn class action litigation, some of the larger cases could result in private civil actions which tag-along behind the facts established by the SEC. The Dodd-Frank whistleblowing bounty provisions have also started to take effect: In the seven weeks following finalization of the rules, the SEC received 334 whistleblower tips.

While "traditional" securities class action filings might ebb and flow, the evolving nature of business and regulation, coupled with the predatory skill of the plaintiffs' bar, continue to establish new fronts in the conflict that characterizes securities litigation. This constant and changing threat is a reminder for companies to have in place a sound D&O "ABC" program, and that maintaining a separate but complementary Side A / DIC program is becoming a necessity.

THE DIRECTOR OF THE FEDERAL INSURANCE OFFICE WANTS TO HEAR FROM YOU

The now-installed Director of the Federal Insurance Office has commenced his study —as required by the Dodd-Frank Act— on how to modernize and improve the system of insurance regulation in the United States. Pursuant to that study, Director Michael T. McRaith is formally soliciting comments from the general public. This is a rare opportunity to have your voice heard by those in government.

Perhaps you are frustrated by the multiple nonresident producer licenses required by virtually every state, and think that a better model might be the driving license: one for the state where you reside, which is then good for everywhere else?

Maybe you think that admitted policies for commercial buyers should be exempt from the exhaustive and delaying form- and rate-filing requirements, noting that a growing number of states already allow such an exemption?

Or possibly you believe that the whole notion of surplus lines is archaic, penalizes the buyer with an added tax, and that recourse from most state guaranty funds is generally capped at $300,000 and so is largely meaningless for most commercial buyers?

Or you may feel the current insurance regulatory system is just fine, and no changes need to be made. Whatever your thoughts on the current regulatory environment, passing them on by responding to this request should be seriously considered.

Let the Director know your thoughts: Comments are due by December 16, 2011. ❖

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Chicago Underwriting Group, Inc.

Web: www.cug.com
Email: info@cug.com
Phone: (312) 750-8800
Fax: (312) 750-8965

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