

# CHUBB®

## Emerging multinational management liability risks

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## Contents

1. Introduction	4
2. The increasing severity of claims	5
3. Establishing, developing and emerging global risks	10
4. Insuring multinational D&O liability	12
5. Country based studies	16
6. Conclusion	28

# 1. Introduction

Our latest multinational report, written in conjunction with Clyde & Co LLP, analyses the current international management liability risk landscape and considers some of the issues which are impacting both businesses and individuals in different parts of the world.

The last decade has seen significant changes affecting Directors and Officers (D&O) risk following the 2008 global financial crisis. Increased legislation and greater regulatory scrutiny in the United States and in other key centres for business, has prompted a sharp increase in litigation against companies and their Directors and Officers. Significant regulatory reform, the growing willingness of courts and regulators to hold individuals accountable, an increasingly active and engaged shareholder pool and a heightened compensation culture, have all led to D&Os facing a constantly evolving set of exposures - including regulatory fines, criminal sanctions, civil liabilities and collective and shareholder claims.

Furthermore, we are seeing increased regulatory activism arising from risks such as climate change, cryptocurrency and other areas which threaten criminal exposure for multinational companies and personal liability for its D&Os. It is therefore important to understand the value of local insurance policies in multinational insurance programmes and how building the right programme with both local and master policies offers robust cross-border insurance protection.

This report explores the rise in litigation around the world and how tougher law enforcement means more claims. A major consequence of this has been the continuous increase in defence and indemnity costs incurred, commensurate with the protracted timeframes now taken to reach conclusions in what are often highly complex cases. We examine D&O risk trends arising from climate change and technological developments such as artificial intelligence and also identify hot spots for regulatory activity as D&O threats evolve. While the US remains the most active and aggressive landscape, other jurisdictions including the United Kingdom, Australia, Germany, Canada and China are accelerating scrutiny of corporate management. We therefore look at individual countries where some of the new D&O risks are emerging and examine what risk professionals working for multinational companies need to consider when dealing with these challenges.

Focusing particularly on key countries and territories such as Australia, Brazil, Canada, China, France, Germany, Hong Kong, Singapore, Spain, the US, and the UK, we identify common emerging D&O risk trends, discuss the underlying triggers and drivers and assess how these issues might develop in the future. In addition, we illustrate that, while local differences exist, there are nonetheless global D&O liability trends emerging which should be considered carefully by all multinational corporations and their senior management.

“ This report explores the rise in litigation around the world and how tougher law enforcement means more claims ”

# 2. The increasing severity of claims

Investigations and claims costs for business are increasing in most geographies. Not only has the value of claims and settlements risen but also investigation and defence costs have grown significantly.

The potential for ever-larger losses and costs is driven by many factors including greater complexity, claims globalisation and larger costs

## The reasons behind claim increases

### Greater complexity



Meaning they are increasingly expensive to defend and settle.

### Increased D&O litigation



Reflecting a global trend towards culpability of the individual.

### Increase in class actions



The number continues to increase as does the claims quantum involved.

### Defence costs



Have at least doubled, due to more extensive disclosure (including e-discovery), higher expenditure for experts and increased legal fees.

### New and emerging risks



Presenting an increasing number of pitfalls.

### Regulatory activity and security



Investigations are now large, global and long lasting. This shows little sign of diminishing.

## Class actions

Collective action presents a significant risk to defendants, who face exposure to damages (and, in some jurisdictions, punitive damages) and costs, in addition to considerable operational and reputational consequences arising from dealing with large-scale litigation.<sup>2</sup>

This litigation risk has led to increased settlement amounts in recent times (although spikes can be caused by infrequent large settlements).

Settlement year	Average settlement value for US securities class actions
2015	\$56 million
2016	\$77 million
2017	\$25 million*
2018	\$69 million

(NERA Consulting, 'Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review'.)

\* Regulatory activity initially decreased under President Donald Trump. See page 22 for more information about US trends.

## Why is this happening?

Directors and Officers are increasingly being named in class actions in the US.

Boards are being held accountable for their failure to recognise, manage and mitigate risks. While this is not a new risk in itself, the trend for such action is on the rise, particularly as directors now have to take into account many emerging risks, without the benefit of historical data, including:

- climate change financial risk
- cyber security and data loss
- human slavery in the supply chain
- environmental impact of the company
- use of technology and Artificial Intelligence

The emergence of these risks has to be considered in the context of increased shareholder awareness, engagement and activism.

Securities class actions also continue to be filed in record numbers in the US. This is fuelled by a high number of M&A actions, event-driven actions filed by emerging-law firms (for example, the Volkswagen actions) and, possibly, the increased use of litigation funding.

Following the US Supreme Court's ruling in *Cyan*, securities class actions are also being filed in state courts in increasing numbers, meaning that companies and their D&Os may face simultaneous battles in both state and federal courts.<sup>1</sup>

<sup>1</sup> Under the Securities Litigation Uniform Standards Act ("SLUSA"), federal courts have exclusive jurisdiction over claims under the Securities and Exchange Act of 1934 (the "34 Act"). In *Cyan, Inc. v. Beaver County (2018)*, the US Supreme Court examined whether SLUSA also provided federal courts with exclusive jurisdiction over claims under the Securities Act of 1933 (the "33 Act"). Cyan unanimously held that state courts retain concurrent jurisdiction with federal courts over claims under the 33 Act. As a result, plaintiffs may file securities class actions under the 33 Act for misrepresentations and omissions in offering documents, as well as a separate action in federal court for violations of the 34 Act based on the same facts as the state court action.

Foreign companies with securities listed on US exchanges have also been targeted in standard securities class actions.<sup>2</sup>

In addition, a recent ruling by the United States Court of Appeals for the Ninth Circuit in *Stoyas v. Toshiba Corp., et al.*, 896 F.3d 933 (9th Cir. 2018), which includes California and several Western states, makes it more likely that foreign companies with un-sponsored American Deposit Receipts (ADRs) will be sued in US securities class actions.<sup>3</sup>

Similar risks apply due to the spread of such actions throughout the globe. This is driven by a combination of:

- continuing corporate scandals
- availability of third-party litigation funding
- legislative reform
- a developing appetite for litigation outside of traditional markets

Many countries such as the US, the UK, Germany and China now offer some form of collective action mechanism, even if it is just a process for consolidating linked actions rather than a true group procedure.

In recent years such tools have been utilised for collective shareholder actions in increasing numbers.<sup>4</sup>

<sup>2</sup> This is even after the US Supreme Court's ruling in *Morrison v National Australia Bank (2010)*, though the numbers were down slightly in 2018. This may be due to fewer allegations of regulatory violations which were previously alleged against foreign companies. (Furthermore, a previous spike was related to litigation against Chinese companies concerning reverse merger objections).

