



WOODRUFF SAWYER

Insurance Services | Risk Management | Employee Benefits

Focus on D&O Insurance Limits

DATABOX™

Woodruff Sawyer's Proprietary D&O Litigation Database

Focus on D&O Insurance Limits

How much in D&O limits is enough? Can a company have “too much”?

In your annual analysis of D&O insurance limits, you probably use a variety of information ranging from loss data to peer buying trends. Woodruff Sawyer believes that the most relevant metrics come from objective data derived from securities class actions. **Despite the flood of non-class action suits that have arisen over recent years, your leading exposure as a public company director or officer continues to be securities class action lawsuits.** The severity of the settlements and defense costs associated with these suits continues to top the list of exposures for public companies.

Securities class action settlements are made public and the raw data is readily available for all cases; however, the data in itself is not enough to use for your analysis as it often contains information that is irrelevant, including costs that would not be covered under your D&O insurance program. Woodruff Sawyer’s proprietary analytical tool, DataBox, solves this problem by building a database to specifically analyze exposures relevant to domestically traded issuers and their insurance coverage.

DATABOX™

Not all data sets are equally relevant. DataBox, Woodruff Sawyer’s premier analytic tool, contains all securities class action cases back to 1988. DataBox analyzes each case and excludes those costs that are not relevant to D&O insurance, such as third-party settlements. DataBox allows you to tap into a near real-time resource and model your specific potential securities class action exposure. Woodruff Sawyer’s DataBox model also incorporates the same defense cost data used by major actuaries, thus providing additional insight on these hard-to-quantify costs.

Woodruff Sawyer makes DataBox the core resource for clients when making decisions about limits.

Taking a Data-driven Approach

First: understand who your peers are

One of the key steps to benchmarking your limits is to define an appropriate peer group. Most companies define their peers by industry sector competitors. While industry sector is of interest, market capitalization is actually the most meaningful factor to consider when assessing D&O exposure and choosing insurance limits. A drop in market cap is the starting point for calculating investor losses and, ultimately, damages.

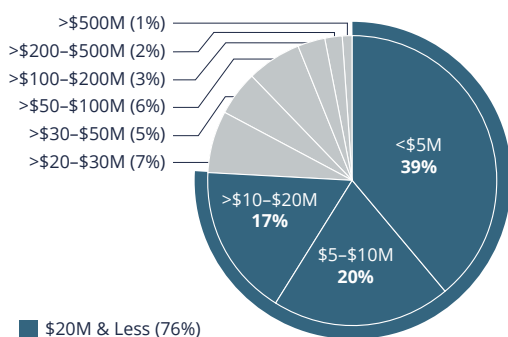
Selecting the right D&O insurance limits

Would you be surprised to know that **76% of all securities class actions in the past 10 years settled for under \$20M?**

Market Cap All

Sample: 752

Mean: \$34.7M Median: \$7.3M 75th%: \$20.0M



Given this statistic, why is there such great diversity among companies in limits selection? Who is buying more and why? One reason is that settlements are sensitive to market capitalization. If we index all cases by narrower market capitalizations, we get a different picture:

Market Caps \$150M-\$500M: 96% of all settlements are under \$20 million

Market Caps \$5B to \$30B: 35% of all settlements are under \$20 million

A clearer picture emerges of what you may intuitively sense: market capitalization drives settlement values—but the story doesn't end there.

This is a useful starting point, and we can be a lot more sophisticated and nuanced in our analysis by modeling loss by drop in market cap and considering the distribution of share ownership.

How Much is the Right Amount?

Case Study

Consider the case of the two companies profiled below. Both have \$2 billion in market capitalization.

Company A buys \$60 million in D&O insurance, while Company B buys \$20 million.

If your personal liability as a director were your only consideration, on which board would you choose to be? Of course you know by the way we set up the question that you need more information—but many directors and officers might see the lower limits as much riskier—verging on imprudent—and stop there.

