

WINSTON
& STRAWN
LLP



MANAGING RISK FROM PRIVATE TO PUBLIC

Your IPO and D&O Insurance

SPEAKERS



MIKE BLANKENSHIP

Managing Partner
Houston
+1 (713) 651-2678
mblankenship@winston.com



BEN SMOLIJ

Associate Attorney
Houston
+1 (713) 651-2644
bsmolij@winston.com



AARON W. WALKER

Associate Attorney
Dallas
+1 (214) 453-6536
awwalker@winston.com



KEVIN SMITH

Senior Vice President
+1 (201) 314-0801
kevin.m.smith@nfp.com



MATTHEW SCHOTT

Managing Director
+1 (856) 287-1496
matthew.schott@nfp.com

Agenda

- Directors & Officers Liability Insurance coverage basics
- Shift in personal and corporate liability as a public company
- State of the Directors & Officers Liability Insurance market
- Securities litigation claims trends
- Determining the appropriate limits
- The IPO D&O underwriting process and how to best position your company

Fiduciary Duties of Directors Overview

DUTY OF CARE

Be informed of all material information reasonably available and relevant to the matter at hand

DUTY OF LOYALTY

Act in the best interests of the company and its stockholders while avoiding conflicts of interest and remaining independent of outside influences that could affect business judgment

DUTY OF GOOD FAITH

Subsumed within duty of loyalty and violated by intentionally disregarding known risks or a knowing failure to apply minimum levels of diligence

Duty of Loyalty including good faith and oversight are not exculpated under DGCL section 102(b)(7)

DUTY OF DISCLOSURE In the context of a public transaction, there is also a duty of disclosure

- Duty to disclose fully and fairly all material information within the board's control when it seeks shareholder approval
- The court may also apply the heightened standard of review due to conflicts of interest



Fiduciary Responsibility

- Each Director & Officers stands in a relationship of trust and confidence to the corporation
 - Public
 - Private
 - Non-profit
- Three Basic Duties (“OLD”)
 - **O**bedience
 - **L**oyalty
 - **D**ue Diligence/Due Care

Business Judgement Rule

5 ELEMENTS OF THE BUSINESS JUDGEMENT RULE

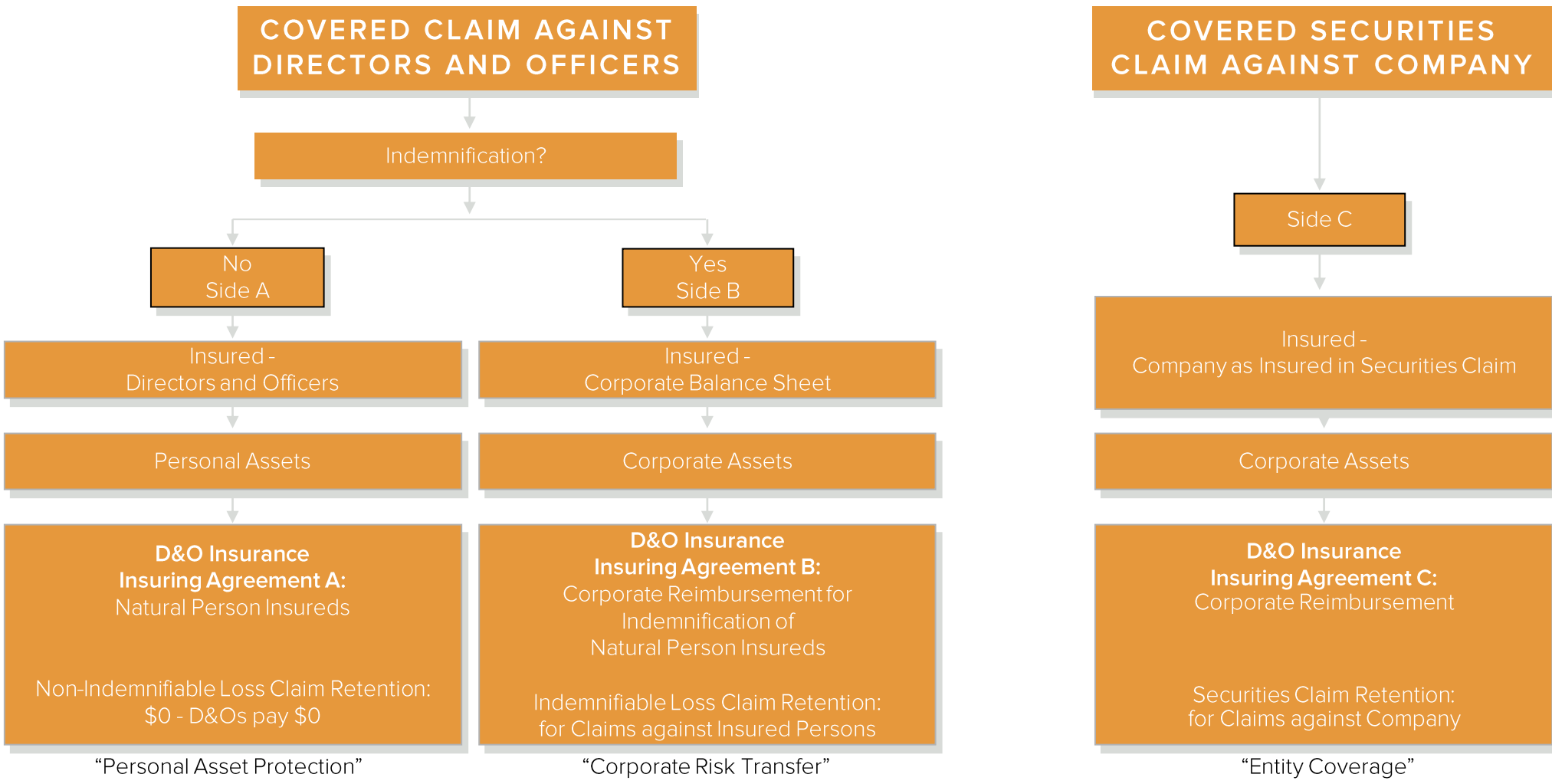
- Business decision – must have a business decision involving a wrongful act or conscious decision not to act (the BJR does NOT protect for their failure to act)
- Disinterestedness – must be disinterested in action, which means no personal gain or self dealing
- Exercised due care
- Acted in good faith
- No abuse of discretion – decisions must be based on a reasonable amount of information – need a rational basis for decisions

