ANNUAL STATE OF THE D&O MARKET REPORT

2018

AHT
INSURANCE

EXECUTIVE SUMMARY

AHT Insurance is proud to provide our sixth Annual State of the Directors and Officers Liability (D&O) Market Report – intended to better prepare organizations for the issues that impact liability risks and assist them with addressing best practice needs for corporate governance and compliance issues in 2018 and beyond.

We endeavored to compile a comprehensive overview of the D&O marketplace – researching well over 40 sources to touch on some of today's most important D&O liability topics, including:

- Securities Litigation Trends Update
- SEC Enforcement Activities
- Return of the IPO
- The Bitcoin Dilemma
- Cyan Opinion Update
- Expert Testimony – Perspectives from Prominent Securities Defense and Insurance Attorneys

SPECIAL FEATURES IN THIS YEAR'S REPORT INCLUDE:

"Ask the Underwriters"

A popular segment from previous reports

In it, we disclose the results from a survey we recently conducted that polled over 150 underwriters, representing more than 30 insurance carriers – gaining their perspective of the current D&O marketplace and predictions for the future.

"Expert Testimony"

A new feature added this year

We asked a highly respectable panel of securities and insurance attorneys to give us their input about some of the industry's most pressing questions.

SECURITIES LITIGATION:
RECORDS ARE MADE TO BE BROKEN

There seems to be a palpable shift in the D&O Liability landscape. After what seems to be almost 15 years of softening rates and increased coverage grants, the tide is starting to change, and carriers have seemingly drawn a line in the sand – with lawsuit frequency being a critical factor.

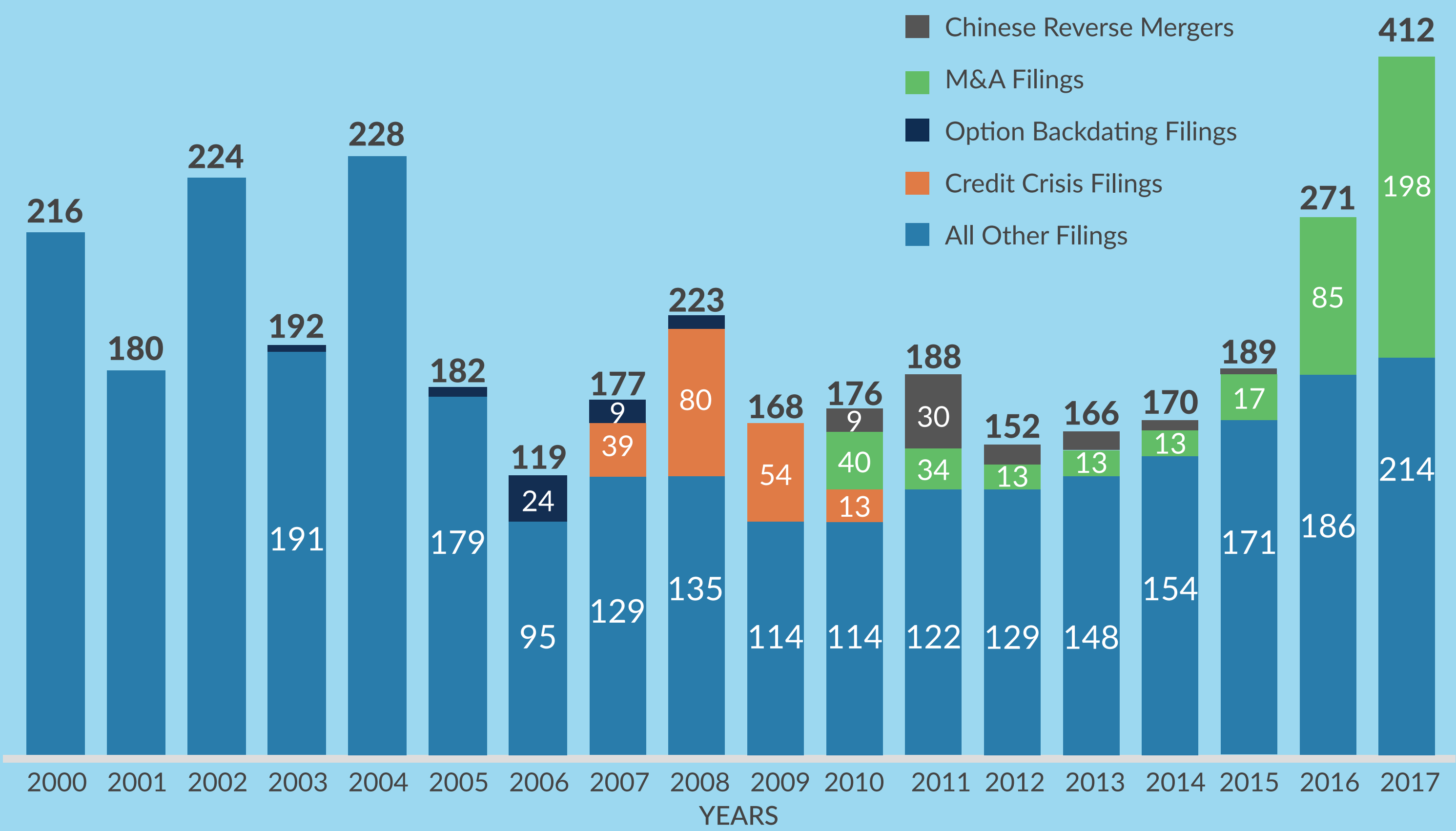
BAD NEWS FIRST...

In 2016, there were 271 federal class action lawsuits filed, according to Cornerstone Research, which set a record for the number of securities suits filed in a year. That record lasted all of 12 months, as 2017 saw **412 new federal class action securities cases filed – more than a 50% increase over last year's high-water mark.**

A contributing factor in the overall number of claims was the drastic increase in merger and acquisition (M&A) related filings. There were 198 M&A related claims in 2017, which more than doubled the 85 filed in 2016, as plaintiffs continue to take these claims out of state court and bring them to the federal level.

In 2015, following the Delaware Chancery Court's position on discourse-only settlements after the Trulia decision, there was a sense that M&A litigation claims would dry up. However, federal courts seem unable to take a consistent stand on these matters. On one hand, you have the Seventh Circuit that fully adopted the Delaware Court's stance on disclosure-only settlements in a recent Walgreen's acquisition claim, even going as far as to state these claims are a "racket" and claiming the disclosures were "worthless". On the other side, there was a recent example of the New York Appellate reversing a lower court's rejection of a settlement involving a Verizon acquisition and noted the thought that these types of disclosure-only settlements are close to extinct "may be premature".

FEDERAL SECURITY CLASS ACTION LAWSUITS



Source: Cornerstone Research

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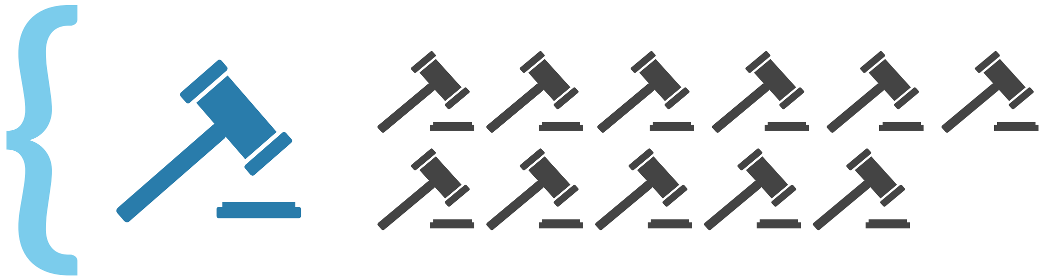
While M&A claims certainly increased, it cannot be ignored that "core claims", or traditional securities class actions unrelated to M&A, still increased by 15% year-over-year and were still the highest number of claims filed since 2004.

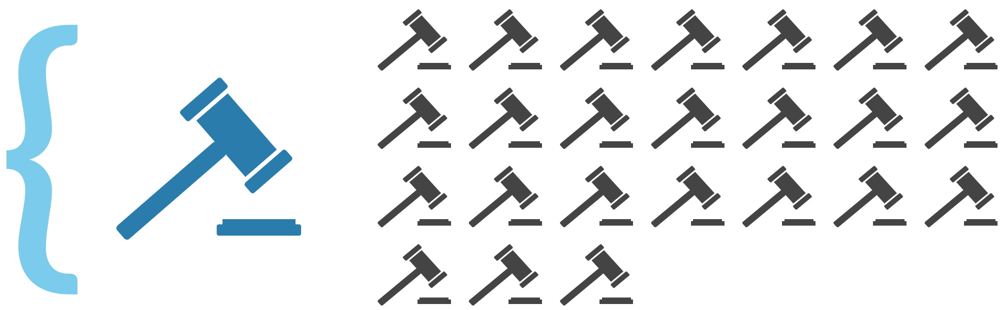
In addition, due to the smaller number of publicly listed companies and the massive increase in claims, the likelihood of a NASDAQ or NYSE listed company subject to a federal lawsuit jumped from 5.6% in 2016 to a record-setting 8.6% – **a 50% increase**.

Out of roughly 4,400 exchange-listed, publicly-traded companies:

1 in 12
Saw some type of litigation (including M&A)



1 in 25
Saw a core filing



Not surprising, due to all this activity, the number of pending federal cases in the courts has reached a record 785 cases up from 702 a year ago and 559 five years ago – leading to carriers paying more in defense costs than ever before.

This starts to paint the picture as to why insurance carriers, especially primary players, have steadily increased rates and retentions.

There was also a 28% increase in claims brought against non-U.S. issuers, going from 39 in 2016 to 50 in 2017, the highest total since 2011 when Chinese reverse mergers were at their pinnacle. Claims against European companies set the pace with 21 claims in 2017, triple the average from 1997-2016, with United Kingdom, Greece and Ireland based headquartered companies leading the way.

Plaintiffs are also running to the courthouse much faster than ever before. According to NERA, the median time to file fell to a record low of 10 days from the end of the class period in 2017 – indicating that it took 10 days or less to file a complaint in 50% of the cases.

This lends itself to the notion that plaintiff firms are being even less patient and not allowing any time for a stock to rebound prior to filing a complaint.

REALLY BAD NEWS...

In what seemed to be good news was the significant drop in Section 11 claims being brought in California state courts. In 2015, plaintiffs in CA started to really focus on state court for their Section 11 claims. There were 15 CA state-filed Section 11 claims in 2015 and 18 in 2016. This caused a real disturbance for carriers because the feeling was that these state courts were ill-equipped to handle these complex federal claims and the decisions and adverse settlements began to bear that out. The number of Section 11 state filings in CA dropped to 7 in 2017. The steep drop in cases was tied to the Supreme Court's decision to hear *Cyan, Inc. v. Beaver County Employees Retirement Fund*. The case, being brought by Cyan, Inc., was challenging the ability to bring a '33 Act securities claim in state court – arguing that the intent of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) was that these cases be heard in federal court.

