2017

STATE OF THE D&O MARKET

AHT
INSURANCE

EXECUTIVE SUMMARY

AHT Insurance is proud to provide our clients with our Fifth Annual State of the D&O Market Report; to better prepare your organization for the issues that impact your organization's liability risks and to assist you in addressing best practice needs for your Corporate Governance and Compliance issues for 2017 and beyond.

We have attempted to compile a comprehensive overview of the D&O Marketplace; researching well over 40+ various sources to touch on some of today's most important D&O liability topics, including:

- Update on Securities Litigation Trends
- SEC Enforcement Activities
- 2016 IPO Market Downturn
- A Q&A on Cyber Risks
- Understanding Reg A+ Filings
- New Administration and Potential D&O Impact

Once again, we have included our "Ask the Underwriters" segment which will disclose the results from a survey we recently conducted that polled over 150 underwriters representing more than 30 insurance carriers – getting their perspective of the current D&O Marketplace and their predictions for the future.

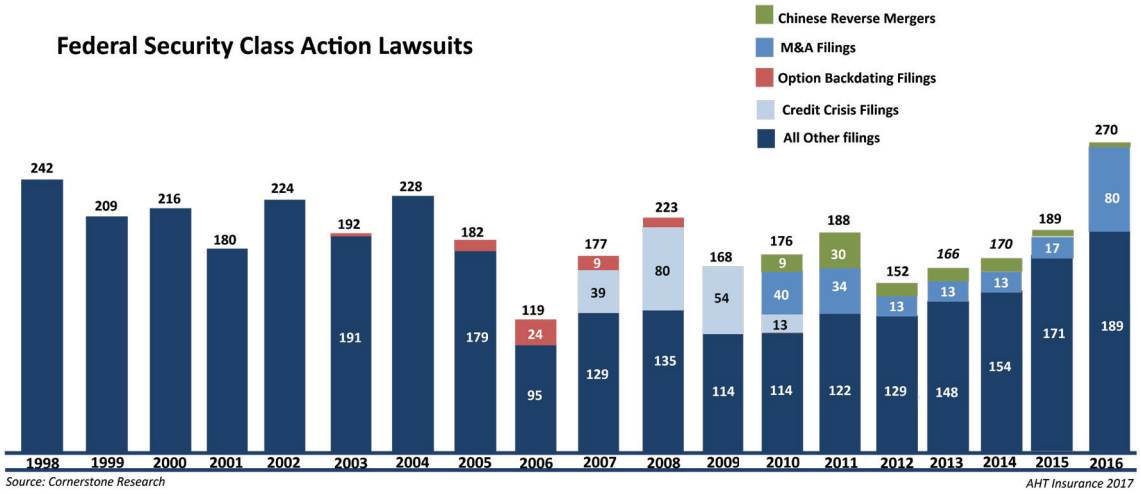
SECURITIES LITIGATION: A RECORD YEAR

2016 seemed to come in like a lamb and out like a lion. Just when it seemed that securities cases would continue to sit at record lows, we saw a record high number of claims brought this year. Leading the way was the re-invention of the M&A claim and the continued pressure on Healthcare.

Despite rates continuing to soften and a lack of new public companies entering the marketplace, 2016 quietly saw a record number of class action securities lawsuit filed. According to Cornerstone Research, there were 270 new federal class action securities cases filed (this compares with the 300 cases reported by NERA; Cornerstone counts all cases against the same company as one case, NERA counts them separately when brought in different districts).

The 270 cases, represents an increase of 44% over the prior year's filing of 180 cases and was the highest total in history (when omitting 2008's IPO laddering claims). Not only did frequency increase, but severity on an average and median basis also increased significantly. NERA reported an average settlement amount of $72M, an increase of 35% over $53M in 2016; and a 100% increase over the average settlement of $36M in 2015. The median settlement is also on the upswing at $9.1M, up from $7.4M and $6.7M in 2015 and 2014, respectively.

The likelihood of a public company being subject to a securities class action lawsuit hit an all-time high of almost 4%. The average historical likelihood of seeing a class action lawsuit is around 2.8%. In addition, there were more cases filed against S&P 500 firms than in the past 7 years, which certainly lends an explanation as to the increase in claim severity; larger market



cap companies being sued with larger amounts of market cap value loss will certainly lead to larger settlements. Also of note, for the fourth year in a row, filings against NASDAQ companies were more common than NYSE firms.

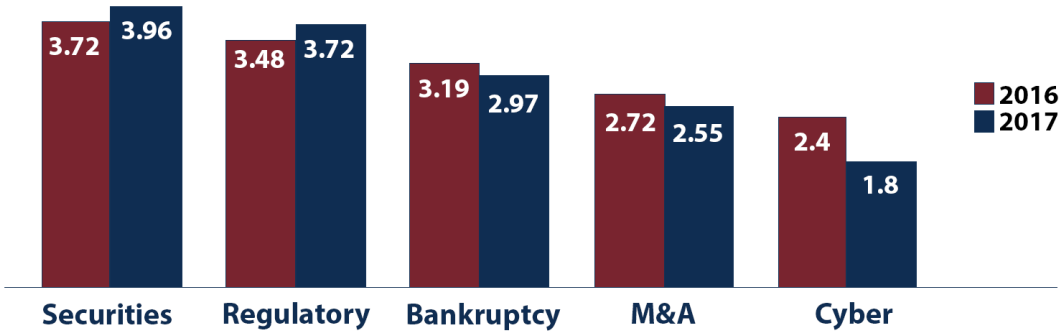
The main driver in the sheer number of claims can be directly tied to how Merger and Acquisition claims are now being brought. The trigger for this was the rejection of a "disclosure-only settlement" by the Delaware Court of Chancery in the case involving Zillow's acquisition of Trulia. While some were proclaiming this a nail in the coffin for these easy state-brought M&A claims; it may only be the beginning.