<sup>3</sup> In *Toshiba*, the Ninth Circuit held that the 34 Act could apply to claims against a foreign issuer, relating to un-sponsored American Depositary Receipts ("ADR") of the foreign company, and that the focus under *Morrison v. National Australia Bank* should be on the location of the transaction and not whether the foreign company was involved with the ADR transaction, although plaintiffs must still demonstrate that the misrepresentation and omissions were in connection with the purchase or sale of securities in the US.

<sup>4</sup> The unprecedented magnitude of losses suffered by investors (both retail and institutional) as a consequence of the international financial crisis in 2008 is one factor behind the increase in collective action in Europe.

The limiting of the extra-territorial reach of US securities laws by the US Supreme Court in the *Morrison* decision has also certainly played a part in encouraging damaged investors to consider causes of action on a collective basis in jurisdictions other than the US, particularly in the Netherlands via the Collective Settlement of Mass Damage Claims (WCAM) procedure.

Forum shopping is becoming more prominent and the 2019 UK Supreme Court case of *Vedanta Resources PLC v Lungowe (2019) UK SC 20* should make it easier for UK parent companies to be pursued in the UK in relation to the activities of overseas subsidiaries, particularly in countries where local legal resources are considered insufficient to facilitate substantial justice.

### Impact of shifting regulatory process

Regulatory action increases the chances of civil claims. It attracts early and pointed attention, and immediately labels what has happened as potentially wrongful. Public notices of investigations being opened may mean that evidence gets out early with the attendant risk of ill-informed political comment about what has happened. Regulatory action can also support claims in other ways. In our experience, there have been examples of regulators, including in developed economies, cooperating with claimants through a two-way exchange of information and ideas about how to frame or establish allegations.

In many civil law jurisdictions, it is possible for civil claims to be added alongside a criminal prosecution, with the criminal result binding the defendant in relation to the related civil claims - this is of particular concern in Spain and Italy, where anyone can bring a criminal complaint for damages.

Another example of the impact of regulatory activism upon civil exposures is governments/regulators stepping in and compensating 'victims' and then seeking recovery from the at-fault companies.

### Increased regulatory activism

Regulatory scrutiny has also intensified around the world since the global financial crisis and is a significant source of exposure for D&Os. There are several drivers for this:

**1. Politicisation of the regulatory process** - Regulators are under increasing pressure to open inquiries. We are also seeing a rise in inquiries by government committees where directors or advisers give evidence in a summary fashion. This can lead to reputational risk based on how it plays out in the media and on social media platforms.

**2. Global leaning towards individual accountability** - there is a growing demand from politicians, shareholders, the media and the public, particularly on social media, that members of senior management be punished when companies fail. The driver for this is for "credible deterrence" to improve confidence in the market and encourage better individual behaviours.

**3. International cooperation** - An unprecedented rise in cooperation, coordination and resource sharing between international regulators seeking to impose fines on a single firm. This increases the complexity and costs of responding to and dealing with such matters.

**4. Corporate governance** - The regulatory landscape is shifting to focus on supervision, with many jurisdictions reforming corporate governance models. These reforms place a burden on D&Os to implement the changes and to ensure compliance, thereby increasing exposure.

**5. Multiple exposures** - It is not uncommon for a director to face multiple investigations in relation to the same root cause. In addition to financial regulators, there are those who regulate and enforce pensions, competition, bribery and corruption, health and safety, the environment and data protection (particularly of note in Europe due to the General Data Protection Regulation (GDPR)).

Linked to this is the extra-territorial reach of legislation, the effect of which is to require entities to increase due diligence across the supply chain, wherever it reaches geographically.

### The broadening of criminal exposures

While it is not new that directors face criminal exposures, we are currently in a time of heightened media and political scrutiny, coupled with an increasingly engaged shareholder pool.

Traditional risks - combatting corporate fraud and market abuse and clamping down on bribery and corruption - remain in the crosshairs of regulators and prosecutors. And laws are being strengthened in many jurisdictions.

This is set within a landscape of broadening corporate criminal liability in many jurisdictions, including "failure to prevent" offences as seen in the UK's Bribery Act 2010 and Criminal Finances Act 2017.

Crucially for directors, the UK's Serious Fraud Office (SFO) can only enter into Deferred Prosecution Agreements (DPAs) with culpable companies and not with individuals. This exposes D&Os who may be exposed in the pursuit of cooperation by the corporate to facilitate a deal.

Extensive cooperation and facilitating the SFO in identifying culpable individuals is key to obtaining a Deferred Prosecution Agreement.

In addition, we are seeing an increase in criminal actions against directors for health and safety and environmental failures. Bribery and cartel investigations and prosecutions are also on the increase in Europe and in Latin America, France for example having underpinned its focus on combatting white collar crime through the introduction of DPAs and new preventative measures against bribery and corruption.



### 3. Establishing, developing and emerging global risks

Across many jurisdictions, plaintiffs have continued to explore new areas for litigation:

**\$3bn**

The NotPetya malware attack in 2017 caused more than \$3bn in cyber claims and affected a range of businesses.



**Cyber, data and privacy risks** - Cyber risks transcend geographical boundaries.

The D&O implications of large-scale, high-profile cyber attacks were brought into focus by a number of shareholder derivative suits and class actions in the US against directors in the aftermath of large data breaches, essentially alleging they had failed to manage and mitigate cyber risk adequately.

While we have not yet seen this in the UK and Europe, claims of this kind are certainly growing in likelihood as more and more public companies are hit by damaging cyber attacks, and shareholders, regulators and others may look to boards to ascertain what went wrong.



**Sexual misconduct** - There have been rising numbers of sexual misconduct allegations, in particular in the US, the UK and Germany, since the start of the #MeToo movement.

Sexual misconduct by a company executive or employee can result in legal claims not only against the accused but also the company itself, for example, civil claims from victims, criminal proceedings and claims by the shareholders, acting on behalf of the company (if the alleged misconduct impacts negatively on the value of the shareholders' investment). Other directors may also find themselves facing similar claims if proven to have turned a blind eye or if they have failed to follow procedures or act on warnings or complaints.



**Cryptocurrencies** - Currently, the transfer, purchase and sale of cryptocurrencies is largely unregulated but the question of whether they should and how this could be done is a priority for many regulators.<sup>5</sup>



**Climate change** - This is a growing and increasingly high-profile risk. Many companies are vulnerable to climate-related risks, even if they are not operating in the energy sector.

The rise of activism, such as Extinction Rebellion, should be a consideration for companies and adequate business interruption insurance policies should be in place to protect against the potential impact of disruption.

