StrategicRISK

GUIDE TO:

Directors' & Officers' Liability Insurance

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CHARTIS

Testing times for the D&O safety net

Europe's sovereign debt crisis will mean more insolvencies

THE MARKET FOR DIRECTORS' AND officers' (D&O) liability insurance is now 80 years old, having initially been developed by Lloyd's of London in the early 1930s during the worldwide Great Depression. At that time, companies were not permitted to provide indemnification to their directors and officers.

Although focused on providing directors and officers of any company with financial protection, the buyers' profile of D&O insurance has steadily evolved and transformed over subsequent decades. Until the 1980s cover was purchased mainly by US companies, together with a number of non-US multinationals with a significant presence in North America.

In the past 30 years, the purchase of D&O has extended to many other regions around the world. This has in part been due to society becoming more litigious, with little tolerance for mistakes made by directors and officers – even when committed honestly and in good faith. "Previously thought a luxury of large companies, D&O liability insurance in Europe is primed for robust growth across companies of all sizes, as it is increasingly viewed as essential," stated Advisen in a recent report

For example, take-up among Russian companies, which at the start of the 21st century was confined to those with US listings, is percolating down to locally listed and even private companies. Significant future growth is expected in countries such as Brazil, venue for the 2016 Olympics, which is already seeing a high level of partnering between local companies and multinationals in areas ranging from telecommunications to credit card data processing.

In the wake of the worldwide financial crisis, notification levels of claims brought against directors in Europe rose to an all-time high during 2009 and 2010 as macroeconomic conditions deteriorated. However, Chartis and other insurers currently report a further 20% increase for 2011 on what had been regarded as peak years. Europe's sovereign debt crisis and the continent's weak macroeconomic dynamics could trigger a second wave of company insolvencies over the near term. The first quarter of 2012 was marked by a record number of business bankruptcies in both France and Italy.

Not surprisingly, surveys suggest that the number of directors and officers who ask about the amount and scope of D&O coverage purchased by their organisation is rapidly increasing.

Despite this challenging environment, conditions for corporate buyers of D&O insurance have grown steadily more favourable over the past eight years. As premium rates have reduced, many companies have taken the opportunity to increase the total limits of liability in their D&O programme at renewal and secure enhancements of the policy cover.

However, claims experience is biting hard. According to Nik Rochez, a partner at law firm Hill Dickinson: "It's difficult to get reliable figures, but talk in the European market is of some loss ratios being in excess of 100% and, staggeringly, some experiences in the US in excess of 1,000%."

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Plan ahead to feed the meter

Ligitation or claims against directors and officers can drag on for five to seven years. That's a lot of time in court to pay for without cover

Key points

01: D&O liability cover protects the personal assets of directors and officers in case of litigation

02: Criminal and regulatory cases can last five years and private claims even longer

03: Without insurance, the director or officer has to pay high defence costs personally

THE PERSONAL ASSETS OF directors and officers are at risk when they face investigations, proceedings and litigation – either individually or as a co-defendant alongside their company. Actions can be brought by regulators, public attorneys, any stakeholder of the company and, in some cases, even by the company itself against its own employees.

D&O liability insurance policies offer cover for directors and officers to protect themselves from claims arising from actions taken and decisions made in the course of performing their duties and responsibilities.

The time period that typically elapses between the initial notification of a potential D&O claim and its conclusion (for example, a final settlement) is substantial. For alleged criminal activity or regulatory issues, typically 90% of cases are still open five years after notification takes place. For claims involving private litigation, a period of seven years is typical. Of cases first notified in 2009, relatively few have so far been settled.

In some cases, D&O actions can be brought by the company itself against its employees

Not surprisingly, actions taken against directors and officers are expensive to fund. They generate substantial defence costs and potentially extremely high damages in the form of awards or settlement. Unless he or she has corporate indemnification or insurance, the individual director or officer must fund these expenses from personal resources. **SR**


Reuters

A decade of standards in common

How formal codes of practice for listed companies have spread through Europe

Key points

01: Europe has followed the US's lead in creating a more rigorous climate for governance

02: The UK, France and the Netherlands all require companies to follow codes of practice

03: The annual report and accounts is the usual means of reporting on how the code has been applied

THE INTRODUCTION IN THE USA OF the Sarbanes-Oxley Act in 2002 to establish more rigorous standards for US public company boards and management had its EU counterpart in the Company Law and Corporate Governance Action Plan of 2003, under which the European Commission recommended that member states should develop best corporate governance practices for their publicly traded companies.

Following the subsequent financial crisis, the commission issued a public consultation and green paper in April 2011 to review progress and give impetus for moving the focus from short-term policies to longer-term, more sustainable growth.

The liabilities of company directors and officers vary from country to country. Those of UK directors and officers are set out in the Companies Act 2006, which replaced the general principles that previously governed directors' duties with a more specific set of rules. The Act confirmed that the directors' duties are owed to the company – the basic duty being to promote the company's success – and this applies to all directors, whether elected and registered, de facto or shadow directors.

UK companies must also observe the obligations set out in the Corporate Governance Code (formerly the Combined Code) published by the Financial Reporting Council in 2008. Listed companies incorporated in the UK are required to report annually on how they have applied the code.