Unfortunately, during the writing of this paper, the decision was made and was very unfavorable to the insurance community. The Supreme Court voted unanimously 9-0 that states can hear claims under the '33 Act.

There are many reasons that this is troubling for carriers and defendants:

FIRST The state courts seem to be friendlier to plaintiffs and may not grant the same protections that defendants get in federal court under the Private Securities Litigation Reform Act – making the hurdle to bring a claim lower and the road to dismissal much harder.

SECOND This may allow plaintiffs to bring multiple state cases simultaneously without a need to consolidate a class.

THIRD There is a concern that state court judges are not equipped to hear these types of cases. When a judge can hear an alimony case in the morning and a Section 11 claim in the afternoon, there is reason for alarm. The only hope is that some type of legislation is enacted to amend SLUSA that makes it crystal clear that all securities suits are to be brought in federal court.

We will address how this specifically affects the IPO market and hear directly from several nationally recognized defense attorneys about this matter later in the report.

FINALLY, A LITTLE GOOD NEWS...

FIRST

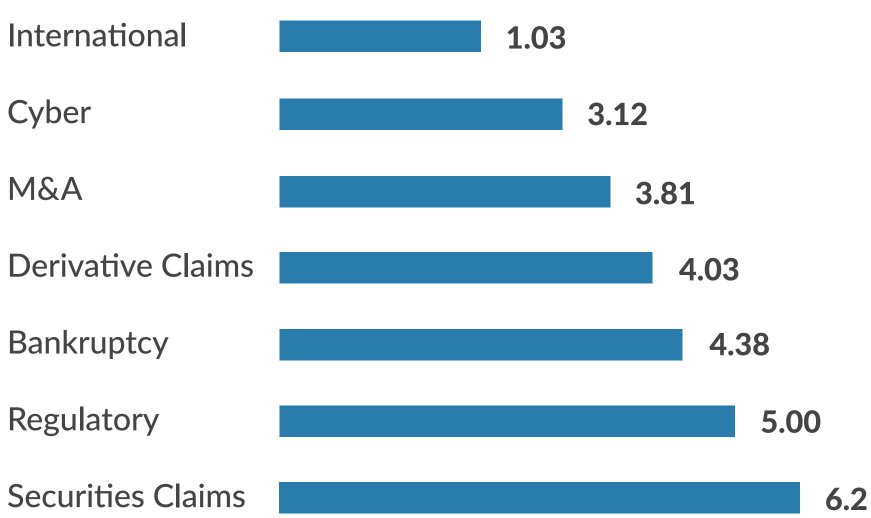
Despite the record number of M&A claims, there is still an average dismissal rate of roughly 80% from 2009 through 2016.

SECOND

NERA Economic Consulting reported significant decreases in both the average and median settlement amount in 2017. The average settlement in 2017 was only $25 million, a drop of almost $50 million from 2016's average of $74 million. This was the lowest average settlement amount in the last 10 years. Median settlement amounts also were at a record low of $6 million, down from $9 million in 2016. Part of this drastic drop in settlement values can be tied to what this report documented last year, which was the increase of claims against micro-cap companies. Claims against smaller market capitalization sized companies will inevitably lead to lower settlement valuations.

ASK THE UNDERWRITERS

We asked D&O underwriters to rank, on a scale from 1-7, what type of claims concern them the most, with 7 being most concerned. It's no surprise that securities claims are the most concerning type of claims, but regulatory and bankruptcy are still a significant concern.



INDUSTRY ANALYSIS:
SOMETHING SCARIER THAN BIOTECH

Since the end of the financial crisis, the most worrisome sector for D&O underwriters had been the pharmaceutical and biotechnology space. That all changed in 2017 with two new industry sectors creating more buzz and angst than any others.

Not inclusive of M&A Claims, the healthcare sector was responsible for **66** of the **214** core filings, making up 31% of all securities class action litigation.

Pharmaceutical companies alone saw the number of claims climb from **23** in 2016 to **30** in 2017.

In the past three years the healthcare sector, including pharmaceutical and biotechnology, have generated **172 securities class action lawsuits.**

This explains why insurance premiums for pharmaceutical and biotechnology companies have climbed so steeply the past 12 months, especially for companies in this space conducting an initial public offering.

TREND ALERT:

An interesting new trend to watch is the uptick in claims made against industrial companies. The average number of claims in this sector between 1997-2016 was 16, yet 26 were filed in 2017. The industrials sector has long been considered a safer sector for insurance underwriters but outpaced technology, financial, retail and communications companies in claims for 2017.

ASK THE UNDERWRITERS

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

	2016	2017	2018
Bitcoin/Blockchain/Cryptocurrency	N/A	N/A	100
Biotechnology & Pharmaceutical	96	95	96
Cannabis Related Organizations	N/A	N/A	94
Other Healthcare/Medical Device	86	92	77
FI-Banks	68	78	71
Educational	78	79	71
Technology	67	76	66
FI-All other	72	74	62
Energy/Utilities	72	56	42
Retail/Consumer Products	32	42	39
Business Services	29	29	27

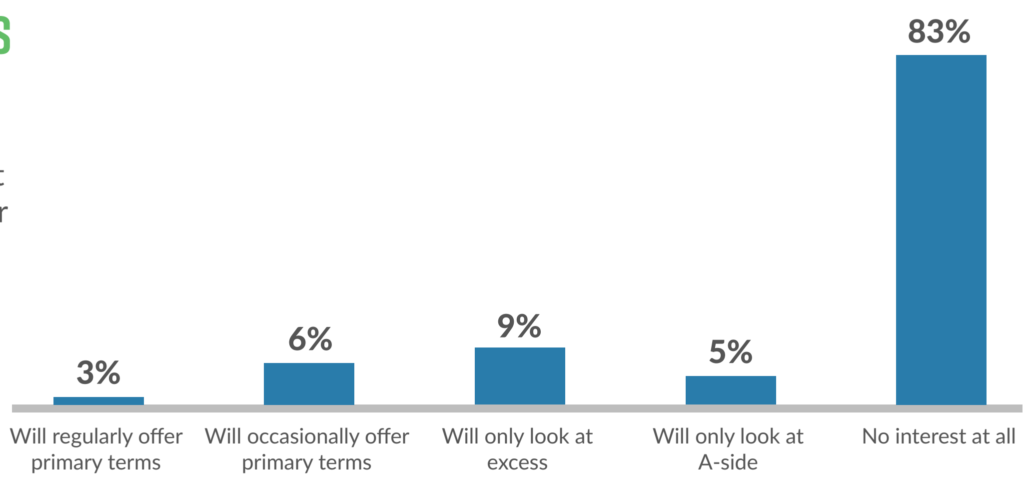
Bitcoin has taken the lead as the most concerning industry, registering a perfect 100. It seems that bitcoin and pharmaceutical company concerns may be taking the heat slightly off other industries, such as medical device and technology, as carriers look for somewhere to put their capacity.

Two new segments of the marketplace, that have become underwriting plutonium, are companies in the cannabis and bitcoin space. The fear of cannabis-related companies is tied to the uncertainty between federal and state laws and enforcement and the impact this may have on shareholder and regulatory claims.

Earlier this year, those carrier fears were intensified by comments made by White House spokeswoman, Sarah Huckabee Sanders, who said President Trump supports enforcing federal law. “Whether it’s marijuana or whether it’s immigration, the President strongly believes that we should enforce federal law.” While fears in this segment may be justified, it has yet to result in meaningful shareholder or regulatory claims.

ASK THE UNDERWRITERS

We asked the D&O Underwriters specifically about their appetite to offer terms for cannabis-related companies - the results were not surprising:



ICO, ICO OY VEY!!

The fears surrounding the Bitcoin space, especially companies conducting Initial Coin Offerings (ICOs), are much more concrete. The SEC has recently weighed in heavily about this space with numerous admonishments from commission Chairman, Jay Clayton, who believes that unregistered ICOs represent a violation of the law.

Comments have included:

> ...there is substantially less investor protection than in our traditional securities markets, with correspondingly greater opportunities for fraud and manipulation.

12.11.17

> Investors should understand that, to date, no initial coin offerings have been registered with the SEC. The SEC also has not, to date, approved for listing and trading any exchange-traded products (such as ETFs) holding cryptocurrencies or other assets related to cryptocurrencies. If any person today tells you otherwise, be especially wary.

12.11.17

> I have instructed the SEC staff to be on high alert for approaches to ICOs that may be contrary to the spirit of our securities laws and the professional obligations of the U.S. Securities bar.

1.22.18

> We should all come together, the federal banking regulators, the CFTC and SEC—there are states involved as well—and have a coordinated plan for dealing with the virtual currency trading market.

2.6.18

SPITTING THE BIT...

Recent Securities Lawsuits
Against Bitcoin Companies

December 12, 2017: Centra Tech, Inc.

A company, promoted by boxer Floyd Mayweather and entertainer DJ Khalid, was accused of violating U.S. securities law through a token sale that ultimately raised $30 million for the development of a cryptocurrency-focused debit card.

The complaint alleges that the Centra sale constituted an unregistered offering and sale of securities.

December 21, 2017: ATBCoin LLC

The class action suit alleges that ATBCoin had violated the Securities Act by issuing unregistered securities with the expectation of profit in the form of the ATB coin and the placement of all remaining funds invested into a trust in the interest of investors.

The complaint estimated the total to be somewhere "between $20,400,000 and $24,210,000" in bitcoin, ether and litecoin.

January 24, 2018: BitConnect, Inc.

The class action alleges that BitConnect issued cryptocurrency tokens that were effectively unregistered securities and gathered additional funds as a "wide-ranging Ponzi scheme" after receiving two cease-and-desist orders by U.S. state regulators. The company allegedly promised investors that its proprietary trading platform would generate a monthly return of 40 percent, which could amount to 3,000 percent annually.

The six named individuals said their loss totaled $771,000.

There have been numerous detractors, including the oracle himself, Warren Buffet, who had this to say about the space, “In terms of cryptocurrencies, generally, I can say almost with certainty that they will come to a bad ending.” In September, J.P. Morgan CEO, Jamie Dimon, called Bitcoin a “fraud”.

At the time of this writing, the Securities and Exchange Commission had just announced a serious probe into the sector and issued hundreds of subpoenas and information requests to technology companies and advisers involved in digital tokens.

Unlike the Cannabis sector, Bitcoin-related companies have seen several securities lawsuits filed already, with five suits coming in December of 2017 alone. In addition, numerous Bitcoin-related stocks have had their trading halted by the SEC.

