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

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In This Issue... we ask our D&O underwriters, Diane Vasti, Jim Crockett and Frank Kastelic the question, "What do you look for when evaluating a company for D&O insurance?" Their responses will give you some insight into our underwriting process. Most of our D&O policyholders are either public companies or companies about to go public, and the underwriters' comments generally refer to this segment of the D&O market.

Diane Vasti: Our analysis really starts with the management of the company, which is critical for an established company; but for a new Internet company, management is sometimes almost all there is to analyze. We look at the individuals' history, including their biographies and their experience at leading other public companies.

Jim Crockett: We can find out if anyone on the management team has ever been sued, in what capacity and if they have been involved with bankruptcies or restatements of company accounts.

Frank Kastelic: It used to be that frequent job hopping was a red flag but now it's more common and doesn't give us quite the same concerns, although we still question whenever a senior executive has resigned or been terminated. For start-up companies (usually Internet related) about to experience an Initial Public Offering (IPO), we like to see what we call "adult supervision" on the board. Are there board members who have some substantial business experience at other public companies?

JC: We look at the company's business partners; this is especially important for an IPO account. Who are their lawyers, accountants and investment bankers? And, have any of these changed recently?

FK: We also review who their investors are, evaluating the venture capital firms and other companies who might be investing in the company. If an established, reputable company is putting money into the business, it's a good sign.

DV: If it's an IPO, we'll examine the S-1 filing closely. Who, if anyone, is selling shares at the IPO? If a lot of individuals are selling too many shares, this can raise questions. Why are they cashing in so soon? Ideally, we like to see no insiders selling during the IPO, however, 5-10% of the offering would fall within an acceptable range.

JC: For more established public companies we study their historic operating performance and watch for any erratic swings in their earnings and stock price. These days, most companies have web sites, and so we will look at these to see how the company is portraying itself to the outside world, particularly the Investor Relations section.

DV: "Insider selling" of shares is

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Here are some of the resources our underwriters use:

- » **Bloomberg Financial Service** - Excellent source of information for publicly traded companies.
- » **Dow Jones Interactive -** Good source for local news about public and private companies.
- » **IPO Express -** Part of EDGAR on-line, a summarized version of S-1 filings used as a screening mechanism.
- » **Vickers On-Line -** Via CNBC, gives information on insider holdings and trading.
- » **YAHOO! Finance -** Another good source for insider trading information and corporate news.
- » **EDGAR On-Line -** The source for all public SEC filings.
- » **California Technology Stock Letter -** Gives insight on technology companies business and investment outlook.
- » **Value Line Investment Survey -** Provides a thorough snap-shot of a company and its investment merits and risks.
- » **Red Chip Review -** Research publication focusing on small capitalization stocks in the Western U.S.

something we monitor very carefully: who sold how much and at what times, and what percentage of their total holdings is involved? We also look at insider buying, usually a sign of confidence in their own company.

FK: The technique of "pump and dump" is something we try to spot: a company issues a flurry of press releases depicting a rosy future, leading to a rise in share price, upon which there is selling by insiders, taking advantage of the inflated price.

JC: For both established and emerging companies we look at the nature of their business: what goods or services do they produce or provide? How diversified are they? How many customers do they have? What are the "barriers to entry" which might delay or discourage competition?

DV: We look to see if the company is in a "niche" market, whether it's a growing market or if it's shrinking. For the new companies we are wary of "me-too" companies, belatedly jumping on a band-wagon - although sometimes a "me-too" company can be more successful than the leader.

FK: We review the general litigation that the company has experienced, not just D&O related. Indeed, if a company has experienced - and successfully weathered - a lawsuit, this can be a positive from our perspective. It can make them less of a target, and they will almost certainly have learned from the experience.

JC: How a company runs itself is important. We look at the composition of the Audit and Compensation committees, and assess if these committees are too cozy with management.

DV: We usually request a copy of the company's internal share trading policy and their internal revenue recognition policy. One of the most frequent allegations made against corporate directors' and officers' is improper revenue recognition and misleading financial statements. By reviewing a company's revenue recognition policy we hope to confirm that management has a meaningful policy in place and is conservative in their accounting approach. With respect to their stock trading policy, we look for a defined trading window, blackout trading powers by the Investor Compliance Officer, pre-clearance procedures and a definition of "material inside information." These items are very helpful to us, and as they are usually not publicly available, we depend upon our producers to get them for us.

FK: For insight into how others perceive the company, we can review "short interest" activity; in other words, how much have investors been betting that the share price will fall. "Shorting" a company's stock is a risky ploy, usually employed by the professional investing community, so if this is happening someone may know something we don't. ❖

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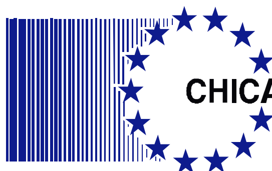

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