

Monte Carlo Risk Management Forum

Financial Services Industry Session

16 October 1991

"EMERGING ISSUES IN EUROPEAN
FINANCIAL SERVICE RISK MANAGEMENT"

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(SLIDE 1) THE SUBJECT OF THIS ARTICLE IS EMERGING ISSUES IN EUROPEAN FINANCIAL SERVICE RISK MANAGEMENT. FOREMOST AMONG THESE ARE THE GROWING LIABILITY OF INDIVIDUAL DIRECTORS AND OFFICERS AND THE RELATED EXPOSURE OF FINANCIAL SERVICE FIRMS TO PROFESSIONAL LIABILITY. THE GREATEST SINGLE SOURCE OF GROWTH IN THIS EXPOSURE COMES FROM MERGERS AND ACQUISITIONS. FOR THE FINANCIAL SERVICE FIRM, MERGER AND ACQUISITION ACTIVITY PRESENTS TWO POTENTIAL EXPOSURES. A FINANCIAL FIRM MAY ITSELF BE DIRECTLY INVOLVED IN A MERGER OR ACQUISITION OR IT MAY ASSIST THE PROCESS AS ADVISER, ACCOUNTANT, ATTORNEY OR INVESTMENT BANKER.

IT IS CLEAR FROM THE AMERICAN EXPERIENCE THAT THERE ARE MANY FACTORS THAT CAN LEAD TO LIABILITY. THE BOARD OF THE TARGET FIRM IS SUBJECT TO A SUIT WHETHER OR NOT IT ACCEPTS AN OFFER TO BE ACQUIRED. THE MANAGEMENT OF THE ACQUIRING FIRM IS AT RISK IF THE DEAL DOESN'T WORK OUT AS PLANNED, FOR EXAMPLE, IF EARNINGS DO NOT MATCH PROJECTIONS AND THE SHARE PRICE DROPS. OF COURSE, CORPORATE DIRECTORS AND OFFICERS READILY SHARE THE BLAME WITH THE FINANCIAL SERVICE FIRMS ON WHOSE ADVICE THEY RELIED.

I WILL LOOK BRIEFLY INTO THE AMERICAN EXPERIENCE WITH SUCH LITIGATION AND THEN ANALYZE HOW THESE EXPOSURES ARE DEVELOPING IN THE PROFOUNDLY DIFFERENT EUROPEAN CONTEXT. THIS ISSUE IS PARTICULARLY INTRIGUING NOT ONLY TO RISK MANAGERS FOR WHOM IT REPRESENTS A NEW CHALLENGE, BUT ALSO FOR THE INSURANCE BROKERS AND UNDERWRITERS FOR WHOM THIS MAY, FOR THE FIRST TIME IN MANY YEARS, PROVE TO BE A SIGNIFICANT SOURCE OF TRULY NEW BUSINESS.

(SLIDE 2) WHEN WE ANALYZE THE SOURCES OF D&O SUITS IN THE U.S., WE FIND THAT OVER 50% ARE INITIATED ON BEHALF OF SHAREHOLDERS AND INVESTORS.¹ IN FACT, A HIGHLY SUCCESSFUL SEGMENT OF THE LEGAL PROFESSION, CALLED THE PLAINTIFFS' BAR, HAS COME TO SPECIALIZE IN THIS TYPE OF SUIT. THESE ATTORNEYS CONSISTENTLY MONITOR THE FINANCIAL REPORTS OF PUBLIC CORPORATIONS SEARCHING FOR DISPARITIES BETWEEN FINANCIAL PROJECTIONS AND ACTUAL RESULTS, POUNCING ON ANY COMPANY THAT CAN BE ALLEGED TO HAVE IN ANY WAY MISLED THE PUBLIC IN VIOLATION OF U.S. SECURITIES DISCLOSURE LAWS. AS M&A ACTIVITY HAS DECLINED IN THE UNITED STATES, PLAINTIFF'S LAWYERS ARE REPORTEDLY LOOKING FOR NEW VENUES OF OPPORTUNITY, SUCH AS EUROPE, IN WHICH TO APPLY THEIR WELL-DEVELOPED SKILLS.