In a number of jurisdictions - the UK, US, Canada, and Australia in particular - there are concerns about how companies are assessing and reporting on this risk. It is still very much an emerging D&O liability risk, with allegations including:

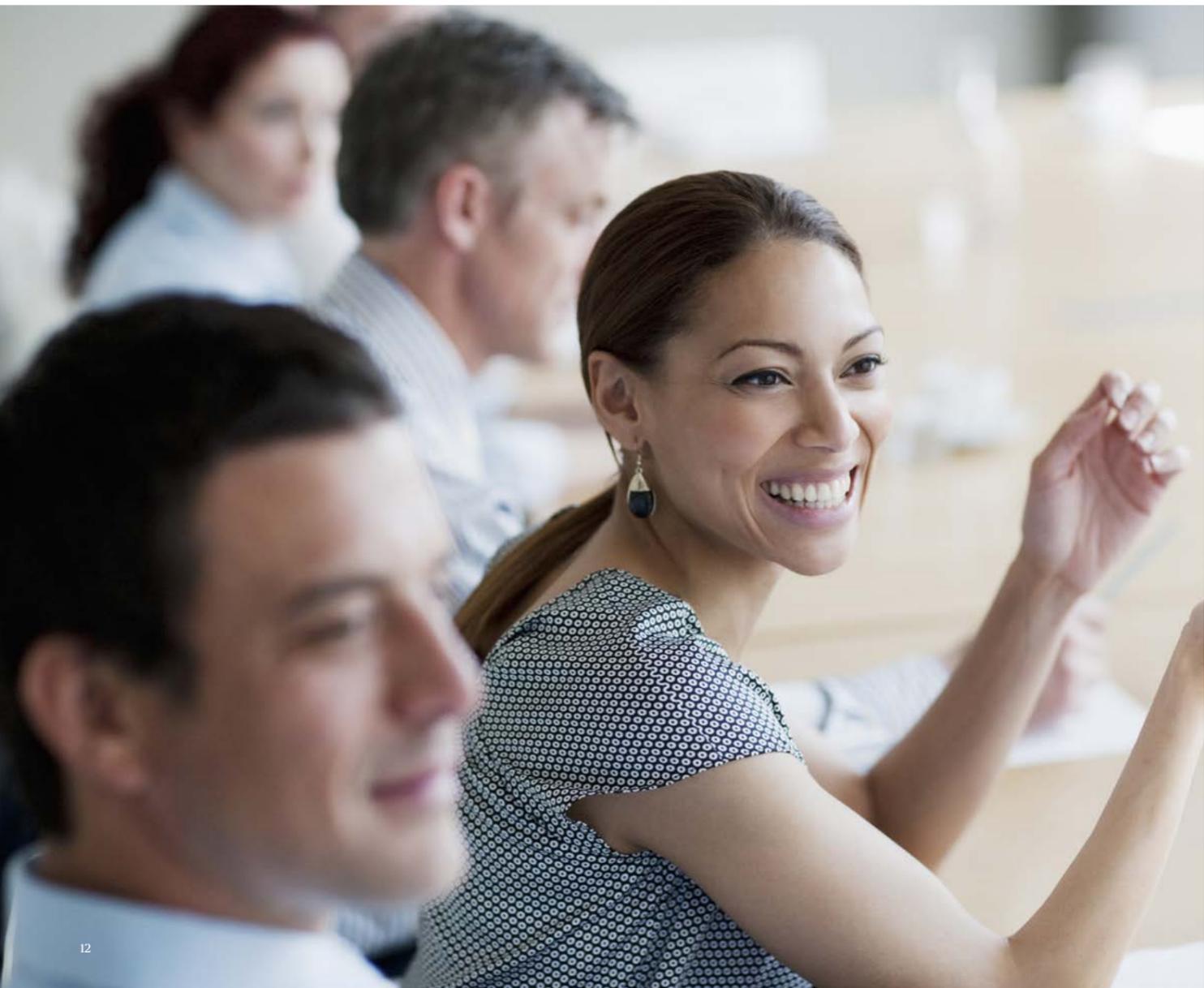
- Mismanagement of climate risk or breach of fiduciary duties in not considering the financial risks associated with climate change
- Failing to comply with legislative reporting requirements or disclosure liabilities
- Disseminating false, misleading or incomplete information on climate risks
- Negligence in allowing the company to emit greenhouse gases into the atmosphere
- Failing to protect the company's assets

<sup>5</sup> For example, the US Securities and Exchange Commission's (SEC) Cyber unit has focused on cyber-related misconduct and, increasingly, is looking at misconduct relating to Initial Coin Offerings (ICOs) of cryptocurrencies. Further, in the UK, the Cryptoassets Taskforce comprising Her Majesty's Treasury, Financial Conduct Authority (FCA) and Bank of England Cryptoassets Taskforce is looking to legislate, recognising that while the use of cryptocurrencies may be beneficial, they present a risk to market integrity and to consumers, and could be utilised to perpetrate financial crime. Civil claims are also emerging: at least nine new securities class actions relating to ICOs or cryptocurrencies were filed in 2018.

## 4. Insuring multinational D&O liability

Regulatory activism arising from climate change, cryptocurrency, cyber data and privacy risks threatens exposure for multinational companies and personal liability for its directors and officers. As a result, it is important to understand the value of cross-border, multinational insurance protection and how building the right programme with local and master policies protect both the entity and the individual.

In today's increasingly complex business environment, a global offering of different coverages protecting distinct parties against different types of liability may not work everywhere and may be subject to challenge - either from D&Os who understandably expect certainty; or from local regulators who demand compliance. It is only by separating the respective elements and understanding their interplay that a multinational company can protect itself and its people adequately.



### The make-up of a multinational D&O policy

A D&O policy protects distinct parties against different types of liability. It generally affords three types of coverage:

- "Side A" insurance indemnifies individual D&Os against their personal liability and defence costs in circumstances where a corporation is prohibited or unable to do so. This coverage is meant to provide critical personal asset protection to the D&Os.
- "Side B" insurance covers the corporate entity where it can and does indemnify or defend its D&Os.
- "Side C" insurance covers the corporate entity for its own exposure to securities litigation

First, it is important to understand that a typical insurance policy for D&O insurance is actually a bundle of these three different coverages for which limits can be shared and risk exhaustion by one Side over another.

To illustrate the point, Side B D&O insurance protection is purchased as balance sheet protection in the event that the company must pay for the defence and expense of litigation and settlement on behalf of its D&Os. It is generally the duty of the corporation to indemnify in accordance with its bylaws. Depending on how countries regulate unlicensed or unauthorised insurance - where there is reimbursement protection for local indemnity payments -, jurisdictional nuances can affect the efficacy of insurance payments for covered loss. Such nuances can lead to a more fundamental problem for Side A cover since it may be questionable whether specific countries would even permit indemnification.