For French companies, basic corporate governance is set out in the Code de commerce and directors' duties in company bylaws, with specific additional requirements applied to listed companies by the Monetary and Financial Code and the regulations of the Autorité des Marchés Financiers (AMF).

Lawyers representing Deutsche Telekom shareholders in a 2008 class action suit which accused the telecommunications company of overvaluing its assets

Two more French corporate governance codes have been added in recent years: the APEF-MEDEF Code, introduced in December 2008, outlines recommendations for listed companies; and the MiddleNext Code, which followed in December 2009, applies to companies with market capitalisation of less than €1bn.

Directors of companies in the Netherlands, which is one of Europe's most litigious environments, have followed the Tablaksblat code on good corporate governance since its introduction in 2004 and subsequent 2009 updating. This code is based on the premise that each company comprises a long-term alliance between the company and its stakeholders, and requires that they use the annual report to inform investors how they have complied with its principles and best practice.

Italy's stock exchange, the Borsa Italiana, beefed up the country's Corporate Governance Code in 2006 in the wake of the financial scandal at dairy and food group Parmalat. The Code – recommended to companies but not compulsory – promotes the cause of independent directors and recommends that limits should apply to the power of the chief executive or any other senior executive.

Romania deserves mention as the first EU country (in December 2006) to make D&O insurance compulsory for directors of joint stock companies and subsidiaries of foreign companies, **SR**

Country focus: the thriving German D&O market

New rules insist directors and officers must pay at least 10% of their own damages

Key points

01: Since 2009, VorstAG has made directors' liability claims easier

02: A major shift has been in limiting cover that companies can provide for board members

03: DAX30 firms have responded by paying their board members more

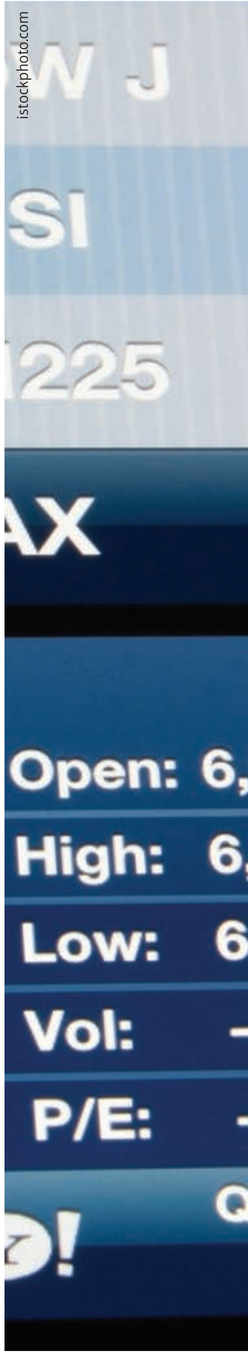
THE GERMAN D&O INSURANCE market is particularly competitive, with up to 40 participants. They range from international groups such as Chartis, underwriting companies ranging from small businesses to DAX-listed multinationals, to others focusing solely on select niches. There is a particular focus on the SME sector.

As Europe's largest economy, Germany presents both companies and underwriters with a number of special D&O considerations. Executives must observe a wide range of requirements under the Public and Private Companies Law and social security legislation. Up to 80% of claims made against directors and officers are made by their own companies, rather than coming from third parties.

Germany's Corporate Governance Code, otherwise known as the Cromme Code, was introduced in 2002 and has undergone two subsequent updates to clarify shareholders' rights in Germany's dual-board system.

In addition, following a series of corporate scandals, the government has made it easier to enforce liability claims against company directors. Since August 2009, German companies have had to contend with the requirements of the Act on the Appropriateness of Management Board Compensation, or VorstAG; ministers' response to the financial crisis.

VorstAG is based on the premise that the crisis resulted from companies pursuing short-term goals, to the



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detriment of their longer-term welfare. It established new requirements for determining the compensation of management board members. For listed stock corporations, it also established incentives for sustainable and long-term management.

The regulation affected stock companies purchasing D&O cover for their directors and officers. It decreed that the policy must incorporate a self-insured retention or deductible of at least 10% of any damages awarded against an individual director or officer, and with a maximum of 150% of his or her fixed annual remuneration. Individual directors and officers are permitted to take out additional insurance that covers the deductible, with the proviso that the company does not bear the cost.

The blue chips of the DAX30 have responded to VorstAG by adjusting their management board remuneration schemes; in many cases modestly increasing the remuneration paid to members.

However, the change has had limited impact on the D&O insurance market. Following the entrance of a major new player into the D&O market, premium rates were typically stable to 10% lower in 2011. Brokers report that more mid-market companies are focusing on compliance and international programmes, while there is competition among insurers to write business for SMEs. **SR**

The nuts and bolts of risk review

What kinds of cover are available and what questions should purchasers and underwriters ask first?

DIRECTORS' AND OFFICERS' (D&O) liability insurance should be comprehensive enough to cover liabilities that directors and officers face personally for any act or omission while acting in such capacity, in addition to liabilities that attach simply because they serve as a director or officer. Key elements for indemnification by the insurer are a wrongful act, a loss, a claim and resulting defence costs.