WHILE MY FOCUS IS ON INVESTOR-DRIVEN SUITS, WE CANNOT LEAVE A DISCUSSION OF THE AMERICAN SCENE OR OF ITS AFFECT UPON WORLD INSURANCE CAPACITY, WITHOUT TOUCHING ON THE S&L CRISIS. (SLIDE 3) IT WAS REPORTED EARLIER THIS YEAR THAT THE FEDERAL DEPOSIT INSURANCE CORPORATION WAS CONSIDERING LEGAL ACTION AGAINST THE DIRECTORS AND OFFICERS OF ONE-THOUSAND THREE-HUNDRED THRIFTS AND BANKS.² AT THAT TIME IT ALREADY HAD 500 CASES PENDING. ALTHOUGH 80% OF THESE WERE AGAINST DIRECTORS AND OFFICERS, IT IS SIGNIFICANT TO NOTE, FROM A PROFESSIONAL LIABILITY STANDPOINT, THAT 20% WERE DIRECTED AGAINST ATTORNEYS AND ACCOUNTANTS. IN TERMS OF THE INTERNATIONAL RAMIFICATIONS OF THE CRISIS, (SLIDE 4) LLOYDS INITIAL GUESSTIMATE OF ITS OWN POTENTIAL LIABILITIES WAS FROM 3 TO 5 BILLION DOLLARS.³

(SLIDE 5) HAVING ACHIEVED AN APPRECIATION FOR THE MAGNITUDE OF THE PROBLEMS WHICH CAN ARISE, WE CAN IDENTIFY EMERGING TRENDS IN EUROPE BOTH GENERALLY AND IN SPECIFIC COUNTRIES. WHILE ACQUISITION

ACTIVITY HAS FALLEN OFF IN THE U.S., THIS HAS NOT BEEN THE CASE IN EUROPE. ACCORDING TO ONE ANALYSIS OF 1990 ACTIVITY:

"WHILE DOMESTIC TURNOVER IN THE U.S. AND BRITISH MARKETS PLUMMETED BY 40% OR MORE, THE DOLLAR TOTAL OF CROSS BORDER TRANSACTIONS IN EUROPE SET A RECORD - UP 20% TO 60 BILLION DOLLARS."⁴

EVEN AFTER ADJUSTING THE NUMBERS FOR THE DOLLAR'S WEAKNESS DURING THE PERIOD, THIS STILL REPRESENTS A SIGNIFICANT INCREASE IN ACTIVITY. INDEED SUCH ACTIVITY IS SELF-PERPETUATING:

"INDUSTRIAL RESTRUCTURING IS A PROCESS WHICH FEEDS ON ITSELF AS AGGRESSIVE MOVES BY SOME COMPETITORS OBLIGE OTHERS TO RESPOND IN KIND, WHILE BUYERS DISGORGE THOSE PARTS OF THE PREY THAT ARE IRRELEVANT TO THEIR STRATEGIES AND THE RECONFIGURATION OF NUMEROUS EUROPEAN INDUSTRIES CONTINUED INEXORABLY IN 1990."⁵

THE ACTIVITY IN EUROPE HAS NOT INCREASED WITHOUT CONTROVERSY. BRITISH AND COMMONWEALTH DISPUTED THE ROTHCHILDS' ACQUISITION OF ATLANTIC CORPORATION; THE IRISH FIRM, CLF PROCEEDED AGAINST WARBURGS OVER THE ACQUISITION OF CLF HOLDINGS; AND HILL SAMUELS RECENTLY SETTLED A DISPUTE IN CONNECTION WITH A BID.⁶ IN THE U.K., FOR EXAMPLE,

"CORPORATE FINANCIERS OFTEN BASE THEIR PRE-BID VALUATION (OF THE COMPANY TO BE ACQUIRED) ON THE BID PRICE THAT THEY THINK THE ACQUIRING BOARD CAN JUSTIFY TO ITS

SHAREHOLDERS ... ON THE BASIS OF LIMITED PUBLICLY AVAILABLE INFORMATION ... A FAR CRY FROM AN INDEPENDENT ARMS LENGTH EVALUATION."⁷

