

Client Alert:

Considerations for High Growth / Pre-Initial Public Offering Companies

In any given year, many private companies are evaluating the potential transition from private to public ownership. An Initial Public Offering (“IPO”) comes with a myriad of financial and operational concerns, ranging from public disclosure requirements, to additional regulatory/compliance infrastructure, to confidentiality and trade secret concerns. One potentially under-appreciated area for consideration, for those companies considering an IPO, is Directors’ & Officers’ Liability Insurance (“D&O”). Recent claims trends and the March 2018 US Supreme Court’s decision in *Cyan*, emphasizes the need to approach the D&O insurance topic with great diligence, and to obtain maximum protection for a company and its key executives. At Aon, we have considerable experience helping clients navigate these dynamic and challenging considerations. In our experience, key topics for careful review include the following.

D&O Insurance

Road Show Exposure and the Transition to a Public Company

Beginning at the “all hands” initial kick-off meeting and through the road show, company executives are making decisions and representations that could create liability exposures. The private company D&O policy, which almost certainly excludes public securities claims, should not be so restrictive as to exclude pre-IPO preparatory and “road show” activity. Additionally, pre-IPO private company policies should contain carve out language for “failure to launch” claims. The transition to a public company will also require clear policy language that determines how pre and post-IPO allegations are addressed. Detailed negotiations of the “tail coverage” and “prior acts” coverage are critical to providing the appropriate protections for both the respective former private company and new public company Boards and executives. IPO candidates should ensure that their current private company D&O program, with regard to terms, structure, and limits, provides the necessary pre-IPO coverage to provide a seamless transition to public company status.

Insurance Carrier Selection

The relationship with the insurance companies that have determined they will underwrite your risk and those that you have chosen to partner with will be one of the most crucial decisions in the placement of your public company D&O program. The partnership between the insurer and the insured is as important on the claims side of the business as it is on the underwriting side - not only the insurer’s ability to pay, but also their willingness to pay is critical. Further, recent severe restrictions in IPO appetite by many leading D&O insurers have further complicated what historically were already challenging D&O placements, making access to global insurance marketplaces (such as Bermuda and London) critical. IPO candidates should inquire whether their broker has direct access to all leading D&O insurers with current IPO interest, as well as whether their broker utilizes a quantifiable method, such as Aon’s proprietary FSG Annual Carrier Matrix, to evaluate an insurer’s underwriting and claims behavior. Tools, such as the FSG Annual Carrier Matrix, are just one of several data driven modules that Aon utilizes to assist its clients in program design decisions.

We're Here to Empower Results

If you have any questions about your specific coverage, or are interested in obtaining coverage, please contact your Aon broker.

www.aon.com

Coverage Terms

Ensuring breadth of policy terms is perhaps the most critical component to a public company D&O insurance program placement. Maximizing coverage in the event of a claim is rooted in contract certainty and broadest and best in class terms and conditions. Unfortunately, inexperienced D&O practitioners can lead to debilitating coverage gaps and exclusions. It takes an IPO-experienced and detail oriented brokerage tactician to obtain critical coverage enhancements. Coverage topics such as straddle claims, definition of Loss, and E&O exclusions can be the difference between maximizing policy proceeds and an outright claim denial. The D&O program coverage negotiations are multifaceted – the negotiations are not limited to the primary layer of insurance, but rather, involve numerous layers of negotiations with your excess insurers, including importantly your Side A insurers. IPO candidates should partner with detail-focused D&O professionals (which can include both brokers and outside counsel), to ensure maximum coverage.