THE BUSINESS JUDGMENT RULE PROTECTS DIRECTORS & OFFICERS AGAINST HONEST ERRORS OF JUDGMENT

Limitations on Corporate Indemnification

- Corporation may become insolvent or lack of funds to indemnify
- Derivative action
- Breach of duty of loyalty
- Violations of Federal Laws
- Corporate takeover may change indemnity provisions
- By-laws can change

D&O Program Structure



Public Company D&O Program Mechanics

D&O “Tower”

- Built-in layers with excess markets sitting on top of the primary
- Each layer of Full Coverage shares A+B+C components across one limit

Side A DIC

Provides excess for non-indemnified loss with a drop-down provision

Side A

Provides for directors and officers when indemnification is not provided

No Retention

Side B

Reimburses the company for its indemnity obligations to directors and officers

Retention

Side C

Provides coverage to the entity when named in a securities claim

Hypothetical Claim and How Each Coverage Component Responds

Fact Pattern: Company discloses during their 1st public earnings release that they are going to reduce guidance associated with a new product launch and re-state historical earnings - the stock drops 25% in a single trading day

	Side-A DIC	Side-B	Side-C
Securities Class Action brought against a Director or Officer and the Company <u>is not indemnifying</u> them	Covered	N/A	N/A
SEC and DOJ investigation into a Director or Officer and the Company <u>is not indemnifying</u> them	Covered	N/A	N/A
Derivative Action brought against a Director or Officer which ultimately results in a settlement or judgement	Covered	N/A	N/A
Securities Class Action brought against a Director or Officer , the Company <u>is not indemnifying</u> them and the primary insurer wrongfully denies Side-A coverage	Side-A DIC Triggered	N/A	N/A
Securities Class Action brought against a Director or Officer and Company <u>is indemnifying</u> them	N/A	Covered	N/A
SEC and DOJ investigation into a Director or Officer and Company <u>is indemnifying</u> them	N/A	Covered	N/A
Securities Class Action brought against the Company	N/A	N/A	Covered
SEC and DOJ investigation into the Company	N/A	N/A	N/A

Different Landscape as a Public Company

The requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 can be overly burdensome for companies transitioning from a private company to a public company. As a result, companies exploring the IPO avenue need to ensure that they structure an effective D&O program that will respond accordingly. This also applies to companies taking advantage of the JOBS Act and its relatively less arduous IPO filing requirements. Securities class action investigations and lawsuits are a financial burden to the directors and officers and to the corporation itself. Noteworthy legal exposures include the following:

SECURITIES ACT OF 1933 APPLIES TO OFFERINGS

Section 11 – Imposes strict liability for misstatements in registration statements for public offerings. Reliance, scienter or loss causation are required to be proven in connection with a Section 11 claim.