Rather than take their chances in state court with the Trulia decision hanging over their heads, plaintiff firms have started taking their M&A litigation to federal court. The number of federal M&A filings increased from 17 cases in 2015 to a staggering 80 cases in 2016, a 470% increase. It will be very interesting to see if federal judges are quick to follow the precedence set by Chancellor Andre Bourchard in the Trulia case; or if the change of venue for these cases gives M&A litigation renewed life.

ASK THE UNDERWRITERS

We asked D&O Underwriters to rank on a scale from 1-5 what type of claims concern them the most, with 5 being most concerned, we then compared 2016 to 2017:

When underwriting, please rank these claims in order of concern



It should come as no surprise that given the high number of securities claims filed in 2016, that the concern has increassed even more since last year. It's worth noting that Regulatory concerns have increased by about 6.5%, while bankruptcy and M&A as a concern each dropped by around 7%. Cyber claim concerns changed the most and dropped by 25%.

The increase in M&A litigation also had an effect of the makeup of allegations brought in these filings. Due to the increase in non-traditional filings, there was a decrease in 10b-5 and Section 11 claims. Section 11 claims were down from 15% of claims in 2015 to 9% in 2016. The reduction of Section 11 claims in Federal Court is also due to these allegations now being brought in California state court, mostly in San Mateo County.

The decrease of 10b-5 allegations was also very notable, falling from 84% of cases in 2015 to only 67% in 2016, however, that reduction seems directly tied to the increase in non-traditional M&A federal cases.

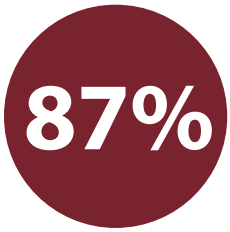
D&O POLICY RESPONSE

As mentioned in last year's report, there was some concern regarding the way a policy responded to aiding and abetting claims, and if those types of claims were covered at all; considering they were being brought by someone else's shareholders. To that end, several carriers will now offer explicit coverage for defense costs incurred with aiding and abetting allegations in an M&A transaction.

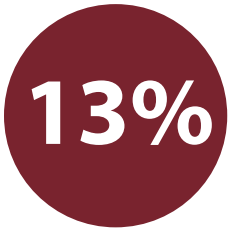
A second coverage grant that companies should be aware of relative to securities claims is Event Studies Coverage. This coverage allows for costs involved in conducting a class certification event study to be covered under the policy.

ASK THE UNDERWRITERS

We asked the underwriters in light of recent DE court rulings, what their policy will be regarding Separate (higher) M&A Claim Retentions in 2017:



Keep retentions consistent with 2016



Will keep a separate retention, but at a lower level than 2016

It comes as no surprise that the DE rulings are not enough yet to really move the needle on M&A retentions, especially with the wave of M&A claims being brought as Federal Securities claims.

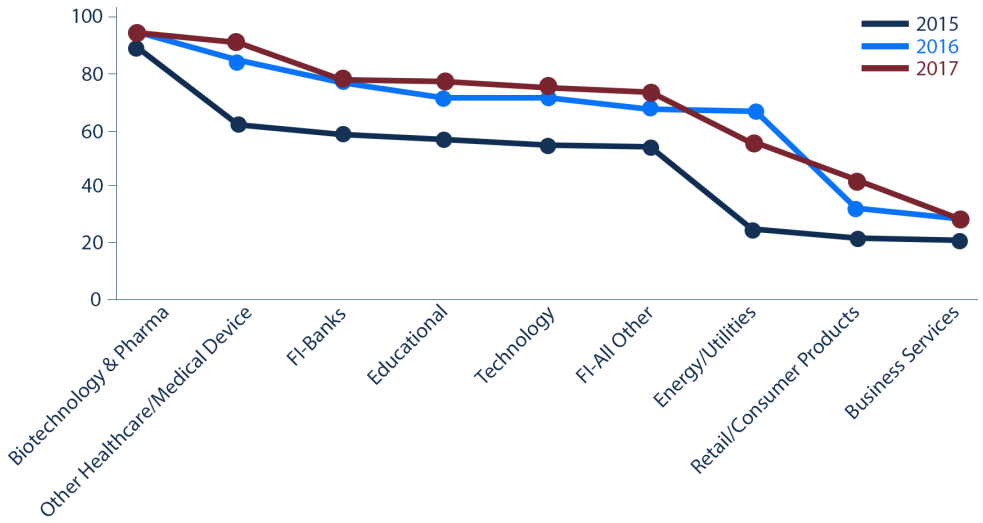
INDUSTRY ANALYSIS: HEALTHCARE LEADS THE WAY AGAIN

Once again, the Healthcare Industry is easily the most volatile and most targeted industry class. Specifically, according to NERA, there were 43 claims filed against Healthcare, Biotechnology and Pharmaceutical companies in 2015. Those same three segments comprised a total of 80 claims in 2016, an 86% increase year over year

One new trend that stood out was that these claims were no longer just targeting the smaller cap, pre-clinical or pre-revenue firms. According to Cornerstone Research's Heat index; the likelihood of an S&P 500 Health Care company being subject to new securities litigation ballooned from a 1.9% chance in 2015 to a 21.4% chance of seeing securities litigation in 2016. This year was also almost 3x higher than the historical percentage of suit which was 8.6% from 2001-2015. Similarly, S&P 500 Companies in the Energy/Materials industry subject to litigation in 2016 was 10.6%, up from 1.4% in 2015 and a historical average of 1.4% since 2001.

ASK THE UNDERWRITERS

AHT created a proprietary heat map score (Scale of 1-100) based upon underwriter feedback on various industries:



As securities claims mount, concerns have steadily increased across all sectors. All Healthcare related companies still lead the way of industries most worrisome. Technology company concerns increased by roughly 13% since 2016 and 38% since 2015. Energy company concerns dropped by 22% this year, however still up 224% since 2015.

SEC AND DOJ ACTIVITY UPDATE

In what was Mary Jo White's last year as Chair of the SEC, the commission had a record year of enforcements and penalties.