IN THE U.K. DILIGENT LITIGATORS WILL REVIEW THE CIRCULAR SENT TO SHAREHOLDERS, ESPECIALLY THOSE CIRCULARS WHICH REFERENCE THE MERCHANT BANK AND ITS RECOMMENDATIONS. THESE CIRCULARS ARE THE DOCUMENTS SENT OUT TO CONVENE MEETINGS AND TO RECEIVE SHAREHOLDER CONSENT OF PROPOSED TRANSACTIONS. FOR A RESENTFUL SHAREHOLDER ADDING A MERCHANT BANK AS A DEFENDANT IS "JUST ANOTHER LINE ON THE WRIT."⁸ AS TIME GOES ON, SUING THE FINANCIAL ADVISER MAY BECOME AS STANDARD A REACTION TO ADVERSE NEWS AS FIRING THE FINANCE DIRECTOR AND CALLING FOR AN INDEPENDENT AUDIT.⁹

I HAVE THUS FAR POINTED TO SIMILARITIES IN AMERICAN AND EUROPEAN EXPOSURES. HOWEVER, THERE ARE ALSO SOME FUNDAMENTAL DIFFERENCES WHICH SHOULD BE NOTED. ONE INSURER RECENTLY PUBLISHED AN ANALYSIS OF THESE DIFFERENCES EXPLAINING THAT:¹⁰ (SLIDE 6)

1. THERE ARE NO SPECIFIC DUTIES TO MINORITY SHAREHOLDERS IN MANY EUROPEAN COUNTRIES.

(SLIDE 7)

2. EUROPEAN COURTS FOCUS ON SUBSTANTIVE DECISIONS RATHER THAN THE PROCESS BY WHICH THEY ARE MADE. PRIMARILY ADDRESSING THE QUESTION: WHAT ULTIMATELY IS IN THE BEST INTEREST OF THE CORPORATION? RATHER THAN: HOW HAS BUSINESS JUDGEMENT BEEN EXERCISED?

(SLIDE 8)

3. WITHIN THE EUROPEAN CONTEXT THE TERMS, "DIRECTOR AND OFFICER,"

ARE NOT CONSISTENTLY DEFINED.

(SLIDE 9)

4. ONE OF THE KEY EXPOSURES IN EUROPE, UNLIKE THE U.S., IS THE POTENTIAL PERSONAL LIABILITY OF DIRECTOR FOR HIS FIRM'S DEBTS.

(SLIDE 10)

5. THE PERSONAL LIABILITY OF DIRECTORS GENERALLY TAKES THE FORM OF FINES, PENALTIES OR PROSECUTION, WITH SIMPLE DISMISSAL A COMMON REMEDY.

(SLIDE 11)

6. CIVIL DAMAGES ARE NOT PREVALENT AND, IN SOME COUNTRIES, CLASS ACTIONS ARE NOT ALLOWED. CONTINGENCY FEES FOR ATTORNEYS ARE RARE.

(SLIDE 12)

7. REGULATOR FOCUS REMAINS POST-TRANSACTIONAL ADDRESSING THE RESULT OF THE TRANSACTION; UNLIKE THE U.S., WHERE PRE-ACQUISITION APPROVALS MAY BE NECESSARY.

HOWEVER, THESE DISTINCTIONS ARE BLURRING. INCREASING GLOBALIZATION NECESSARILY LEADS TO WORLDWIDE SECURITIES' REGISTRATION AND THE NEED TO SATISFY THE REQUIREMENTS OF U.S. SECURITIES' LAWS. WITHIN EUROPE ITSELF, THE E.C. COMMISSION IS NOW PROMULGATING TAKEOVER GUIDELINES WHICH STRESS MANAGEMENT'S RESPONSIBILITY TO SHAREHOLDERS.

THUS FAR, I HAVE SPOKEN ABOUT EUROPE IN GENERAL, HOWEVER, DESPITE THE MUCH HERALDED PLANS FOR 1992, IT MAY BE MANY YEARS BEFORE WE CAN TRULY GENERALIZE. IT THEREFORE REMAINS NECESSARY TO EXAMINE EACH NATIONAL ENVIRONMENT. IN 1990 AS IN 1989, FRENCH COMPANIES WERE THE MOST AGGRESSIVE IN EUROPE IN CROSS-BORDER ACQUISITION.¹¹ OUT OF A SAMPLE OF 370 SIGNIFICANT DEALS, FRENCH FIRMS ACCOUNTED FOR

