

Boardroom Summary

Boardroom Summaries are designed to give directors and executives a quick appreciation of new or changing issues and regulations that affect themselves or their companies.

The text on the left provides a broad overview of the subject, with additional information on selected areas being provided in the coloured band.

Public Offering of Securities

DISCLAIMER

This Boardroom Summary aims to give you an overview of the effect that UK legislation could have on businesses raising capital by prospectus, and possible insurance protection that is available. It is not offered as advice on any particular issue and should not be considered as such. Therefore you should not act or refrain from acting without taking professional advice on the particular facts or circumstances which affect you.



Raising Capital in a Risky World

Would be investors and analysts have always scrutinised the prospectuses of companies raising capital for MBOs, stock exchange listings, mergers, expansion and so forth. And that scrutiny does not stop once the transaction has been completed. Stakeholders and potential investors want to know how well their money has been invested - and in an unforgiving recessionary environment, there are no buoyant equity markets to conceal underperformance.

In times like these, the issuing companies' underlying performance is truly exposed. Meanwhile (inspired by huge exemplary actions in the US) shareholder litigation in the UK continues to grow. The need for specialist insurance protection for the issuers of securities has never been greater - and **yet alarming numbers of public offerings go ahead without suitable protection for directors, officers, issue underwriters and professional advisors.**

Risky business

UK legislation (see box) spells out the possible liabilities of those people responsible for the prospectus to anyone who buys the securities and who loses money as a result of **untrue or misleading information** contained in the prospectus. Several immediate points comes flow from this:

1. The liability is potentially huge. This is because it can take the form of compensation for losses sustained, and of course the amounts of money involved in capital raising transactions are considerable (around £25bn was raised in new capital in 2000 on the London Stock Exchange alone)
2. There is a wide range of possibilities for "untrue or misleading information" (see box) particularly in view of the requirements for trend and forecasting information about the issuing company
3. • Individuals who sign the prospectus
 - Each and every director of the entity
 - The issuer of the securities
 - Everyone who has authorised themselves to be named in the prospectus
 - Everyone who has authorised the contents of any part of the prospectus
4. Actions can be brought some time after the securities issue. In fact up to 6 years after the transaction in the UK and up to 3 years after the transaction in the US. Actions like these can (and do) follow individuals - even into retirement.

RELEVANT LEGISLATION

The criminal and civil exposures for the accuracy of the content of a prospectus are defined in the **Public Offers of Securities Regulations 1995** and from December 2001 the **Financial Services and Markets Act**.

COMPENSATION AND OFFENCES

The Public Offers of Securities Regulations explain how "the person or persons responsible for a prospectus or supplementary prospectus shall be liable to compensation to any person who has acquired the securities to which the prospectus relates and suffered loss in respect of them as a result of any untrue or misleading statement...or the omission from it of any matter required to be included"

The Financial Services and Markets Act provides for 2 criminal offences concerning misleading statements - punishable by a fine and **up to 7 years imprisonment.**

The 1st offence is where a misleading statement, promise or forecast is deliberately or recklessly made, or facts concealed to try and induce someone to act (or not to act) in relation to a investment.

The 2nd offence is the creation of a misleading impression about an investment

FORM AND CONTENT OF THE PROSPECTUS

The regulations are quite precise about the information required in a prospectus covering :

- General Requirements (including names and addresses of issuer directors)
- Responsibility for prospectus and advisors (including a declaration by the directors)
- The securities being offered (including the purpose for which the securities are being issued and the expected proceeds)
- General information about the issuer (such as indications of any people who could exercise control over the issuer)
- The issuers' activities (including any exceptional influencing factors)
- The issuer's financial position
- The issuer's management (including directors' service contracts and remuneration)
- Significant trends affecting the business since last full year and information about issuers future "prospects"

Public Offering of Securities Insurance (POSI) addresses all 4 of these threatening issues.

POTENTIALLY HUGE LIABILITIES

- Some issuers arrange insurance protection for their prospectus related exposures, by simply extending their D&O policies. But we strongly recommend that a standalone POSI product with a suitably constructed limit is put in place. **This ringfences the large exposure, that could exhaust the cover available under a D&O policy.**

WIDE RANGE OF EXPOSURES

- **POSI covers all liabilities relating to the prospectus, and beyond.** POSI also covers liabilities relating to prior negotiations, discussions and decisions in connection with the offering. It also provides punitive and exemplary damages with "most favourable law" language

MANY INDIVIDUALS EXPOSED

- POSI is a flexible product that is **tailored around the particulars of the transaction.** So cover can be extended to the issue underwriters, the selling shareholders, and professionals involved in preparing the prospectus such as accountants, solicitors and consultants

LONG TAIL EXPOSURES

- POSI is a transaction specific product. It is unlike conventional insurance products that typically last for a year then have to be renewed. POSI is only purchased once for the specific transaction, and **its protection lasts as long as the residual exposure remains - ie the statute of limitations which is up to 6 years in the UK.**

The POSI premium can be capitalised and offset against float proceeds

Accounting rules allow for the POSI premium to be capitalised and deducted from the issue proceeds and as such the premium does not have to be seen as a bottom line deduction from the profit and loss account.