- Cyan Supreme Court ruling (2018), allowed for concurrent suits in both state and federal court. as a result, this increased overall liability.



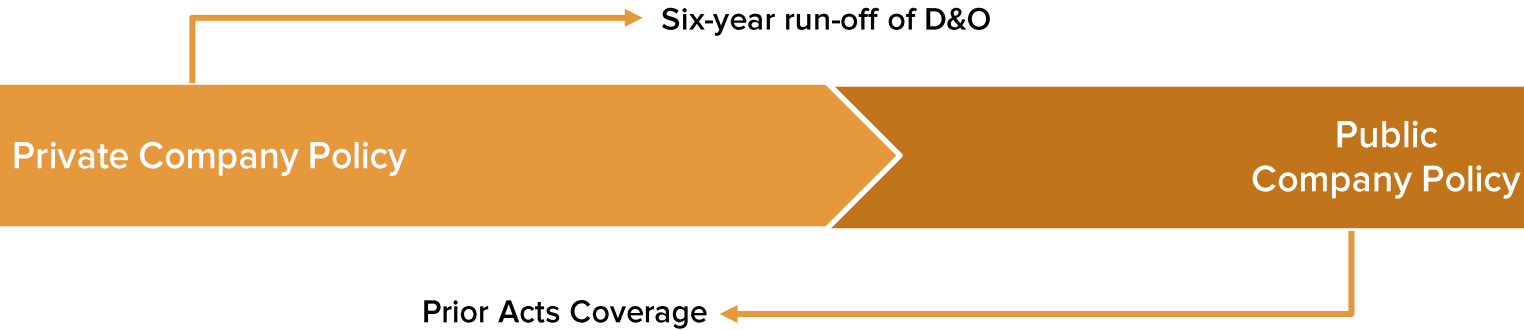
SECURITIES EXCHANGE ACT OF 1934 APPLIES TO ONGOING TRADING

Rule 10b-5 – General anti-fraud provision and creates liability for the “maker” of materially misleading statements or omissions, or manipulative and deceptive devices, in connection with the purchase or sale of a security. In order to establish liability under section 10(b), a plaintiff must prove that the defendant:

- Made a False Statement or Omission of Material Fact
- Made With Scienter
- Made in Connection With the Purchase or Sale of a Security
- Plaintiff Justifiably Relied Upon the Statement/Omission
- Proximately Caused the Plaintiff’s Economic Loss

PRIVATE TO PUBLIC

Directors & Officers Liability Insurance



Considerations for Private D&O Program

- Add or increase Side A DIC coverage if needed
- Evaluate primary carriers for IPO vs. existing carrier line-up
- Negotiate run-off cost
- Review provisions of policy to ensure private company form will cover pre-combination activity, including any business combination related exposures



















Public Company D&O Program Considerations:

- Full prior acts coverage secured for pre-IPO activities with broader coverage for Insured Persons OR straddle language coverage for pre- and post-IPO acts
- Public company program is preserved for more severe public company securities claim exposure including Section 11 claims

General Considerations:

- Companies should strongly consider forum provisions in bylaws, especially DE and CA-based entities
- Public company experience amongst board and/or management teams
- JOBS act filing vs. public prospectus filing
- Potential for direct listing or “de-SPAC” transaction and resulting impact on D&O

