

July 2004

Mid-Year Marketplace Updates on D&O, Fiduciary Liability & EPLI

Through the first half of 2004, much of the Executive Risks marketplace continued to be rocked by the opposing forces of claims and competition. In the short run, the persistence of competition means that most companies will be able to choose between several options at renewal. In the longer run, these opposing forces could result in increased carrier instability. A segment-by-segment discussion of these issues follows.

Directors & Officers (D&O)

During the first half of 2004, over \$1 billion in claims were paid or set to be paid by D&O insurance carriers. Settlements include: Global Crossing (\$245M), Raytheon (\$210M), Symbol Technologies (\$102M), Honeywell (\$100M), i2 (\$85M), Montana Power (\$67M) and Providian Financial (\$64M).

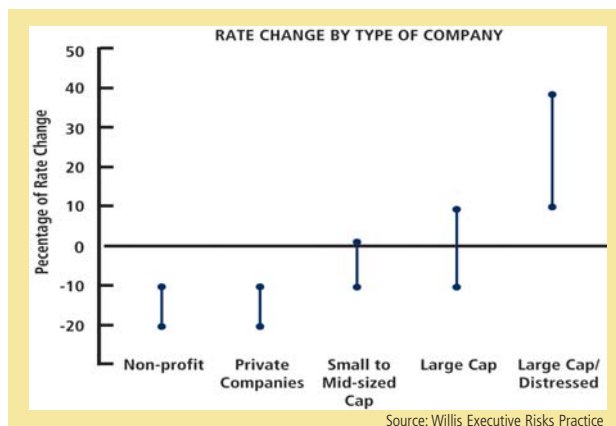
Of additional concern is the ongoing practice by government enforcement agencies known as "wildcatting," wherein agencies open broad investigations into entire industries when evidence of problems surface at a single company. Corporate governance and insurance industry experts are troubled about the disclosure issues that wildcatting presents for public companies. Regardless of whether a company is guilty – or even under inquiry at all – the mere disclosure of a wildcat investigation can have negative market implications.

According to figures from the President's Corporate Fraud Task Force, the government focus on prosecuting white-collar criminals has resulted in over 660 charges of corporate fraud since the task force was created in mid-2002, with an additional 150+ civil-enforcement actions by the SEC from 2003 to the present.

All of these adverse claims developments notwithstanding, increased competition among D&O carriers has been a boon to insureds. Based on activity in early 2004, we expect that average premium rates for the remainder of the year will continue to soften, terms will improve and a number of carriers will offer increased limits (increasing the competitive pressure on excess markets). The D&O marketplace is still very much divided into segments. Industry segment, combined with individual account risk differentiators, will

dictate rates. Buyers can expect anything from decreases of 30 percent to increases of similar size.

A ruling to watch out for in the second half of 2004 is the US Supreme Court's decision in Dura Pharmaceuticals. This case should have immediate impact on how damages are calculated in securities fraud cases.



Fiduciary Liability

Employer security or company stock claims continued to be loss leaders for Fiduciary Liability carriers. Mirroring D&O claims experience, Fiduciary claims settlements in 2004 have already been sizable. In addition to the Fiduciary portion of the D&O settlements mentioned above, there was also the \$85M Enron partial settlement. While some companies have been modifying their plans to reduce this exposure, a recent survey from Hewitt Associates concluded that when plans involve company stock, those securities account for a large proportion (41 percent on average) of each employee's investment. This indicates that any such changes will take some time to work their way into plan allocations.

Ongoing enforcement action by the Department of Justice, SEC and Department of Labor continued to examine potential conflicts of interest within 401(k) plans. The government worries that mutual funds may have paid 401(k) plan administrators and consultants to influence their fund selections, and these illegal payments may have come, ultimately, from investors' money. A second line of investigation, into 401(k) fees, is also causing some concern for Fiduciary Liability carriers.



The Fiduciary Liability market, however, remains more stable than the D&O market. Rates will be driven by premium momentum during the recent hard market as well as individual risk characteristics, but overall, rates through year end may be flat to +15 percent.

While awaiting a decision on the appeal of the IBM cash balance decision, we note that in June, the Treasury Department and Internal Revenue Service withdrew their proposal governing how companies could convert traditional pension plans to cash balance plans, contributing to an atmosphere of uncertainty in Fiduciary.

Employment Practices Liability Insurance (EPLI)

After a period of recent calm, Employment Practices Liability insurance (EPLI) claims are heating up. The most significant sign is clearly the class certification granted in the gender discrimination lawsuit against Wal-Mart. While this decision is currently on appeal, plaintiffs' counsel had indicated that if the decision is not upheld, the plaintiffs will pursue the claims through as many separate, state-based class actions as necessary. Also of note was the decision in the first Sarbanes-Oxley whistleblower case in which a CFO alleged that he was fired after refusing to certify the company's financial results over concerns that they improperly inflated the company's income. The CFO was ordered to be reinstated; he is also entitled to lost wages, damages and reparations to his employment record.

A closely-watched Supreme Court decision on constructive discharge can be seen as a win by either employers or employees. In an unprecedented ruling in *Pennsylvania State Police v. Suders*, the Court overruled the Third US Circuit Court of Appeals in finding that Title VII of the Civil Rights Act of 1964 applies to claims of constructive discharge – meaning that employees do not have to prove that the employer intended to force them out. However, the court also ruled that an employee claiming constructive discharge must prove that the offending behavior was "severe or pervasive" enough to justify voluntarily ending their employment. The ruling gives employers the opportunity to argue that they had complaint

or grievance systems in place, and that employees failed to take advantage of those systems before resigning. The overturned lower court ruling held that a constructive discharge was a tangible employment action resulting in strict liability for the employer.

In EPLI, competition is again driving down rates for the majority of companies, though some will see increases of 10 percent to 20 percent, or more, depending on relative risk (claims history, centralization of HR, level of M&A activity, etc.). Retentions and terms and conditions continue to be a serious area of contention in many renewals.

In addition to watching for the appeal decision in Wal-Mart, industry observers should keep an eye on the Supreme Court review of several "disparate impact" cases related to age discrimination and an Alien Tort Claims Act case regarding human-rights violations by American companies on foreign soil.

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