ROUGHLY 20% WITHIN THIS SAMPLE. (SLIDE 13) THE FRENCH EXECUTED 71 TRANSACTIONS VALUED AT 13 BILLION DOLLARS IN PURCHASES WIDELY SPREAD THROUGHOUT EUROPE: FOR EXAMPLE, 17 WERE IN BRITAIN, 12 IN ITALY, 11 IN THE BENELUX COUNTRIES, AND 8 EACH IN GERMANY AND SPAIN. THE LONG LIST OF FRENCH ACQUIRERS INCLUDED RENAULT, ALCATEL, LVMH, ELF AQUITANE, LAFARGE COPPIE, CREDIT LYONNAISE, AND GENERALE DES EAUX. AS TO THE POTENTIAL FOR FUTURE BUY-OUT ACTIVITY, ACCORDING TO ONE RECENT ESTIMATE, THERE IS PRESENTLY MORE THAN 5 BILLION IN CAPITAL AVAILABLE TO FRENCH DEAL MAKERS, WHICH WHEN LEVERAGED, YIELDS BETWEEN 10 TO 15 BILLION DOLLARS IN AVAILABLE FUNDS.¹²

THE SAME REPORT SPECULATED THAT IN ITALY NEARLY 11,000 COMPANIES COULD BE TARGETS OF MANAGEMENT LED BUY OUTS IN THE NEXT FEW YEARS.

(SLIDE 14) UNLIKE FRANCE, SPAIN HAS PRIMARILY BEEN A TARGET OF ACQUISITION FROM OUTSIDE.¹³ 90% OF THE M&A ACTIVITY IN SPAIN HAS RESULTED FROM FOREIGN COMPANIES ACQUIRING SPANISH FIRMS. WHILE DURING 1990 THERE WERE 128 ACQUISITIONS IN SPAIN BY FOREIGN FIRMS, SPANISH FIRMS MADE ONLY 18 CROSS-BORDER DEALS. IN TERMS OF DISCLOSED VALUE OF CROSS-BORDER DEALS, SPAIN RANKED FIFTH AS A SELLER BUT ONLY FIFTEENTH AS A BUYER BEHIND MUCH SMALLER COUNTRIES LIKE NORWAY AND IRELAND. HOWEVER, BY SOME REPORTS IT IS EXPECTED THAT THIS "TRICKLE OF ACQUISITIONS TO DATE WILL BECOME A FLOOD, WITH THE GREATEST ACTIVITY IN THOSE SECTORS OF SPANISH BUSINESS THAT ARE EXPOSED TO E.C. CONSOLIDATION," SUCH AS FINANCIAL SERVICES.¹⁴

IF WE FOCUS FOR A MOMENT ON BANKING AND INSURANCE WITHIN THESE COUNTRIES, EXTENSIVE OVERLAPPING OWNERSHIP ALREADY EXISTS, FOR

EXAMPLE, IN FRANCE THE INSURER, GAN, NOW OWNS BANKS, AND SPANISH BANKS, SUCH AS BANESTO, NOW OWN INSURERS.¹⁵ IN ITALY, THE TREASURY RECENTLY CLEARED THE WAY FOR INSURANCE COMPANIES TO OWN OR CONTROL BANKS BY EXEMPTING INSURERS FROM ANTI-TRUST LAWS.¹⁶ LOOKING AT ITALIAN INSURERS FROM A CROSS-BORDER PERSPECTIVE, IT IS INTERESTING TO NOTE THAT ALREADY 30% OF THE PREMIUM INCOME OF THE ITALIAN MARKET FLOWS TO FOREIGN INSURERS.¹⁷

(SLIDE 15) THE ACQUISITION ACTIVITY BY SCANDINAVIAN BUYERS WITHIN THE E.C. HAS BEEN COMPARED TO A NORDIC INVASION,¹⁸ LED BY SWEDEN, WHOSE TOTAL SPENDING SOARED FROM 1.5 BILLION IN 1989 TO MORE THAN 11 BILLION IN 1990. ABOUT 2/3 OF THIS CAME FROM THREE MEGA-DEALS OF OVER 1 BILLION DOLLARS, VOLVO'S INVESTMENT IN RENAULT AND TAKEOVERS BY STORA AND SCA IN PAPER AND PACKAGING. HOWEVER, THERE WERE ALSO SIGNIFICANT ACQUISITIONS IN THE FINANCIAL SECTOR.