Market Update - Directors & Officers Liability

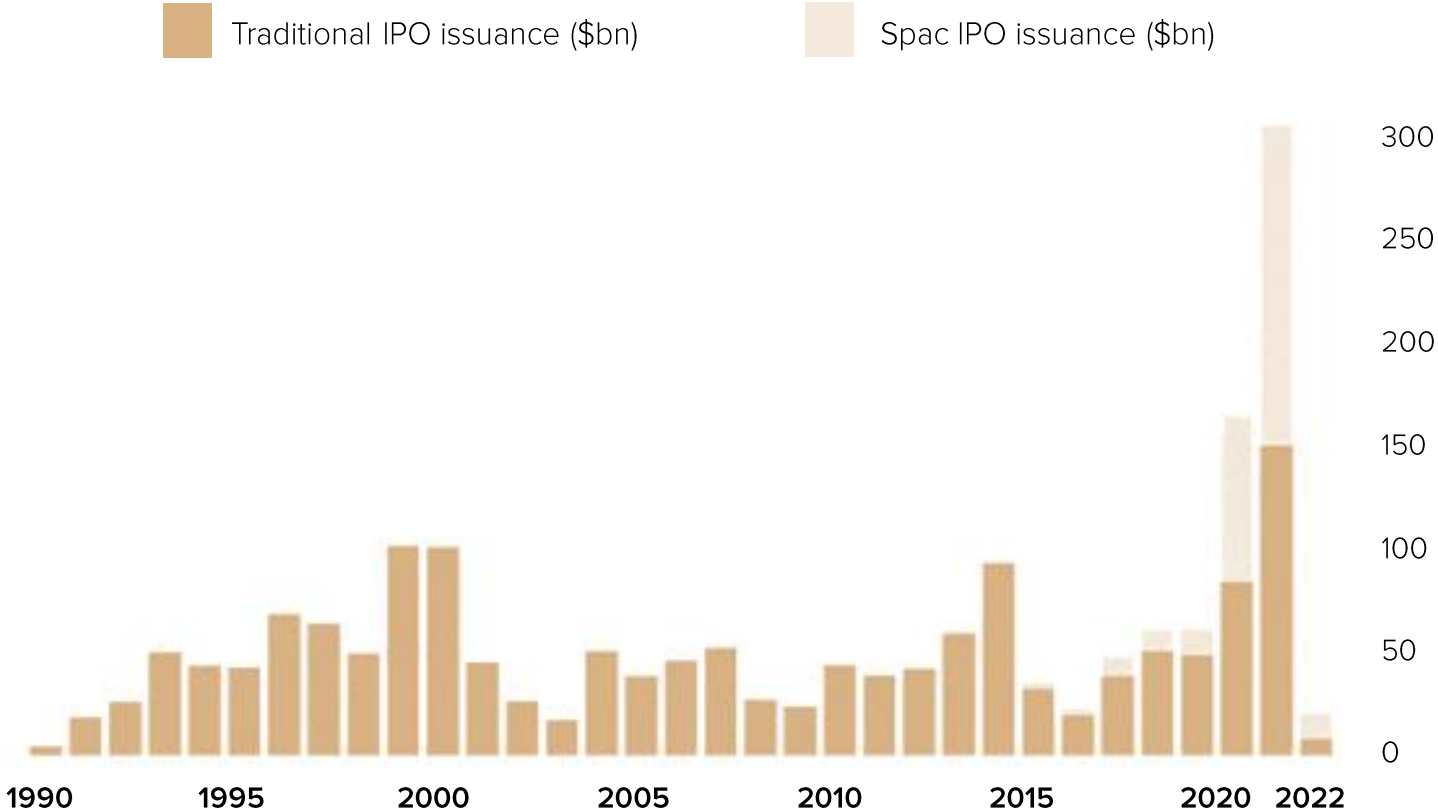
METRIC	Q1 2023 YOY CHANGE	Q1 2023 COMMENTARY	12 MONTH FORECAST	12 MONTH FORECAST COMMENTARY
 <p>Pricing</p>	 <p>-15% to 0%</p>	<p>After a lengthy hard market in the directors and officers (D&O) space, we expect rates for the remainder of 2023 to flatten or decrease over prior year (the latter for those companies that have strong risk profiles and for those companies that took significant increases during the hard market cycle). New capacity has led to increased competition in the space, with carriers offering more competitive terms to either retain business or win new business.</p>	 <p>-15% to 0%</p>	<p>We expect continued pressure on pricing, given the new capacity effect and the reduction in securities class action filings. The slowdown in the IPO and SPAC market has put pressure on carriers' year-over-year growth budgets, and competition has increased across the entirety of the public D&O market.</p>
 <p>Limits</p>		<p>Carriers have been maintaining their average limits deployed for over two years, and we anticipate a stabilization over the next 12 months. In Q4, we did see limit tranches increase, with expiring tranches of \$2.5M moving to \$5M and \$5M moving to \$10M after major reductions in past years. Carriers are still limiting capacity in certain industries, especially on difficult risk profiles such as digital assets, cannabis, IPOs and special purpose acquisition companies (SPAC).</p>		<p>Like we saw in Q4, we expect carriers to maintain and, in some cases, increase their capacity over the next 12 months, using the "more limit, more money" philosophy.</p>
 <p>Retentions</p>		<p>We are starting to see more decreases on retentions given the competitive marketplace.</p>		<p>We expect to see potential reductions in retentions as the competition continues to increase and intensify in the next 12 months. Certain events and classes will most likely maintain their retention levels, such as IPOs, SPACs, digital assets and cannabis.</p>
 <p>Coverage</p>		<p>Breadth of coverage is stable in comparison to prior year and quarters.</p>		<p>Barring any unexpected event-driven occurrences, we expect the breadth and scope of coverage to remain unchanged. We expect appetite for coverage expansion, considering the new capacity trying to get market share.</p>
 <p>Carrier</p>		<p>Capacity continues to be abundant in the public D&O market, which continues to put downward pressure on pricing and retentions. New entrants chasing deals is driving this trend.</p>		<p>The entry of new capacity into the excess market will result in the introduction or reshuffling of carriers onto multilayered programs.</p>
 <p>Claims</p>		<p>We have seen a decrease in the past two years in federal securities class actions. So far in 2023 there have been 42 Subsidiary Controlled Affiliation (SCA) filings, which is down over 2022 filings at this time. With the recent banking crisis, we will be keeping an eye on the SCA filing trends through 2023.</p>		<p>We expect claims volume to increase in connection with increased SEC scrutiny, new regulations in the Insider Trading Prohibition Act and continued focus on environmental, social and governance. Uncertainty in the economy has the potential to lead to increased stock market volatility and bankruptcies.</p>

