Marsh

D&O coverage considerations before, during, and after an IPO

An initial public offering (IPO) presents many financial benefits, but also materially changes a company's risk profile.

March 2022

The IPO process adds significant exposure to the personal assets of a company's directors and officers and draws increased scrutiny from regulators, plaintiffs' attorneys, and the public. A comprehensive directors and officers liability (D&O) insurance policy is a critical step to effectively manage this risk before and after the offering.

Roadshow risks

The journey from private to public company is fraught with new risks and exposures. Exposure to securities liability typically begins with the company's IPO roadshow, or even as a business makes legal, tax, and operational decisions leading up to it. Investors rely heavily on statements made during roadshow presentations, including information provided within a company's prospectus. Allegedly misleading statements made during this time, or failure to execute the IPO, can lead to claims.

If D&O insurance is in place prior to an offering, this is typically on a "private" policy form and coverage is often tailored to the needs and risks of a private company. Some D&O policies allow for roadshow coverage as part of the base "private company" policy wording. Other insurers, however, specifically exclude this coverage — meaning that the policy form would need to be endorsed. "Failed IPO" coverage is also important should the company be unable to execute the offering. While some insurers may exclude this coverage, others might be willing to add it by endorsement onto a private company D&O policy.

If a company does not have any D&O coverage in place, it should consider partnering with an insurer with appetite for public company exposure to purchase coverage prior to its roadshow and preliminary prospectus filing. It is important for the company and its directors and officers to seek proper advice early on in the process to ensure that their nuanced coverage needs are adequately addressed.

LEGAL BASIS FOR SECURITIES LITIGATION

In Canada, the majority of litigation brought against directors and officers of public companies arises out of actual or alleged violations of the applicable provincial securities act, such as the Ontario Securities Act, as amended by Bill 198.

In the United States, securities litigation is brought against directors and officers on the basis of actual or alleged violations of the Securities Act of 1933 and the Securities Exchange Act of 1934.

Ontario Securities Act and Bill 198

- Section 130 of the Ontario Securities Act lays the ground for civil liability for material misrepresentation in a prospectus. A purchaser of securities has the right to sue for damages regardless of whether he or she relied on the misrepresentation made in the prospectus.
- Section 138 of the Ontario Securities Act defines the limitation period for bringing a claim based on Section 130 (at the earlier of 180 days after knowledge of the facts or 3 years after the date of the IPO).
- Bill 198 establishes a statutory cause of action for persons who acquire or dispose of securities from third parties in the market by granting these parties a right of action for misrepresentation or failure to make timely disclosure regardless of whether or not they actually relied on the misrepresentation or failure to make timely disclosure of any material.

US Securities Act of 1933 and 1934

- Section 11 imposes liability for material misrepresentation in the prospectus.
- Section 12 imposes liability as a seller for misrepresentation in the prospectus or oral communication related to the prospectus.
- Section 13 establishes timelines for bringing actions under 11 and 12. However, this has changed as a result of Sarbanes-Oxley. Claims must be filed within two years after the discovery of the untruth or omission and within five years of the IPO.
- Rule 10b-5 makes it illegal to commit fraud or deceit, or omit to state a material fact in connection with the sale or purchase of securities.

Post-IPO exposures

Public companies are subject to greater regulatory scrutiny than private companies and must comply with extensive securities laws designed to enhance public trust and corporate governance. Disclosure requirements for public companies can create significant liability. All statements made during a roadshow or contained within the prospectus and any subsequent public disclosures of material information should be carefully considered and reviewed by outside counsel.

One of the biggest IPO risks is stock underperformance after listing, which can lead to lawsuits against the company and its directors and officers alleging mismanagement and misrepresentation in the prospectus, among other claims. Any material misrepresentation — even if negligently made — could form the basis of liability against a corporate director and officer.