The certainty of indemnification appears increasingly to be a simplistic assumption that may miss the mark of what Side A protection can actually afford. In fact, many Side A buyers determine whether to purchase these policies only by asking the question about whether local laws and regulations permit indemnity. Such a linear approach may not achieve the goal of protecting the personal assets of the corporation's D&Os at all. Side A coverage, of course, is intended to provide insurance to protect the personal assets of the individuals where no indemnification is available by the corporation - whether because of something as indisputable as bankruptcy or something less legitimate. Notable countries where the law is silent on indemnification rights, yet D&O insurance can be (and is routinely) purchased by corporations on their behalf include Argentina, Colombia, South Korea, Switzerland, UAE and the Netherlands.

Interestingly, India and China - countries where many European multinationals are building their footprints and where growth is expected to outperform the West in the decades ahead - currently do not address the concept of the use of corporate assets to indemnify directors and officers at all. In fact, these countries' laws (and those of many others) are silent on the issue. This suggests they have acknowledged the market acceptance of a local corporation purchasing D&O insurance (for instance, Chinese law has expressly permitted corporations to purchase D&O insurance under certain conditions). So, while the law says nothing on whether indemnification is permitted, the law expressly permits the purchase of insurance, and consequently the safest route for corporations to insure their D&Os.

“ The key to mitigating both risks is to ensure that the program is customised to manage each of the three sides of D&O insurance effectively ”

### Considerations when building robust D&O multinational programmes

Multinational corporations are generally governed in a way that permits them to operate as seamlessly as possible across national borders, creating synergies that lead to more competitive pricing, innovation and profit. It is little wonder that these corporations prefer to take the same approach to structuring their D&O insurance programmes.

Instead of having each affiliate negotiate its own policy in its own jurisdiction, there is often a centralised effort to achieve the best terms, conditions and price in the most efficient way. The majority of multinational corporations employ risk managers, located at the parent level, whose main responsibility is to negotiate and administer insurance programmes that provide coverage for the parent company, as well as its affiliates and directors, officers and employees at both the parent and affiliate levels.

National insurance regulations governing the purchase of insurance policies create a challenge for multinational organisations seeking to insure such risks in a consistent and cost-effective manner. Another critical concern is whether a single policy can pay claims in all of the jurisdictions where the insured operates and D&Os can potentially suffer. These challenges, which may appear daunting, can be overcome with forethought, consultation and expertise. A multinational D&O insurance programme may be designed in a way that satisfies the need for consistent coverage and limits for an organisation's worldwide operations and that exhibits deference to the tax and regulatory requirements in each country. A key question that needs to be addressed is whether D&O insurance policies purchased to provide worldwide insurance protection can deliver this protection.

In the case of multinational companies, structuring a compliant program to manage global D&O risk is never simple. If a D&O program is not designed thoughtfully, two main areas of risk begin to emerge for a company and its directors, ultimately threatening their personal assets: execution risk and compliance risk.

The master policy arranged by the parent may be able to cover some of its foreign subsidiaries - for example, an ABC D&O insurance policy purchased by a British parent company from an insurer licensed only in the UK can legitimately cover subsidiaries elsewhere in the EU—even if there is a so-called Hard or No Deal Brexit. It can (a) fill coverage gaps in local policies with the inclusion of Difference in Conditions (DIC), and (b) provide consistent limits with the inclusion of Difference in Limits (DIL). But could this same policy directly indemnify the parent company's Brazilian or Chinese affiliate, or the affiliate's local directors or officers, for the local legal defence costs incurred and any settlement or judgment when they are sued in Brazil or China for a loss in Brazil or China?

The key to mitigating both risks is to ensure that the program is customised to manage each of the three sides of D&O insurance effectively, by clearly distinguishing how the program will work in practice. This means looking closely at how the three types of D&O coverage operate in connection with where the risks are located and where claims can be paid.

Many insurers continue to issue a single global insurance policy to the parent company in the parent's jurisdiction, intended to insure the parent's directors and officers as well as those of its foreign subsidiaries, affiliates and joint ventures.

However, certain countries, including Brazil, China, Mexico, Japan, some provinces in Canada and almost every state in the US, either impose strict conditions on insurance companies operating within their borders or prohibit the purchase of insurance for local risks from insurers not licensed or authorised there. In such cases, the company can mitigate this compliance risk by purchasing local policies covering all three areas of D&O risk, in addition to a master parent policy.

But this does not eliminate execution risk. Distinct classes of insureds may actually be competing for a finite amount of Side A insurance capacity, and individual directors could be left with no coverage at all for these claims. This is because claims made under Side B and Side C insurance will typically begin to exhaust the cover before the Side A claims start to materialise.

For Side B and Side C insurance, a master policy may add supplemental insurance to the parent (in addition to local policies) for the parent's insurable or financial interests in its local affiliates. The critical Side A coverage may then be purchased separately and locally.

In today's increasingly complex business environment, a global offering of different coverages protecting distinct parties against different types of liability may not work everywhere and may be subject to challenge—either from a company's D&Os who understandably expect certainty; or from local regulators who demand compliance. It is only by separating the respective elements and understanding their interplay that a multinational company can protect itself and its people adequately.

Understanding the personal exposures of D&Os presents a challenge for multinational companies. After all, the extent of these individuals' duties, the range of potential lawsuits and the regulatory landscape vary widely from country to country.

## 5. Country based studies

By way of illustration of these broader themes, we now look at the main risks and exposures in the D&O sphere in a local context, examining them on a country by country basis.

In order to provide a holistic view of the global outlook, we have categorised the countries into three classes:



### Established countries

#### Australia



The Australian class action regime is among the most plaintiff-friendly in the world with businesses who have shares traded

in Australia most likely to face class action litigation outside of the US.

D&O liabilities in Australia are long established and the key risks are class actions, securities claims, regulatory litigation and liquidator claims.

An emerging risk arises from the Australian Law Reform Commission's (ALRC) 'Final Report into Class Action Proceedings and Third-Party Litigation Funders in Australia' issued on 24 January 2019, which recommended

contingency fees be permitted in certain circumstances. This is expected to further increase class action claims activity.

In July 2019 Australia implemented a regime to protect whistleblowers from civil or criminal penalties and workplace retaliation, which is also expected to drive more claims.

Further, it is predicted that there will be an increase in claims resulting from data/privacy breaches and disclosure of the effects of climate change.

One area where claims may decrease is insolvent trading, since D&Os now have the protection of "safe harbour" defences which can be deployed to avoid personal liability.

#### Canada



##### Developing Risks

Cyber and privacy breaches are among the leading growth areas for claims against

corporations and boards.

Shareholder class actions also remain a dominant concern for publicly traded companies. Canadian courts remain relatively generous and liberal in recognising jurisdiction, including situations where the wrongful conduct may have occurred elsewhere, so long as it affects Canadian residents.