CLE Code

- CLE Code - 59198
- CLE code forms will be distributed after the webinar
- Please email your forms to Lewis Marin at lmarin@winston.com

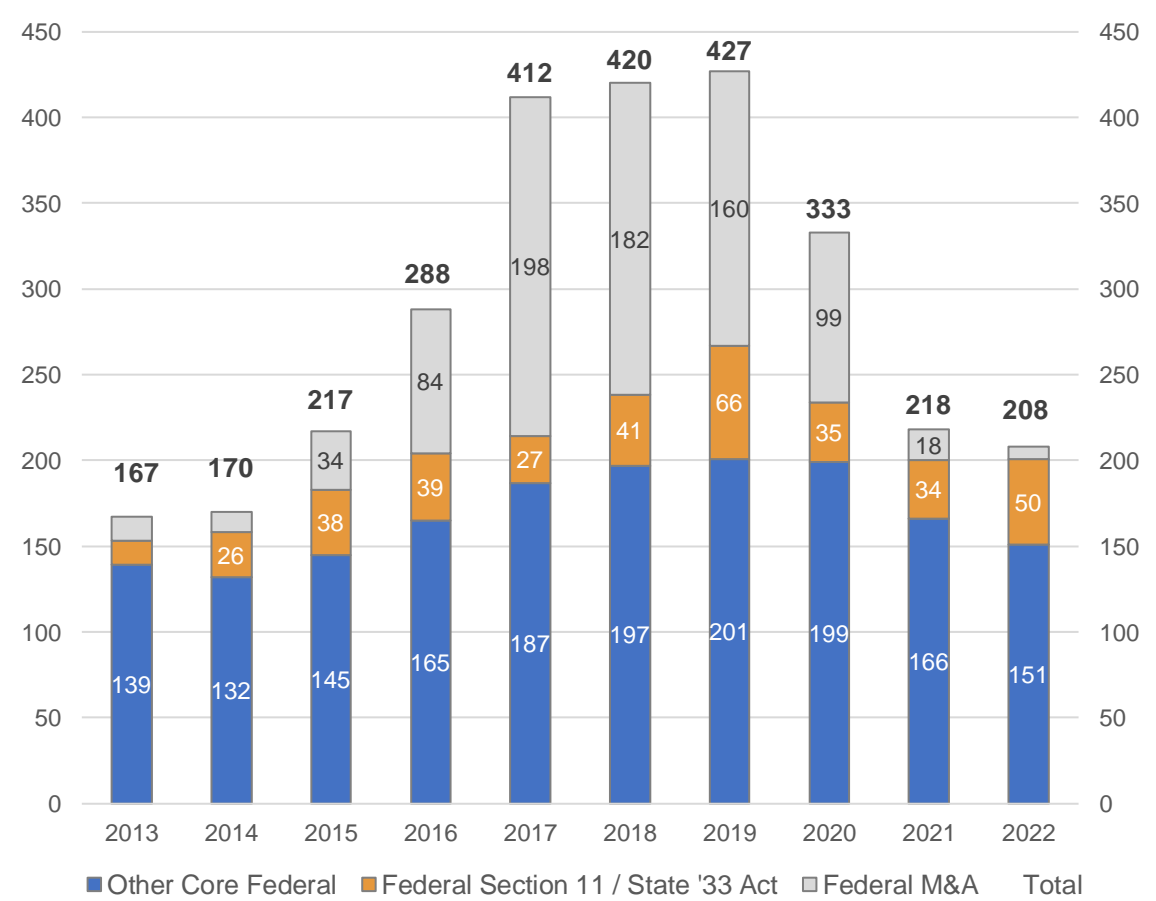
Market Update – Directors & Officers Liability