Cover generally extends to past, present and future directors, and also to non-executive, shadow, outside, retired or resigned directors and to their spouses, heirs and estates. It can also cover employees who are acting in a managerial capacity or joined as co-defendant with a director.

D&O policies divide into three basic categories, offering varying degrees of coverage:

'Insurance is part of, rather than a replacement for, good corporate governance'

Paul Hopkin Airmic

Side A cover:

This directly covers the personal liability of the company's directors and officers for losses resulting from claims made against them for wrongful acts committed in their capacity as an executive and for which their company is not permitted to provide indemnification.

Side B/Company reimbursement cover:

This reimburses the insured company for the cost of indemnifying its directors and officers as a result of claims made against them.

Side C/Securities entity cover:

This provides coverage for losses for claims relating to the violation of securities laws, which typically are brought by shareholders. **SR**

TOP TIPS

Airmic (the UK Association of Insurance and Risk Managers) technical director Paul Hopkin says that the following considerations should form part of a company's review when considering D&O cover.

1. Purchasers of D&O insurance should first undertake an evaluation of **why they are buying this insurance** and the circumstances in which they anticipate claims may arise, so that the insurance is relevant to their needs.
2. Organisations should consider the need for a formal **deed of indemnity agreement** between the company and its directors, setting out the extent of the indemnity provided to directors by the company.
3. Airmic views the purchase of D&O insurance as a **valuable protection for directors**, but only as part of, rather than a replacement for, the design and implementation of good corporate governance standards.
4. Ensuring compliance of **multinational insurance programmes can be a challenge**, and these challenges are, perhaps, at their greatest when purchasing D&O insurance, where individual territory requirements vary greatly.
5. It is important for underwriters to understand the D&O risk exposures that they are underwriting, and a **meeting with underwriters** to present details of the governance arrangements within the company is usually helpful.
6. Deciding on the limit of indemnity to be purchased is important, but **restrictions in cover** created by specific contract terms, detailed definitions and limitations or exclusions within the policy should be carefully evaluated.

Source: Airmic

Commercial opportunities beckon

The market has expanded across Europe despite steady softening, although financial institutions still present a problem for underwriters

Key points

01: There is room for new players, which leads to reduced rates and cover enhancements

02: If a company is level with its peers, poor financials are tolerated

IN 2011, REPORTS SUGGESTED THAT as many as 35 insurers were active in the UK market for directors' and officers' liability (D&O) insurance. Such is the degree of competition that the figure had risen further to more than 40 by the first half of 2012, offering total capacity of €1bn to companies in most sectors outside financial services.

The interim period has been marked by three new entrants into the market, collectively adding a further €22.8m to total capacity. They are the Channel Syndicate at Lloyd's, managed by Whittington Capital Management and capitalised by French reinsurer SCOR; Dutch-headquartered ANV Holdings and Lloyd's insurer Amlin, which plans to begin underwriting D&O in 2012. Except for a small number of companies with a significant US American depository receipts (ADRs) exposure, D&O rates for commercial organisations have continued to soften.

The D&O market has expanded across Europe despite conditions in the

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Athens, the centre of the sovereign debt crisis: the cost of Solvency II could lead to rate rises in 2013 market steadily softening since around 2004. For the majority of sectors, D&O rate reductions were still typical in 2011 despite an increase in notifications.

According to the *EMEA Insurance Market Report* published by broker Marsh, commercial directors' and officers' liability rates have continued to decline as underwriters view the middle market business as 'better risks'.

In a number of European countries, such as the Netherlands, the entrance of new players into the D&O market has led to increased capacity, reduced rates, broader policy wordings and an increase in the number of special facilities available. Even in Greece, the country most heavily impacted by the sovereign debt crisis, D&O rates as yet show little sign of hardening and there is still competition for business among the SMEs.

"Financial institutions in mainland Europe represent a particularly hard market and relatively few insurers want to offer D&O cover," says Mike Lea, head of management and transactional liability at broker Jardine Lloyd Thompson. "By contrast, commercial firms can secure plenty of capacity and various enhancements of the basic cover on the policy form, particularly if they are listed on an exchange such as the LSE."

"Underwriters have become accustomed to companies in financial difficulties; not least because in many cases their own company is enduring tough times. So they are ready to accept a weak financial performance, especially when the whole sector is performing poorly, as is often the case. A company is less likely to attract a D&O lawsuit if its performance is in line with that of its peers."


Reuters

A Spanish Treasury bills auction at a private bank in Madrid last month, part of a €3.2bn sale

'Underwriters are ready to accept a weak financial performance'

Mike Lea Jardine Lloyd Thompson

While D&O market conditions remain stable in 2011 for the majority of risks in Portugal, financial institutions were an exception, with rate increases of between 50% and 100% depending on the company's claims history. European financial institutions also face potential rate rises in 2013 as the cost of Solvency II begins to impact on insurers. **SR**

No longer a matter of 'one size fits all'

The need for global D&O policies to be tailored to local conditions is increasing

Key points

01: A global D&O policy may be ineffective or even illegal in some countries

02: Conditions can vary even between EU countries

03: A master policy plus back-up local policies may be a solution

FOR MANY YEARS MULTINATIONAL master D&O policies have been purchased by companies with international sales and operations. However, as more countries amend their laws to facilitate actions against directors and officers, companies have reviewed their risk exposures in countries where they have a presence to assess whether their D&O cover can respond to each potential exposure.