The SEC ended the fiscal year with a total of 868 enforcement actions, an increase of 8% over 2015 and 15% over 2014. There was a focus on advancing the rules required by the Dodd-Frank Act as well as the JOBS Act, including the completion of new rules for reporting and trading security-based swaps and new rules permitting crowdfunding.

The SEC obtained judgments and orders for over $4 billion in penalties and disgorgement in cases ranging from Insider Trading and Accounting Fraud to Foreign Corrupt Practices Act and Microcap Fraud.

Insider Trading & FCPA

There were 78 parties charged with Insider Trading this year, including a case where a board member of Dean Foods passed along non-public information to a professional sports gambler in order to pay down his gambling debts. This case also involved pro golfer Phil Mickelson who paid over $1M as a relief defendant to settle the claim. The SEC also brought 21 enforcement actions under the Foreign Corrupt Practices Act (FCPA), the most ever. FCPA claims included a $795M global settlement with telecom provider VimpelCom Ltd. to resolve charges of bribes involving government officials in Uzbekistan and an over $400M settlement with hedge-fund Och-Ziff, including charges against their CEO and CFO separately.

Whistleblower Actions

Fiscal Year 2016 was a watershed year for the SEC's Whistleblower program. According to their annual report, the agency awarded over $57 million, which was higher than all awards issued in previous years combined. To date, the enforcement actions due to tips from 34

TALK ABOUT A SEVERENCE PACKAGE

The Commission also brought its first ever enforcement action for retaliation of a whistleblower. International Gaming Company (IGT) agreed to pay a $500,000 penalty for firing an employee for reporting to SEC that the company's financial statements might be distorted. The claims regarding the financials proved to be wrong and no enforcement action was taken; which seemingly led the company to fire the whistleblower.

Not that there was any reported ill-intent with this case, but it will be interesting to see if this starts a trend of employees purposely bringing false claims in the hope of a lucrative retaliation claim.

whistleblowers has led to over $584 million in financial sanctions, including $346 million in disgorgement of ill-gotten gains and interest. The office received over 4,200 tips in 2016, a 40% increase since the program inception in 2012.

False Claims Act

One increasing area of focus for the Department of Justice continues to be settlements under the False Claims Act (FCA). The FCA goes all the way back to 1863, also called the "Lincoln Law", which was originally enacted by Congress because of concerns that suppliers to the Union Army during the Civil War were defrauding the Government.

In 2016, the DOJ obtained more than $4.7 billion in settlements under the FCA, which was the 3rd highest annual total, of which 53% came from the health care industry, including; drug companies, medical device, hospitals and laboratories. The DOJ gets most of their actionable intel from its own whistleblower program, which can pay up to 30% of an FCA settlement. In 2016, $519 million was awarded under the program.

D&O POLICY RESPONSE

Traditionally, policies had only responded when a formal order or subpoena was brought against an individual. Over time, the policy language has expanded to include Wells Notices, Target Letters, and now informal investigations (which can include interview requests and/or requests for documents). It is also important to understand how the policy responds to SEC actions against the company (e.g. Does an individual also need to be named? Does there also need to be a securities suit?).