One of the best examples of this new craze was Long Island Iced Tea Corp., an unprofitable beverage company changing their name to Long Blockchain Corp. and seeing their stock increase 289 percent with the news they were going to partner or invest with a blockchain company. NASDAQ has recently accused the company of misleading investors, with lawsuits sure to follow at some point.

Undoubtedly, this sector will prove to be the most difficult to retain D&O insurance for in 2018, and we dedicate an entire section to this topic later in the report.

REGULATORY REVIEW:
UPDATES ABOUT THE SEC & DOJ

There seemed to be a great deal of curiosity heading into 2017 with some wondering if the new administration's take on regulatory oversight would impact the activities of the SEC and DOJ. However, 2017 seemed to be business as usual for the regulatory and criminal justice branches of government, but perhaps there are potential changes in 2018.

NEW LEADER SAME RESULTS

With former Wall Street lawyer Jay Clayton taking over as SEC Commissioner and comments made by President Trump stating, “We’re going to be cutting regulations massively...we think we can cut regulations by 75%, maybe more”, there was an expectation that perhaps enforcement actions by the SEC may dip a bit from previous years. That line of thinking seems to be unfounded, at least in 2017.

According to the SEC’s Annual Report:

Minimal Change

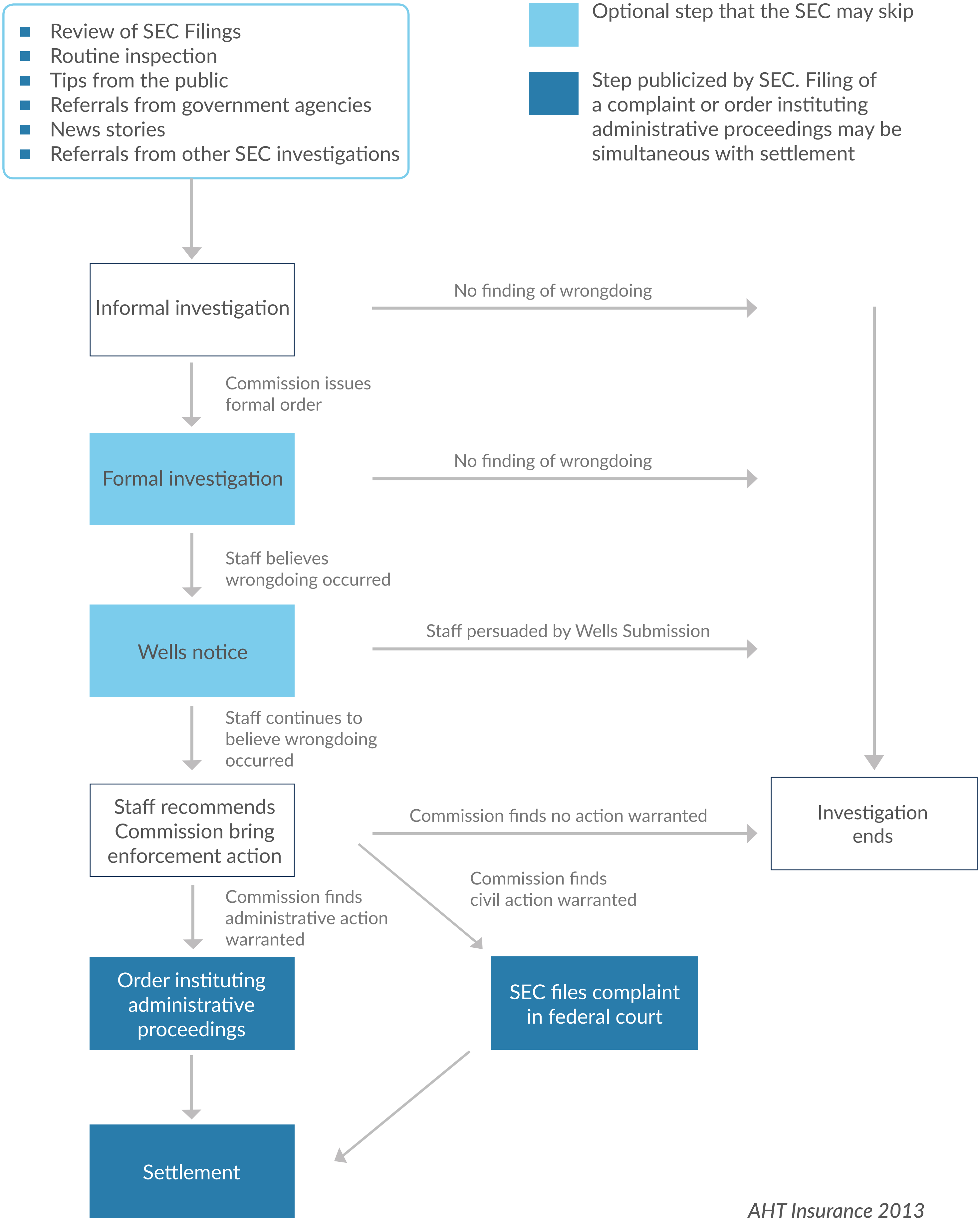
	2017	2016
Their enforcement agency brought:	754 total actions	784 total actions
Monetary penalties ordered were also similar at:	$3.8B	$4.1B
Likewise, led by Jeff Sessions, the Department of Justice’s white-collar crime unit posted similar results with:	207 convictions on 301 charges	201 convictions on 300 charges

NEW CYBER UNIT

One significant development that was undertaken by the SEC in 2017 was the formation of a cyber unit. The cyber unit combines enforcement’s substantial, existing, cyber-related expertise and its proficiency in digital ledger technology. The unit will focus on the following key areas:

- Market manipulation schemes via spreading false information through electronic and social media
- Hacking to obtain non-public information and trading that information
- Violations involving ICOs
- Misconduct using the dark web
- Intrusions to retail brokerage accounts
- Cyber-related threats to trading platforms and other market infrastructure

STEPS IN AN SEC ACTION



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RELIEF IN SIGHT?

While the change in enforcement actions and convictions has not been meaningful, there is a belief that while the White House has not “cut regulations by 75%”, they are at least curbing them. According to POLITICO analysis, the Trump administration has added less regulations in his first year than his two predecessors. The Trump White House has approved only 156 new regulations, compared to George W. Bush with 445 and Barack Obama with 510 new rules in their first years in office.

There was also a recent report of major indications that the SEC leadership may be seriously considering making a push that allows corporations going public to use forced arbitration language in their S-1 to ban securities class actions in their IPO. SEC Commissioner Michael Piwowar has even stated:

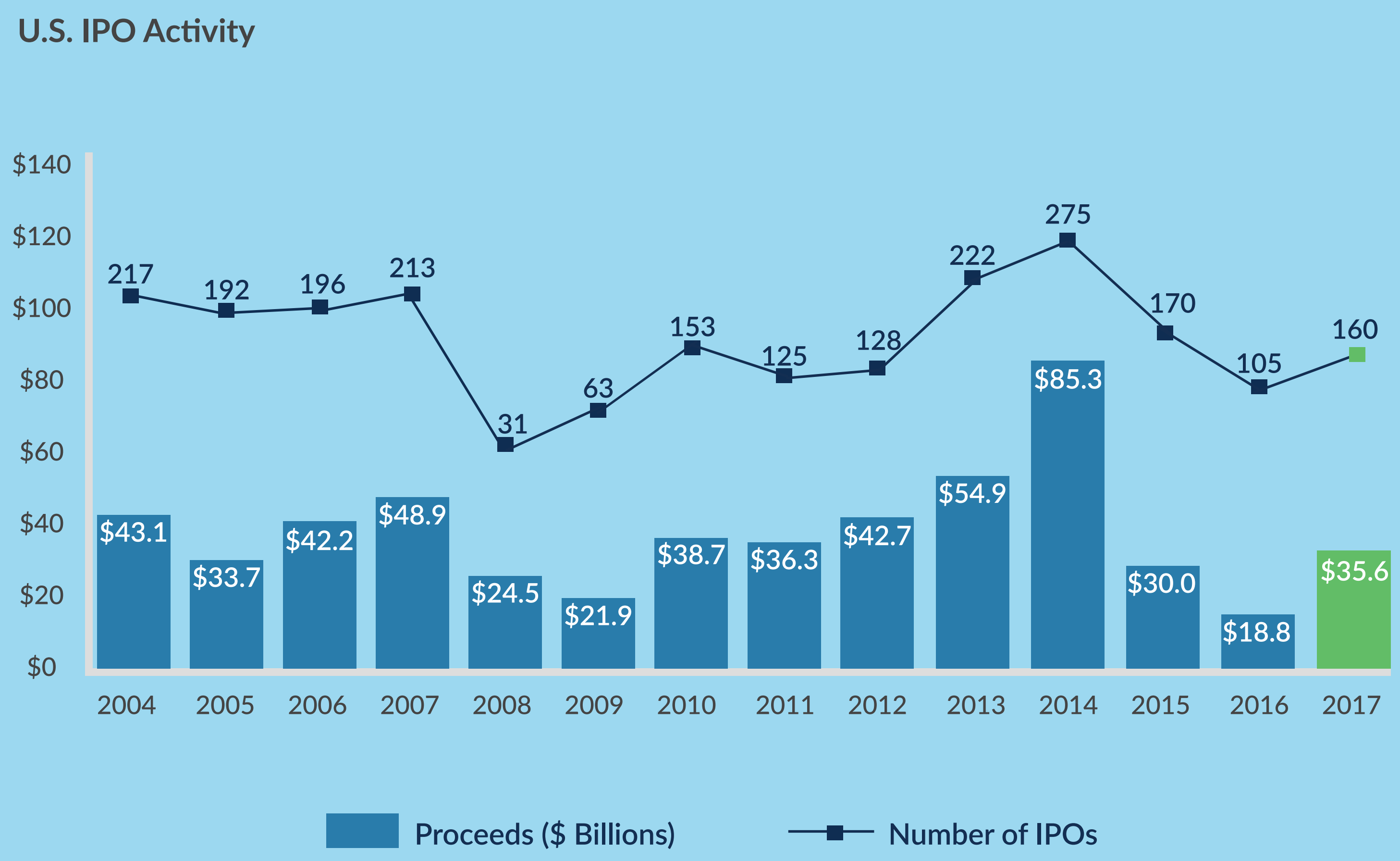
> “For shareholder lawsuits, companies can come to us to ask relief to put in mandatory arbitration clauses into their charters…I would encourage companies to come and talk to us about that.”

