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PRESS RELEASE

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LADDERING CLAIMS

Laddering claims have been whispered about as a potential problem for D&O insurers and reinsurers since they were first brought to light in an article in the Wall Street Journal on 6 December 2000. However, it is only recently that the potential exposure of reinsurers has become apparent. Reinsurers liability to these claims will of course depend on the terms of the reinsurance and insurance coverage provided. There are, however, a number of general issues which all reinsurers facing potential laddering claims should consider in order to mitigate their exposure.

Laddering claims arise out of the boom in Initial Public Offerings ("IPOs") in the late 1990s fuelled by the high-tech bubble and increased stock market speculation. The label "laddering" describes one particular type of claim, namely the practice of investment banks, as a condition for allocating shares in one IPO, to require investors to participate in another IPO. Hence the investor climbs another rung on the ladder of IPOs. Laddering, however, has become a more generic label for a number of other claims arising from IPOs concerning the payment of undisclosed commissions to investors in exchange for preferential share allocation or obliging investors to purchase further shares in the issuing company after the launch of the IPO. The common factor of laddering claims is that they concern the creation of a false market for shares. This has given rise to claims by investors and regulatory actions against issuing companies and investment banks.

These actions are being progressed in the US courts in various stages and a number of confidential settlements are reported to have taken place to limit the exposure of issuing companies and investment banks to these claims. In addition, coverage litigation has also taken place between issuing banks and their D&O insurers in order to determine the existence and scope of cover for claims. The guidance given so far in these cases has highlighted that there are likely to be a number of coverage issues. For example, will the deliberate fraud of the directors and officers of an investment bank or issuing company be covered under the underlying policy? Will it in fact be possible to identify and obtain judgments in respect of such deliberate acts? What losses should be covered under D&O policies? In cases where issuing companies or investment banks are not only paying investor claims but also civil penalties and returning secret profits, will these be covered by a D&O insurer? Will D&O insurers be liable for an insureds defence costs?

For reinsurers there are a number of additional issues to consider. A reinsurer will first have to estimate its exposure. Reinsurers may be exposed to laddering claims on several different policies. They may even find themselves covering the same claim several times on different reinsurance and insurance policies. Reinsurers may, for example, be looking at claims on the same policies in respect of Enron and Worldcom and will need to reserve against these potential liabilities.

Reinsurers should consider whether or not they will be obliged to indemnify their reinsureds in instances where reinsureds or insureds have entered into settlements. The presence or indeed the lack of a "follow settlements" clause could be crucial to determining or limiting liability. In addition, reinsurers should look at claims control clauses to establish whether they can influence the conduct of reinsureds in dealing with these claims. Reinsurers should also be aware of the choice of law clauses in both reinsurance and insurance policies as coverage disputes may be determined differently in the UK and the USA.

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