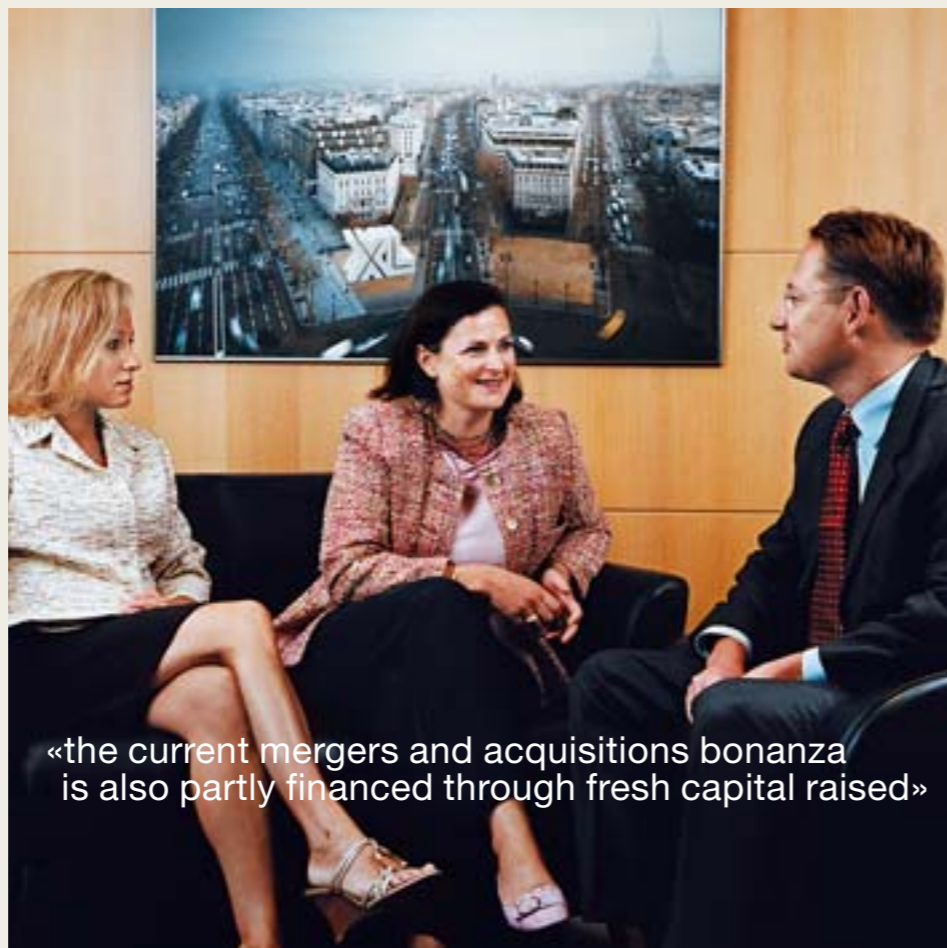


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«the current mergers and acquisitions bonanza is also partly financed through fresh capital raised»

## THE DARK SIDE OF THE BOOM

### With the rush to IPOs it's time to look at the pros and cons

- July 2005: The Initial Public Offering (IPO) of Gaz de France, the world's largest IPO in three years, is 27 times oversubscribed; shares open 20% up upon market debut
- April 2006: Wacker Chemie AG's IPO, Germany's biggest IPO in three years, is 18 times oversubscribed; shares gain 12% upon debut

Outstanding events? Maybe in terms of size and market capitalisation but not as a general phenomenon. According to PWC's IPO Watch Europe, in the first quarter of 2006 126 companies had IPOs, up 23% over Q1 2005, raising nine billion euros in capital, representing a 46% increase. Across all IPOs in 2005 the emission price in 65% of cases was within the upper one-third of the

bookbuilding rate, while in 2004 72% of them reached only the lower one-third.