Most countries also have laws that make it illegal to use non-admitted insurance, so a global D&O policy in a country where the insurer is not admitted may not protect directors and officers in that country.

Having non-admitted coverage in local jurisdictions is also likely to present problems, such as premium tax compliance and claims payment tax. Some countries place restrictions of the movement of money, and in certain cases the authorisation of the national bank is needed before money can be paid into the country from outside.

"As a result, there has been an evident trend for more companies to purchase locally issued D&O policies, as opposed to a global master D&O policy – possibly reflecting pressure from the company's local directors," reports Mike Lea of Jardine Lloyd Thompson.

"Many of our own clients opt for a master global policy plus local policies in addition, to address any potential gaps in the coverage. Chartis, ACE, Chubb, Allianz and Zurich all have the international

'There has been a trend for more companies to purchase locally issued D&O policies'

Mike Lea Jardine Lloyd Thompson

presence that enables them to provide this service."

As an example Chartis, which has more D&O licences than any other carrier and in excess of 90 owned and managed local offices to handle claims, has the ability to issue and service locally admitted D&O policies in more than 180 jurisdictions worldwide.

In deciding which option best suits their needs, companies must balance conflicting factors: the high policy limits and wide protection that is provided by a global D&O insurance policy against the fact that local laws, regulations and customs erode – and in some cases even prohibit – non-local D&O liability cover.

What is an indemnifiable claim in the company's home jurisdiction may not be indemnifiable elsewhere. There is even considerable variety across the EU. So local D&O policies can provide a valuable back-up for foreign executives based in jurisdictions where the global policy may not be effective.

Buyers of a global policy should look to ensure that it provides excess insurance and possibly incorporates difference in conditions/difference In limits (DIC/DIL) cover to local policies. **SR**

US businessman Christopher Tappin was extradited to the USA earlier this year for allegedly selling batteries used in Iranian missiles

Anxiety comes in many guises

Directors and officers are increasingly aware of the risks and keen to protect themselves

AS A LEADING PROVIDER OF D&O coverage globally – and for companies ranging from the FTSE 100 blue chips to SMEs and non-profit organisations – Chartis has regular feedback on what executives regard as their most important personal concerns.

Directors and officers around the world are generally more aware of the duties and responsibilities placed upon them and the scrutiny to which they are subjected.

Non-executive directors in particular are conscious that their role has moved far beyond that of merely 'rubber-stamping' the decisions of the executive management team.

As a result, few individuals still seek a position on the board for reasons of prestige or money. Candidates offered a board seat want to ensure that the company has a high standard of corporate governance and that taking up the position does not carry potential for them subsequently becoming financially liable or placing their reputation at risk.

Reflecting the challenging economic and regulatory environments of recent years, directors' and officers' most pressing personal concerns are currently:

THE REGULATORY CHALLENGE

Towers Watson, which conducts an annual survey of D&O insurance purchasing trends, reports in its 2011 survey that 81% of 401 participant organisations cited regulatory claims as their biggest D&O liability concern. This was up from 78% in 2010.

- exposure to criminal and regulatory issues;
- exposure to insolvency risks and heightened economic stress;
- exposure to the consequences of cost-cutting and social disputes
- reputational risks.

For public and multinational companies, additional concerns are:

- investor relations, disclosure and accurate forecasting/reporting; and
- executing transactions and alliances, business model changes and globalisation.

The D&O liability exposures related to merger and acquisition activity and to divestments are also regarded as particularly acute.

"Deals involve a significant amount of disclosure; shareholders may not like the terms and conditions, while US companies routinely get hit with a 'bump up' suit from any acquisition or disposal," says Adam Codrington, a partner of the financial risks division at broker Jardine Lloyd Thompson.

The USA has also witnessed a high volume of so-called 'merger objection' lawsuits, characterised by investors of the target company suing their directors and claiming that the deal is not in shareholders' interests unless the offer price improves. These suits have been examined in some detail in a report produced by National Economic Research Associates (NERA).

A high level of claims have also been brought by the acquiring company against the company acquired for alleged misrepresentation or concealment of material facts that might otherwise have affected the price paid or prevented the deal from going through at all. Directors and officers can get dragged into this type of litigation as co-defending parties.

"Despite the financial crisis, strategic acquisitions are still very much on the boil," observes Ann Longmore, D&O, employment practices liability and fiduciary leader for the New York office of broker Willis. "Some companies gain the opportunity to cherry-pick the assets of a competitor who has become insolvent." **SR**

THE NATWEST THREE AND OTHERS

A controversial issue in recent years has been the US-UK extradition treaty of 2003, enabling the USA to extradite UK citizens for contravening American law. In 2006 three British businessmen – dubbed the NatWest Three or Enron Three – were extradited to the USA on allegations of fraud and subsequently served prison sentences of 37 months.

Subsequent cases include the extradition of Ian Norris, former chief executive of Morgan Crucible, in 2010 on charges of price fixing, and retired businessman Christopher Tappin in February 2012 for allegedly selling batteries used in Iranian missiles. The concerns that these cases have created among UK directors and officers makes extradition cover a 'mission critical' element of a D&O policy, says JLT partner Adam Codrington.