In addition, personal liability for environmental remediation costs is a reality. The Supreme Court of Canada's decision in *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 that energy companies must fulfill environmental obligations before paying back creditors in insolvency situations could have far reaching implications. D&Os may also face claims of preferential treatment in agreeing to pay creditors in advance of clean-up costs. Finally, various public-interest coalitions are exploring the use of class actions against fossil fuel companies and governments in connection with climate change issues.

##### Emerging Risks

The #MeToo Movement has heightened the prospect of claims against senior executives for failure to provide a harassment-free work environment.

Non-medical cannabis became decriminalised across Canada in 2018. However, significant volatility and regulatory uncertainty continues to affect the production and the marketing of cannabis products and several securities claims are already underway. Going forward, there may be new risks as the potential for cross-border selling with the US is explored.

Increasing activism by Canada's First Nations in relation to aboriginal rights, including the assertion of constitutional and treaty rights, creates a risk of claims against board members, particularly in the Energy sector.

M&A activity is anticipated among energy companies fuelled by the continued slump in oil prices. Transactional activity of any kind will include potential risks against directors and officers, notably in respect of insider dealing and breach of confidential information.

## France



### Established Risks

Although a French form of class action has been introduced in various fields (consumer protection, competition law, environmental harm, medical, data protection), there has been resistance against its introduction for shareholder actions.

Criminal proceedings are generally possible against directors and can be initiated by way of a civil complaint under certain conditions. Non-compliance with labour law or health and safety regulations will often result in criminal proceedings against individual directors or officers.

Non-compliance with labour law remains a frequent source of exposure of D&Os in France as many breaches can lead to the prosecution of individual directors.

The involvement of private equity firms in companies sometimes leads to claims against D&Os as they often give rise to disputes between shareholders, following share purchases.

For small and medium sized enterprises, insolvency-related claims brought by insolvency administrators or liquidators remain a major source of D&O litigation.

### A new fight against corruption

For a long period, France has taken a rather softer approach to white-collar crime than other jurisdictions. With the creation of a new prosecution unit, France now has a prosecutor with specific resources and procedures dedicated to fighting corporate crime.

More recently, "Loi Sapin II" has been enacted, leading to the creation of a new agency to fight corruption and imposing new preventative measures against bribery and corruption, with personal responsibility for the individuals.

The Sapin II law on corruption has introduced a new form of Deferred Prosecution Agreement. In the financial market sphere, administrative composition agreements with Autorite Des Marches Financiers (AMF) have been extended and are increasingly popular.

Although it remains restricted to certain areas, some regulatory settlements or decisions impose obligations on offenders to indemnify civil parties outside the scope of traditional civil proceedings. This is notably the case with DPAs under the Sapin II law or AMF's administrative composition agreement process.

### Emerging Risks

The handling of data has become a central issue for managers. Considering the financial impact of GDPR fines or cyber security events, particular attention will have to be paid to this by D&Os.

Further to a 2019 reform, companies must consider the social and environmental impacts of their activity. Companies may optionally define one or more social and environmental objective, which may become a new source of liability.

## Germany



### Developing Risks

The main risk for D&Os in Germany still lies in claims against them by the company itself. In a typical dispute, the company has suffered damage due to a business decision, which later turns out to be unprofitable or unsuccessful. In insolvency situations, the trustee is obliged to evaluate the potential claims by the company and take action where reasonable. This includes claims against D&Os, generating an increased risk for (insured) D&O claims in insolvency situations. The trustee therefore has the same obligation as the supervisory board of a stock company.

Another area for potential D&O claims risks connected to insolvency is reimbursement claims made by the trustee against D&Os for payments made after factual insolvency. The Higher Regional Court Dusseldorf, however, decided in July 2018 that D&O policies do not respond to this type of claim, as they are not regarded as damage claims in the context of D&O policies.

Another potential driving force for D&O exposure (not just in Germany but Europe-wide) is the new EU whistleblower directive (in force from 2011) under which companies must set up internal reporting channels to strengthen whistleblower protection. We are starting to see cases in which criminal proceedings were initiated after whistleblower reports, and we expect subsequent D&O claims in the future.

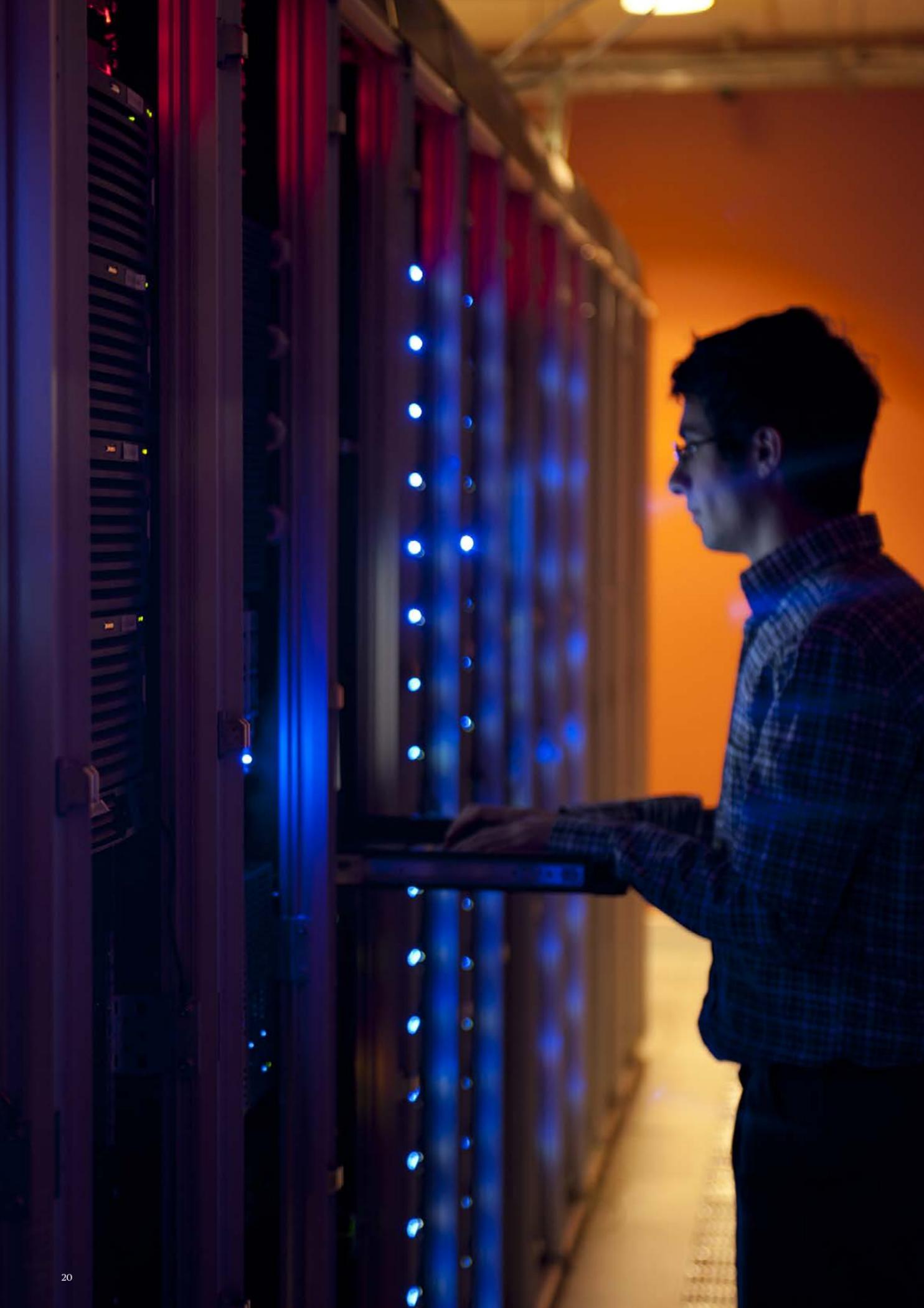
In addition to the above, further risks are fines (cartel, GDPR etc.), cyber, climate change and #MeToo.