This is a fascinating topic, especially with the recent SCOTUS opinion about Cyan, Inc. There are many things to watch, starting with whether the SEC take steps to prohibit class actions lawsuits in IPOs all together, to whether Congress will consider bringing forth new legislation or at least tighten the language around ’33 Act Claims in the existing Securities Litigation Uniform Standards Act.

IPO MARKET STARTS TO SEE SOME LIFE

While 2017 may have not been a record-setting year for IPOs, it was certainly a welcome relief for investors, compared to what was a dismal market in 2016. According to Renaissance Capital, 2017 saw 160 IPOs generate $35 billion in capital compared to only 105 deals in 2016 raising a record-setting low of $18.8 billion.

TOTAL U.S. IPO ACTIVITY 2004-2017



HEALTHCARE SETS THE PACE ONCE AGAIN

In 2017, with 47 deals, healthcare made up 29% of total IPOs compared to 40% in 2016.

EVERY OTHER INDUSTRY SAW THEIR INCREASE IN DEALS

Technology	**38** in 2017 compared to **21** in 2016
Financials	**22** in 2017 compared to **11** in 2016
Energy	**14** in 2017 compared to **4** in 2016

SIMILARLY, THE RETURNS FOR INVESTORS WERE MUCH MORE POSITIVE IN 2017

IPOs averaged a 26% return in 2017 – slightly higher than the five-year average.

Healthcare IPOs	**34.4%** return in 2017 - led by: AnaptsyBio **572%** and Argenx **271%** in 2016
Technology Companies	**30.2%** return in 2017 - led by: Roku **270%** and SMART Global Holdings **206%** - a nice rebound in 2017
Biotech Companies	Many were in early stage trials, therefore reducing the potential late trial failures that can so negatively impact a stock price.

NOT EVERY INDUSTRY FARED AS WELL IN 2017

Two industries that did not fare as well were energy companies, which underperformed for the third straight year at only a 4.9% return, and telecom companies generating a -33.5% return.

Both private equity and venture-backed companies saw a significant rise in the number of deals. Private-equity backed companies going public were up over 50% from 30 to 46, while VC-backed companies jumped 45% from 42 deals to 61, more than tripling the capital raised year-over-year ($3.5 billion to $11.3 billion).

FUTURE LOOKS BRIGHT

The market seems primed for a potentially record-setting year in 2018. The market has performed well, and corporate taxes are on their way down with a pipeline of significant unicorns such as Lyft, Dropbox, Spotify and Airbnb set to test the market. Dropbox was the first to file an S-1 on 2/23/18, hoping to raise $500 million, followed quickly by Spotify, which filed on 2/28/18, hoping to raise $1 billion.

Through the first 2 months of 2016, only 17 companies priced, compared to the 41 companies that have already priced in 2017 – led by Brazilian fintech company, Pagseguro Digital, in a $2.3 billion raise and security services company, ADT, raising $1.4 billion.

UNDERWRITING CONCERNS

While the economy looks stable and the path to IPO seems clear, the costs associated with acquiring D&O insurance are rising steeply. The rates on biotechnology D&O for IPOs were already climbing, and the recent *Cyan, Inc. v. Beaver County Employees Retirement Fund* has insurance carriers on edge. It would not be unexpected to see rates on D&O for IPOs increase 25%+ with similar increases to retention amounts.

ASK THE UNDERWRITERS

We asked the D&O underwriters specifically about their view regarding the D&O marketplace for IPO companies (Note: this poll was taken prior to Cyan opinion, which most likely would have negatively impacted results):

Will regularly offer primary terms	13%
Will occasionally offer primary terms	67%
Will only look at excess	21%
Will only look at A-Side	14%
Consider JOBS act IPOs more risky than traditional IPOs	45%
Consider JOBS act IPOs less or equally as risky than traditional IPOs	18%
I believe there will be more IPO related claims in 2018 than in 2017	42%

MAKING SENSE OF THIS ALL

It will be prudent for any pre-IPO company to discuss with their outside counsel the concept of adopting a choice of forum provision into their bylaws and certificates of incorporation mandating federal venue for securities claims. This clause, also known as the Grundfest Clause, was originally proposed by Stanford professor and former SEC commissioner Joseph Grundfest. Typical language for this clause would look like this:

Unless the Corporation consents in writing to the selection of an alternative forum, the federal district courts of the United States shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing, or otherwise acquiring any interest in any security of the Corporation, shall be deemed to have notice of and consented to this provision.

EXPERT TESTIMONY

For the first time, this report reached out to a panel of four nationally recognized attorneys with prominent securities and insurance experience and asked their thoughts about some of the hottest topics in the industry.

OUR PANEL

Christina Costley
Partner
Katten Muchin Rosenman LLP

Christopher Durbin
Partner
Cooley LLP

Douglas Greene
Partner
Baker & Hostetler LLP

Carl Metzger
Partner
Goodwin Procter LLP

Q

Let's jump right into the topic du jour. What do you believe the impact of the recent Supreme Court opinion about Cyan Inc. v. Beaver County Employees Retirement Fund will have on Section 11 and other '33 Act claims?

CHRISTINA

We expect to see a significant increase in state court filings following the Supreme Court's recent holding, in Cyan, that the Securities Litigation Uniform Standards Act ("SLUSA") does not eliminate state courts jurisdiction over Section 11 claims (public offering claims).

The number of Section 11 claims has been trending upward in recent years because the "strict liability" standard imposed by Section 11 makes them easier to plead than a traditional securities fraud claim. State courts, in particular, have become an increasingly popular forum for these cases because many do not enforce the mandatory discovery stay imposed by the Private Securities Litigation Reform Act (the "Reform Act") to deter frivolous litigation. To date, plaintiffs have litigated these claims primarily in California state court because district courts outside the Ninth Circuit had, for the most part, allowed defendants to remove Section 11 claims to federal court. Following Cyan, however, we expect to see Section 11 claims proliferate in every plaintiff-friendly state in the country. Venue may not be limited to just the company's state of incorporation or principal place of business, as some courts have allowed cases to proceed based on the location of secondary defendants, including underwriters and sometimes even venture capital funds who have invested in the offering.

CHRIS I expect the court's unanimous decision, affirming the concurrent jurisdiction of state courts to hear Section 11 claims (among other '33 Act claims), and clarifying the Section 22(a) removal bar, will result in a significant overall increase in state-court filings nationwide. The plaintiffs' bar has for years shown a strong preference for filing '33 Act claims in California state court (particularly Santa Clara and San Francisco counties) whenever possible, so I do not expect to see a dramatic surge in filings in those jurisdictions. However, I do expect (and am already beginning to see) an increase in state-court '33 Act filings in other jurisdictions — including my own, Washington — now that any lingering doubt about the removal bar has been eliminated.

DOUG At the most basic level, Cyan will increase the overall number of unconsolidated securities class actions. In any case involving a registered offering, the defendants must brace themselves for Securities Act claims in state court and parallel claims in federal court. There is no ability to consolidate related state and federal cases. The only way to coordinate them is to file motions to stay and/or coordinate an approach that is always unpredictable and often unsuccessful. So, the sheer number of unconsolidated cases will increase. The most significant difference in state court is the lack of a meaningful motion to dismiss procedure. In many state courts, the pleading standard for falsity is far lower than the particularity standard established by Federal Rule of Civil Procedure 9(b), requiring no more than notice pleading.

Q Any impact on the federal courts?

CHRISTINA Because it is easier for plaintiffs to plead a claim and obtain discovery in state court, we expect that, going forward, most Section 11 claims will be filed there. We also expect to see plaintiffs voluntarily dismiss existing cases in federal court, and refile in state court, to the extent they can do so without violating the statute of limitations.

CHRIS Whether this trend results in a net decrease in '33-Act-only complaints in federal court remains to be seen. As Professor Grundfest recently noted, that question may largely depend on the adoption of federal-only jurisdiction provisions in issuers' articles of incorporation — and the Delaware courts' review of such provisions in the pending Blue Apron/Stitch Fix/Roku cases.

DOUG Of course, Congress may act here, similar to how it did two decades ago when it passed SLUSA, by abolishing concurrent jurisdiction to ensure that its vision for uniformity in securities litigation can (finally) become a reality. I agree, an increasing number of companies may include federal-forum clauses in their articles of incorporation or bylaws, a solution proposed by Professor Joseph Grundfest — though time will tell whether they are enforceable.

Q **In July, SEC Commission Michael Piwowar commented about the ability of companies to include mandatory arbitration clauses into their charter to minimize IPO litigation, going as far as to say "For shareholder lawsuits, companies can come ask for relief to put mandatory arbitration into their charter… I would encourage companies to come and talk to us about that."**

Have you seen companies start to request relief from the SEC, and do you think mandatory arbitration clauses will start to become more commonplace?

CHRISTINA ▶ I have not personally seen companies implementing mandatory arbitration clauses, and while the idea is intriguing, I do not think it is likely to become commonplace in the immediate future. The SEC has historically taken the position that mandatory arbitration clauses violate Section 29 of the Securities Exchange Act of 1934, which voids any contractual provision that purports to waive any rights under that act.

Many companies also may view mandatory arbitration clauses as an unacceptable risk. Such clauses may raise concerns by institutional investors, activist investor groups, and shareholder advisory groups, which could drive down the value of the IPO. Moreover, many companies may prefer to litigate 10(b) claims in federal court, where it is easier to get a dismissal on the pleadings and before discovery.

CHRIS ▶ Since Commissioner Piwowar's much-discussed comments in July 2017, we have not seen a rush to request CorpFin's blessing of mandatory arbitration clauses. As my colleague Cydney Posner recently noted (read 03/12/18 article, read 02/08/18 article), and more recent public comments by SEC Chair Jay Clayton and Commissioner Robert Jackson seem to signal, the SEC is not eager to take up review of such clauses any time soon.

DOUG ▶ Our current securities-litigation system is straightforward, predictable and manageable. There is a relatively small group of plaintiffs' firms that file securities class actions. The Private Securities Litigation Reform Act provides a framework for the procedural and substantive issues. Securities class actions rarely go to trial, and they settle for a predictable amount. Indeed, executives who do their best to tell the truth really have nothing to fear under the securities laws. The idea of abolishing securities class actions comes up from time to time. Fortunately for defendants, it hasn't become reality. The world of securities litigation with securities class actions is far safer for companies and their directors and officers than it would be without them. Predictability of the process and outcomes are key to a manageable system of resolving securities disclosure disputes. Mandatory arbitration would disrupt both process and outcomes. I hope the current idea blows over.

CARL ▶ I personally have not seen this develop, though I am monitoring the comments by SEC Chairman Clayton, other SEC commissioners and the SEC investor advocate to gauge how seriously to take this Piwowar proposal. This is not the first time that mandatory shareholder arbitration has been floated as a cure to what ails the capital markets at any given point in time. In testimony regarding ICOs before the Senate Banking Committee on February 6, Clayton indicated that barring shareholder securities fraud litigation was not in the offing. So, while this issue is worth keeping an eye on, I personally do not think there is likely to be a big policy shift in the short term.