Pinocchio Would be Proud

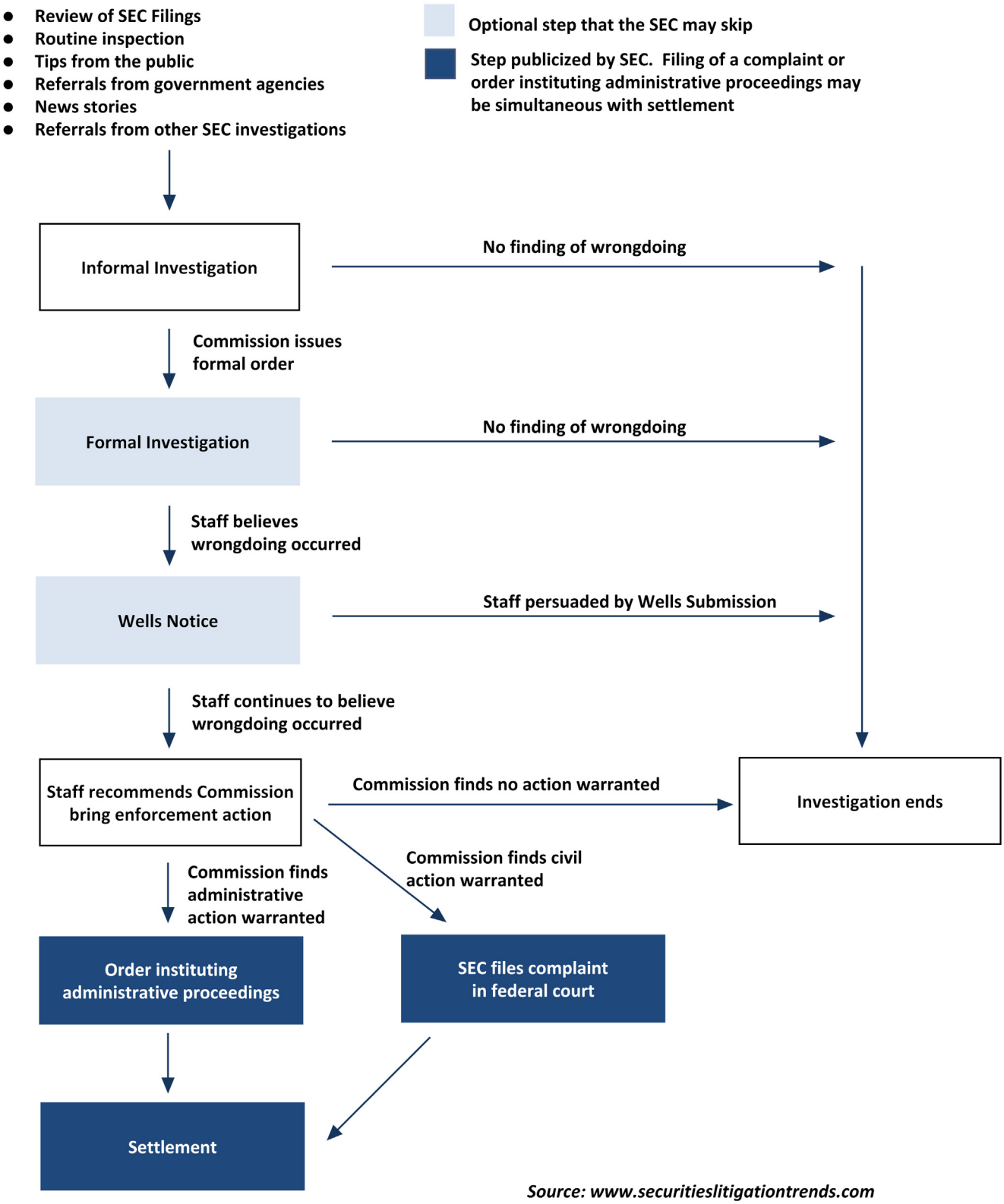
FCA Examples

Wyeth and Pfizer Inc. paid $784.6 million to resolve federal and state claims that Wyeth knowingly reported false and fraudulent prices on two drugs used to treat acid reflux, Protonix Oral and Protonix IV. The government alleged that Wyeth (before it was acquired by Pfizer) failed to report deep discounts available to hospitals, as required by the government to ensure that the Medicaid program enjoyed the same pricing benefits available to the company's commercial customers. Wyeth paid $413.2 million to the federal government and $371.4 million to state Medicaid programs.

Tenet Healthcare Corp., a major hospital chain in the United States, paid $244.2 million to resolve civil allegations that four of its hospitals engaged in a scheme to defraud the United States by paying kickbacks in return for patient referrals. Tenet paid an additional $123.7 million to state Medicaid programs, and two of its subsidiaries pleaded guilty to related charges and forfeited $145 million, bringing the total resolution to $513 million.

Novartis Pharmaceuticals Corp. paid $390 million based on claims that the company gave kickbacks to specialty pharmacies in return for recommending Exjade, an iron chelation drug, and Myfortic, an anti-rejection drug for kidney transplant recipients. The settlement includes $306.9 million for the federal government and $83.1 million for state Medicaid programs.

Steps in an SEC Action



Source: www.securitieslitigationtrends.com

CYBER LIABILITY Q&A: PHISING FOR ANSWERS

We created a Q&A segment based on the most common questions we get from directors and officers regarding cyber liability:

Q: Let's start with the question that is most paramount on the minds of directors and officers. Have you seen a trend where they have an increased liability arising from cyber-attacks?

A: To be honest, we have yet to see a correlation between cyber incidents and claims against D&O's. Of all the major cyber-attacks, there are less than 10 actual derivative claims against the D's and O's. This includes highly publicized cases such as Home Depot and Target. All the claims have been dismissed except for Wendy's which was only filed in December of 2016.

Q: What is the reasoning behind the dismissals?

A: The typical allegation claims 'breach of the duty of loyalty' to the company. This is traditionally a high hurdle to overcome. In the Home Depot case, Judge Thrash stated that to meet this requirement, the plaintiffs must "show with particularity of facts beyond a reasonable doubt that most the Board faced substantial liability because it consciously failed to act in the face of a known duty to act."[1]

Q: Do you see any federal or state regulatory bodies increasing their cyber security or cyber liability insurance requirements?

A: Yes, but… We have a senate bill[2] under consideration whose intent would be to require public companies to increase board transparency and oversight of cybersecurity risks. The bill appears to be designed to "provide a basic amount of information about the degree to which a firm is protecting the economic and financial interests of the firm from cyber-attacks."[3] The driver of this bill was some alarming statistics. Between 2013 and 2015, cyber-attacks on large companies increased 44% and cybercrime costs businesses more than $400 billion a year, per Lloyd's of London.[3] We are also seeing on the state level that The New York Department of Financial Services (NYDFS) recently issued a revised proposed regulation seeking to add its own mandate of cybersecurity requirements to those already in existence for banks, insurance companies and other financial services institutions...[4]

[1] *http://www.dandodiary.com/2016/12/articles/cyber-liability/home-depot-data-breach-derivative-lawsuit-dismissed/*
[2] *https://www.congress.gov/bill/114th-congress/senate-bill/2410?q=%7B%22search%22%3A%5B%22transparency+the+oversight+cybersecurity%22%5D%7D&resultIndex=1*
[3] *https://www.reed.senate.gov/news/releases/reed-collins-seek-to-prioritize-cybersecurity-at-public-companies-through-sec-disclosures*
[4] *https://www.hklaw.com/Publications/New-York-Department-of-Financial-Services-Revises-Proposed-Cybersecurity-Rule-01-12-2017/*

This regulation intended to take effect 3/1/17 has varying compliance deadlines for the different cyber requirements. This is the first state specific cyber regulation that I have seen, but I wouldn't be surprised if other follow suit. Lastly, we are seeing that the European Union is considering testing banks against cyber-attacks.[5]

Q: But…

A: But, we now have a new administration that is clearly in a direction of less regulation, at least at the federal level. So, it is not too difficult to foresee a scenario where any regulations including those for cyber security get driven down to the state level.

Q: What is the most common cyber-attack you are seeing.

A: Great question. As recently as last year, the most frequent claims scenario was related to either notification costs or forensics. However, we have seen a dramatic increase during the past 12 months in the cyber ransom/cyber extortion scenarios. There was an IBM study that showed that 70% of businesses infected with ransomware have paid to regain access to their business data. It also shows that the FBI estimates that cybercriminal are on pace for over $1B in ransomware payments.[6]

Q: What does a typical cyber ransom case look like?

