Directors and officers claims are increasing both in cost and severity

Is your business exposed?
The cost of the average large loss for D&O policies in the UK has tripled and the number of claims has increased by a third in the last decade, compared to the previous decade.

Historically, D&O risks were weighted towards securities litigation in North America, with many other territories experiencing a benign claim environment. This has changed in recent years.

According to Chubb’s own data, the average large loss cost for D&O policies in the UK has tripled and the number of claims has increased by a third in the last decade, compared to the previous decade.

But what is driving that change? Using our own claims data and underwriting experience we’ve identified several key legislative catalysts:

Incurred frequency and average severity
1. Broadening of corporate criminal liability in the UK and the use of deferred prosecution agreements

Chubb Claims Example

» The UK Serious Fraud Office (‘SFO’) launched a formal criminal investigation into the activities of ABC plc. The concerns related to bribery and corruption involving intermediaries in various overseas markets. The investigation was triggered by a whistle blower. ABC plc entered into a Deferred Prosecution Agreement (‘DPA’) resulting in substantial penalty payments to the SFO, Department of Justice (‘DoJ’) in the US and another regulator to date almost 100 individuals have been called to participate in the investigation.

» In this case Chubb have advanced claim payments currently running into millions of pounds to the client and the client will most likely exhaust the primary level coverage on their policy.

The SFO is increasingly using deferred prosecution agreements. Although in the UK these are entered into with the company itself, the focus on co-operation heightens the risk of subsequent individual prosecutions for associated Directors and Officers. The number of claims we have seen based on regulatory prosecutions has tripled since 2012.

2. Tougher action against directors of insolvent companies

Chubb Claims Example

» When a cash-handling business went into administration, the administrators claimed against the former directors of the company alleging that they allowed the company to trade whilst insolvent; paid unlawful dividends and mismanaged the company’s accounts. The Administrators sought to recover circa £750,000. The Directors denied all allegations against them and relied on the fact that they took professional accountancy advice at all times.

» Chubb has funded the fees of the directors’ solicitors and barristers, and was able to provide support from forensic accountants ahead of a key settlement meeting. In addition to the administrators’ claim, the Insolvency Service investigated and recommended that the Secretary of State for Business begin proceedings to disqualify the directors from acting as directors for a period of up to 10 years. Chubb will be funding the legal fees to respond to these proceedings.

As insolvencies increase in the years following a recession, as do the duties owed by directors to the company and creditors involved.

Additionally, since 2015 under the Small Business, Enterprise and Employment Act, liquidators have been able to sell claims arising from wrongful and fraudulent trading to third parties. Litigation funding of liquidators’ claims is becoming bigger business.

With tougher action being taken, more opportunities to litigate and an increase in insolvencies overall, adequate protection for board members has become key.
3 Increased activity by the Pensions Regulator

Chubb Claims Example

» Shortly before entering into liquidation, our insured identified a substantial deficit in their pension fund, resulting in the Pension Protection Fund (a state-backed fund) taking a 33% stake in the company’s fund. Various investigations by the administrators, the Insolvency Service, the Pension Regulator and a Work & Pensions/Business Innovation Select Committee began to establish why the group collapsed. The SFO are additionally monitoring developments and may consider a separate investigation.

» Legal representation costs are now being advanced by Chubb to over 50 individuals, and currently total several million pounds.

With more companies entering into insolvency, greater scrutiny is being placed on their activity in the lead-up to liquidation. In particular the pensions regulator is holding more companies to account for their actions and the powers vested in the regulator could be strengthened even further.

Penalties imposed by the Pensions Regulator currently include disqualification and contribution notices, and the latter can be sizeable. Directors can also be called to attend governmental or parliamentary select committees. But the repercussions and penalties may be increasing.

The Department for Work and Pensions in the UK recently released a white paper on the subject: Protecting Defined Benefit Pension Schemes.

The paper includes proposals to give the Pensions Regulator power to punish those (including individual directors) who deliberately put their pension scheme at risk. Proposed measures include the introduction of punitive fines; treating wilful or grossly reckless behaviour as a criminal offence, and building on the existing process to support the disqualification of company directors.
In conclusion, it can be seen that the changing regulatory landscape, coupled with new and emerging areas of risk are leading to a sea change in the world of D&O insurance.

Emerging Risks

In addition to the more established exposures set out above, we are seeing early stage changes in the legal environment that are beginning to impact exposures to directors and officers and therefore potential D&O claims:

**Environmental Exposure**

**Chubb Claims Example**

» Seventeen fatalities resulted from severe property damage at our client’s location and the subsequent pollution. The company’s share price dropped significantly and its operational licence was suspended until they agreed to settle a civil claim brought by the government. Our client and several of the individual directors now face a US Securities class action, where allegations include that materially false information was provided to investors regarding health and safety and the risks posed by the property. These representations artificially inflated the price of the American depositary receipts, causing a large loss to shareholders when the price crashed following the property damage.

» The headline loss is over $1bn. At the same time, the company and several individuals face criminal prosecution by the Authorities where the premises were located. Chubb are working with both the company and the directors to resolve the Securities Class Action and support the individuals in the criminal action.

When environmental exposures impact on share price then there is always the possibility of vulnerability to claims.

**Product liability**

In terms of product liability the key issue will be deciding what senior management knew, and when, in order to determine whether conduct exclusions are relevant and to understand potential defence cost exposures.

**Sexual Harassment**

Directors and officers may be exposed if, for example, they were shown to be failing to address issues within a working environment; to devise and implement policies to protect employees; or if they didn’t investigate claims thoroughly.

**Cyber Risks**

Directors and officers may also be held liable for failing in their supervisory duty to protect the data within an organisation or for a lack of proper controls to prevent cyber-attacks and fraud.

**More UK Class Actions**

Shareholder group actions are growing in number in the UK and are brought against commercial as well as financial entities.

Some shareholder group actions have been fuelled by third party litigation funding whilst others are the result of the increase in claims from other jurisdictions. This type of global “forum shopping” by shareholders, due to the extra territorial nature of some mechanisms such as WCAM in the Netherlands, are leading to the possibility of multiple actions and settlements arising out of the same issues. From a D&O perspective, this clearly heightens cost and complexity.