Key points

01: Non-executive directors also feel the weight of responsibility attached to their role

02: Criminal and regulatory issues, risk of insolvency, and reputation risks are high on the list of concerns

03: Mergers in the USA are a rich source of lawsuits. The acquiring company sues the target and the target sues its directors

A first anniversary vigil on 20 April 2011 commemorating the workers who died in the Deepwater Horizon BP oil rig explosion, now the subject of a class action suit

Reuters

Where America led on high exposure, Europe follows

The private sector is no longer a safe haven for liability and the USA now has rivals for its pole position on costly litigation

Key points

01: European directors face more indigenous claims

02: Australia, Canada, Germany and Holland are now high-risk jurisdictions

03: Claims against directors of private firms now outnumber those against their public peers

DATA ON D&O CLAIMS ACTIVITY IN Europe compiled by Chartis shows that there was a steady rise in claims activity in the years preceding the financial crisis of 2008. The trend was accelerated by this event and has been maintained over the past four years.

Notification levels of claims brought against directors and officers in 2011 were consistently 20% above those of 2009 and 2010, which had previously been regarded as the peak years.

Three distinct shifts have been noted by Chartis, derived from a client base of more than 50,000 directors' and officers' policies in Europe that spans the large multinationals to the smallest companies. First, directors in Europe now face far more indigenous claims. The USA has traditionally been prolific in terms of very costly litigation for directors. While this continues to be the case, it has now

> *'We witnessed more claims directed at private companies for the first time'*
>
> **Géraud Verhille** Chartis Europe

been joined by jurisdictions elsewhere in the world as high exposure areas.

Australia, Canada, Germany and the Netherlands have the greatest volume of shareholder litigation activity after the USA, while France, Italy and the UK have the largest number of regulatory proceedings.

Costly and long investigations, proceedings or litigation have become commonplace in most countries of Europe, although the basic causes will differ between individual countries. As a result, defence costs typically comprise the greatest proportion of a covered loss.

A second noticeable trend has been that the volume of claims brought against the directors of private companies now outnumbers those against their public peers. In 2008 losses incurred by Chartis from claims against executives of private companies in continental Europe represented 22% of all claims notified; by 2010 this had risen to 56% – only partly reflecting an increase in the number of private companies buying D&O insurance.

"For a long time, private companies were regarded as a safer haven for

CASE STUDY: FORTIS AND VEB

The perilous position of Fortis, the Dutch/Belgian financial services company, was exposed by the 2007-08 financial crisis. Fortis had considerable US subprime mortgage debt and was in the process of completing the world's biggest bank takeover of the Dutch operations of ABN Amro. By October 2008 the company had been bailed out by a combination of the Dutch, Luxembourg and Belgian governments. Fortis was broken up and sold to various third parties. Investors lost out.

Since the collapse there have been a number of investigations into the circumstances of Fortis's demise, by the Belgian regulator, BFIC, and the Netherlands Authority for the Financial Markets. Much criticism was made by those regulators.

Investor groups have pursued legal proceedings in the Dutch courts. Allegations include mismanagement by the Fortis board of directors and that investors were misled regarding the level of exposure to subprime mortgage and other collateralised debt. It has been alleged that the company misrepresented the extent to which the decision to acquire ABN Amro compromised the company's solvency.

In February 2010 Fortis was fined for violations of the Dutch Securities Act. In February 2012 the former chief executive and finance chief were found by a court in Utrecht to be guilty of making wrongful statements and are liable to compensate investors.

The most recent development, in April 2012, is a finding by a Dutch court in proceedings brought by the Dutch investor group Vereniging van Effectenbezitters (VEB). The court agreed with VEB that there were elements of mismanagement, including in respect of measures to improve and maintain the solvency of the Fortis companies, information provided by Fortis about subprime exposure in its prospectus and trading update in September 2007, and the publication of information about Fortis's liquidity and solvency in September 2008.

The court nullified the effect of an AGM decision in April 2008, which had provided a discharge of all liabilities for the Fortis directors.

Ageas, the new Fortis entity responsible under termination agreements with the former directors, will appeal the decision in the Dutch Supreme Court.

Source: Hill Dickinson

SOURCES OF CLAIMS

For exposures faced by directors of all companies in Europe, both private and publicly traded, excluding securities issues, Chartis Europe notes the following in its *Claims Intelligence Report** as the five main sources of exposure by nature of loss:

1. **Regulatory or criminal actions** – including investigations and proceedings brought by state attorneys or regulators for matters such as alleged corruption, antitrust, unlicensed activity or misappropriation of assets.
2. **Bankruptcy actions** – including claims brought by receivers for continuing to trade while insolvent, or asset stripping.
3. **Company vs insured actions** – or claims brought by or on behalf of the company by shareholders for breach of fiduciary duty, causing waste of assets.
4. **Co-defendant actions** – including claims brought by third parties against the company for anti-competitive behaviour or misrepresentation, and naming a director or officer as co-defendant.
5. **Merger and acquisition actions** – including claims brought by minority shareholders alleging unfair treatment or valuation in a sale, acquisition or merger deal.