(SLIDE 16) IN RECENT YEARS, THERE HAS ALSO BEEN A GREAT DEAL OF ATTENTION PAID TO POTENTIAL INVESTMENTS IN EASTERN EUROPE. FROM THE STANDPOINT OF POTENTIAL LIABILITIES IT HAS BEEN ASSERTED THAT:

"TO DATE THERE IS NO LAW CONCERNING THE RESPONSIBILITIES, DUTIES OR OBLIGATIONS OF BOARD MEMBERS, MANAGERS AND OFFICERS OF EASTERN EUROPEAN JOINT VENTURES."¹⁹

NEVERTHELESS OF HUNGARY'S SIX INSURANCE COMPANIES, SEVERAL ARE JOINT VENTURES WITH WESTERN FIRMS. ONE SUCH JOINT VENTURE, AB GENERALE, IS 20% OWNED BY GENERALE OF ITALY.²⁰

I HAVE SAVED A DISCUSSION OF GERMANY FOR LAST, BECAUSE RECENT ACTIVITY THERE PERHAPS MOST CLEARLY DEMONSTRATES THE SIMILARITIES AND PROFOUND DIFFERENCES BETWEEN THE AMERICAN AND EUROPEAN M&A ENVIRONMENTS.

IN JUNE OF THIS YEAR, AN AMERICAN FINANCIAL MAGAZINE PUBLISHED AN EXTENSIVE REPORT AND ANALYSIS OF THE EVENTS LEADING UP TO THE ACQUISITION OF THE GERMAN TIRE MAKER, CONTINENTAL, BY THE ITALIAN CONGLOMERATE, PIRELLI.²¹ WITHOUT DWELLING ON THE SPECIFICS OF THE TRANSACTION, THE GENERAL CONCLUSIONS REACHED ABOUT THE GERMAN ENVIRONMENT DESERVE ATTENTION. (SLIDE 17)

1. VOTING RESTRICTIONS DESIGNED TO KEEP AGGRESSORS AT BAY ARE INEFFECTIVE.

(SLIDE 18)

2. TRADITIONAL LEGAL DEFENSE MECHANISMS IMPORTED FROM THE U.S. AND THE U.K. DON'T WORK.

(SLIDE 19)

3. INSTITUTIONAL AND PRIVATE SHAREHOLDERS CAN NO LONGER BE RELIED UPON TO AUTOMATICALLY SUPPORT MANAGEMENT AGAINST UNWANTED SUITORS.

(SLIDE 20)

4. SINCE STOCK IS HELD IN BEARER FORM, LARGE AMOUNTS CAN CHANGE HANDS UNOBSERVED AND DISCLOSURE IS NOT REQUIRED UNTIL A 25% INTEREST IS ACHIEVED. IN ADDITION, THERE IS NO REQUIREMENT FOR A PREDATOR FIRM TO BUY ALL OUTSTANDING SHARES ON EQUAL TERMS.

IN VIEW OF ALL THIS, THE REPORT QUOTED MR. JEREMY LUCAS, A SENIOR

MEMBER OF MORGAN GREENFELLS' M&A TEAM, (SLIDE 21) WHO CONCLUDED THAT "THE PIRELLI AFFAIR SHOWS THAT GERMAN COMPANIES HAVE NO FORMAL DEFENSES."²²

NEVERTHELESS, ALTHOUGH MANY U.S. AND U.K. DEFENSE MECHANISMS DON'T WORK, NEITHER DO SOME TRADITIONAL AGGRESSIVE TACTICS.²³ (SLIDE 22)

1. HIGHLY LEVERAGED TRANSACTIONS ARE DIFFICULT SINCE GERMAN REGULATIONS DO NOT ALLOW THE ASSETS OR CASH FLOW OF THE TARGET COMPANY TO BE USED AS COLLATERAL FOR THE DEBT OF THE ACQUIRING FIRM.

(SLIDE 23)

2. THERE IS NO JUNK BOND MARKET.

(SLIDE 24)

3. THERE ARE A RELATIVELY SMALL NUMBER OF PUBLICLY QUOTED COMPANIES IN GERMANY, APPROXIMATELY 750 VS. 2600 IN THE U.K. AND 5900 IN THE U.S.

