ARE YOU CONFIDENT?
D&O COVERAGE CONSIDERATIONS AHEAD OF AN IPO

The private business you started years ago has grown steadily and you're now considering taking it public. Going public is a significant milestone that can offer many financial benefits, including:

- Greater access to more sources of capital for growth and expansion, at lower costs.
- The use of stock to attract and retain company officers and key personnel, as well as fund mergers and acquisitions activity.
- Enhanced company image.
- An exit strategy for early investors.

But an initial public offering (IPO) also materially changes a company's risk profile and adds significant exposure to the personal assets of its directors and officers. Ensuring you have comprehensive directors and officers liability (D&O) insurance in place will be critical to all involved.

ROAD SHOW RISKS

The journey from private to public company can bring several new risks and exposures. Exposure to securities liability typically begins with the company's IPO road show, or even as a business makes legal, tax, and operational decisions leading up to a road show. Investors rely heavily on statements made during road show presentations and on any information provided within the road show prospectus. Allegedly misleading statements made during this time can lead to claims post-IPO.

If a company has D&O insurance in place prior to an offering, it is usually written on a private company policy form and coverage is typically tailored to the needs and risks of a private company. Some D&O policies allow for road show coverage as part of the base policy wording. Other insurers, however, specifically exclude this coverage — meaning that the policy form would need to be endorsed.

If a company does not have any D&O insurance in place, it should consider purchasing such coverage prior to its road show and preliminary prospectus filing. It is important for the company and its directors and officers to seek proper advice early in the process in order to ensure that coverage needs are properly addressed. This is also the case for companies able to take advantage of the JOBS Act's easing of the IPO filing requirements.

POST-IPO EXPOSURES

Public companies are subject to greater regulatory scrutiny than private companies, and must comply with extensive securities

RELEVANT FEDERAL LEGISLATION

Securities Acts of 1933 and 1934

Securities offerings are governed by the Securities Act of 1933, while ongoing trading in a company's stock is governed by the Securities Exchange Act of 1934. Under Section 11 of the 1993 Act, directors and officers are held to a strict liability standard in the event of a materially misleading statement in their company prospectuses. Meanwhile, Rule 10b-5 of the 1934 Act makes it illegal to commit fraud or deceit or omit to state a material fact in connection with the sale or purchase of securities.

Sarbanes-Oxley Act of 2002

Passed in the wake of several high-profile incidents of corporate wrongdoing and accounting fraud, this law requires internal controls for financial reporting to be established and maintained. The overall intent was to improve corporate governance, accountability, and responsibility. The law also requires compensation clawbacks for chief executive officers and chief financial officers in the event of financial restatements.

Dodd-Frank Wall Street Reform and Consumer *Protection Act (2010)*

Passed after the financial crisis of 2007 and 2008, this law promotes the financial stability of the US by improving accountability and transparency in the financial system. The law also introduced wider compensation clawback rules that apply to all current and former executive officers.

laws designed to enhance public trust and corporate governance (see sidebar). Disclosure requirements for public companies can create significant liability. All statements made during a road show or contained within the prospectus and any subsequent public disclosures of material information should be carefully considered.

One of the biggest IPO risks is that the stock does not perform well after listing. In this event, lawsuits could be filed against the company and its directors and officers alleging mismanagement, misrepresentation in the prospectus, or other claims. Such lawsuits are almost always based on the strict liability provisions of Section 11 of the Securities Act of 1933. Under this law, any material misrepresentation — even if negligently made — could form the basis of liability against a corporate director or officer.

While the vast majority of securities class-action complaints are filed in federal court, in recent years Section 11 claims have increasingly also been filed in state court (especially in California) which has seen more lenient pleading standards, more permissive procedures, and lower dismissal rates than in federal courts. When a complaint is filed in both federal and state courts, this is known as a "concurrent jurisdiction" claim and has led to an increase in both frequency and severity of IPO claims.

Depending upon the severity of the problem and the drop in the stock price, an IPO could also draw the attention of state and federal securities regulators and other enforcement agencies, which could also result in concurrent regulatory investigations, further increasing the overall costs.