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

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

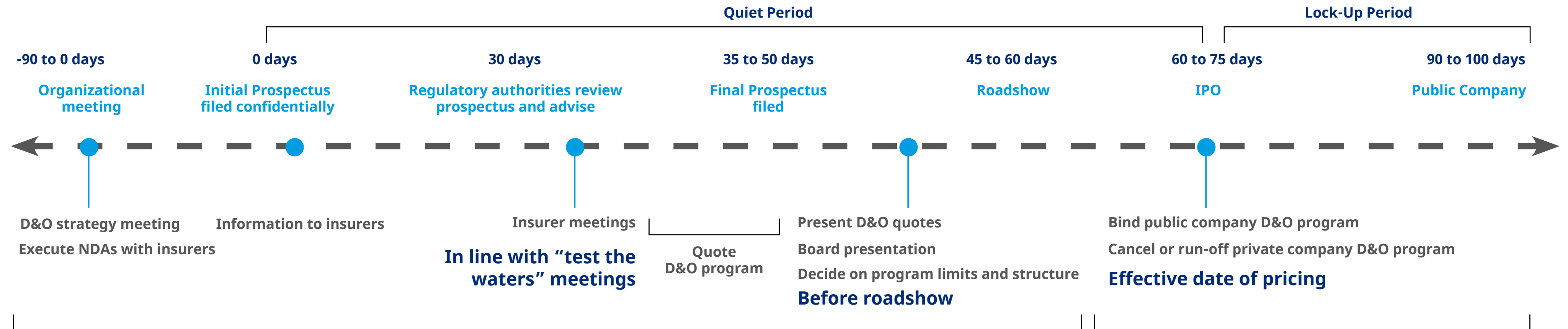
- Accounting restatements.
- Earnings failing to meet projections.
- Announcement of products or services failing to perform as expected or being delayed.
- Investigations by the provincial regulators into corporate conduct or that of individual directors and officers.
- Internal investigations based 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 process (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, risk professionals should work with their insurance advisors to:

- Assess limits needed and optimal program design based upon tailored benchmarking and securities class-action claim modeling.
- Differentiate the company’s risk profile, highlighting positive underwriting characteristics to help set it apart from competitors.
- Prepare for meetings with potential insurers (including global markets) using the draft prospectus and latest financial statements.
- Negotiate, evaluate, and select D&O program structure, including consideration for international exposures.
- Prepare and present the D&O program to the company’s board/audit committee.
- Ensure proper placement of coverages for ancillary lines, such as cyber, employment practices liability, fiduciary liability, and crime.
- Conduct a midterm stewardship meeting with both the underwriting and claims teams from the primary insurer.

01| D&O coverage timeline during an IPO



Private company D&O considerations:

- Roadshow coverage.
- Failed IPO coverage.
- Partner with carrier with appetite for IPOs.
- Discuss run-off or policy cancellation and unearned premium treatment.

Public company D&O considerations:

- Increase limits.
- Expect higher retentions and premium.
- Purchase dedicated Side A coverage.
- Maintain continuity date of private company limit.
- Purchase standalone EPL, fiduciary, and crime.
- Review international exposure (locally admitted D&O policies).

Although warranties are currently waived, this may change.

About Marsh

Marsh is the world's leading insurance broker and risk advisor. With around 45,000 colleagues operating in 130 countries, Marsh serves commercial and individual clients with data-driven risk solutions and advisory services. Marsh is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. With annual revenue nearly $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. For more information, visit marsh.com, follow us on LinkedIn and Twitter or subscribe to BRINK.

Marsh is a business of Marsh McLennan.

This document and any recommendations, analysis, or advice provided by Marsh (collectively, the "Marsh Analysis") are not intended to be taken as advice regarding any individual situation and should not be relied upon as such. This document contains proprietary, confidential information of Marsh and may not be shared with any third party, including other insurance producers, without Marsh's prior written consent. Any statements concerning actuarial, tax, accounting, or legal matters are based solely on our experience as insurance brokers and risk consultants and are not to be relied upon as actuarial, accounting, tax, or legal advice, for which you should consult your own professional advisors. Any modelling, analytics, or projections are subject to inherent uncertainty, and the Marsh Analysis could be materially affected if any underlying assumptions, conditions, information, or factors are inaccurate or incomplete or should change. The information contained herein is based on sources we believe reliable, but we make no representation or warranty as to its accuracy. Except as may be set forth in an agreement between you and Marsh, Marsh shall have no obligation to update the Marsh Analysis and shall have no liability to you or any other party with regard to the Marsh Analysis or to any services provided by a third party to you or Marsh. Marsh makes no representation or warranty concerning the application of policy wordings or the financial condition or solvency of insurers or re-insurers. Marsh makes no assurances regarding the availability, cost, or terms of insurance coverage.

Copyright © 2022 Marsh Canada Limited and its licensors. All rights reserved. www.marsh.ca | www.marsh.com 663384386