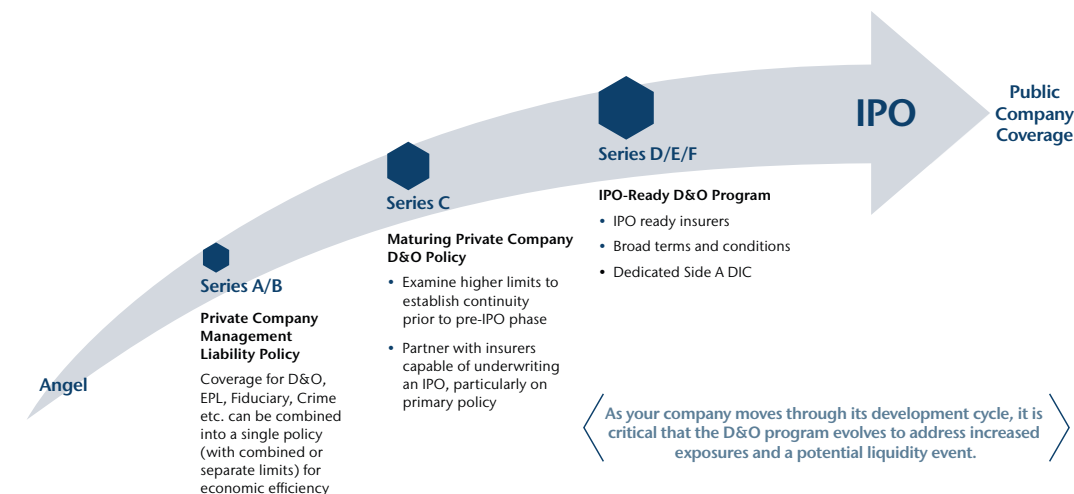
Policy Structure

Public company D&O insurance can be markedly different, structure-wise, than private company D&O insurance. Two very common examples include the separation of limits (i.e., the D&O is no longer tied-to other management liability coverages, such as employment practices and crime) and the addition of dedicated Side A Difference in Conditions (“DIC”) insurance. Additional structural considerations, such as entity investigative coverage, the inclusion of DIC limits within the “A/B/C” tower, and the decision to run-off prior coverage or maintain continuity of a program are all structural items of critical importance to review prior to an IPO. IPO candidates should weigh the pros/cons of each approach, and select a program structure that aligns with their unique risk factors and corporate purchasing philosophy.

IPO Insights Conceptual Program Lifecycle

Matching development stage needs to program structure

- With investment by the venture capital community, most portfolio companies are requested to procure D&O coverage.
- As the company develops further, it needs to ensure the insurance program evolves with the strategic direction of the company.
- As the company approaches a possible IPO, it will seek board members to govern the public offering and address corporate governance requirements.
- A strong D&O program is critical to this process



Limits

Limits selection is not a “one-size-fits-all” question, and can be influenced by various factors including: expected offering size/market cap, industry risk factors, historical claims activity, merger/acquisition exposure, bankruptcy risk, a company’s risk retention capacity, limits availability relative to budget, and board directives. Aon has several proprietary tools to assist clients in making informed decisions around the appropriate limits to purchase at the time of your offering. Aon’s proprietary data driven tools include robust peer benchmarking that can be customized by industry, market capitalization, revenues, or employee count; stock price analysis looking at pricing highs and lows during a certain historical time period; and claims data, engineered by historical settlement in industry and market capitalization. Also Aon utilizes our own client centric individually customized actuarial model (“D&O Insights”) to help clients evaluate limits adequacy. IPO candidates should partner with a broker well-versed in such analyses, and involve all relevant stakeholders to determine appropriate limits.

Pricing

Undoubtedly, many insureds experience “sticker shock” when contemplating the potential cost of a post-IPO D&O program. This is particularly true in the post-Cyan world as D&O Insurers consider separate state court retentions and pricing commensurate with increased ’33 Act state court exposures. IPO candidates should prepare senior management and the Board to anticipate a meaningful change as compared to the private company program with regard to D&O premium. Candidates should also work closely with their broker to align strategies to maximize the return on this premium. These strategies can include proactive meetings with key national decision-makers at leading D&O insurers, risk/retention analyses with regard to potential retention levels, and competition via access to national and international D&O insurers. Partnering with a broker that has a proven ability to “make a market” with regard to competitive D&O pricing is crucial to maximizing the marketing opportunity and obtaining competitive pricing results.

International

While this topic is germane to both public and private companies, the IPO process can be a catalyst to review broad D&O topics, including the need for locally-admitted policies. In many countries, non-admitted insurance is problematic, and would not be permitted to respond in the event of a claim

in such a country. Particularly for D&O insurance, which is intended to help protect individuals’ personal assets, the certainty of available coverage within problematic countries is critical. All companies, particularly IPO candidates, should consider their international exposures and implement locally-admitted policies as needed. Aon’s global footprint and local offices in 120 countries allows us to support our clients’ risk needs in nearly every corner of the world.

Other Considerations

At Aon we are consulting our clients on a holistic approach to the IPO transition - D&O insurance is not the only risk management and human capital topic that IPO candidates should consider. Related considerations include:

- **Compensation & Rewards:** Executive compensation and employee benefits can differ significantly as a public company. Distinct groups within Aon, such as Aon Strategic Advisors, and Radford, can assist with the evaluation of your company’s compensation and rewards design as it transitions to public equity.
- **Cyber:** “Cyber Risk is D&O Risk,” and the examples of public companies experiencing D&O claims arising out of cybersecurity incidents are growing. Particularly following the May 2018 implementation of the European Union’s General Data Protection Regulation (“GDPR”), a robust cybersecurity program, including cyber liability insurance, is paramount.
- **Employment Practices Liability (“EPL”):** “EPL Risk is D&O Risk,” and numerous companies have experienced D&O litigation following various harassment allegations corresponding with the #metoo movement. IPO candidates are advised to not only ensure robust anti-harassment policies and controls, but also to ensure that the corporate EPL insurance program meets the company’s risk tolerances and exposures.

Conclusion

An IPO is an exciting, but challenging time, for corporate issuers and their leaders. Partnership with subject matter experts across several disciplines, such as accounting, finance, legal, and insurance can help a company execute a successful transition to public equity. Aon is well experienced and uniquely positioned to help clients address IPO-specific challenges across D&O insurance, as well as, related topics such as Compensation & Rewards, Cyber, and EPL.