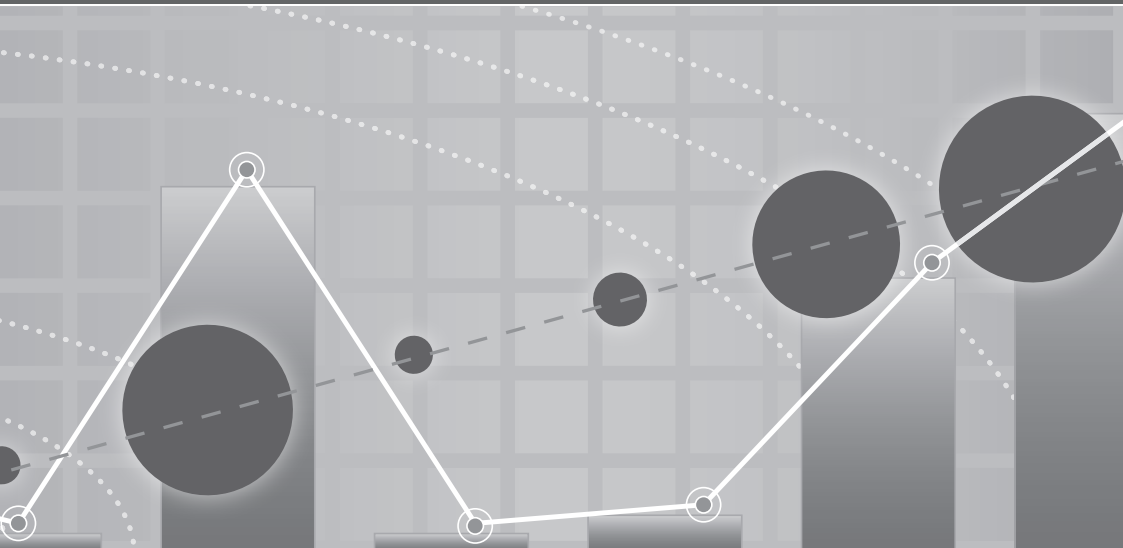


**DATABOX™**

Woodruff-Sawyer's Proprietary D&O Litigation Database

## FOCUS ON D&O INSURANCE LIMITS



## 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.

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

#### 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.

Your leading exposure as a public company director or officer continues to be securities class action lawsuits.

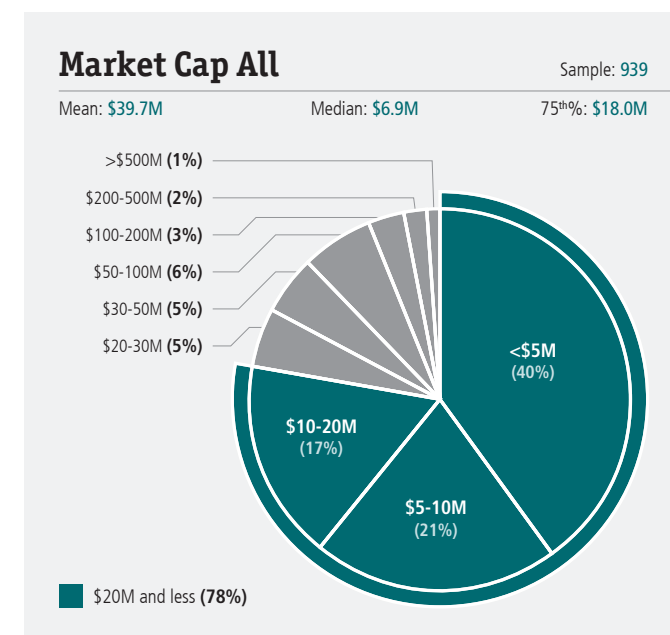
## Taking a Data-driven Approach

### 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 80% of all securities class actions in the past 10 years settled for under \$20M?



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:** 47% of all settlements are under \$20 million

A clear picture of what you may intuitively understand emerges: larger companies tend to pay more to settle their litigation.

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 was 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	COMPANY B \$20M IN D&O INSURANCE
<ul style="list-style-type: none"> <li>• Mature company in the motor and auto parts industry</li> <li>• Heavy manufacturing</li> <li>• Doesn't go into the capital or debt market to raise funds</li> <li>• Founders and others on the board hold 10% of the company</li> </ul>	<ul style="list-style-type: none"> <li>• Relatively young company in the biotechnology industry</li> <li>• Biopharmaceutical</li> <li>• Frequently goes into the capital or debt market to raise funds</li> <li>• Founders and others on the board hold 75% of the company</li> </ul>

# 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 (sources like Tower Watson place the median as high as \$100M). 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	SHARE PRICE \$ 20.00
		TO	SHARE PRICE \$ 10.00
			MARKET CAP \$2,000,000,000
			MARKET CAP \$1,000,000,000
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
<b>Potential Securities Class Action Exposure</b>			<b>\$900,000,000</b>
POTENTIAL EXPOSURE CALCULATION			
	50 <sup>th</sup> PERCENTILE	75 <sup>th</sup> PERCENTILE	85 <sup>th</sup> 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
<b>Total Potential SCA Exposure</b>	<b>\$19,000,000</b>	<b>\$33,000,000</b>	<b>\$54,000,000</b>
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.

Customized Damages Model for **Company B**

EXPOSURE CALCULATIONS WORKSHEET			
→	50% DROP	FROM	SHARE PRICE \$ 20.00
		TO	SHARE PRICE \$ 10.00
			MARKET CAP \$2,000,000,000
			MARKET CAP \$1,000,000,000
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
<b>Potential Securities Class Action Exposure</b>			<b>\$250,000,000</b>
POTENTIAL EXPOSURE CALCULATION			
	50 <sup>th</sup> PERCENTILE	75 <sup>th</sup> PERCENTILE	85 <sup>th</sup> 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
<b>Total Potential SCA Exposure</b>	<b>\$9,000,000</b>	<b>\$18,000,000</b>	<b>\$21,000,000</b>
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.

## 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.

### CONSIDERATIONS FOR 2013 & BEYOND

- 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.
- Explore alternative insurance program structure options.
- Consider the impact of retentions as the insurance market hardens.

# About

## WOODRUFF-SAWYER & CO.

Woodruff-Sawyer, an independent insurance brokerage, provides full-service insurance and risk management services to clients globally. Our Corporate & Executive Protection team is a leading advisor for management liability insurance and delivers D&O liability solutions to public and IPO-ready private companies. You can find out more by visiting us online at [www.wsandco.com](http://www.wsandco.com).

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## PRIYA CHERIAN HUSKINS, ESQ.

### SENIOR VICE PRESIDENT, PARTNER

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



Listed as one of the "Most Influential Women in Bay Area Business" by the San Francisco Business Times in 2012, Priya serves on the board of the Silicon Valley Directors' Exchange and the advisory board of the Stanford Rock Center for Corporate Governance. Priya also serves on the board of directors of Realty Income Corporation (NYSE: O).

> Priya can be reached at 415.402.6527 or [phuskins@wsandco.com](mailto:phuskins@wsandco.com).

## 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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