### Emerging Risks

A highly discussed topic for potential new D&O exposure is the GDPR and the relevant national laws. German authorities have been reluctant to issue large fines so far, but we expect higher fines in coming years.

In Germany, class actions have traditionally not been part of the litigation landscape and the effects of the introduction of collective proceedings in 2018 have been the subject of much debate. Under this regime qualified bodies (e.g. consumer associations) can request declaratory judgment regarding the basis of a claim. Consumers can register claims with the Federal Office of Justice, and class action decisions are binding for subsequent (necessary) actions on the merits. Currently only five model proceedings have been commenced. We anticipate that these numbers will rise due to more litigation funders entering the market in Germany.

Another example for potential future claims is the "Cum/ex" scandal. Since 2011, hundreds of individuals and approximately 100 financial institutions have been subject to investigations. "The issue received international attention when the "CumExFiles" (project name for a joint investigation by 19 European media outlets from 12 countries) were released in October 2018. Criminal proceedings are pending in German courts. We expect to see more such actions against corporations and individuals.



## United Kingdom



### Established risks and a tough regulatory landscape

Post financial crisis, the liability landscape for D&Os has changed markedly.

Alongside significant corporate governance reforms, particular exposures include regulatory actions for systems and controls failings, increased shareholder activism, and greater enforcement powers on regulators to investigate and sanction all directors for any failure to discharge their duties to prepare and approve true and fair corporate reports.

Enforcement activity has increased, 2018/19 saw the FCA open more enforcement investigations than ever. Individuals continue to be targeted: the number of fines imposed on individuals in 2018/19 is similar to that in the two prior financial years but the aggregate amount of fines far exceeds prior levels.

The Pensions Regulator is taking an increasingly tough stance against directors of insolvent companies, and two new criminal offences to prevent and penalise mismanagement of pension schemes are anticipated. With the introduction of the GDPR and the UK's Data Protection Act 2018, the Information Commissioner's

Office can now impose hefty fines and penalties on companies and individuals and recently announced its intent to fine Marriott International (£99.2m), and British Airways (£183.39m). Exposures for D&Os include regulatory action, breach of duty claims (though note that derivative actions are generally hard to establish in the UK), and privacy claims from data subjects.

There is also increased activity from other regulators/prosecutors, impacting all sectors. The Competition & Markets Authority is ramping up cartel investigations and using its director disqualification powers, and the Health & Safety Executive and the Environmental Agency are routinely handing out fines for breaches and increasingly pursuing criminal sanctions against directors.

The broadening of corporate criminal liabilities has continued post Bribery Act 2010. The Criminal Finances Act 2017 created strict liability offences rendering companies criminally liable if they fail to prevent the facilitation of domestic or overseas tax evasion by an associated person; more "failure to prevent" offences have been suggested. These acts allow the use of DPAs which risk a director being served up to the prosecutor in pursuit of a deal by the corporate.

\$2.3m

Chubb's July 2018 study found that the average cost to dismiss M&A cases rose from \$880,000 in 2012 to \$2.3 million in 2016.<sup>6</sup>

## United States



### Securities class actions - the "new norm"

In the past two years, securities class actions have risen alarmingly.

During 2017 and 2018, more than 400 federal securities class actions were filed each year, and the 198 cases filed in the first half of 2019 suggests this trend will continue. These numbers are double the annual average in the previous 20 years and may be the "new norm".

Many of the latest filings involve M&A transactions or are "event-driven." Potential damages were significantly higher in 2018, and average settlements rose to \$69 million from \$25 million in 2017.

While many of the new securities class actions appear to be weaker (evidenced for example by a record high dismissal rate of 58% for 2015 filings), exposure from even weak cases is rising.

### Established and significant risks

Derivative lawsuits are a significant D&O risk, and large derivative settlements are becoming more common. Companies are typically unable to indemnify D&Os for derivative settlements, which may impact Side-A policies.

Regulatory activity initially decreased under President Donald Trump. In 2018, however, enforcement actions rebounded and monetary settlements increased.

The SEC and Department of Justice have continued policies and programs impacting D&O risks, including holding individuals responsible, using deferred prosecution agreements, and promoting the SEC's Whistleblower Program. US regulators also remain focused on uncovering money laundering and Foreign Corrupt Practices Act (FCPA) violations.

### Developing Risks

**Cyber** - In 2018, cyber was a focus for plaintiff firms and regulators. Investors filed at least seven securities class actions relating to data breach disclosures, and a case against Yahoo settled for \$80 million. Two other securities class actions addressed GDPR disclosures, while another alleged misrepresentations regarding privacy policies and data transfers. The SEC's Cyber Unit brought 200 cyber cases, 225 cyber investigations and 12 cryptocurrency actions, and settled with Yahoo for \$35 million.