NASDAQ AND NYSE LISTINGS - IPOS



Securities Litigation Claims Trends

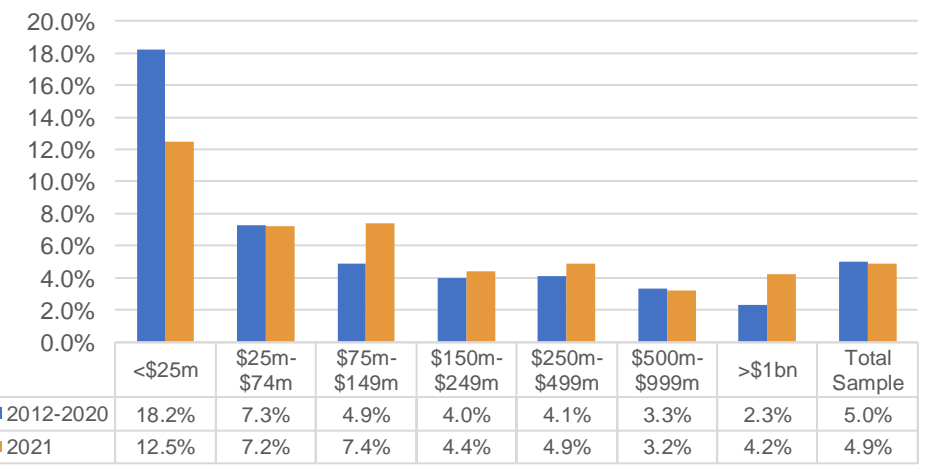
Securities Class Action Filings



SCA Settlement Percentiles

	Average	25th	Median	75th	90th
2017	\$20.4	\$2.9	\$5.8	\$16.9	\$39.2
2018	\$70.0	\$3.9	\$12.1	\$26.7	\$53.0
2019	\$29.7	\$6.0	\$11.7	\$21.2	\$53.0
2020	\$57.1	\$3.5	\$10.6	\$20.9	\$55.7
2021	\$20.5	\$3.1	\$8.3	\$17.9	\$58.6

Median Settlements as Percentage of Damages



IPO FREQUENCY

Securities Litigation Claims Trends

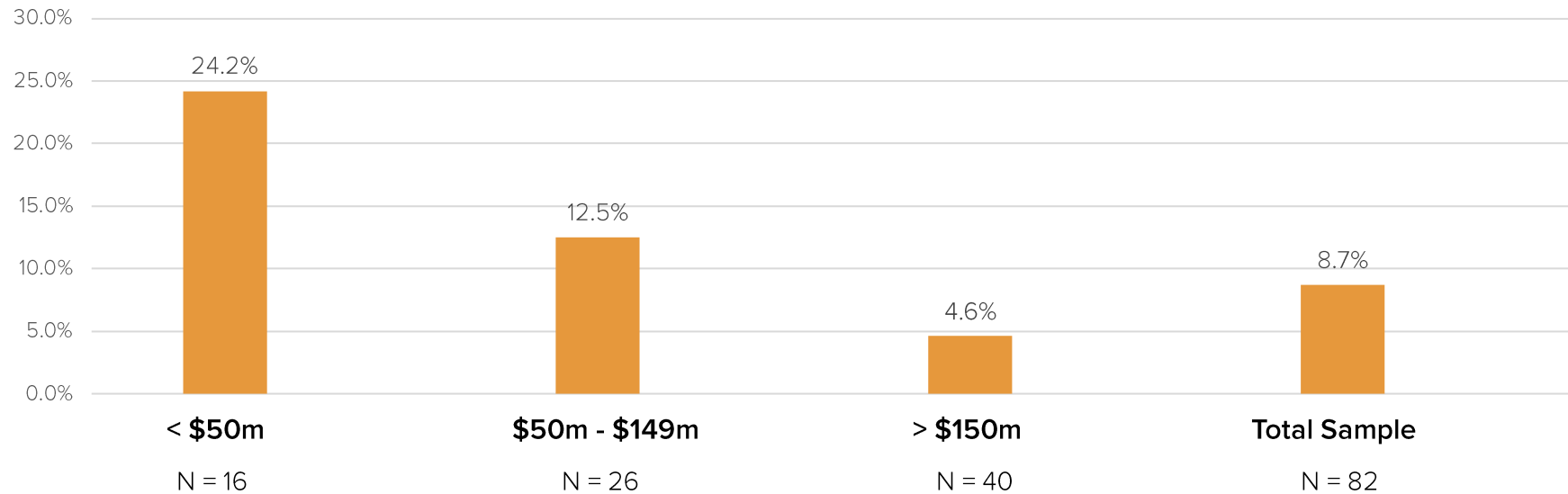
LITIGATION EXPOSURE FOR IPO'S AND DE-SPACS – CORE FEDERAL FILINGS

YEARS SINCE IPO OR DE-SPAC TRANSACTION	IPO EXPOSURE 2019 – 2022		SPAC EXPOSURE 2019 - 2022	
	Cumulative Exposure	Incremental Exposure	Cumulative Exposure	Incremental Exposure
1	8.7%	8.7%	11.1%	11.1%
2	14.7%	6.0%	14.2%	3.2%
3	16.1%	1.4%	16.3%	2.1%