In addition to these five, three additional major exposures can be added for companies with listed securities:

6. **US securities actions** – claims brought by shareholders or securities regulators in the USA.
7. **Non-US securities actions** – claims brought by shareholders or securities regulators outside of the USA.
8. **Regulatory action** by the Securities and Exchange Commission and/or the Department of Justice in respect of corruption allegations (Foreign Corrupt Practices Act) on the back of a US listing

**Claims Intelligence Report 2012 – Directors' & Officers' Liability,* Chartis Europe

directors' and officers' liability than listed companies," comments Géraud Verhille, head of D&O liability at Chartis Europe. "But over the period we witnessed a paradigm shift, with more claims directed at private companies for the first time."

And third, empowered regulatory bodies, state attorneys and criminal courts around the world have begun to aggressively pursue directors for actual or alleged misdeeds. They have become the more prevalent sources of action against directors, overtaking the number of actions brought by civil plaintiffs.

Following the US decision in the case of *Morrison v National Australia Court* (see box, 'Recent legal actions'), Nik Rochez of law firm Hill Dickinson believes that the Netherlands could become the focus of jurisdiction for securities class actions.

He adds that the UK is witnessing increased activity by both the Financial Services Authority (FSA) and Lloyd's, with the FSA routinely commencing section 166 (aka Skilled Person Report) investigations.

Other common sources of D&O claims have included company employment practices and HR issues, reporting errors, and inaccurate or inadequate disclosure in company accounts, and actions taken by a director or officer that exceeds his/her authority.

Another trend evident in the past five years has been that of UK pension funds taking the lead in securities class actions in the USA, reports Ann Longmore of Willis.

RECENT LEGAL ACTIONS

- Among the most high-profile legal actions against UK directors and officers was a claim by insurer **Equitable Life**, which in 2005 pursued 15 former directors for a figure of €4bn alleging that they had failed in their duties to policyholders. Equitable eventually abandoned the case at a cost of €12m.
- In 2010 supermarket group **Safeway** successfully applied to pursue a groundbreaking lawsuit against former employees and directors to recover competition law fines from the individuals allegedly involved in price fixing. The suit was ultimately dismissed by the Court of Appeal on the grounds that it was barred by public policy.
- **BP directors** are being sued by both US and UK shareholders for derivative damages under the UK Companies Act relating to the April 2010 Deepwater Horizon explosion. The class-action suit alleges that the company misled investors by concealing a history of cost cuts, safety lapses and workplace accidents.
- Non-securities-related class action lawsuits against **Carnival Corporation**, owner of the cruise ship Costa Concordia, were filed in US courts following the sinking of the vessel and resulting fatalities in January 2012. Although Costa Cruise Lines has its headquarters in Italy, it is also registered in Florida, but as the plaintiffs' law firm acknowledges: "It is unknown whether the US courts will accept the class action claim, given that the conditions set forth by the cruise ship tickets specify that litigation must take place in the Italian courts."
- Shareholders of **Tokyo Electric Power Co Inc** (TEPCO), operator of the Fukushima nuclear plant in northeast Japan, filed a €51bn lawsuit against 27 current and former directors in March 2012, alleging that they failed to prepare the plant to withstand a severe natural catastrophe such as a tsunami.

"UK pension funds suddenly woke up and became more aggressive after an article took them to task, pointing out that they were neglecting their fiduciary duties in not taking action in these cases," she says.

"They responded by starting to lead them and gained good training in how to handle themselves. As a result they have become more sophisticated and more knowledgeable. We now see UK pension funds – and sometimes French pension funds – lead securities litigation in Europe." **SR**

'We now see UK and French pension funds lead securities litigation'

Ann Longmore Willis

No hiding place from the people's revolt

With scrutiny by regulators and stakeholders ever tighter, the class action is here to stay

Key points

01: The US model of collective or class action suits has spread to Europe

02: One reason for this is US courts routing claims back to Europe

03: The rise in corporate bankruptcies has led to more executives being sued

04: There has also been a rise in Serious Fraud Office cases in the UK and discrimination cases in France

THE PAST FEW YEARS HAVE BEEN marked by several trends that have emphasised the importance of directors' and officers' liability (D&O) insurance for both publicly traded and private companies in Europe.

Among the most significant is a greater number of collective action suits brought in European courts. Traditionally the USA was regarded as the most favourable forum for such disputes. As a result, many foreign investors were persuaded to join US actions, even when their case was not directly related to that jurisdiction.

This situation has changed as a result of the US Supreme Court decision in June 2010 in the case of *Morrison v National Australia Bank*. This served to strengthen the hand of judges to reject cases that they deem as belonging in more geographically relevant arenas.

"They may not happen as readily as class action suits like we see in the USA yet, but multiple party actions involving groups that have suffered common losses or share common problems are emerging in Europe," comments Géraud Verhille of Chartis. "What also contributes to this is US courts telling holders of foreign shares 'there is an alternative forum for your class, as you did not purchase your shares on the US stock exchange' and redirecting the case to an indigenous forum.

"As a result, we see the foreign components of existing US actions being pushed back into Europe and litigated here."