(SLIDE 25)

4. MANY LARGE GERMAN COMPANIES ARE INDIGESTIBLE BECAUSE THERE IS NO PROVISION IN GERMAN COMPANY LAW FOR AN ACQUIRING FIRM, EVEN ONE WITH OVER 50% OF THE STOCK, TO SQUEEZE OUT MINORITY SHAREHOLDERS. INVESTORS WITH STAKES OF 25% ARE ENTITLED TO BLOCK KEY DECISIONS SUCH AS CAPITAL INCREASES OR CORPORATE RESTRUCTURING.

BECAUSE OF THIS MOST TRANSACTIONS IN GERMANY REMAIN FRIENDLY, WITH OVER 1000 SUCH DEALS STRUCK DURING 1990, TWICE AS MANY AS 1989, AND THREE TIMES THE ACTIVITY IN 1988.²⁴

IN LOOKING AT GERMANY OVERALL, IT IS SIGNIFICANT TO NOTE THAT A QUARTER OF GERMANY'S TOTAL MARKET CAPITALIZATION IS PRESENTLY HELD BY FOREIGNERS AND IN MANY SECTORS, SUCH AS CHEMICALS, FOREIGN OWNERSHIP IS AS HIGH AS 50%.²⁵

CLEARLY M&A HAS EMERGED AS A POWERFUL FORCE IN RESHAPING THE MARKET VALUES OF PUBLICLY QUOTED CONTINENTAL EUROPEAN COMPANIES. EACH OF THE FOUR GERMAN COMPANIES THAT APPEAR IN THE FINANCIAL TIMES' LIST OF THE TOP TEN EUROPEAN FIRMS, MOVED UP AS A RESULT OF RECENT ACQUISITIONS, THREE HAVING MADE CROSS BORDER MOVES.²⁶

(SLIDE 26)

- ALLIANZ 3.3 BILLION DOLLAR INVESTMENT IN FIREMAN'S FUND IN 1990.
- SIEMENS' INVESTMENT OF 2 BILLION DOLLARS IN PLESSEY IN 1989.
- DEUTSCHE BANKS' 1.5 BILLION DOLLAR MORGAN GREENFELL DEAL.

EXCLUDING AMERICAN ACQUISITIONS AND LOOKING ONLY AT CROSS-BORDER DEALS WITHIN EUROPE, 5 OF THE LARGEST HAVE DIRECTLY INVOLVED FINANCIAL SERVICE FIRMS:²⁷ (SLIDE 27)

AMV OF THE NETHERLANDS WITH GROUP AG IN BELGIUM; NATIONAL AUSTRALIA BANK WITH YORKSHIRE IN THE U.K.; GROUP AMA IN FRANCE WITH LA FONDIARIA IN ITALY; BARCLAYS IN THE U.K. WITH MERCK FINK IN GERMANY; AND FINALLY NORWICH UNION IN THE U.K. WITH PLUS ULTRA OF SPAIN.

HOWEVER, FROM THE STANDPOINT OF INSURANCE, IT MUST BE STRESSED THAT THIS ACTIVITY AND RESULTING EXPOSURE IS IN NO WAY LIMITED TO LARGE FIRMS. IN 1990, NEARLY 45% OF ALL DEALS WERE PRICED AT 15 MILLION

DOLLARS OR LESS AND TRANSACTIONS PRICED AT 25 MILLION DOLLARS OR LESS ACTUALLY CONSTITUTED THE MAJORITY, AT 55%.²⁸

IT MUST ALSO BE RECOGNIZED THAT MANY EUROPEAN FIRMS ARE NOT READY TO OPERATE ON A PAN-EUROPEAN BASIS.²⁹ THESE FIRMS SEE SMALL SCALE CROSS-BORDER ACQUISITIONS AS AN OPPORTUNITY TO EXPLORE THE RISKS AND REWARDS OF WORKING IN OTHER COUNTRIES AND BUILDING DISTRIBUTION NETWORKS. IT IS ANTICIPATED THAT LARGE SCALE CONSOLIDATION WILL FOLLOW WHEN THE BUYERS ARE READY.