Q

Do you expect more or less Securities Class Action lawsuits to be filed in 2018 than in 2017? Why?

CHRIS I do not expect a dramatic increase over 2017, but I do expect the multi-year trend of increasing securities class-action filings to continue through 2018. Among other reasons, the plaintiffs' bar appears to be in a continuing process of building inventory in M&A, 10b-5, and '33 Act class actions. As to the latter, the Cyan decision will likely lead to an uptick in '33 Act complaints. It also appears that M&A deal activity is on track to match or exceed last year's record pace which will likely produce a significant stream of cases in that area.

DOUG More, and there will continue to be more indefinitely. The securities litigation landscape now clearly consists of a combination of two different types of cases: smaller cases brought by a set of smaller plaintiffs' firms on behalf of retail investors and larger cases pursued by the larger plaintiffs' firms on behalf of institutional investors. This change is now more than five years old and appears to be here to stay. Although it isn't possible for me to know for sure, I strongly believe that there is a very large amount of capacity among the larger and smaller plaintiffs' firms to increase securities class action filings. Larger plaintiffs' firms have finished working through the bulge of the credit crisis cases and employ a large number of securities class-action specialists who have time for more cases. And, the smaller firms are aggressively filing cases and pursuing lead-plaintiff roles.

CARL I expect that filings in 2018 will be roughly similar to 2017. The M&A market remains active, and the post-Trulia migration of class actions challenging deal disclosures to federal courts looks like it will continue. The number of securities class action cases filed against biotech and pharmaceutical companies continues to grow. Because of the uncertainties and delays that these companies often experience when going through the FDA approval process, plaintiffs' lawyers view these issuers as an attractive target for suits.

One area where there might be a downtick is the number of securities class actions following issuers' announcement of the commencement or the resolution of a regulatory investigation or government enforcement action. As government enforcement will likely slow in the Trump era, the number of these sorts of suits may also decline.

Q

What is the one piece of advice you would give any public company in trying to minimize the likelihood or severity of a securities lawsuit?

CHRISTINA

Manage your disclosures! When disclosing bad news, it may be helpful to frame the disclosure in a way that tracks prior risk warnings and does not admit that any earlier statement was untrue. In some circumstances, it can also help to make clear when the company learned of the bad news, so there is no question that the knowledge did not predate a prior public filing. Also, be cognizant of timing — disclosing bad news at a time when the stock price is unlikely to fall, or the plaintiffs' lawyers are less likely to notice, may help avoid a lawsuit.

Strong risk disclosure can be invaluable. This does not necessarily mean that companies should over disclose — it may be better to say nothing rather than to make a statement that can be viewed as omitting information a "reasonable investor" would consider material. On the other hand, if forecasts or business plans rest on the outcome of an event that is uncertain, it is almost always better to warn investors about that.

CHRIS

Beyond adhering to common-sense best practices with respect to public statements — particularly exercising discipline and restraint in responding to investor or analyst questions during earnings calls and conference presentations — among the most important steps a public company can take to mitigate its exposure is to ensure that its D&O tower adequately reflects the company's evolving risk profile and is populated with underwriters who understand and appreciate the unique challenges of securities litigation. Among other things, this requires public companies to develop and maintain a relationship of trust and open communication with their broker and outside counsel.

When a public company is faced with any form of securities litigation, few things are as conducive to an efficient and successful resolution as an established working relationship between in-house counsel, outside litigation counsel, the broker and the carrier's claims representative.

DOUG

Draft what I'll call "better-feeling" disclosures. Nearly all public companies devote significant resources to accounting that conforms with GAAP and non-accounting disclosures that comply with the labyrinth of disclosure rules. Despite tremendous efforts in these areas, later events sometimes surprise officers and directors — and the market — and make a company's previous accounting or non-accounting disclosures appear to have been inaccurate.

Another way for companies to improve their disclosures is through more precision and a greater feel of candor in the comments they make during investor conference calls. Companies sweat over every detail in their written disclosures, but then send their CEO and CFO out to field questions about the very same subjects and improvise their responses. What executives say, and how they say it, often determines whether plaintiffs' lawyers sue – and, if they do, how difficult the case will be to defend. A majority of the most difficult statements to defend in a securities class action are from investor calls, and plaintiffs' lawyers listen to these calls and form impressions, positive and negative, about officers' fairness and honesty.

CARL

Involve securities litigators in the process of crafting disclosures around any deal or public offering. We can help flag and address issues before they become a source of exposure. Finally, take the time to work with expert advisers to build a strong D&O insurance program with "best of class" terms of coverage — you need to make sure the program provides bullet-proof protection for the company and its directors and officers in the event of a lawsuit.

THANK YOU

This feedback has been invaluable. We would like to thank every member of our panel for taking the time to share their experience and expertise with us about these very critical matters.

#METOO
IMPACT ON PUBLIC COMPANIES

Among one of the most highly publicized news stories dominating the second half of 2017 has been the sexual misconduct allegations/scandals. Led by a multitude of celebrity women working in Hollywood coming forward in the public eye, a wave has taken over in society. It has led to what many are calling a Watershed moment for women who are finding their courage to speak their truth about sexual wrongdoings they have endured in the workplace.

Two of the highest profile sexual misconduct stories involved highly powerful executives Harvey Weinstein of The Weinstein Company and Steve Wynn of Wynn Casinos and Resorts.

THE STORIES

1 Multiple women have come forward with allegations detailing how Weinstein used his influence and power in Hollywood as a media mogul and movie producer to exploit his employees and women seeking job opportunities within the company. As this matter continues to unfold, the financial and liability impact remains to be seen. One of the latest updates now reveals a civil rights lawsuit, filed by the New York State Attorney General, against the Weinstein Company and Harvey and Robert Weinstein alleging "egregious violations" of the state's human rights and business laws. The suit accuses Harvey Weinstein of engaging in quid pro quo sexual harassment and allegedly touching women and threatening others with their jobs to force them to facilitate his sexual activity. The suit also states that "key members" of the company's management were "fully aware" of Harvey Weinstein's alleged misconduct, "yet they did not take reasonable steps to investigate or stop it". The Weinstein Company filed for bankruptcy protection in the aftermath of the volume of sexual misconduct allegations made against co-founder Harvey Weinstein and the company for not releasing any victims/witnesses from non-disclosure agreements that prevented them from speaking out.

2 Another high-profile case involving multiple sexual misconduct allegations over decades arose against billionaire casino mogul Steve Wynn. According to Las Vegas police, reports from two women allege sexual assault against them back in the 1970s. According to a Wall Street Journal report, several other women claimed Wynn had harassed or assaulted them, including one case that led to a $7.5M settlement. Mr. Wynn is both the name and face of Wynn Resorts, and these incidents expose the company, which is highly dependent on Mr. Wynn's reputation, to significant harm, including the potential loss of licenses and legal liability. As these sexual misconduct allegations have led to multiple shareholder lawsuits, Steve Wynn has recently resigned as Chairman and Chief Executive Officer of his company.

THE IMPACT

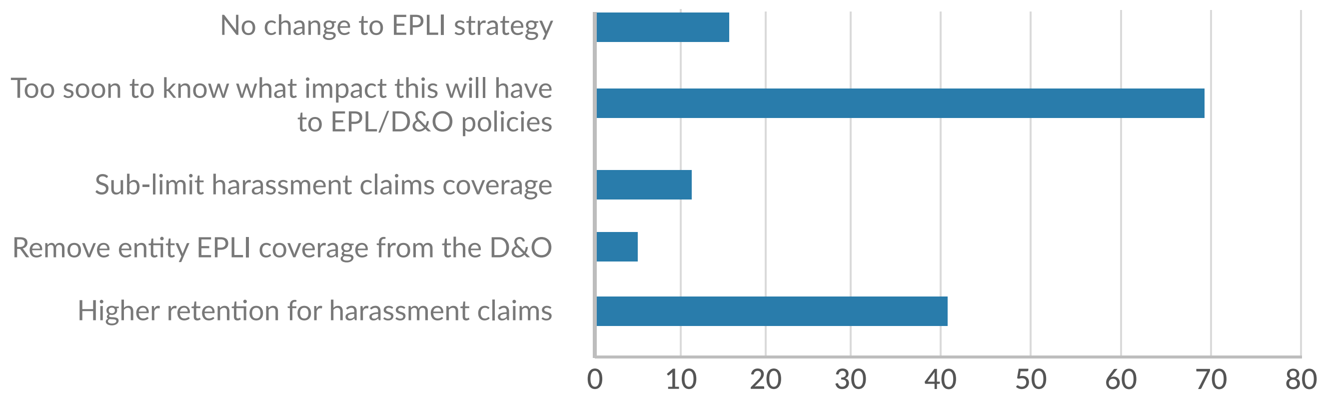
What we are now seeing is, because of the #MeToo movement, not only do these allegations pose liability concerns under an Employment Practices liability policy, but they can also impact a corporate liability exposure under the Directors & Officers liability policy as well (for breach of fiduciary duties) — especially when such allegations are against a founder and namesake of a company.

Subsequently, this has now led to the beginning of several shareholder derivative lawsuits against the company. Law firms are now seeking class-action plaintiffs, and the New York State comptroller's office is investigating accusations of insider trading by senior executive officers and board of director members relating to $20 million of company stock that was sold while they were aware of sexual misconduct allegations against Mr. Wynn.

ASK THE UNDERWRITERS

What do you believe will be your carrier's response to the recent influx of harassment cases?

Summary of Responses from 111 underwriters:



We also opened that question for additional commentary, and there were some common themes throughout the comments, including:

- Specifically limit coverage for sexual harassment (not impacting discrimination coverage, which is the other major claims scenario)
- Ask additional underwriting questions during the D&O/EPLI underwriter meeting. Those questions can include:
    - What measures is your company taking to ensure best practices are being incorporated to address such types of allegations?
    - Are companies talking about #MeToo in their workplace?
    - Have they engaged any outside firms for a review of their processes and procedures to minimize these types of risks?
- Limit their underwriting appetite or increase self-insured retentions for certain industry classes (entertainment and media were the two most common referenced at-risk industries)

As carriers continue to observe the claims trends regarding these coverages, it would not be unexpected to see some carriers re-evaluate how to address this additional exposure. This could lead to programs providing more split retention structures (with varying retentions based upon compensation levels of employees and sexual harassment/misconduct allegations, as well as by geographic location of employees and possibly industry class). This is something we are continuing to monitor closely in 2018 and beyond to see what the overall impact will be and what litigation trends/settlements arise accordingly.

