CUG.COMments

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

Issue 23 **August 2002**

Directors & Officers Liability Today: A Comment

Sometimes accusations are leveled against the D&O insurer "community" that it is not doing enough to change corporate governance practices. Such accusations are for the most part unwarranted. The market for D&O insurance is just that: an open market in which the brokers and buyers typically - and not irrationally - take the path of least resistance. No single carrier can simply decide to change the market with either pricing or conditions.

It is the business of Congress to legislate, the SEC to regulate, the stock exchanges to impose and state attorneys general to prosecute. To varying degrees, these groups have been doing this. In addition, there is the threat by some institutional investors that their vast funds will follow good corporate governance and desert the bad.

Inability to effect mandatory change does not mean D&O carriers have no voice. In a recent communication to producers, National Union [the largest D&O writer] identified three areas where the D&O market could have an impact.

To paraphrase, these are: 1) concentrate on producing policy language that protects the individual Directors and Officers; 2) maintain premium increases to ensure the market remains viable; and 3) return to risk sharing between insurers and insureds through co-insurance, pre-set allocations and retentions.

This may not be a message that buyers and brokers want to hear, but red ink has saturated the results of insurers and reinsurers as loss frequency has increased and severity exploded. Every carrier knows creating hurdles may turn away business that will be accepted by less discriminating underwriters, however brokers and buyers should recognize that the most stable and effective placement is not always the easiest placement.

While insurers may not have the stick, they certainly have the carrot. They can respond favorably to insureds that demonstrate good corporate practices such as independent boards and audit committees, appropriate insider trading policies, and the expensing of stock options. Brokers should impress upon their clients that these measures will improve their risk profile, and they need to point out to insurers when their clients have taken these positive steps. It is during the current market conditions that the best brokers are able to demonstrate their value to both buyer and underwriter.

Complete D&O Submissions: More Important Than Ever

Providing us with a comprehensive underwriting submission enables us to produce a timely and thorough response for your client. As a reminder of what constitutes a complete submission here are some guidelines.

[*Thank you to those producers already giving us this information.*]

1) For all new business, whether we are being asked to quote primary or excess, our completed and signed "long" form application, ORUG-18. On renewal business, the shorter form ORUG-67 completed and signed.

2) For public companies, the latest 10Q, 10K, DEF 14A [proxy information] and recent 8Ks.

3) A copy of the company's internal Revenue Recognition policy.

4) A copy of the company's Insider Stock Trading Policy that spells out who is an insider, and what restrictions have been placed on time of stock sales, amount of sales or both. Also, identification of any director or officer who is trading under a 10b5-1 trading plan.

5) Details and status of any known SEC investigation.

6) Details of all prior or pending claims.

7) A copy of the company's public communications policy, showing who is allowed to speak publicly on behalf of the company.

8) A copy of the latest auditor's management letter along with management responses.

9) A description of the current insurance program and the broker's proposed renewal strategy.

These are our basic underwriting information requirements. Each risk may warrant other underwriting information due to its particular circumstances. The closer a submission is to fulfilling the above requirements, the faster and more effective will be our response. We understand that some of the material we require may be of a confidential nature and we are therefore willing to sign appropriate Confidentiality Agreements.

THE SEC ORDER ON SWORN CEO STATEMENTS

SEC Order No. 4-460 requires the CEOs and CFOs of the 947 listed companies with last fiscal year revenues of over $1.2 billion to attest that their publicly stated numbers are accurate.

This has produced plenty of discussion and no shortage of speculation as to its likely effect. Here are some comments:

1) Currently, SEC filed documents already require signing by the CEO / CFO with the implicit presumption that the CEO / CFO are responsible for the validity of the information. For practical D&O insurance purposes therefore, there may be no meaningful increase in executive liability. What may change is that a false certification made knowingly under oath could increase exposure to charges of perjury.

2) Some corporate attorneys, perhaps with the threat of perjury in mind, are said to already be looking for a middle ground, modifying the sworn statements with the use of footnotes. The SEC, perhaps recognizing that hard-to-read and inaccessible footnotes sometimes contain information the company wants to bury, has said it must be either sign or don't sign.

3) Executives can therefore opt not to attest, but then have to explain why. Opting out would trigger very close attention from investors and D&O underwriters.

4) The deadline for these 947 companies is August 14, 2002 and attestation will include information regarding the quarter ended 6/30/02. Investors and D&O insurers will watch with interest to see if there is any house cleaning to exhume financial skeletons hidden in the corporate closet, allowing the CEO to swear with a clearer conscience. ✍

[Due to pressure of space, "Aesop's Fable" will appear in the next issue of CUG.COMments.]

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