PTO for the **implications** for businesses and directors

ACTUAL INCIDENTS

These exposures are not merely theoretical. Here are some recent examples of the kind of prospectus related claims increasingly made in the UK:

OVERSTATEMENT OF REVENUES

An interactive services group raised £30million on the AIM in March 2000 achieving a market value of £150M shortly after the listing. In February 2001 shares were suspended once it was discovered revenues had been massively overstated in the prospectus. An investigation found substantial overstatement of registered users, page impressions and revenues. As a result the CEO and 2 other managers have resigned and an investigation is being carried out by the SFO. Since relisting the company was valued at a mere £8M a fraction of the £153M peak. A group of 140 shareholders has engaged solicitors to investigate the possibility of a claim against directors following allegation of accounting irregularities

MISREPRESENTATION IN PROFIT FORECASTS

Shareholders were recently awarded £4.5M after successfully settling a claim under the Financial Services Act. It was established that the Particulars of a £20.6M capital raising contained, what was later found out to be falsified profit forecasts

MISREPRESENTATION OF RISK FACTORS

A shareholder derivative action is being pursued in relation to an IPO alleging misrepresentations, breach of fiduciary duty and non-disclosure of certain risk factors in the Company's flotation prospectus. Since the company floated raising £50M the company has been forced to issue 3 profit warnings and been the subject of investigations by the DTI and FSA. Concerns have been raised that certain miscalculations that have been disclosed as part of the profit warnings could have been forecast when the company floated.

Who can buy a POSI?

POSI is designed for any company that is raising capital through the publication of a prospectus and the sale of unlisted securities. POSI provides cover for open, placing and introductory offerings, secondary offerings and can also cover private placements. POSI can be tailored to different sizes of offerings from placements on the New York Stock Exchange (where capital raised averages around £300m per new listing) to issues on Offex or AIM (where the average is around £3m).

“**The prospect of losing the hard-won proceeds of a securities issue to a shareholder action should mean that a decent risk transfer mechanism in support of a securities issue is an absolute pre-requisite as far as the board and their advisors are concerned**”

Details of the Public Offers of Securities Regulations 1995 are available from the stationery office's website at www.hms.o.gov.uk the Financial Services and Markets Act is available from www.fsa.gov.uk

AIG UK is one of the largest companies in the UK specialising in the commercial lines insurance market. We are proud to include over half of the UK's top 1,000 companies among our clients.

Our wide and innovative product range includes Public Offering of Securities Insurance for directors, advisors and other prospectus signatories.

For more information e-mail: marketing.uk@aig.com

POSSIBLE IMPLICATIONS FOR BUSINESSES AND DIRECTORS

It might not even be you!

The directors of the issuing company retain joint and several liabilities for false, misleading statements or omissions. The actions or statements of a single director can bring down shareholder retribution on the board as a whole - years after the transaction. This in itself is a powerful reason for making sure that properly constructed insurance protection is implemented alongside the transaction.

"Reckless" vs. dishonest

Although there is an obvious distinction between deliberate and dishonest representation and reckless speculation, both can eventually result in an action against the issuers of the prospectus. It is not difficult to envisage scenarios involving the latter, particularly in the context of high growth stock. As the spectacular rise and fall of many dot com enterprises has shown, what may once have appeared to be a justifiably bullish forecast, can with 20-20 hindsight be judged wildly optimistic and unsubstantiated.

Exposing the float proceeds?

The prospect of the hard won proceeds of a securities offering being lost to a shareholder action is another powerful reason why robust insurance protection should be established alongside the transaction. AIG's durability and rock solid financial security is another good reason for entrusting the company with the liability insurance in respect of these unusually large, longer term exposures.

The criminal threat makes a top defence essential

Not every claim or action by aggrieved shareholders results in a prison sentence. But it goes without saying that fast and expert defence counsel is essential for the directors of securities issuers. Our panel of legal experts have great experience in these issues.

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