D&O 2016 H1 — fallout from the perfect D&O storm?

By: Rob Yellen

As predicted in our *A Perfect D&O Storm* (February 2016), this year has seen some rough seas — at least from a D&O liability perspective.

Securities class action filing activity grew to more than one-third higher than the 10-year securities class actions filing average. When considered along with several huge settlements announced this year, the heightened activity could mean rising D&O claim tides.

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Putting aside securities class actions, 2016 offers a few rays of sunshine. Last year's first-half drop in derivative filings from 131 to 87 (34%) has been followed in 2016 by a drop of 31% — from 87 to 60 derivative shareholder actions. Also, merger objection claims are down 17% to 87.
Securities class actions

Not so long ago, several respected experts trumpeted as imminent the likely demise of the securities class action. That did not happen. Then, a couple of years ago, *Halliburton Co. v. Erica P. John Fund* (Halliburton II) practically put the industry on hold as, again, experts contemplated the potential demise of the securities class action. That also did not happen. Rather, the contrary proved true. Securities class actions are alive and well. They remain a persistent, potentially growing threat to directors, officers and issuers.

**Frequency:** Stanford Law School's Securities Class Action Clearinghouse reports 119 securities class actions filed in the first half of 2016 — 37% higher than the 10-year average of 87. Does that suggest a record year or simply a rough first half? It is hard to know. With the tough economic environment — made a bit tougher by the U.K. decision to leave the EU — continued heightened volatility is likely. Prepare for a continuing trend of heightened securities class action filing activity. Better to play it safe.

**Severity:** The data from the first half of 2016 suggests we can expect securities class actions to remain the predominant driver of D&O claim severity. Household International, Inc. topped the reported settlements at $1.575 billion, followed in the U.S. by the $830 million settlement of the long-running Vioxx-related securities class actions. At least five top SCA settlements exceeded $200 million. Although not a securities class action, the $1.3 billion settlement of Fortis investor actions in the Netherlands through the Dutch collective settlement procedure is the second biggest securities settlement announced so far in 2016. More importantly, it demonstrates very real securities claim severity risk outside the U.S. borders, too.

**Who was targeted?:** Of the 119 new securities class actions, health care (30), technology (22) and services (20) sectors were targeted the most. Seemingly perennially leading targets, life sciences and high tech companies, lead again with 25 (21%) and 13 (11%) of the securities class actions filings.

Derivative shareholder actions

The 34% drop in first half derivative shareholder actions was 44% below the 102 filing average for the last 10 years. This is particularly good news since last year's first half fall in derivative shareholder actions was followed by an 11% increase in the second half — potentially leaving doubt as to whether derivative shareholder actions were trending downward. What is driving that potential trend? Maybe forum selection bylaws are actually working? Perhaps Delaware courts' heightened scrutiny of non-monetary settlements has plaintiffs' lawyers chasing other options? Again, it is hard to know.

Merger objection suits

In the first half of 2016, merger objection suits dropped 17% year over year — following drops in the prior two first half periods of 18% and 26% respectively. While M&A activity is down so far this year, last year saw a record $4.77 trillion worth of deals announced. So, it is unclear whether an uptick in deal activity would necessarily result in a corresponding increase in merger objection suits.

Total withdrawn M&A for the first half of 2016 is at the highest level since 2007. Will the failed deal activity result in more M&A suit filings? Not so far.

Critical action items

With D&O markets still very competitive, this may be the time to talk to your Willis Towers Watson client relationship director and broker about taking greater advantage of risk transfer opportunities. This market may not last.

- **Review limits adequacy.** Intense competition among insurers has brought premiums to historic lows. This is the ideal market in which to look for opportunities to maximize the value of risk transfer by buying more insurance.
- **Harness analytics:** Take advantage of the Willis Towers Watson's D&O Quantified tool. Our model allows for multiple outputs to be tested in a live environment with real-time input from you and your brokers. By considering alternate possible futures, you may develop greater insights into risk and a broader view of potential losses than you might from a one-and-done, static review or peer benchmarking.
- **Update loss cost data:** Update your loss cost driver information. With top firms charging as much as $2000/hour (a 25% spike over the prior year’s top rate), the cost of resolving claims and responding to investigations may be considerably higher this year.

*Source: Stanford Law School's Securities Class Action Clearinghouse*
Review Policy Wording: D&O insurance is not a uniform commodity. Subtle wording differences can have a profound impact on outcomes, and specialized expertise is paramount. Remarkably, in this competitive market, best-in-class policy wording may not cost more, and some markets have become far more willing to discuss wording changes.

Consider Material Coverage Enhancements: As carriers look to grow in the wake of successive years of premium decline, pockets of opportunity to get more coverage may develop. For example, qualified commercial accounts may now be able to buy some entity investigation coverage or derivative investigation coverage that is broader than what was available this time last year. Although an increased premium may be associated with some enhancements, the risk transfer value proposition may far outweigh the modest incremental cost.

Please do not hesitate consult with your Willis Towers Watson contact to find out about opportunities that may have become available to your company.

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Sources

The statistics provided in this alert were compiled from information contained in the Stanford Law School's Securities Class Action Clearinghouse and Advisen databases as of the date this report was prepared.

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