Nik Rochez, who recently moved from US law firm Dewey & LeBoeuf to UK firm Hill Dickinson adds: "Don't underestimate the resolve of the US plaintiffs' bar. This is their livelihood and they will find ways to bring similar claims, either in the USA or in other jurisdictions. This type of claim is here to stay."

The rise in notification of claims against directors and officers observed by Chartis Europe over recent years can be related to the following areas, mentioned in its *Claims Intelligence Report*:

(i) An active regulatory investigative environment:
   - The number of cases handled by France's regulator against discrimination rose from 1,400 cases in 2005 to 10,000 in 2009.
   - The UK's Serious Fraud Office (SFO) handled more than 100 cases in 2011, against a total of 60 in 2006. The UK Bribery Act, which came into force on 1 July 2011, gives the SFO more power over a much greater number of companies and individuals.

(ii) Active criminal law enforcement in the corporate sphere:

Protest in Madrid on 15 April against health service cuts to combat the sovereign debt crisis

'Don't underestimate the resolve of the US plaintiffs' bar. This is their livelihood'

Nik Rochez Hill Dickinson

- In France, the number of criminal convictions in health and safety, antitrust and other corporate law cases increased by 17% between 2004 and 2008.
- In the USA, over the period 2007 to 2010 the number of anti-corruption enforcement actions by the Department of Justice and the Securities and Exchange Commission increased by 95%.

(iii) The effect of the global financial crisis reflected in more bankruptcies and claims made for or on behalf of companies uncovering a breach of fiduciary duties by executives:

- In France bankruptcy litigation rose from 47,000 cases in 2006 to 61,000 cases in 2009. The latter year saw a record 61,595 corporate bankruptcies in France, but in the first two months of 2012 a total of 10,900 companies filed for bankruptcy.
- The number of Spanish companies declared bankrupt has steadily risen, from less than 1,000 in 2006 to nearly 6,000 in 2009 and 2010, and 6,500 in 2011.

(iv) Increasing scrutiny by regulators and stakeholders of the acts of individual directors and officers:

- In the UK the number of directors reported for alleged misconduct by insolvency practitioners has risen from 3,539 in 2002 to 7,030 in 2010. While there was a slight dip in the amount of corporate fines issued by the Financial Services Authority between 2010 and 2011, the amount assessed against individual directors rose by 47%.
- In the USA the number of criminal charges by the Department of Justice linked to antitrust against individuals increased by 67% between 2004 and 2009.

The examples are derived from publicly available sources. **SR**

Valencia, October 2011: Protest against Spanish government cuts

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Casualty toll of sovereign debt crisis still mounting

Real estate joins finance in the eurozone corporate insolvency firing line

THE PROLONGED PERIOD OF WEAK and negative economic growth in Europe, which has particularly affected the economies of Portugal, Ireland, Italy, Greece and Spain, has repercussions for companies in many sectors and their D&O cover.

Despite efforts to address the problem of sovereign debt in many eurozone countries, the crisis appears to be far from resolved and many companies, particularly in banking and financial institutions, are exposed to sovereign debt, rating downgrades and potential debt write-offs.

More companies could suffer the fate of securities firm MF Global, whose filing for bankruptcy protection in October 2011 triggered a spate of securities class action lawsuits filed against its former chief executive and other directors.

The prospect of further corporate bankruptcies poses a challenge for D&O insurance underwriters in determining not just which companies are directly exposed to sovereign debt but those with an indirect exposure.

"Spain has witnessed a definite increase in D&O cases over the past year, the majority relating to corporate insolvencies," confirms Ignacio Figuerol, a managing partner of law firm DAC Beachcroft's Madrid office. "The biggest have been in the real estate sector."

One of the most high-profile cases has involved real estate group Martinsa-Fadesa. The company was created in September 2006 when Manuel Jove, founder of property company Fadesa Inmobiliaria, sold his 55% stake to Martinsa for $3bn, shortly before the bubble in the Spanish property market burst.

In 2008 Martinsa-Fadesa filed for bankruptcy protection in the largest corporate collapse in Spanish history (it has more recently emerged, following reorganisation). The group subsequently sued Jove for $2bn, alleging that the purchase price of Fadesa had been artificially high. Although the case was rejected, the group has the option to appeal.

Another massive claim, for $1.3bn, was lodged against Colonial, which was Spain's second-biggest real estate group before its shares fell by 40% in two days at the end of 2007. Half of its board members were forced to resign and the price drop prompted an investigation by Spanish market regulator the Comisión Nacional del Mercado de Valores (CNMV), who suspended trading in the shares.

In France, D&O underwriters anticipate an increase in the incidence of fraud – typically relating to disclosure on performance or the misuse of corporate assets – as a result of slow economic growth, and are concerned that financial institutions will be forced to make more write-offs. Insurers are responding by requesting more information on a company's sovereign debt exposures and a detailed financial analysis.

Athens, December 2011: A pensioner takes on the government in the midst of recession

'Spain has witnessed a definite increase in D&O cases over the past year'

Ignacio Figuerol DAC Beachcroft

Economic slowdown is likely to spur more widespread purchase of D&O cover in the countries of central and eastern Europe. Claims activity had been more subdued, due largely to laws in many regions requiring shareholder actions against directors or officers to be brought in the name of the company.