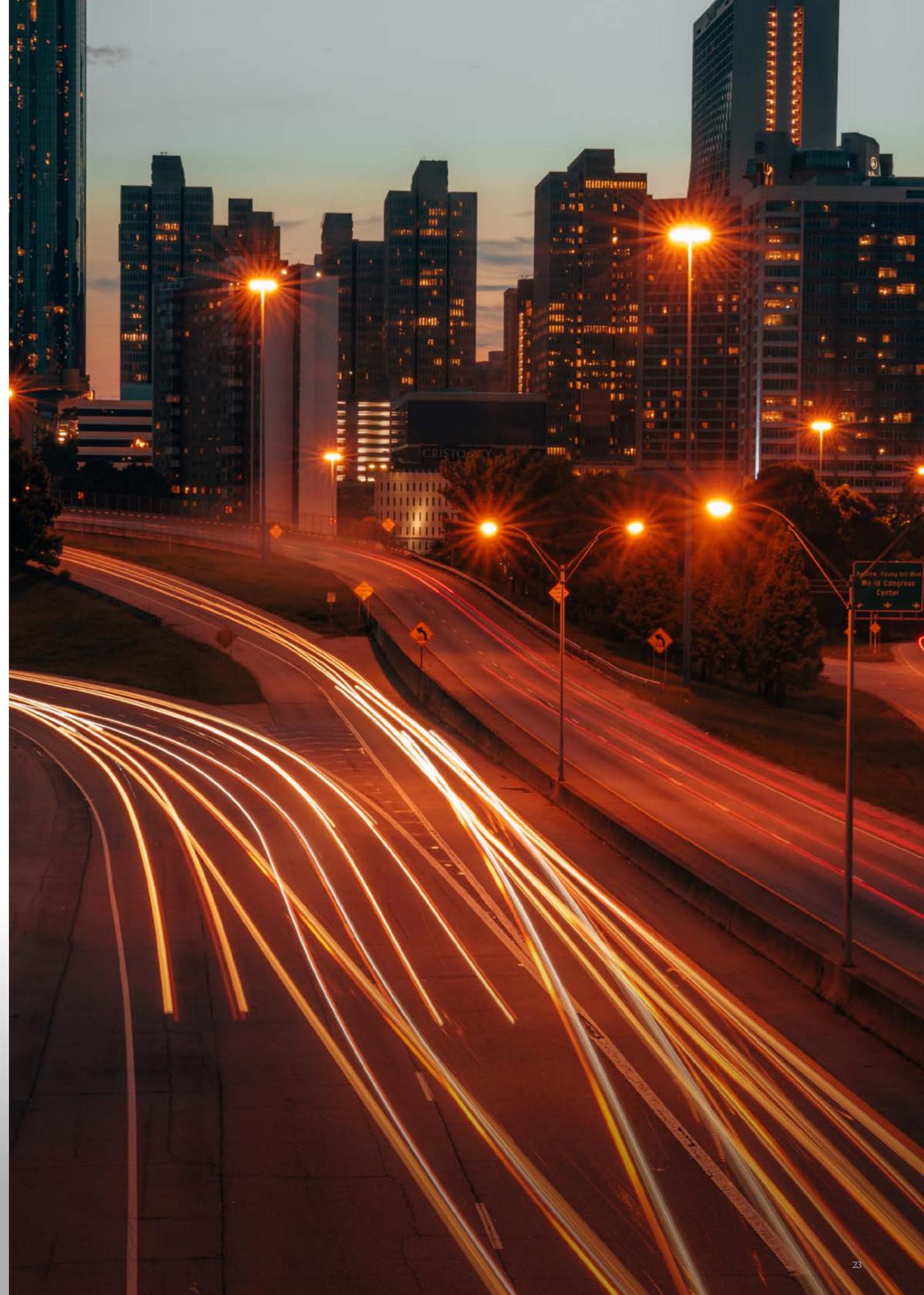
**Sexual misconduct** - Shareholders continued to file actions regarding sexual misconduct by management. In late 2017, a major media business agreed to a \$90 million derivative settlement. In 2018, investors filed at least four securities class actions and two shareholder derivative actions.

**Climate change** - The threat of shareholder and regulatory actions relating to climate change disclosures continues. On 14 August 2018, a court denied a motion to dismiss a securities class action against ExxonMobil alleging misrepresentations regarding climate change exposures.

<sup>6</sup> Plaintiffs continue to target foreign companies, despite the Supreme Court's 2010 ruling in *Morrison*, (see comment in Overview), with core filings in 2017 and 2018 doubling the 1997-2017 annual average of 24 cases. A recent ruling in the Ninth Circuit regarding unsponsored ADRs (see below) may make it more likely that foreign companies will be sued in the US.

Further, the Supreme Court's March 2018 *Cyan* ruling, which allows state courts concurrent jurisdiction for Securities Act claims, opened the door to more state court securities class actions. As a result, filings in state courts jumped from 13 in 2017 to 33 in 2018. State courts often have less stringent pleading requirements and plaintiff-friendly judges and juries, and such actions may be more costly to resolve.

"Emerging plaintiff firms" were appointed lead counsel in 40% of 2017 filings. Those firms often file smaller, weaker and event-driven cases, and may be supported by litigation funders.



## Developing risk countries

### Singapore



The key changes in the D&O liability landscape are the increased regulatory activity and scrutiny on the part of regulators. The Monetary Authority of Singapore (MAS) has been increasingly focused on anti-money laundering enforcement in the aftermath of revelations of the scandal-hit Malaysian state investment fund IMDB, funds of which had been channelled through Singapore's banking system.

Singapore's open economy makes it particularly susceptible to risks of money laundering. Over the past 2-3 years, the MAS has imposed nearly S\$30 million in fines on eight banks in relation to IMDB. Increasingly, the MAS approach is to place responsibility on the individual responsible for the lapses and their supervisor.

The Singapore Exchange's (SGX) regulatory arm recently announced that it will establish a whistle-blowing office to channel all regulation-related feedback to staff who can process these concerns. The Personal Data Protection Act is likely to be amended soon to make reporting data breaches mandatory.

Singapore's regulators are also cooperating more with their foreign counterparts in bringing errant companies and individuals to account, which is a key emerging risk.

### Spain



#### **Criminal Liability**

There is currently less emphasis on regulatory fines, as a general concept, in Spain compared with the UK and US.

An area of greater concern is criminal liability that may arise following an administrative action by a regulator. The Spanish Criminal Code is very broad, and there are a number of offences relating to corporate crime.

Regulators (including the Comisión Nacional de los Mercados y la Competencia (CNMC) and Comisión Nacional del Mercado de Valores (CNMV)) can report to the public prosecutor, who may then bring a criminal complaint.

A growing exposure for companies and D&Os contracting with public entities is bribery prosecutions (within which civil damages can also be claimed). In addition to criminal penalties, there is the potential for the criminal judge to impose a civil bond.

#### **The growing exposure of non-criminal offences**

Directors should be aware of the general trend in Spain towards increased liability for directors for non-criminal offences. For example, the CNMC is ramping up its sanctioning of both entities and directors for infringements of competition law.

The number of insolvency proceedings remains high, and the amounts awarded against directors are increasing.

The Spanish Insolvency Act 2003 provides a specific regime for liability in insolvency. This is applicable to directors where the company goes into liquidation in circumstances in which the insolvency is classified as 'guilty' (broadly, where there has been bad faith or gross negligence on the part of the directors in the generation or aggravation of the insolvency).

The implications of a "guilty" finding can be severe, including requiring the directors to cover the financial deficit of the company, in addition to any other damages caused. Further, from the commencement of the insolvency proceedings the judge may in certain circumstances order the seizure of the goods and assets of the directors.