(SLIDE 28) THE POTENTIAL PROBLEMS RESULTING FROM M&A ACTIVITY ARE NOT SHORT-LIVED. IN THE UNITED STATES, THE FREQUENCY OF CLAIMS AGAINST DIRECTORS AND OFFICERS IS GROWING AT A COMPOUND ANNUAL RATE OF ALMOST 10% A YEAR.³⁰ THE GREATEST PART OF THIS INCREASE IN FREQUENCY ARISES OUT OF WHAT IS BEING CALLED SECOND GENERATION MERGER AND ACQUISITION CLAIMS. THIS REFERS TO THE ACTIVITY STEMMING FROM PRIOR ACQUISITIONS SUCH AS DIVESTITURE AND RESTRUCTURING, AS WELL AS THE LINGERING AFFECT OF INCREASED CORPORATE DEBT. FROM A POTENTIAL PROFESSIONAL LIABILITY STANDPOINT, IT IS ALSO SIGNIFICANT TO NOTE THAT 78% OF THESE CLAIMS TARGET THE CORPORATION AS WELL.³¹

(SLIDE 29) ALTHOUGH THE EUROPEAN M&A MARKET HAS ENORMOUS AS YET UNREALIZED POTENTIAL, IT IS IN SOME WAYS ALREADY MATURING. THE ALLIANZ, FOR EXAMPLE, IS NOW EXPERIENCING THE SHORT TERM AFFECTS OF ITS ACQUISITION OF FIREMAN'S FUND IN THE U.S. AND WHAT IS NOW KNOWN AS DVAG IN EAST GERMANY. SEVERAL ANALYSTS ALREADY ANTICIPATE THAT THIS YEAR'S UNDERWRITING RESULTS WILL BE A DISASTER. WHILE FIREMAN'S FUND IS EXPECTED TO CONTRIBUTE SIGNIFICANTLY TO THIS LOSS, THE NET LOSS IN EAST GERMANY IS PREDICTED TO BE OVER 300 MILLION

DOLLARS.³² IN ADDITION, THERE ARE REPORTEDLY SERIOUS DIFFICULTIES IN UNRAVELING THE ADMINISTRATIVE AND FINANCIAL ASPECTS OF THE FORMERLY STATE-OWNED INSURER.

A RECENT REPORT SUGGESTS THAT IN THE U.K., D&O DISPUTES ARE ALREADY COMMON AND THAT THE RELATIVE LACK OF CASE LAW IS NOT AN INDICATION OF THE ABSENCE OF A PROBLEM BUT RATHER OF A DESIRE ON THE PART OF DIRECTORS FOR UNPUBLICIZED OUT OF COURT SETTLEMENTS.³³ GOING BEYOND INVESTMENT RELATED LITIGATION, THE REPORT STRESSES THAT THE LEGAL PROCEEDINGS THAT FOLLOWED THE ZEEBRUGGE FERRY DISASTER AND THE KING'S CROSS FIRE HAVE HIGHLIGHTED THE ROLE AND DUTIES OF DIRECTORS. TO FURTHER AGGRAVATE THIS SITUATION, THE 1990'S ARE DEVELOPING AS A PERIOD OF GROWING REGULATORY ENFORCEMENT.

GIVEN THE ENVIRONMENT WHICH I HAVE DESCRIBED, IT IS NOT SURPRISING THAT DEMAND FOR DIRECTORS AND OFFICERS LIABILITY INSURANCE IS REPORTEDLY INCREASING, WITH THE U.K. THUS FAR DEMONSTRATING THE GREATEST INTEREST, AN INTEREST WHICH HAS BEEN FUELED BOTH BY RECENT LITIGATION AND CHANGES IN LEGISLATION. THE 1989 COMPANIES' ACT NOW PERMITS CORPORATIONS TO PAY PREMIUMS FOR D&O INSURANCE ELIMINATING PREVIOUS DOUBT ABOUT WHETHER SUCH PREMIUMS MIGHT BE AN INDIVIDUAL RESPONSIBILITY.³⁴ BY ONE ACCOUNT, OVER HALF OF THE TOP 250 QUOTED COMPANIES IN THE U.K. HAVE COVER IN FORCE.³⁵ THERE IS ALSO INTEREST IN SPAIN, WHERE LAST YEAR THE STOCK EXCHANGE ENACTED NEW RULES ON DISCLOSURE AND IN FRANCE, MEDIUM SIZE FIRMS AS WELL AS LARGE CORPORATIONS ARE REPORTEDLY DEMONSTRATING A DESIRE FOR THIS INSURANCE.