IPO SEVERITY

Securities Litigation Claims Trends

MEDIAN SETTLEMENT PERCENTAGE OF DAMAGE IN '33 ACT CLAIMS 2013 - 2022



JURISDICTION OF '33 ACT CLAIM SETTLEMENTS

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
STATE COURT	1	0	2	4	5	4	4	7	6	6
FEDERAL COURT	7	2	2	6	3	4	5	1	10	3

NFP InSITE Public Company D&O Limit Analysis Model

SAMPLE ONLY

InSITE – Initial Stock Impact Translated to Exposure

- Provides severity metrics for Public Company Directors & Officers Liability
- Applicable to public companies and companies considering an IPO or De-SPAC transaction.
- Utilizes predictive metrics to tailor the severity output to your company’s exposures:

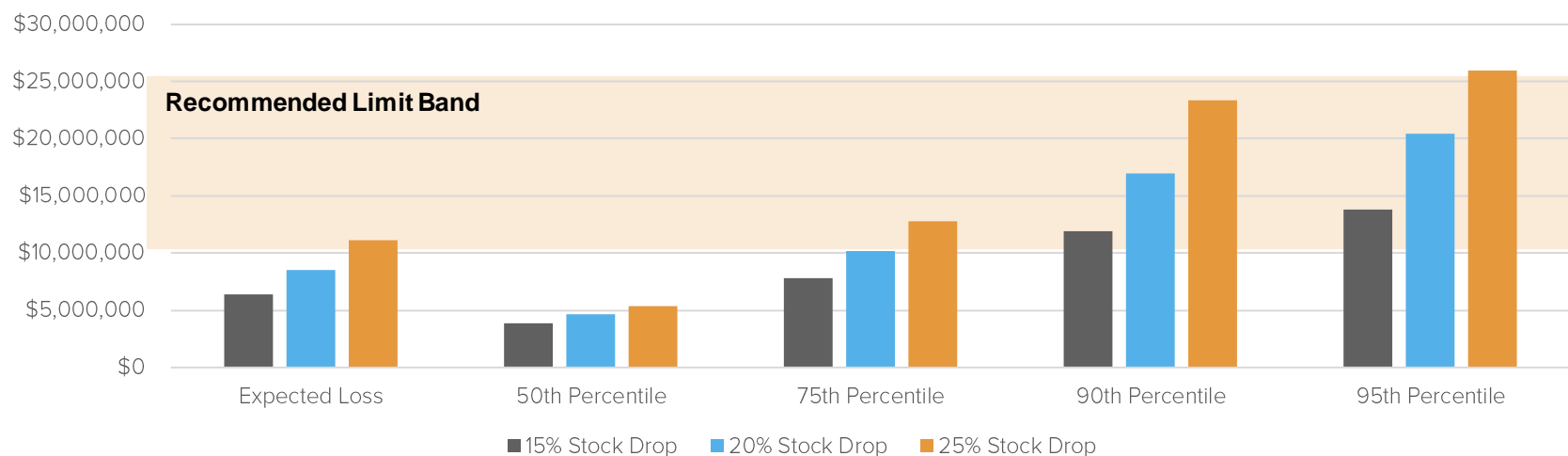
*Market Capitalization |
Industry | Sector |
Jurisdiction |
IPO or Secondary offering
within the prior 3 years*

- Goes beyond peer benchmarking in determining the appropriate D&O limit profile
- Customizable and adjustable in real-time for stress testing

Model Inputs – Predictive Metrics	
Company	xxx
Industry	xxx
Sector	Other
Circuit (Jurisdiction)	2 nd Circuit (NY)
Market Capitalization	\$600,000,000
Recent IPO?	Yes

Hypothetical Stock Drop	15%	20%	25%
Expected Loss	\$6,367,042	\$8,515,735	\$11,096,319
Additional Severity Outcomes			
50th Percentile 1 in 2 Claim	\$3,821,615	\$4,618,554	\$5,355,340
75th Percentile 1 in 4 Claim	\$7,770,518	\$10,196,979	\$12,786,115
90th Percentile 1 in 10 Claim	\$11,887,301	\$16,951,310	\$23,345,271
95th Percentile 1 in 20 Claim	\$13,792,070	\$20,460,650	\$25,964,411