A: A typical scenario is where a cyber-attack will encrypt files such that they can only unlock with a 'private key'. That key will be provided only after receiving payment. The most common payment is digital currency referred to as bitcoin. The reason why bitcoin is the preferred method of payment is that this is an electronic currency that can be used without a banking structure, so it offers a greater level of transparency. I've seen ransom amounts that can range from $1,400 to $28,000. In most cases, after payment is sent the data is released. There are reports[7] that some banks are looking to stockpile bitcoins to cover the costs of these types of cyber extortions.

Q: What are the most common industries to be victims of these types of attacks.

A: The highest risk industry segments remain consistent over the past several years; Hospitals (and other healthcare institutions), learning institutions, and financial institutions.

Q: And finally, what steps can our readers take to help improve their cybersecurity profile?

A: There are a host of steps a company can take to remediate against a cyber-attack[4,6]. They include:

- Promote employee vigilance with regards to e-mail phishing attacks. Continued employee training and testing is the best course of action. Remember, if an e-mail offer looks too good to be true, it very well may be a malware. Be cautious when opening

[5] *http://www.reuters.com/article/us-eu-cyber-finance-idUSKBN15711H*
[6] *http://www.bizcommunity.com/Article/196/661/155767.html*

attachments in clicking on hyperlinks and double check the sender's full e-mail address on your mobile device.

- Backup your data on a regular basis and in a separate location.
- Ensure your IT department has processes in place that disables macros from e-mails automatically and regularly patch/update all software. Also, ensure they perform periodic penetration testing and vulnerability assessments
- Assign someone as either a chief information security officer or chief cybersecurity officer. And have that person report directly to the board. This individual should provide reports regularly (at least annually, if not quarterly) to the board of directors.
- Develop and maintain a cybersecurity written policy
- Consider an e-mail distribution that encrypts data both in transit and at rest.
- Implement data retention and disposal program as well as an incident response plan.

In closing we'd add that even if you take advantage of all the risk management tools explained relating to people, process and technology, while it may decrease (possibly significantly) the likelihood of a cyber-attack, nothing can 100% guarantee that you will not get hacked. We recommend the transfer the remaining risk via a cyber liability insurance policy. Because of the increased focus that boards of directors are placing on the risk management of cyber security, we are seeing a dramatic increase in the cyber insurance market. The expectation is the volume of cyber insurance premium will grow from $2.5B in 2015 to $14B in 2022.[8] The result of this growth in capacity is broader terms and decreased costs.

ASK THE UNDERWRITERS

We asked D&O underwriters how concerned they were with Cyber related claims and compared that with last years' response:

	2016	2017
It is a Major Concern	***36%***	***26%***
It is a Minor Concern	***59%***	***73%***
Not a concern	***5%***	***1%***

It appears that despite a minimal amount of actual cyber related D&O claims, there still seems to be an overhang of concern. However, it is worth noting that Cyber being a major concern dropped by 28%.

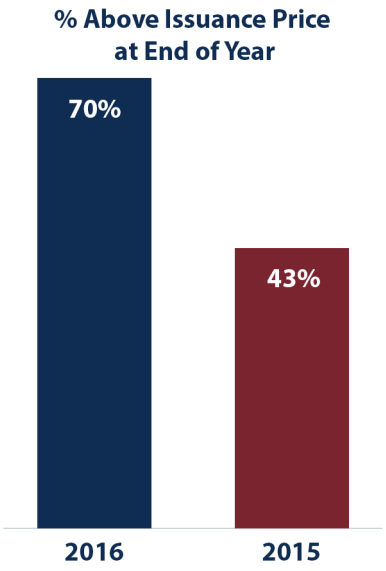
[7] *https://www.theguardian.com/technology/2016/oct/22/city-banks-plan-to-hoard-bitcoins-to-help-them-pay-cyber-ransoms*
[8] *http://blogs.wsj.com/riskandcompliance/2016/12/21/cybersecurity-a-race-without-a-finish-line/*

STATE OF THE IPO MARKET

The overall IPO market hit a 7 year low in activity in 2016 and hit a 13 year low in proceeds raised; partly due to the Brexit vote in the second quarter and the US presidential election in the fourth quarter.

Renaissance Capital reported that there were only 105 IPOs in 2016. There was also less than $19 billion raised in 2016, down 37% from 2015 and the lowest level since 2003. Small biotech offerings again drove down the medial deal size to under $100 million and there weren't any multi-billion dollar offerings.

Renaissance suggested that the slowdown began in August 2015, when markets started to sell off over concerns in China combined with the impact of a Fed rate hike. The IPO market came to a grinding halt in the beginning of 2016, with January not providing a single IPO for the first time in history. The market for IPOS began to recover during the Spring but again was derailed by the Brexit vote in June and the election in November.



Despite the small number of deals, actual performance of the companies that went public was excellent. The average total return of a 2016 IPO was 25.5%, compared to -2.1% the year prior. In addition, 70% of IPOs finished the year above their issuance price, compared to only 43% in 2015. The economic and governmental uncertainties created a lower volume of deals, but that also resulted in a greater percentage of quality deals that went out.