HOWEVER, THERE ARE MANY POTENTIAL COVERAGE ISSUES TO RESOLVE.

(SLIDE 30) PERHAPS THE MOST FUNDAMENTAL IS HOW A POLICY, PROTECTING DIRECTORS AND OFFICERS, IS TO APPLY IN AN ENVIRONMENT WHERE THESE TERMS ARE NOT CONSISTENTLY DEFINED? (SLIDE 31) IS IT POSSIBLE TO WRITE BROAD POLICIES COVERING ALL OF A CORPORATION'S E.C. ACTIVITIES OR MUST SUCH CONTRACTS BE ESPECIALLY TAILORED TO EACH COUNTRY? HOW ARE EUROPEAN AND NON-EUROPEAN INSURERS PROPOSING TO MEET THIS NEW DEMAND? IS THE INSURANCE BROKERAGE COMMUNITY TAKING ANY INITIATIVE?

(SLIDE 32) WHAT ABOUT PROFESSIONAL LIABILITY COVERAGE FOR THE CORPORATION ITSELF? ARE PROFESSIONAL LIABILITY PROGRAMS FOR CERTAIN SEGMENTS OF THE FINANCIAL SERVICE COMMUNITY, SUCH AS ATTORNEYS, ALREADY IN PLACE, OR IN PREPARATION? (SLIDE 33) HOW FAR DOES TRADITIONAL PROTECTION AND INDEMNITY COVERAGE GO TO ADDRESS THIS EXPOSURE? WHAT SPECIAL PROGRAMS EXIST IN CERTAIN COUNTRIES FOR CERTAIN TYPES OF FINANCIAL FIRMS?

(SLIDE 34) WHAT ONE FINDS IS THAT THE RISK MANAGEMENT DISCIPLINE IS NOT YET WELL DEVELOPED IN EUROPE, IN PART BECAUSE IT LACKS OUR PREDATORY LEGAL SYSTEM. HOWEVER, IN THOSE FIRMS WHERE SOPHISTICATED RISK MANAGEMENT IS PRESENT, THE EXPOSURES I HAVE BEEN DESCRIBING ARE RECOGNIZED AND COVERAGE IS BEING PURCHASED. ONE OF THE LARGER BANKS IN THE U.K. BOUGHT D&O INSURANCE FOR THE FIRST TIME THIS YEAR, AND A MAJOR FRENCH BANK NOW MAINTAINS BOTH D&O AND PROFESSIONAL LIABILITY COVERAGE IN A COMBINED PROGRAM. FROM AN AMERICAN PERSPECTIVE, THERE ARE CLEARLY DANGERS IN PLACING D&O AND CORPORATE PROFESSIONAL LIABILITY COVERAGE UNDER THE SAME PROGRAM. WE WOULD AVOID DOING THIS IN THE U.S. BECAUSE OF THE POTENTIAL EROSION OF AGGREGATES AND THE ADVERSE AFFECT OF PROFESSIONAL LIABILITY CLAIMS ON THE D&O RELATIONSHIP. BUT AS THESE EXPOSURES ARE JUST NOW

EMERGING IN EUROPE, IT MAY BE SOME TIME BEFORE AMERICAN PURCHASING PRACTICES MAKE SENSE IN THE EUROPEAN ENVIRONMENT.

AS TO THE PROBLEM THAT THE TERMS DIRECTOR AND OFFICER ARE NOT CONSISTENTLY DEFINED THROUGHOUT EUROPE, INSURERS APPEAR TO BE PREPARED TO OFFER BROAD COVERAGE AT THIS PRELIMINARY STAGE, ALLOWING IT TO BE DEFINED OVER TIME IN THE VARIOUS JURISDICTIONS.

DIRECTORS AND OFFICERS LIABILITY AND CORPORATE PROFESSIONAL LIABILITY IN EUROPE CLEARLY REPRESENT A RISK MANAGEMENT CHALLENGE. HOWEVER, GIVEN THE EMBRYONIC STAGE OF RISK MANAGEMENT DEVELOPMENT IN MOST EUROPEAN FINANCIAL SERVICE FIRMS, IT IS NOT AT ALL CLEAR THAT SUCH FIRMS WILL SEIZE THE PRESENT OPPORTUNITY TO ANTICIPATE THE EMERGING EXPOSURES.

ENDNOTES

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