DIRECTORS & OFFICERS CYBER-BILITY

An area that continues to pose significant risks to corporations is their vulnerability to a cyber related data breach incident. We continue to see that, not only is it important to have procedures in place to continually safeguard your data, but how a corporation reacts in the aftermath of a breach is just as important from a corporate reputational and an organization's liability standpoint.

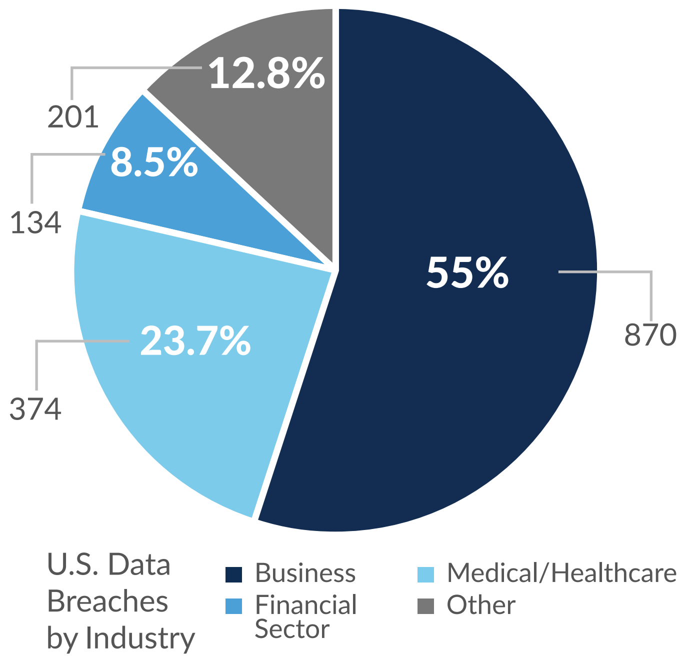
According to a 2017 Ponemon Study conducted of 419 organizations across 13 countries/regions, the global average cost of a data breach was down by 10% to **$3.62 million.** The average cost for each lost or stolen record, containing confidential and personally identifiable information, also decreased to $141 vs $158 in 2016. However, notwithstanding the decrease in overall average cost, the study found that companies are having larger breaches and they estimate an average probability that 27.7% of the organizations in the study will have a material data breach in the next 24 months – up from a 25.6% probability the year before.

Additionally, a survey of 4,000 businesses conducted by insurer Hiscox found that nearly half (45%) had been hit by at least one cyber-attack in the past year and two thirds of those organizations that were targeted had suffered two or more attacks. The average cost for those companies targeted was $229,000. And, for the largest organizations (with > 1,000 employees), the average cost of an attack in Spain was $356,000 and in the United States was $1.05 million.

EXPOSURES CONTINUE TO RISE FOR U.S. CORPORATIONS

U.S. data breaches hit an all-time high in 2017 - totaling **1,579** breaches, a **44.7%** increase over 2016*

Top 3 industry categories to experience breaches in 2017*:



TOP CAUSES OF BREACHES IN 2017*

Hacking (includes phishing and ransomware/malware): **60%** of all breaches

Payment Card Data: nearly **20%** of all breaches (up 6% over 2016)

Other causes included:

- Unauthorized access
- Insider theft
- Employee error/negligence/improper disposal/loss
- Physical theft

*Source: CyberScout and Identity Theft Resource Center (ITRC) Year in Review

SOME OF THE LARGEST, MOST NOTEWORTHY CYBER-RELATED DATA BREACHES THE PAST YEAR INCLUDE:

EQUIFAX

The Hack
A massive cyber hack resulted in stolen personal data of 145 million people.

The Aftermath
Equifax CEO, Richard Smith, stepped down after the breach was revealed (which was two months after it had occurred).

Note
One of the worst breaches of all time due to amount of sensitive information exposed.

ANTHEM INC.

The Hack
A cyber-attack in 2015 compromised the personal data of 78.8 million people.

The Aftermath
Anthem agreed to pay $115 million to resolve consumer claims.

Note
Regarded as the largest data-breach settlement in history.

HOME DEPOT INC.

The Hack
Home Depot experienced a massive data breach in 2014.

The Aftermath
They settled a shareholder suit for $27.25 million awarded to the impacted financial institutions. It is estimated that their total costs relating to this breach incident will be as much as $179 million, as they have already paid $134.5 million to Visa, Mastercard and other banks in addition to two class action suits that awarded plaintiffs $19 million last year.

Note
This is the largest point-of-sale theft of all time, in addition to being the biggest credit card compromise ever seen, affecting 56 million credit card accounts.

UBER

The Hack
In 2016, hackers stole the data of 57 million Uber customers and drivers. The company paid them $100k to keep quiet and cover it up. The breach was not made public until November 2017, when revealed by Uber's CEO.

The Aftermath
Lawmakers, city officials in Los Angeles and Chicago and the Washington state attorney general are suing Uber over this massive data breach.

YAHOO

The Hack
In October 2017, the company announced that every one of their 3 billion accounts was hacked in 2013. This was three times the total they first thought when CEO, Marissa Mayer, told Congress they only found out about the breach in 2016 when they reported 1 billion accounts were hacked.

SOCIAL ENGINEERING CLAIMS (FRAUDULENT INSTRUCTION SCAMS) RISE

Another area where we are continuing to see cyber claims steadily arise is fraudulent impersonation (i.e. social engineering fraud) claims. According to one prominent insurance carrier, fraudulent instruction incidents have quadrupled in 2017, with policyholders suffering losses ranging from several thousand dollars up to $3 million. Fraudulent Instruction Claims now average $352,000.

Top 3 Industry sectors affected in 2017 (reported to the carrier) were:

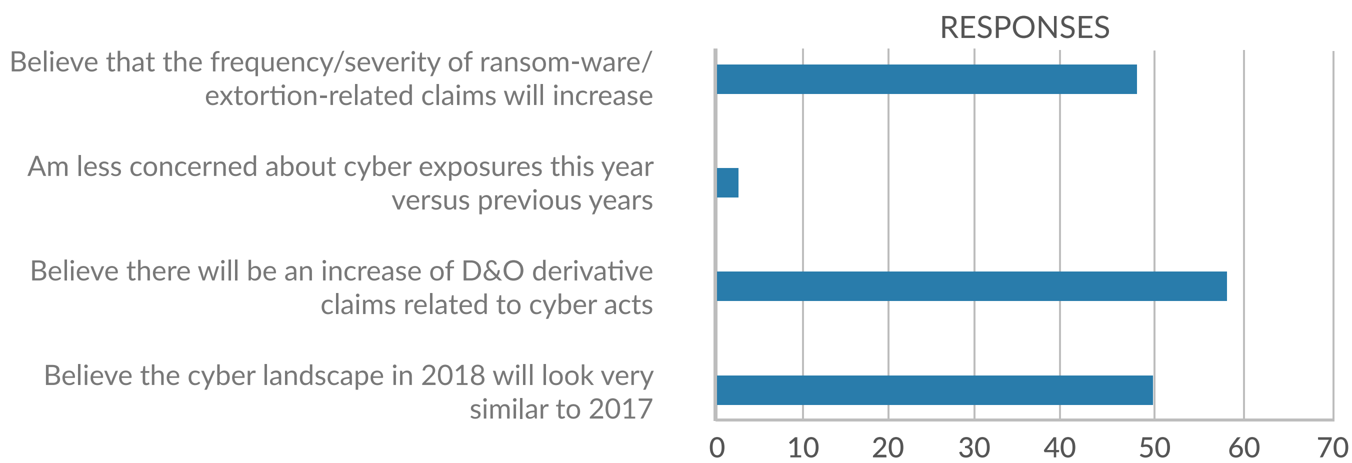
1. Professional Services **22%**
2. Financial Services **21%**
3. Retail **12%**

PREPARATION OF A CYBER RESPONSE

Boards today need to be proactive to combat cyber-related risks to the organization. Boards that attack the issue and develop a rapid response plan will be best suited to address and handle a cyber-attack. And remember, every time cyber risk, cyber controls or cyber insurance is discussed at a board meeting, make sure to include that in the minutes. We have seen cases where regular documented cyber-related discussions at the board level can impact how the court can respond to D&O claims against the directors and officers. In addition to implementing mitigation processes and strengthening relationships with advisors and public relations firms, they should also ensure clear lines of communication are open with stockholders, as the standard of accountability is greater than it has ever been.

ASK THE UNDERWRITERS

We asked the underwriters to provide their continued perceptions when it comes to cyber, and here are their responses:



AND YOU THOUGHT CHARLIE BROWN WAS A BLOCKHEAD

In just the past months, Google, Facebook and Twitter have banned advertisements relating to cryptocurrencies, Initial Coin Offerings (ICOs), crypto wallets, token sales and most crypto exchanges. They appear to do this to avoid the reputational damage that could occur if any of these cryptocurrency ventures are found to enable financial crimes. With that said, not all crypto currency operations are nefarious. In March of 2018, Ripple and its executives donated $29 million dollars to fund all 35,647 classroom requests on donorschoose.org.

Bitcoin, Ethereum and Ripple have made a huge global impact. Critics have labeled these exchanges as fraudulent, and they will never last. The skyrocketed interest is in the security and transparency features that is offered by the underlying ledger technology of these cryptocurrencies, called blockchain. Blockchain is defined as a decentralized ledger of digital transactions that is both transparent (data is embedded within the network and is public) and is incorruptible (as it would require a huge amount of computing power to override the entire network). As a self-auditing system per se, within a certain timeframe as deemed by the blockchain exchange (17 seconds for Ethereum and 10 minutes for Bitcoin), “miners” (the authority behind the technology), go in to create a new blockchain that captures all the present and past trades and reconcile every transaction in the network. Hence, the name blockchain.

Blockchain’s first success story, the Bitcoin exchange, was first employed to create a peer-to-peer banking system with the ability to verify transactions autonomously without the need of an intermediary (aka one’s bank and the Federal clearing house). The blockchain technology has far reaching disruptive capabilities that could be applied for other purposes, such as recording property records, tracking pharmaceuticals and settling stock trades.

As a trusted private ledger, it removes the need for reconciling each transaction with a third party. Santander reckons that it could save banks up to $20 billion a year by 2022. The Economist reported that 25 banks have just joined a Blockchain startup, R3 CEV, to develop common standards, and NASDAQ is about to start using the technology to record trading in securities of private companies.

2017 – 2018 CRYPTO HEISTS:

February 2018
$500 million of digital tokens from Japanese exchange Coincheck, Inc.

December 2017
Crypto-mining marketplace in Slovenia, NiceHash had $63 million of Bitcoin stolen.

