A Newsletter from Chicago Underwriting Group, Inc.
Underwriters of D & O and Professional Liability Insurance

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In this issue … *Added to the civil litigation challenges faced by corporate executives from securities class action filings and merger & acquisition lawsuits comes an escalating threat from governmental agencies and prosecutors. This issue of CUG.COMments examines an emerging pattern.*

SECURITIES CLASS ACTION LAWSUITS AND MERGER & ACQUISITION LITIGATION

The Cornerstone 2012 mid-year report indicates that the number of "traditional" Securities Class Action (SCA) filings rose by 23 percent since the second half of 2011. Because the number of publicly listed companies has been declining, even a stable number of filings means an increase in the probability of being sued.

An exhibit in the Cornerstone annual report for the full 2011 year showed that the number of SCA defendants as a percentage of total issuers rose from 2.5 percent in 2010 to 3 percent in 2011: an increase of 20 percent, and the second highest value since 1996.

Because they may be filed in state court rather than federal, merger and acquisition (M&A) lawsuits brought by an aggressive plaintiffs' bar may sometimes be omitted from SCA numbers. These opportunistic lawsuits are generally directed against the acquired company, and can impact even the best-run companies, whose "crime" may simply be performing so well as to attract the interest of a would-be purchaser. The extent of these lawsuits indicates they are an almost inevitable consequence of M&A activity.

Against this backdrop is the emergence and growth of other forces intent on pursuing alleged executive wrongdoing. The threat posed by these forces is no less worrying, and may be more so.

THE RISE OF THE REGULATORS AND PROSECUTORS

The Securities and Exchange Commission (SEC) is accepted as the primary regulator of publicly traded companies and the securities industry, but the regulatory and enforcement landscape may have shifted. This August, the recently created New York State Department of Financial Services (NYDFS) announced its successful pursuit of Standard Chartered Bank.

Alleging that the bank violated U.S. sanctions against Iran, NYDFS Superintendent Benjamin J. Lawsky obtained a settlement from Standard Chartered of $340 million, and the bank's acknowledgement that: "The conduct at issue involved transactions of at least $250 billion."

An article in the Wall St. Journal discussed possible implications of this aggressive move by Superintendent Lawsky, suggesting that a “race to investigate, indict, subpoena and fine had reached a new level of intensity.”

WHO ELSE IS IN THE RACE?

The smash-and-grab tactics of the NYDFS may indicate a departure from the old ways of cooperation and courtesy among regulators and prosecutors. Collaboration among agencies that involves resource sharing and information exchange would seem to be an efficient and productive approach, but the unilateral NYDFS move that produced a windfall of $340 million will probably cause some rethinking among other agencies about their future strategies.

Such agencies —listed in the Wall St. Journal article— include the federal Departments of Justice in Manhattan and Brooklyn, the New York state attorney general, the New York County District Attorney, the FBI, and the SEC.

Agencies not included in that list are:

1) The **Office of Foreign Assets Control** (OFAC), with responsibility for administering economic and trade sanctions, among other things. The OFAC has the power to penalize —and will likely also extract a settlement from Standard Chartered.

   Enforcement example: June 2012, ING Bank N.V.
   Settlement amount: $619 million.

2) The **Federal Deposit Insurance Corporation** (FDIC), overseer of the U.S. banking sector and also empowered to levy punishment.

   Enforcement example: October 2012, American Express Centurion Bank.
   Civil penalty: approximately $27 million;
   Restitution: approximately $85 million.

   Illustrating the possible ramifications from such regulatory enforcement, a follow-on shareholder derivative lawsuit was recently filed in New York, alleging that the sanctions against American Express Centurion resulted from misconduct by the directors.

3) The **U.S. Commodity Futures Trading Commission** (CFTC), whose jurisdiction to pursue wrongdoers was expanded by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

   Enforcement example: June 2012, Barclays Bank plc.
   Civil penalty: $200 million

4) The **Consumer Financial Protection Bureau** (CFPB), created by the Dodd-Frank Act. This controversial agency —generally welcomed by consumer advocates but strongly opposed by some industry groups— has its own enforcement capabilities. In July 2012 it secured its first enforcement success, a $25 million penalty against Capital One Bank, with restitution of approximately $140 million.

Beyond the Headline Settlements: The Hidden Costs

Paying settlements and penalties is bad enough, but for the beleaguered company they are often the culmination of a lengthy investigative process that drains both money and time. When details of these costs emerge they can be staggering: The Avon company is reported to have spent nearly $280 million investigating an alleged Foreign Corrupt Practices Act violation, and an FCPA-related investigation by Weatherford International has reportedly lasted six years and cost more than $125 million.

Summary

Augmenting the corporate concerns caused by securities class action and merger & acquisition litigation, federal and state agencies beyond the SEC have scored some significant victories in their pursuit of wrongdoers, and will be energized for the foreseeable future. Their counterparts in criminal enforcement are equally anxious to make their mark and not get left behind. The financial services sector may be bearing the brunt of these aggressive initiatives, but any public company could be threatened, especially if its operations extend overseas and the Foreign Corrupt Practices Act becomes a factor. For its 2011 fiscal year, the SEC reported a “record” 735 enforcement actions, and recently announced that the 2012 fiscal year number was only one shy of that record, at 734.

This heightened activity might result in more settlements and fines; it will almost certainly mean increased corporate expenditure related to investigations. The rise of emboldened regulators and prosecutors could be a temporary phenomenon, or it may indicate a longer-term repositioning that will impact publicly traded companies and the D&O insurance market.❖

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