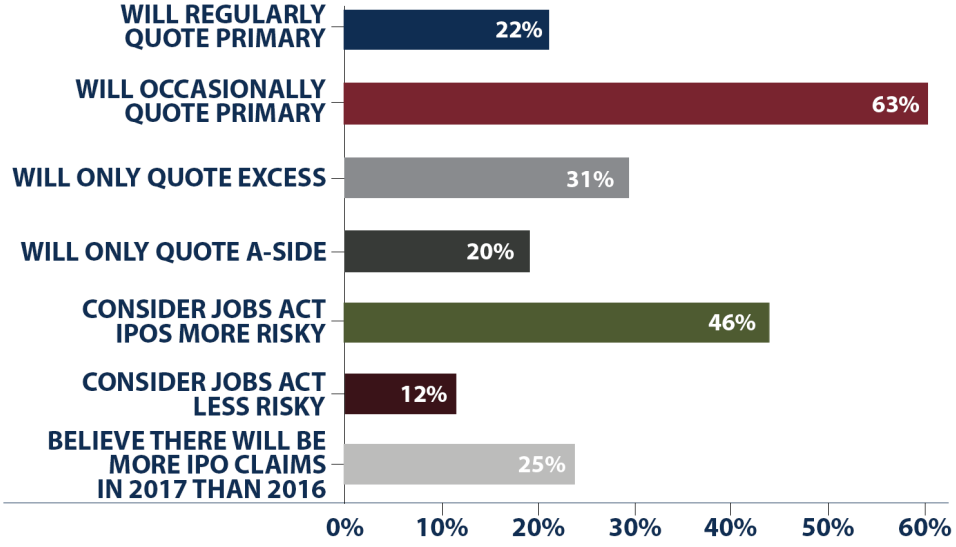
The technology sector experienced the largest resurgence, with the average Tech IPO returning 37%, compared to the paltry return of -2% the prior year. The best performing IPO of 2016 was

Acadia Communications with a 169% return. Financial companies also saw an impressive return of 34%, followed by Consumer Goods at 33%. The worst performing IPOs were small biotech companies, led by PhaseRx (-69%), Aeglea Bio Therapeutics (-57%) and Oncobiologics (-50%). It is worth noting for readers of this report, that all three are micro-cap companies with market capitalization below $100M and none of the companies have seen a securities suit to date.

There is a high degree of optimism for 2017's IPO marketplace. In the first two months of 2017 there will be roughly 20 companies that will go public compared to 5 in the first two months of last year. While the pipeline is about 46% lower than last year with only 66 in the pipeline to start the year there seems to be some potentially huge IPOs on deck. Companies such as Snapchat, Uber, Airbnb and DropBox could all be potential IPOs in 2017. Snapchat is expected to lead the way in March with a current expected valuation of close to $25 billion. Uber currently has a $68 billion valuation as a private company but their timetable is unknown.

ASK THE UNDERWRITERS

We asked the D&O Underwriters about their appetite and thoughts on the IPO D&O Marketplace.



It is clear to understand why Primary D&O Rates have firmed up dramatically over the past 12 months for IPOs; with only 22% of surveyed underwriters regularly offering primary terms, down from 26% last year. Only 25% believe that there will be a higher amount of IPO claims this year versus 39% last year, which may be tied to a low amount of deals in 2016 and above average stock performance of those deals.

TRUMPED-UP CHANGE

As with any change in U.S. Administration, there will be many questions regarding how new policies will affect the D&O landscape; this year there seems to be more than most.

"We're going to be cutting regulations massively…we think we can cut regulations by 75%, maybe more"

~ President Donald J. Trump

SEC Oversight

One of the most prevalent changes that could have an immediate impact on regulatory claims and issues is the new Chairman of the Securities and Exchange Commission. The outgoing chairman, Mary Jo White was a former prosecutor that took SEC enforcements to record levels during her tenure. President Trump's nominated SEC Chairman of Wall Street lawyer Jay Clayton is viewed to be much more "business friendly" than his predecessor. Clayton's client list at Sullivan & Cromwell included Goldman Sachs and Barclays, PLC, and he has experience with large stock deals such as the Alibaba IPO. Clayton seems to fit the bill to implement President Trump's philosophy to "undo many regulations which have stifled investment in American business, and restore oversight of the financial industry in a way that does not harm American workers".

Class in Session

The counter balance to a relaxed regulatory agenda may be a tough, hard on white collar crime Attorney General. Former Alabama Senator Jeff Sessions is now the country's top prosecutor and his record shows he is not likely to shy away from going after big business or white collar crimes. He has been on the record about the dangerous philosophy of not charging companies criminally because of bankruptcy or shareholder concerns. He also recently opposed a bill that would show leniency for non-violent crimes.

The take-away here may be that it might become a little easier to cheat the system, but if you get caught - you may be in a world of trouble.

Twitter-verse

The President also has proven the ability to instantly affect the volatility of a company's stock price (both negatively & positively) with a single tweet. We have never experienced a Command-in-Chief that communicates so openly and regularly through social media channels, and daily thoughts can have an instant impact on the markets. Companies such as Rexnord, Boeing, GM, Ford and Nordstrom are just a few companies that have all experienced instant stock fluctuations after being tweeted about by the President.

REG A+ FILINGS: NEW WAVE OF GOING PUBLIC OR ANAMOLY

Background

Under the Securities Act of 1933, when a company offers or sells securities to potential investors, it must either register the offer and sale or rely ***on an exemption from registration.*** Regulation A is a longstanding ***exemption from registration*** that permits unregistered public offerings of up to $5 million of securities in any 12-month period, including no more than $1.5 million of securities offered by security-holders of the company. In recent years, Regulation A offerings have been relatively rare in comparison to offerings conducted in reliance on other Securities Act exemptions or on a registered basis.

The JOBS Act amended the Securities Act to require the Commission to update and expand the Regulation A exemption. In particular, the JOBS Act directed the Commission to:

- Adopt rules that would allow offerings of up to $50 million of securities within a 12-month period.
- Require companies conducting such offerings to file annual audited financial statements with the SEC.
- Adopt additional requirements and conditions that the Commission determines necessary.

Highlights of the Final Rules

The final rules, often referred to as Regulation A+, would implement Title IV of the JOBS Act and provide for two tiers of offerings:

Tier 1, which would consist of securities offerings of up to $20 million in a 12-month period, with not more than $6 million in offers by selling security-holders that are affiliates of the issuer.

Tier 2, which would consist of securities offerings of up to $50 million in a 12-month period, with not more than $15 million in offers by selling security-holders that are affiliates of the issuer. In addition to the limits on secondary sales by affiliates, the rules also limit sales by all selling security-holders to no more than 30 percent of a particular offering in the issuer's initial Regulation A offering and subsequent Regulation A offerings for the first 12 months following the initial offering.