November 2017
$155 million loss in the Parity Wallet of Ether and other tokens. A malicious attacker stole $31 million worth of the Tether cryptocurrency.

July 2017
White Hat Group attempted to launder $30 million of stolen Ether from an exploited bug in the Parity Wallet software. Within minutes of CoinDash’s launch of an Initial Coin Offering (ICO), hackers stole $6.6 million worth of Ether.

April 2017
A hack of a Bithumb contract worker’s computer, which had customers’ data files on it, resulted in a breach of 30,000 users information and a fine of $55,000 by regulators to the South Korean crypto-exchange.

In the past 10 years, it is estimated that $1.2 billion worth of Bitcoin and Ether (most popular crypto currencies) have been digitally stolen.

Additionally, now that blockchain technology is no longer only thought of as being the digital ledger system for transacting deals with bitcoin or other cryptocurrencies, major blue-chip companies such as IBM, Microsoft Corp. and Oracle are adopting and investing serious resources into this technology to drive usage of their systems and services. Companies such as Wal-Mart and Visa are increasing their testing and usage of this technology to streamline their supply chain, speed up payments and store records in a more efficient and accurate way. Other companies, such as Maersk, British Airways, UPS and FedEx, have all begun testing this emerging technology to help streamline their shipping, provide more accurate and updated real-time data and improve their supply chain.

Bloomberg estimates that the market for blockchain-related products and services will reach $7.7 billion in 2022, up from $242 million last year, according to researcher Markets & Markets.

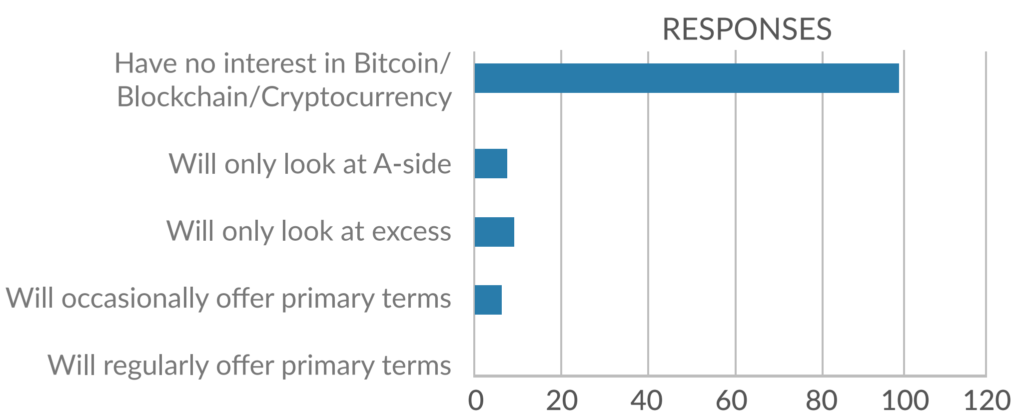
INSURANCE IMPLICATIONS:

As this technology continues to rise in popularity, and becomes adopted by more companies, it will be interesting to see what type of impact this may have from a liability/claims perspective. With regards to blockchain, many published materials widely acknowledge that a blockchain is completely encrypted with permanent transactions that are publicly accessible — making them extremely difficult to be hacked/manipulated. The exposure basis to this point has been seen from hackers stealing cryptocurrencies from user's virtual wallets, not from a theft that occurred at the blockchain ledger.

When we gauged their interest level of offering D&O Liability terms, most underwriters are currently holding off providing premium quotations until they perceive more clarity regarding the regulations of this space. The most common additional commentary is that the underwriters will continue to monitor and research the maturation of the cryptocurrency and blockchain industries. However, there are markets willing to offer terms.

ASK THE UNDERWRITERS

We asked, **"What is your interest in providing quotations for cryptocurrency related entities?"**



And, for those entities where insurers have offered D&O Liability options, they can include:

- U.S. Securities Regulatory sub-limits or exclusions
- Money laundering exclusions
- Future offering exclusion where there would be cover for the first ICO, but any subsequent ICO they would need to be underwritten to

The quality and mission statement behind each blockchain and/or cryptocurrency technology will determine whether markets can support the vision of the entity and, in turn, provide a comprehensive offering from a coverage standpoint. A great qualifying question to ask when assessing a blockchain and/or cryptocurrency is 'Can the goal be accomplished in any other method besides blockchain and/or cryptocurrency'? In other words, is blockchain and/or cryptocurrency the only means to make a project/technology work. The answer to this question will determine the market function of the project/technology. That is the difference between a 'utility' coin and an 'equity' coin. These terms have become a point of contestation in the eyes of the regulatory bodies and law firms. Most critics agree the future will favor 'equity' coins and will become mainstream as they represent ownership of an asset, such as debt or company stock. 'Utility' coins are viewed as more of a social application to provide users with access to a product or service — a means to transact if you will — and aren't necessarily backed by a meaningful asset, other than being a designated blockchain group.

Cryptocurrencies and blockchain have made a significant impact globally and are constantly being debated. Regulatory bodies and law firms are extremely busy investigating companies associated with ICO's and working to find a solution that creates a pure infrastructure system. However, the buzz from the private sector is only increasing. New projects and developments are happening daily in the U.S. and around the world. Countries such as South Korea and China have put zero tolerance sanctions on cryptocurrencies. Whereas Canada, Australia, Iceland, Switzerland, Puerto Rico and Japan are booming with cryptocurrency mining projects and have created a crypto-friendly governmental approach.

WHAT'S IN A NAME?

In the wake of Bitcoin's boom in value appreciation, starting last year at just under $1,000 and skyrocketing to a high-point valuation of $19,783 in December, other companies began shifting gears to take advantage of this hot industry segment. They rebranded themselves, sometimes overnight and with little to no prior announcements or expertise in the blockchain/cryptocurrency industry.

SOME EXAMPLES OF THIS ARE:

Tulip Biomed
changed its name to **Bitcoin Services Inc.** - stock soared 42,500% last year

MGT Capital Investments Inc.
Shares soared after announcing a move from being a cybersecurity firm into a bitcoin mining company

AGriVest Americas Inc.
changed its name to **NXChain Inc.** - stock soared 42,500% last year

Biotech Company Biotix, Inc.
(maker of diagnostic machinery for biotech industry) changed their name to **Riot Blockchain Inc.** - shares soared 1,611%

Long Island Iced Tea Corp.
(ready to drink beverage maker) announced plans to change their name to Long Blockchain Corp. and shift their strategy to blockchain technology - shares jumped 458%

Kodak
Shares jumped 130% based on news that they created their own cryptocurrency called KODAKCoin and a platform named KODAKOne that leverages blockchain technology

THE A, B, C'S OF PE & VC

We are seeing the raising of capital at all-time levels. Whether the 20% increase in the Venture Capitalization median fund size or the fact that 75% of follow-on funds in 2017 were larger than their predecessors, there is no lack of available capital. With that said, there doesn't appear to be a correlating level of attractive investments, thus leaving a lot of 'dry powder' in the investment community. This means that investment vehicles will have to adapt their go-forward strategies to differentiate in 2018. And, with any changes in strategy comes potential risk. The additional perceived risks can impact how the underwriting community views VC and PE firms.

We asked many prominent Management Liability underwriters in the Asset Management (AUM) space what they are seeing with regards to these newest claims and coverage trends and how this has impacted their underwriting. When having these discussions, we found the underwriting community separated the investment space into three buckets:

1. Private Equity
2. Venture Capital
3. Equities (Mutual Fund, Hedge Fund, Investment Advisors)

CLAIMS & LITIGATION TRENDS

For Private Equity firms, the risk lies within its operating strategy. Leverage Buy-Out (LBO) shops are seen as a higher risk that a PE firm focused on growth within their portfolios. LBOs warrant more caution, as the investors can have a perceived conflict of interest with the target company. Extraction of value can occur during the investment and drive up leverage quickly, which can result in the PE firm leaving the target company with little to no value. This inherent conflict forces a dual fiduciary duty as the PE firm must work to benefit the portfolio company (Port Co.) and the Limited Partners (LPs). Debt/EBITDA ratios must be evaluated and scrutinized to ensure the Port Co. is appropriately levered. Breach of Fiduciary claims associated with portfolio company bankruptcy remains as one of the most frequent claims scenarios in this space.

On the other hand, PE firms focused on sustainable growth typically have proper leverage. Their interests are more aligned for all parties, as the growth-oriented PE firm typically only extracts value at the exit of the investment. Other favorable PE risks are Impact PE Funds. However, scrutiny under where the investments are is a concern as they are typically in foreign/emerging markets.

Typical underwriting questions for PE firms are related to the level of board or advisory positions taken by the PE and the disclosure of management fees. We have seen several fees disclosure cases in the headlines recently, and it is a concern that will surely continue to draw attention from the underwriting community. Complete transparency with any form of bulk rebates, and how each PE firm handles this type of reporting, is an important topic of discussion during the immediate and ongoing risk analysis.

Venture Capital firms are sometimes seen as a more favorable risk due to their inherent operating strategy. Investing in startups means the VC firm believes in the business and wants to see their investment succeed. Therefore, the fiduciary interests for the business and investors are aligned. The lack of debt positions in the VC space are also viewed positively, as the lack of debt obligations are hardly ever a going concern for these types of risks. Furthermore, VCs typically take a board/advisory seat to have optics into the management of these growth-stage companies.

Underwriting questions for VC firms stem from the composition of their portfolio of companies in which they have an investment stake. The diversification of the invested companies is very important to the underwriter community. Cases citing preferential treatment to one of two like-minded companies setting out to accomplish the same goals can cause a very timely and costly situation. There could be a fund dedicated to healthcare technology startups, however, the companies within that fund should all have different and distinct objectives.

Lastly, the liquidation or exit strategy for the VC portfolio companies is a big, sometimes the biggest, question mark for the VC firm. Underwriters can perceive "unicorns" and their incredibly high valuations in a negative light. As valuation methods continue to be fine-tuned, volatility in pre-exit vs. post-exit valuations will hopefully stabilize and will produce more efficient/transparent exits. The equities companies are generally seen as the safest of the three categories. This is because there tends to be more publicly available information for these types of funds, and advisors and interests are perceived to be aligned. But even within these types of risks, commodities and other derivative type investments are seen as riskier than equity and fixed-income products.

COVERAGE TRENDS

Limits & Retentions

We can still see self-insured retentions as low as $50,000, but only for those entities perceived as least risky and with low assets under management (under $250M). Here is some general guidance about limits and retentions based on different AUM categories:

AUM	Average Limits	Average Retentions
$0 - $500M	$2M - $3M	$75,000 - $125,000
$500M - $1B	$4M - $6M	$100,000 - $150,000
$1B - $5B	$5M - $10M	$100,000 - $250,000
$5B+	$10M+ (typical)	$250,000+ (typical)

Terms & Conditions

Coverage negotiations continues to be a critical value-added service offered by insurance brokers. Here is a sampling of the newest coverage extensions that can be made available to those asset management entities that can demonstrate the best of risk controls.