Directors are also vulnerable to proceedings by the tax authorities for unpaid taxes since the Spanish Taxation Act provides for the personal liability of directors.



## Emerging risk countries

### Brazil



Although there is not a long history of D&O liabilities in Brazil, authorities such as the Federal and State Prosecuting Offices, the Securities Commission (CVM), competition watchdog (CADE), the Federal Audit Court (TCU) and the Central Bank are all becoming increasingly aggressive in the prosecution of purported breaches of laws and regulations.

We anticipate a continued rise in the number of D&O claims in the next few years.

Key risks are:

- **Criminal:** increase in corruption and unlawful management charges brought against directors of government-controlled companies and private companies in the context of public sector tendering and contracts;
- **Regulatory:** rise in the value of fines and amounts payable under plea-bargain style agreements entered into by directors and CVM authorities in respect of breaches of securities regulations;

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- **Tax:** greater efforts by authorities to collect taxes from companies by initiating criminal proceedings against directors for tax evasion;
- **Environmental:** recent disasters (Mariana and Brumadinho) have resulted in executives being charged with environmental crimes and corporate manslaughter;
- **Public Civil Actions:** increase in the use of this type of procedure whereby directors of government-controlled companies and private companies providing services to the public sector risk being liable to pay compensation to the Brazilian Treasury;
- **US class actions:** more class actions brought against Brazilian multinationals listed on the NYSE;
- **Data Protection Act:** Brazil's new data protection legislation will come into force in 2020 and provides for considerable fines that may be imposed on executives.

### China



Following the Chinese Communist Party's policy on maintaining financial stability, the China Securities Regulatory Commission (CSRC) has been strengthening supervision and law enforcement since 2017.

In 2018, 310 decisions were made, with a rapid year-on-year increase of 38.39%. Individual accountability has also been seen rising. As of November 2019, in 55 out of 70 punishment decisions (i.e. 78.6%), individual directors/senior officers have been punished together with respective legal entities.

As a result, the number of civil claims against concerned legal entities and individual D&Os is growing, mainly because:

- Decisions made by CSRC would usually constitute a key piece of evidence in civil claims against individual D&Os.
- Although Mainland China has not fully adopted a class action regime yet, a number of lawyers seem to focus on soliciting potential claimants upon notice of any CSRC punishment decision.

If both individuals and legal entities are punished by the CSRC and are then found liable in civil claims, individual D&Os could be held jointly and severally liable for the losses sustained by the claimants.

### Hong Kong



Hong Kong's primary legal mechanism for dealing with multi-party proceedings is to bring representative proceedings under the Rules of the High Court. Such proceedings have been rare and, to date, no securities action has been brought using the procedure.

As a means of holding financial institutions accountable, Hong Kong has implemented various regulatory measures, in addition to existing legislation, which give significant powers to the corporate and securities regulator, meeting the enforcement priorities of the Securities and Futures Commission (SFC).

As well as highlighting corporate fraud as a top enforcement priority, the SFC confirmed that it will pay attention to:

1. Companies issuing false or misleading financial statements;
2. IPO fraud and related sponsor failures;
3. Failures to manage conflicts of interest by the senior management of listed companies;
4. Insider dealing and market manipulation;
5. Intermediary misconduct;
6. Sponsor misconduct;
7. Money laundering.

The SFC has openly signalled an intention to place an emphasis on fewer but more "high-impact cases which pose the greatest risks to the investing public." Indeed, the SFC has in recent times commenced fewer investigations.

## 6. Conclusion

In today's increasingly globally complex commercial litigation environment, shouldn't a director be more involved in how her or his personal assets are protected in addition to the protection of the enterprise? Given the many and unique recent litigation trends explored, will it be more difficult to recruit non-executive directors for boards if the risk/reward equation is unbalanced? Will companies have clear, cogent responses when directors ask better and more detailed questions?

Although the US and UK reflect more established and tougher landscapes for D&O liability and mature markets for D&O insurance purchases, China, Brazil and Canada are examples of three countries where the scrutiny of D&Os is increasing and insurance protection both locally and globally is prudent.

Multinational indemnification and insurance arrangements should be regarded as "part of the package" as much as salary and other benefits. This all suggests to us that directors have to take a more active role in the purchasing decisions involving insurance for the protection of their personal assets. In particular, independent (non-executive) directors working with their corporate colleagues need to ask whether personal asset protection is on par with the protection provided to corporate (executive) directors. They should also ask whether there are appropriate local insurance policies available for purchase so that the protection is afforded to them independent of any obligation that the corporation has or doesn't have to them. The risk of liability for independent directors arguably now outweighs their level of reward, and so they have a particularly acute interest in ensuring they are properly protected, as well as their corporate counterparts.

When designing and implementing a multinational insurance programme that insures the risks of D&Os in international jurisdictions, clients, brokers and insurers should be aware of how D&O insurance is structured and whether such a structure will meet the needs and expectations of a company's D&Os around the world. Buyers and brokers of any multinational programme should work with a global insurer and independent financial, legal and tax advisers that maintain a local presence in the major jurisdictions where the multinational enterprise has interests.

Multinational insurance buyers also need to understand the structure of their enterprise and the impact such structure has in connection with insurance protection. For example:

Where does the enterprise directly and indirectly conduct business?

Where does the enterprise have (or intend to have) shares publicly traded?

Where does the enterprise expect insurance protection - for the main board only or does the enterprise expect insurance coverage to extend across the world?

Where does the enterprise's debt and credit financing reside?

An experienced, independent team of accounting, legal, tax and financial specialists can help structure a comprehensive and global insurance programme that fits the specific needs and goals of a multinational enterprise. Attention to these requirements and the need for documentation and supporting contractual arrangements should result in a compliant international D&O insurance programme that ultimately satisfies the collective objectives of the client, the broker and the insurance carrier in protecting D&Os.

## What directors need to ask about D&O insurance



What are my expectations from my business in terms of assisting me should I be named in litigation?



Given recent multinational trends, developments in the insurance products available, and constant legal changes relating to liability and indemnification, has there been a substantive review of the protections provided by the corporation in the last five years?



Will my company extend payment to costs of litigation or will I have to pay costs and then seek reimbursement?



Is there local insurance that is purchased by the company to indemnify the business for costs incurred or paid on my behalf?



If there is not local insurance in place, is there a limit to what my corporation will pay and then get reimbursed by a holding company or other that is in the ownership structure?



If my company chooses not to pay my costs or if my company is financially impaired such that it cannot pay my costs, will it purchase a policy for me for my potential personal liabilities?



Are the personal liability policy limits exclusively for me or are they shared with other directors on the board, including the executives?



Are independent and executive directors treated equally or are there differences between the protection for local independent directors and international executive directors and if so, why?



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