There were a few less-than-shining examples during 2005/06, too. 888.com, floating as the UK's second online gambling platform and inspired by the earlier success of PartyGaming, only managed to place 25% of its shares, just days after PartyGaming released its own revenue and profit warning for the online gaming industry. Belgian cable operator Telenet had a bumpy ride from the beginning, just hitting the bottom of the marketed range for the IPO, then slumping another 12% upon debut and continuing to lose in the aftermarket. Germany's Air Berlin failed to attract sufficient attention at the original price range, postponed the IPO for a week and lowered the price by roughly 33%.

There are several reasons behind this strong IPO activity. The years 2003-05 saw healthy gains all around: companies returned to profitability, share prices soared and shareholders and companies regained confidence in the stock market. Private equity funds and other investors today either seek

to exit the investments made during the bear market period, or to deploy fresh capital. Private companies wish – or are being urged – to access this capital, and finally, the current mergers and acquisitions bonanza is also partly financed through fresh capital raised.

But what are the exposures faced by those joining the IPO party? In all situations where fresh capital is being raised, the emitting company has to issue a prospectus. The requirements for the contents of this prospectus vary considerably, depending on location. Regardless of this, the company data and evaluation of current and potential scenarios clearly go beyond what the company ever compiled and released to the public before. It is not surprising, therefore, to find that the scope of internal and external resources needing to be deployed has also expanded. The employees of legal, financial, controlling and auditing departments generally do not face any liability resulting from negligent misconduct. However, the directors and officers who head these corporate functions or sit on management or supervisory boards can be confronted with either direct third party liability or derivative liability through internal recourse action. In addition, a range of unintended local liability can arise following an IPO, because of the jurisdiction in which the shareholder is based. Finally, prospectus liability, like standard directors and officers (D&O) liability, is personal and unlimited. However, unlike D&O liability, it is strict liability and does not require negligence to be proven!

The liability threat to directors and officers could come up from unexpected quarters. For example, the very same investors and owners of the company who pushed for the IPO could end up holding their own managers liable should the IPO go wrong. Politics can interfere with economics, such as in the case of the IPO of an iconic national industry threatened by globalisation. Consider the German politician who last year likened foreign investors to a swarm of locusts "falling on companies, stripping them bare before moving on", or, more recently, the Borsa Italiana dispute where political fears over a takeover by international shareholders halted the entire process.

The dilemma for directors and officers charged with making the right IPO decision at the right time is made more complex by the nature of the two main external consulting resources: investment bankers and lawyers. The lawyers tend to be cautious, pointing out the potential risks of the IPO. On the other hand, the investment bankers are

often the drivers of the IPO process and thus will be optimistic about the prospects.

Given all of the above, the demand for insurance solutions to protect the emitting entity and its directors and officers is high. This protection can be found in many forms, depending on the provider. It is available "horizontally", ie, within a specified time frame. This would automatically cover the entire process, from initial internal deliberations on whether to have an IPO, all the way to potential Secondary Public Offerings. Coverage can also be provided "vertically", which refers to the variety of cover available. For example, the groups of individuals insured under the policy can be extended in various directions: the emitting legal entity inclusive of existing shareholders; "regular" employees, ie, non directors and officers; and even external consultants like lawyers and accountants. This last endorsement is remarkable in itself, as the cross liabilities between external consultants and the emitting company might be contractual only. Perspectives and thus liabilities could be diverse, if not contradictory. One final comment on coverage: given the latest rescission and severability discussions, the combination of an IPO policy and a DIC A side coverage may make sense. The latter is non-rescindable, regardless of non-disclosure issues, thus enabling protection to continue.

So where is all of the above taking us in the future? Companies that are considering an IPO will continue to find themselves between the hammer and the anvil; between the increasing demands for transparency, corporate governance and corporate and personal liabilities on one side, and on the other, the growing pressure to take advantage of free floating global capital now available.

While new markets and opportunities will emerge, some markets will enter less investor friendly cycles again, making the decision to fix the timing for an IPO even more difficult. Maybe US President Thomas Jefferson was right – at least with regard to managers currently considering whether to access capital through IPOs – when he said in 1802: "I believe that banking institutions are more dangerous to our liberties than standing armies."

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