- Informal Investigations coverage against individual insured persons
- Formal Investigations coverage against the entity
- Mock SEC Examination costs reimbursement coverage
- Dedicated limits for Chief Compliance Officer (CCO)
- Pre-claim lookback coverage
- Fraudulent Funds transfer coverage (aka Social Engineering coverage or Impersonation coverage). This is usually specific to the Fidelity Bond policy.
- Cost of Corrections (specifically for The Equities companies)

CONCLUSION

Just as value differentiation is a critical part of the investment proposition for many PE and VC firms as they approach potential investors, so is risk differentiation as they approach management liability underwriters. We strongly recommend hosting an underwriter meeting, or at least call (similar to an investor presentation), for the subject firm to have the opportunity to tell their story to the underwriting community. The value of this includes, but is not limited to:

- Leverages the competitive influences between the different underwriters
- Expedites the process
- Provides a better understanding of the perceived quality of management they would not be able to obtain from just the application and public filings

FINAL THOUGHTS

Here are some additional thoughts about the overall rates and trends expected by the D&O underwriting community over the next 12 months based on our extensive polling of over 100 D&O underwriters.
It's clear that when it comes to where primary rates are headed, a lot has changed in a year as we compare what underwriters thought about 2017 versus 2018.

2017 RESULTS

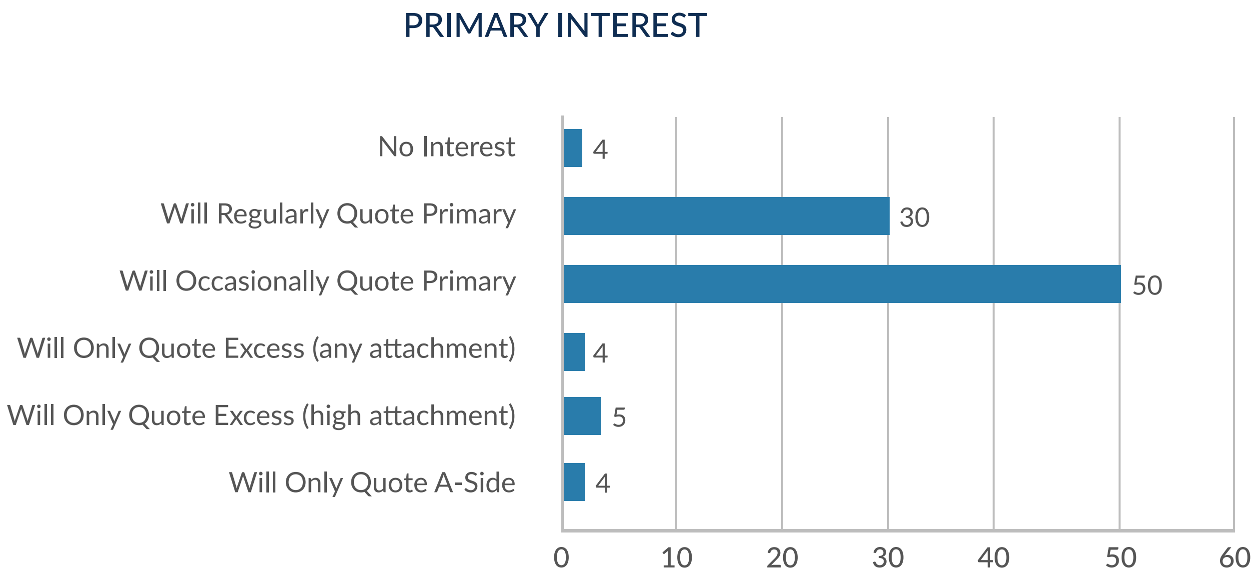
TYPE OF RISK EXPOSURE	Over 20% Increase	11% - 20% Increase	5% - 10% Increase	Flat (+/- 4%)	5% - 10% Reduction	11% - 20% Reduction
Standard Account	1%		14%	60%	24%	1%
IPOs	4%	10%	40%	36%	9%	1%
Micro-caps (<$100M market cap)	1%	6%	19%	58%	16%	
High-Risk Industry (Biotech/Finance, etc.)	3%	21%	46%	29%	1%	

2018 RESULTS

TYPE OF RISK EXPOSURE	Over 20% Increase	11% - 20% Increase	5% - 10% Increase	Flat (+/- 4%)	5% - 10% Reduction	11% - 20% Reduction
Standard Account	6%	11%	57%	28%	1%	0%
IPOs	11%	31%	48%	10%	0%	0%
Micro-caps (<$100M market cap)	4%	14%	44%	35%	3%	0%
High-Risk Industry (Biotech/Finance, etc.)	17%	38%	27%	58%	8%	0%

Headed into 2017, carriers felt rates were mostly stable, with even a bit of reduction still possible. However, the mindset in 2018 is a much different picture. The consensus is rates across the board will increase, and any reductions will be difficult to find.

We also asked what their appetite was to write Primary for standard (non-IPO) business:



One of the most intriguing questions we asked was specific to their space, what they believe are the biggest changes/challenges in the industry since last year (check any that apply):

Fewer Primary Carriers	**23%**
Raising of Attachment Point for Excess	**5%**
Lowering of Attachment Point for Excess	**11%**
Higher Rates on Primary Layers	**54%**
Change in Rates on Excess/A-Side	**29%**
Shift in Underwriting Strategy	**39%**
Increase in Number of Industries a Carrier Cannot Write	**23%**

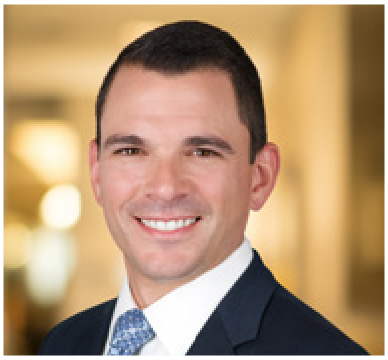
Some of the most interesting comments and observations were:

- Key carriers (mainly Chubb and Berkshire - and AIG to some extent) are now looking to drive a harder market. And, they are reducing their capacity on programs where they once were comfortable with providing larger limits.
- Less creative carriers and "senior management" decisions are starting to make it more difficult for front-line underwriters to act on certain classes, claim deals and certain lower layers
- Material bump in SEC retention and rate for Biotech IPOs
- The speed at which underwriters are expected to quote

And finally, one of our favorite questions is to ask the underwriters to give us one underwriting question they may ask this year that they didn't ask last year:

- Does your company have an office of diversity?
- What is the company doing to eliminate or minimize sexual harassment claims?
- Does company accept, exchange or invest in bitcoins/blockchains/cryptocurrencies?
- Please discuss how you will leverage the Tax Law changes to benefit your organization.
- Exposure to the potential of rapidly changing/disruptive technology within their sector ("The Amazon Effect")
- What are you doing to secure PII?

ABOUT THE AUTHORS



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Mike Tomasulo has over 20 years of experience working with companies to negotiate and understand their Management Liability and Risk Management Programs. Mike has worked with hundreds of publicly-traded companies, from OTC to Fortune 100's, in placing their Directors and Officers Liability Insurance. He is AHT's national practice leader for Management Liability as well as a Principal of the firm heading up the Northeast operations. Mike was one of the inaugural members of Business Insurance's annual 40 under 40 list and is a two-time Risk & Insurance Magazine Power Broker. Prior to AHT, Mike was a Senior Vice President and Team Leader at AON Risk Services in New York City in their Financial Services Division. In addition, Mike was a founding member of the NASDAQ Insurance Agency, creating the Nasdaq Stock Market's in-house insurance brokerage. He ran the agency's East and Central regions until the time he assisted in successfully selling the agency to AON. In addition, he also held Regional Underwriting Officer roles at global insurance companies AIG & Zurich. Mike is a frequent speaker at industry events — discussing topics regarding Management Liability, Board Education and Corporate Governance. He earned a B.S. degree from Kean University and an M.B.A in Finance from Seton Hall University.

DENNIS GUSTAFSON

Principal & Financial Services Practice Leader
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Dennis Gustafson leads the Financial Products Practice for AHT. He has extensive expertise in placing management liability, directors and officer's liability, professional liability, lenders liability and fidelity bond/commercial crime. In addition, he assists clients using his widespread knowledge of the risk exposures and coverage available for cyber liability/privacy for all industries. Dennis maintains AHT's relationships with Bank Director and Corporate Board Member publications and previously with the Americas Community Bankers Association. He is a frequent speaker about management liability topics at industry events and frequently authors D&O specific articles for Bank Director/Corporate Board Members. On March 12, 2013, he was quoted in the Wall Street Journal in an article titled "Small U.S. Banks Hit by Rising Insurance Cost". Most recently, Dennis was recognized by Risk & Insurance as a 2016 Power Broker of the Year for the financial services industry. Prior to joining AHT, Mr. Gustafson was the Managing Director and Financial Institutions Practice Leader at NASDAQ Insurance for seven years, preceded by seven years at a large international carrier in roles including insurance sales, underwriting and operations/technology.

JONATHAN MAIO

Vice President of Client Services
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Jonathan Maio is Vice President of Client Services specializing in the management liability lines of coverage for AHT's private and publicly-traded clients. Jonathan markets and negotiates policy placements, analyzes and reviews policy language and is actively engaged in client and underwriting meetings. He also acts as a claims liaison and matches insurance coverage to the individual needs of each client. Additionally, Jonathan is a current member of the Professional Liability Underwriting Society. Jonathan joined AHT in 2010 with 12 years of industry experience in the New York region. Prior to joining AHT, Jonathan held positions of various underwriting roles and responsibilities at two of the largest international insurance carriers. He formerly worked as the Assistant Vice President and NY Regional Underwriting Manager for financial institutions. Following this, Jonathan held a position as the Assistant Vice President at a regional brokerage specializing in the placement of management liability lines of coverage.

PIERCE LEONARD

Professional Lines Account Manager
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Pierce Leonard joined AHT as Account Manager for the Northeast office with 4 years of insurance industry experience. Prior to joining AHT, Pierce worked as a Financial Services broker placing various executive liability insurance products on behalf of domestic and multinational financial institutions and commercial clients. Pierce brokered vital risk transfer solutions to help companies prepare for public offerings, navigate through bankruptcy proceedings and protect the personal assets of independent directors and officers against alleged claims from shareholders, regulatory agencies and other third parties in the current litigious business environment.

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