COMPANY A \$60M IN D&O INSURANCE

- Mature company
- Motor and Auto parts industry
- Doesn't go into the capital or debt markets to raise funds
- Founders and others on the board hold 10% of the company

COMPANY B \$20M IN D&O INSURANCE

- Relatively young company
- Pharmaceutical industry
- Frequently goes into the capital or debt markets to raise funds
- Founders and others on the board hold 75% of the company

Who has the right answer? Company A or Company B?

Using Peer Limits Data: Many companies place a high value on data derived from the purchasing trends among their peers. Peer data varies widely and can be heavily biased by the source of the data. Using three different sources, the median limits of similar sized companies buy around \$55M in insurance. Based on this, Company A's \$60M in limits seems most prudent.

Using DataBox: Objective settlement data generates a very different result for both companies and from peer purchasing trends. The models below look at securities class action law suits that can result when a company's stock price falls precipitously.

In our example, let's assume that both companies suffered a 50% stock drop off of a \$20 trading price.

DATABOX™

Securities Class Action Exposure

Customized Damages Model for Company A

EXPOSURE CALCULATIONS WORKSHEET			
50% DROP		FROM	MARKET CAP
		SHARE PRICE	\$2,000,000,000
		\$20.00	
		TO	\$1,000,000,000
		\$10.00	
Total Shares Outstanding			100,000,000
Deduction of Insider Shares			(10,000,000)
Potential Class Member Shares			90,000,000
Reduction in Share Price			\$10.00
Potential Securities Class Action Exposure			\$900,000,000

POTENTIAL EXPOSURE CALCULATION			
	50 th PERCENTILE	75 th PERCENTILE	85 th PERCENTILE
Potential SCA Exposure	\$900,000,000	\$900,000,000	\$900,000,000
Settlement % of Exposure	1.6%	2.9%	4.9%
Estimated Settlement Value	\$14,400,000	\$26,100,000	\$44,100,000
SCA Defense Costs	\$4,000,000	\$6,000,000	\$9,000,000
Total Potential SCA Exposure	\$19,000,000	\$33,000,000	\$54,000,000
Budget for Related Claims	\$5,000,000	\$5,000,000	\$5,000,000

DETAIL:
Potential SCA Exposure: The customized exposure based on the variables chosen.
Settlement Percentage of Exposure: Derived from historic securities class action settlements.
SCA Defense Costs: Provided as an estimate.
Total Potential SCA Damages: The sum of "Estimated Settlement Value" and "SCA Defense Costs". The number is rounded.
Budget for Related Claims: Includes common "side-car" litigation such as related derivative lawsuits, and government investigations of individuals.

Customized Damages Model for Company B

EXPOSURE CALCULATIONS WORKSHEET			
50% DROP		FROM	MARKET CAP
		SHARE PRICE	\$2,000,000,000
		\$20.00	
		TO	\$1,000,000,000
		\$10.00	
Total Shares Outstanding			100,000,000
Deduction of Insider Shares			(75,000,000)
Potential Class Member Shares			25,000,000
Reduction in Share Price			\$10.00
Potential Securities Class Action Exposure			\$250,000,000

POTENTIAL EXPOSURE CALCULATION			
	50 th PERCENTILE	75 th PERCENTILE	85 th PERCENTILE
Potential SCA Exposure	\$250,000,000	\$250,000,000	\$250,000,000
Settlement % of Exposure	2.6%	5.2%	6.7%
Estimated Settlement Value	\$6,500,000	\$13,000,000	\$16,750,000
SCA Defense Costs	\$2,000,000	\$4,000,000	\$4,000,000
Total Potential SCA Exposure	\$9,000,000	\$18,000,000	\$21,000,000
Budget for Related Claims	\$5,000,000	\$5,000,000	\$5,000,000

DETAIL:
Potential SCA Exposure: The customized exposure based on the variables chosen.
Settlement Percentage of Exposure: Derived from historic securities class action settlements.
SCA Defense Costs: Provided as an estimate.
Total Potential SCA Damages: The sum of "Estimated Settlement Value" and "SCA Defense Costs". The number is rounded.
Budget for Related Claims: Includes common "side-car" litigation such as related derivative lawsuits, and government investigations of individuals.