For offerings of up to $20 million, the issuer could elect whether to proceed under Tier 1 or Tier 2. Both tiers would be subject to basic requirements as to issuer eligibility, disclosure, and other matters, drawn from the current provisions of Regulation A. Both tiers would also permit companies to submit draft offering statements for non public review by Commission staff before filing, permit the continued use of solicitation materials after filing the offering statement, require the electronic filing of offering materials and otherwise align

Regulation A with current practice for registered offerings.

Additional Tier 2 Requirements

In addition to these basic requirements, companies conducting Tier 2 offerings would be subject to other requirements, including:

- A requirement to provide audited financial statements.
- A requirement to file annual, semiannual and current event reports.
- A limitation on the amount of securities non-accredited investors can purchase in a Tier 2 offering of no more than 10 percent of the greater of the investor's annual income or net worth.

The staff would also conduct a study and submit a report to the Commission on the impact of both the Tier 1 and Tier 2 offerings on capital formation and investor protection no later than five years following the adoption of the amendments to Regulation A.

The Commission is exploring ways to further collaborate with state regulators, including a program for a representative of NASAA or a state securities regulator to work with the staff in the SEC's Division of Corporation Finance in implementing these rules.

Eligibility

The exemption would be limited to companies organized in and with their principal place of business in the United States or Canada. The exemption would not be available to companies that:

- Are already SEC reporting companies and certain investment companies
- Have no specific business plan or purpose or have indicated their business plan is to engage in a merger or acquisition with an unidentified company.
- Are seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas or other mineral rights.
- Have been subject to any order of the Commission under Exchange Act Section 12(j) entered within the past five years.
- Have not filed ongoing reports required by the rules during the preceding two years.
- Are disqualified under the "bad actor" disqualification rules.

The rules exempt securities in a Tier 2 offering from the mandatory registration requirements of Exchange Act Section 12(g) if the issuer meets all of the following conditions:

- Engages services from a transfer agent registered with the Commission.
- Remains subject to a Tier 2 reporting obligation.
- Is current in its annual and semiannual reporting at fiscal year-end.
- Has a public float of less than $75 million as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, had annual revenues of less than $50 million as of its most recently completed fiscal year.

An issuer that exceeds the dollar and Section 12(g) registration thresholds would have a two-year transition period before it must register its class of securities, provided it timely files all of its ongoing reports required under Regulation A.

Preemption of Blue Sky Law

In light of the total package of investor protections included in amended Regulation A, the rules provide for the preemption of state securities law registration and qualification requirements for securities offered or sold to "qualified purchasers," defined to be any person to whom securities are offered or sold under a Tier 2 offering.

D&O POLICY RESPONSE

Current definition of a securities claim in standard policy forms include:

***Securities Claim** means a **Claim** (other than an administrative or regulatory proceeding against, or investigation of the **Company**), made in whole or in part against any **Insured** alleging a violation of any regulation…..*

***"Securities Claim"** means a **Claim**, other than an administrative or regulatory proceeding against the **Company** or an investigation of the **Company**, made against any **Insured**: (1) alleging a violation of any foreign, federal, state or local regulation, rule or statute regulating securities…..*

***Securities Claim** means a **Claim**:*

- *against an **Insured** for a violation of any United States securities law, but solely in connection with the securities of an **Organization**;*
- *against an **Insured** for a common law cause of action, pled in tandem with, or in lieu of, any securities law violation described in Subsection (A)…..*

The standard definition of securities claim commonly requires the allegation of a violation of securities law. There is uncertainty in a Reg A+ filing securities claim if a violation will actually be cited. Due to the fact that a Reg A+ filing can be exempt from many securities laws (i.e. 33 Act and Blue Sky), so without the ability to raise a claim under the 33 act, what if a shareholder claim is also brought with an allegation of breach of contract or simply fraud and misleading information of the offering document – will there be coverage?

*The recommendation is to clearly define in the D&O policy, that the policy will cover **any claim** brought by a security holder of the company, **inclusive** of shareholders that bought into a Reg A+ offering.*

ADA CLAIMS HEAT UP IN THE BANKING INDUSTRY

Although these types of ADA related claims have been in existence for several years, there has been a dramatic increase in the frequency of demand letters against community and regional banks. The typical demand letter states that the bank's website is out of compliance with the ADA as the site does not provide equal accessibility for visually impaired individuals who attempt to access the website.

Possible Insurance Response

Based on the allegations, the first place we look for an insurance coverage response would be the Cyber liability policy as this is based on the bank's website or the Employment Practices liability insurance (EPLI) since it is an ADA violation referencing discrimination. And those are exactly the two coverages where we are seeing possible solutions, but it is very specific to the insurance carrier's approach to these two coverages and the languages that may have been negotiated.

With regards to cyber liability, most policies will only be triggered after a breach of network security and/or the loss or theft of non-tangible property (i.e. personally identifiable information). In the case of these ADA infractions, neither of these triggers have been met. Additionally, many cyber policies will include a specific discrimination exclusion. With that said, several carriers have cyber policies with no such exclusion and have a very inclusive or broad language within the definition of Wrongful Electronic Banking Act or even the basic Cyber Liability Insuring Agreement.

With regards to the possibility of coverage within the EPLI placement, we compare this scenario with an analogous claim scenario where a claimant demands that a handicapped ramp be built at a branch location. They are similar in that they both reference violations of ADA claiming an individual with a disability cannot access the bank's services. Just as is the case in the building of the ramp scenario, there are several language obstacles that need to be overcome before there can be even the consideration of coverage:

1. Definition of Claim should include **non-monetary damages**, just as it does for monetary damages. This will allow for coverage to be considered even if all they are requesting is to fix the website.
2. Third party discrimination coverage is added. A standard EPLI policy protects the bank and the D&O's if there are claims made against them alleging typically harassment or discrimination. Third party EPLI can be added at request. Usually this coverage is only offered as Third Party Harassment coverage. This offers protection if a third party (i.e.

customer, UPS person, etc.) claims they were harassed by an employee. However, many carriers can also offer Third party discrimination coverage. Since these allegations relate to the scenario where a third party to the bank is alleging discrimination, this is a critical addition that needs to be addressed.