InSITE Public Company D&O Limit Analysis



Peer Benchmarking

SAMPLE ONLY

PARAMETERS

Coverage	Public D&O Coverage - ABC + Side-A	Exposure	Market Capitalization
Company Type	Public	Range	\$500m - \$1bn
Industry	Commercial	Sample	27



Underwriter's Risk Profile Analysis for IPO's

IPO CHARACTERISTICS

- Offering Size
- Expected Market Capitalization
- Selling Shareholders
- Secondary offering within next 12 months
- Lock up duration
- New shares being offered or insiders / sponsors selling
- Classes of stock (voting vs. regular common)
- Makeup of shareholder base
- Float (insiders vs. public shareholders)
- Use of proceeds
- Strength of bankers and outside counsel
- Indemnification obligations to bankers

COMPANY-SPECIFIC ISSUES

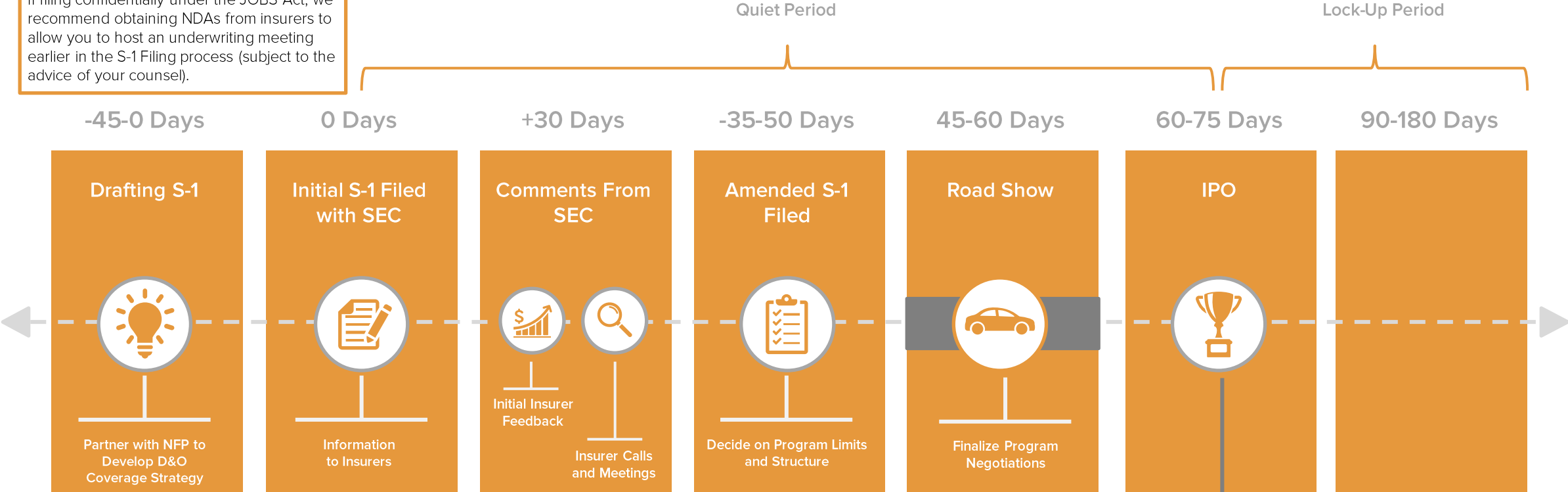
- Financials and access to capital (debt markets)
- Will the Company pursue a credit rating?
- Management's experience, track record and continuity
- Operational differentiators
- Regulatory relationships and track record
- Profitability history
- Revenue diversity
- Industry outlook
- Competitive landscape
- Litigation history
- M&A history and outlook
- Plans to offer guidance
- Exclusive venue in by-laws?

CONTROLS & CORPORATE GOVERNANCE

- Financial controls – Time frame of becoming Sarbanes Oxley compliant
- Internal Audit and relationship with outside auditors
- Disclosure practices
- Insider trading policies – details of any 10(b)5-1 plans
- Ethics policy
- Board composition
- Committee functions
- Outlook for management or board changes
- Compliance program
- Noteworthy related party transactions
- ISS commentary

The IPO Placement Timeline

If filing confidentially under the JOBS Act, we recommend obtaining NDAs from insurers to allow you to host an underwriting meeting earlier in the S-1 Filing process (subject to the advice of your counsel).



Private Company D&O Considerations
 Discuss Run-off Options or Policy Cancellation

- Public Company D&O Considerations**
- Increase Limit
 - Expect Significantly Higher Retention and Premium
 - Purchase Additional Dedicated Side-A Coverage

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