Common post-IPO trigger events leading to securities claims include:

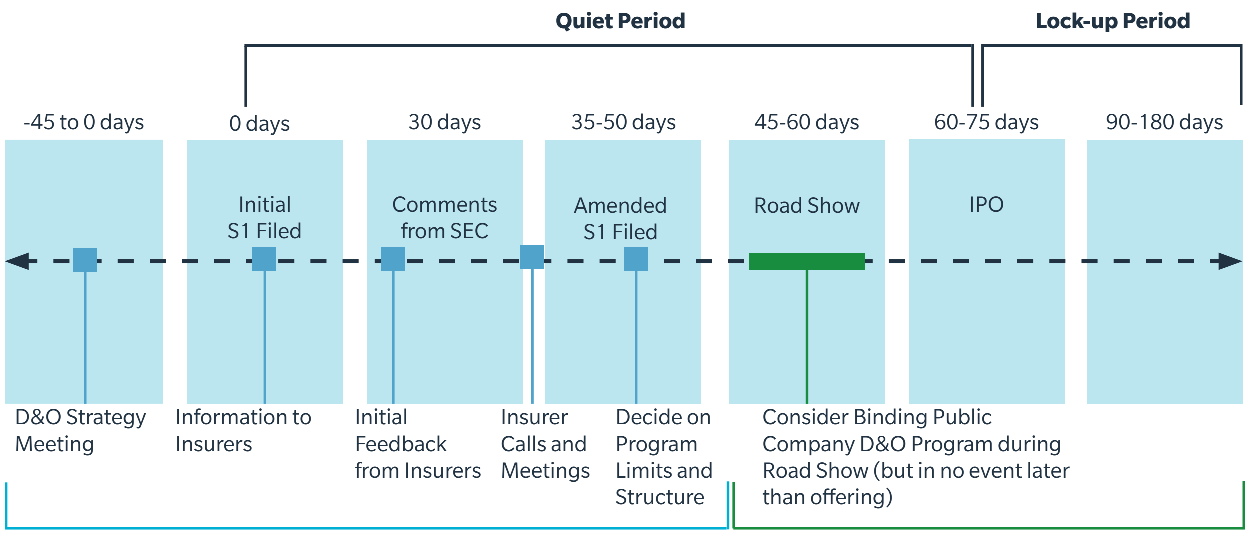
- Accounting restatements.
- Earnings failing to meet projections.
- Announcement of products or services failing to perform as expected or being delayed.
- Investigations by the Securities and Exchange Commission, Department of Justice, or other regulators into corporate or individual director or officer conduct.
- Internal investigations based on whistleblower complaints.
- Inadequate disclosure regarding mergers, acquisitions, and divestitures.

BUILDING AN EFFECTIVE D&O PROGRAM

Before launching an IPO, businesses should work with their insurance advisors to build a D&O insurance program that addresses their critical risks before, during, and after an offering. Businesses can follow a simple timeline (see Figure 1) that can minimize time and effort while better ensuring robust coverage is in place. In building D&O programs ahead of IPOs, companies should work with their insurance advisors to:

- Assess limits needed and optimal program design based upon tailored benchmarking and securities class action claim modeling.
- Obtain initial insurance quotes using the draft prospectus and latest financial statements.
- Schedule face-to-face meetings with underwriters before road shows to finalize competitive quotes.
- Ensure coverage for the ancillary lines such as employment practices liability, fiduciary liability and crime is properly placed
- Determine if any locally admitted D&O policies are needed outside the US.

FIGURE 1: D&O COVERAGE TIMELINE DURING AN IPO



Private Company D&O Considerations:

- Road show coverage.
- Runoff coverage.
- Unearned premium treatment.

***Public Offering of Securities (POSI):** Several London-based insurers offer this alternative, which provides a multi-year policy solely for claims arising from the offering of the shares in an initial public offering. A separate policy provides coverage for the ongoing exposures of the public company, including secondary offerings. A POSI policy can mitigate the premium of the standalone public company policy, although it could add costs. POSI policies are available in the US, but are rare.

Public Company D&O Considerations*:

- Increase limits.
- Expect higher retentions and premium.
- Purchase new or increase limits of existing Side A coverage.
- Maintain continuity date of private company limit.
- Purchase separate standalone employment practices liability coverage.
- Continue ancillary lines (including fiduciary, cyber and crime) for remaining policy period, waiving change in control provisions if needed.

For more information on this topic and others, visit marsh.com, contact your Marsh representative, or contact:

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