One last comment relating to the possibility of claims coverage is that most insurance policies include some form of the following into the definition of Loss:

... Loss shall not include costs to comply with any non-monetary or injunctive relief…

This means that while there could be coverage for defense costs/legal fees associated with defending the bank as well as any actual financial settlement amounts, there will most likely not be any coverage applicable towards fixing the web site. Just as there was not insurance available to build the ramp. That is considered the cost of doing business and is typically not insurable.

Be Proactive

If your institution wanted to be proactive, the ADA offers resources including: https://www.ada.gov/websites2.htm. Including within this guide is a detailed action plan for accessible websites. If your institution has already received a demand letter, then we recommend having your insurance representative provide a detailed review of how both the Cyber Liability and Employment Practices Liability policy can respond to such a letter. We also recommend the input of counsel prior to responding to any demand letters. Lastly, when considering if or how to respond to such a letter, I would like to reinforce an ABA report where they stated:

"…unlike many other compliance obligations, there is much to be gained from making the world more accessible to the disabled. Not only is it the right thing to do, it is also potentially good for business as it expands the market for bank products and services to the broadest range of customers. ABA urges all banks to undertake their continuing review of ADA compliance with this in mind."

UNDERWRITER EXPECTATIONS FOR 2017

Let's turn our attention to where Underwriters see opportunity and change in the upcoming year.

Primary Rates

We asked underwriters their opinion on where they see primary rates going on a number of various risk exposures:

Type Of Risk Exposure	Over 20% Increase	11% - 20% Increase	5% - 10% Increase	Flat (+/- 4%)	5% - 10% Reduction	11% - 20% Reduction
Standard Account			15%	53%	30%	2%
IPOs	2%	25%	27%	27%	14%	2%
Micro-caps (<$100M market cap)		5%	15%	57%	15%	8%
High Risk Industry (Biotech/Finance, etc.)	11%	25%	50%	11%	3%	

For most of the marketplace, primary rates are expected to remain flat. While 85% of the carriers polled believe rates will remain flat to down on standard accounts, at least one prominent primary carrier has publicly acknowledged they are looking for primary rate increases this year. Based on the litigation trends discussed earlier it isn't surprising at all that 70% of the underwriters expect increases in high risk industries like Biotech, Energy and Finance; and 54% expect primary IPO rates to continue to climb.

Excess Rates

The Excess market continues to soften and will continue to be the greatest opportunity for Insureds to lower their overall annual premium.

	50% or Less	51% - 55%	56% - 60%	61% - 65%
Lowest Excess Rate on Line	39%	32%	16%	13%

Despite seeing excess rates at record lows, almost 40% of the carriers polled don't think we've hit bottom yet. Higher excess rates and A-Side layers seem to be feeling a lot of that pressure.

Underwriter Challenges

This year we asked a new question. We asked Underwriters what they classified as significant challenges they face when underwriting an account and vying for new business.

Underwriting Guidelines	***19%***
Pricing Competitiveness	***90%***
Limit Capacity	***15%***
Attachment Point	***28%***
Time/Work Volume	***18%***
Authorization	***13%***
Other	***3%***

Clearly the competitiveness of the marketplace is the largest hurdle when underwriting a new account. It also appears that underwriters feel a bit hampered by corporate appetite and inability to attach to a program at a lower level.

Innovation or Stalemate

We asked underwriters if they expected any new or innovative changes to the D&O Policy form in 2017; while in 2016 the vote was split down the middle, it appears there is a larger consensus that believes innovation is slowing down. Only 37% of the underwriters believed that new coverages would be introduced this year, such as:

- Cyber Related Enhancements, (i.e. Social Engineering Coverage)
- Entity Investigations Coverage
- Side-A restatements becoming the norm

Just like last year, Cyber Enhancements and Entity Investigations coverage were named. For the record, Entity Investigations have been named every year we have conducted the survey, but this continues to be a place no carrier is fully willing to go.

New Concerns for a New Year

We always ask underwriters to give us one underwriting concern or question that they may ask this year that they didn't ask last year. Almost everyone had questions that surround potential changes from the new administration.

- How much impact does the new administration have on your business?
- If company is global, how does potential tariffs effect the revenue?
- Has there been board level discussion regarding shareholder activism?
- What internal controls and risk factor disclosures are planned regarding the company's cyber risk exposures?
- Are there internal controls if regulations are rolled back?
- What are executive guidelines around social media?

And our favorite response this year:

- None, underwriting is irrelevant these days….

CONCLUSION

Taking a look at what we already know and trying to predict the things we don't, what will the year ahead bring?

Rate Changes

While most companies should expect relatively flat rates; companies going public or in higher risk industries should not be surprised by a bump in primary rates. Excess rates, however, should continue to be soft as carriers continue to compete for that business through price alone; as meaningful coverage changes are fairly non-existent.

Administration Changes

There will be a keen interest on how reducing or changing regulation such as Dodd-Frank will affect the D&O landscape. As the stock market continues to climb will there be significant claim fall-out if the bubble bursts? How will changes to global trade policies affect companies with global revenue streams.

Cyber Awareness

Cybersecurity must be a topic discussed at every board meeting and companies should understand all potential risk and not only how to best protect against a breach occurring but also how to potentially mitigate the costs and expenses if a breach or cyber event occurs.

Best Offense….Be Prepared

Finally, as in every other year, the key to a successful renewal is to be prepared and start the process early. Work with your advisor to create a plan, set goals for the renewal, pay close attention to what the claims trends are and understand any potential language changes available to your D&O policy. Make sure that your story is reaching as many interested insurance carriers as possible and if feasible that you meet directly with your insurers to develop a personal relationship.

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