Understanding the Results

Using the 75th percentile as a reasonably conservative goal for insurance coverage, we find that despite sharing the same market capitalization, these two companies have very different exposure to a securities class action suit.

Results for

Company A: Total potential securities class action exposure of \$33M

Company B: Total potential securities class action exposure of \$18M

The results suggest that the insurance analysis would start at very different points for each company.

Considerations for

Company A: Set your limit baseline in the \$35M to \$40M range

Company B: Set your limit baseline in the \$20M to \$25M range

Though other factors can shape your final limits choices, starting the analysis with solid objective data can achieve considerable savings while still providing a very comfortable amount of coverage.

What Next?

The example we've provided is a sample of the critical first step to take when using data to model limits.

The next step involves a sensitivity analysis; further refinement can be undertaken after that. In addition, it's useful to think about what non-insurance solutions can be deployed to mitigate D&O exposure. Taking this sort of sophisticated, holistic approach to D&O risk management yields superior results—fewer suits, and suits get settled faster and for less money—compared to the raw hammer of just spending a lot of shareholder dollars on D&O insurance limits.

Further Considerations

- Understand the data and consider the sources.
- Refine your peer selection.
- Place objective settlement data at the core of your decision making.
- Build into your limits consideration for defense costs.
- Budget for related “side-car” claims, such as derivative litigation and government investigations of individuals.
- Expand or contract your limits depending on whether your programs covers investigations of the corporate entity.
- Explore alternative insurance program structure options.
- Consider the impact of retentions as the insurance market hardens or softens.
- Monitor the impact of emerging litigation trends, newly regulations and governmental initiatives.

About

Woodruff Sawyer

Woodruff Sawyer is one of the largest independent insurance brokerage firms in the nation, and an active partner of Assurex Global and International Benefits Network. For 100 years, we have been partnering with clients to deliver effective insurance, employee benefits and risk management solutions, both nationally and abroad. Headquartered in San Francisco, Woodruff Sawyer has offices throughout California and in Oregon, Washington, Colorado, Hawaii and New England. For more information visit woodruff Sawyer.com.

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Senior Vice President, partner



Priya is a recognized expert in D&O liability risk and its mitigation. In addition to consulting on D&O insurance, she counsels clients on corporate governance matters, including ways to reduce their exposure to shareholder lawsuits and regulatory investigations. Priya is a frequent speaker on D&O issues and a regular guest lecturer at Stanford's Annual Directors' College, among others.

Priya began her career as a corporate and securities attorney at Wilson Sonsini Goodrich & Rosati (WSGR), where she worked with public and private companies through all stages of their development, including IPOs, ongoing public reporting and M&A transactions.

In addition to serving as a board member at Woodruff Sawyer, Priya serves on the board of directors of Realty Income Corporation, The Monthly Dividend Company®, (NYSE: O). She also serves on the advisory board of the Stanford Rock Center for Corporate Governance.

A member of the California Bar, Priya earned her bachelor's degree with high honors from Harvard University and her juris doctorate with honors from the Law School at the University of Chicago.

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Our Value Proposition

- Content-rich model: state-of-the-art proprietary benchmarking supports our fact-based approach
- Highly analytical approach to coverage terms & conditions results in creative solutions for clients and a solid insurance contract
- Methodical, consistent, senior-level service: the team you see today is the team you will see servicing your business everyday
- Clout & leverage in the market: a dominant D&O broker seen as a leader in the industry
- Integrated claims services & advocacy that go beyond the traditional
- Because we're independent, client interests always come first



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