A recent wave of claims brought by or on behalf of companies in eastern Europe seeking redress after speculative and unauthorised currency trading is bringing a stark contrast to this perception. **SR**

Key points

01: Weak growth in Europe has a profound effect on companies and their D&O cover

02: Bankruptcy can trigger a spate of securities class action lawsuits

03: Economic slowdown is likely to spur more purchasing of D&O

Renewed rigour holds warning for Europe in the post-Enron climate

The USA continues to set the pace in the volume and scale of litigation

EUROPEAN COMPANIES WITH ANY degree of D&O exposure in North America need to be up-to-date with recent developments in the USA.

Although D&O insurance is rapidly extending to other parts of the world, the USA still accounts for about two-thirds of a market estimated at €7.5bn, reflecting its status as the world's largest economy, the size of its companies and its reputation as the country setting the pace in litigious activity.

As in Europe, conditions in the US D&O market have been soft for several years but now appear to be moving to a transitional phase, stabilising in 2012 before rate increases in 2013, says Ann Longmore of Willis. Hedge funds are already reported to be encountering renewal premium increases of 5% to 10%.

"The market has traditionally lagged behind developments in the US property/casualty market by between three and five quarters," Longmore says. "As property/casualty rates are now starting to move higher, D&O could follow next year – particularly as most insurers' portfolios have taken a hit and there are relatively few purely monoline D&O carriers."

A decade ago, headlines were made by multibillion-dollar securities claims against corporations such as AOL Time Warner, Enron and WorldCom. Since 2007 there has been a wave of subprime and credit crisis-related lawsuits, which have already resulted in a number of massive settlements although there is still a huge backlog.

In the wake of Madoff

The revelation in 2009 that the wealth management business of Bernie Madoff was a giant Ponzi scheme that defrauded thousands of investors has also had a massive impact on D&O. Madoff implicated many other entities during his trial, from non-profit organisations to brokerages. Underwriters have responded with more detailed, individual assessments of companies requesting D&O cover and more detailed inquiries into companies operating in high-risk industries or with global operations.

The US Department of Justice (DoJ) and the Securities and Exchange Commission (SEC) have stepped up their enforcement of the Foreign Corrupt Practices Act (FCPA), which prevents a company and its employees or agents from making illegal payments to foreign officials to secure or retain business. Private plaintiffs may also file actions against directors or officers who have contravened the FCPA.

In December 2011 news reports stated that Deutsche Telekom and Hungarian subsidiary Magyar Telekom had agreed a €70m payment to US authorities to avoid criminal prosecution by the DoJ over the groups' alleged contravention of the FCPA. Magyar was

'The worst US D&O claims have been those based on M&A deals that go awry'

Ann Longmore Willis

alleged to have bribed government officials both in Montenegro (to keep new competitors out of the market) and in Macedonia (to win a more lucrative contract). Deutsche Telekom, which had a majority stake in Magyar, was said to have lacked internal controls that would have detected the scheme.

Another US government entity, the Federal Deposit Insurance Corporation (FDIC) – created in the 1930s to maintain public confidence in the financial system – has been pursuing executives of failed banks. It has issued D&O liability suits against a total of 27 banks over the period July 2010 to March 2012.

Whistleblowers' charter

More 'whistleblower' lawsuits could begin to emerge following the SEC approving changes to its rules, as mandated by the Dodd-Frank Act, in 2011. The new rules encourage employees to report any securities law violations by their company, and offer them between 10% and 30% of the money the SEC collects through enforcement. Whistleblowers must make the company's own reporting system their first port of call, and as a result internal fraud reporting has increased.

However in recent years "the worst US D&O claims have been those based on merger and acquisition deals that go awry; often where financial fraud is uncovered some 12 to 18 months after the deal has been concluded," Longmore reports. "The acquired company's fraud then becomes the acquirer's fraud and shows up in its financials. Shareholders then claim that the company overpaid for its acquisition."

Chinese effect on class actions

In 2011 a total of 188 securities class action lawsuits were filed, in line with the average figure of recent years, and a further 57 during the first quarter of 2012. Of the 2011 total, 41 filings were against US-listed Chinese companies and a further 27 involved other non-US companies – reflecting a trend for many Chinese companies to acquire a US 'shell' company to achieve a listing on a US exchange. Of the 188 filings, 43 were merger-related and the percentage (22.9%) was similar in Q1 of 2012.

The landmark case of *Dukes v Wal-Mart*, the biggest employment discrimination lawsuit in US history, dragged on for a decade. Lodged with the US District Court of San Francisco in June 2001, it was initiated by Betty Dukes, a female employee of the retail giant who alleged that the group discriminated against women in promotions, pay and job assignments.

The case potentially involved more than 1.5 million current and former employees of Wal-Mart and Sam's Club stores. The lack of progress rested on the issue of whether the suit could proceed as a class action.

In summer 2011 the Supreme Court decreed that as Wal-Mart's local managers determined pay and conditions, rather than corporate policy, a class action was not appropriate. **SR**

Key points

01: Keep up-to-date with developments as regulations change quickly

02: The Madoff scandal had a massive impact on the D&O market

03: More whistleblower lawsuits could emerge following changes to US laws

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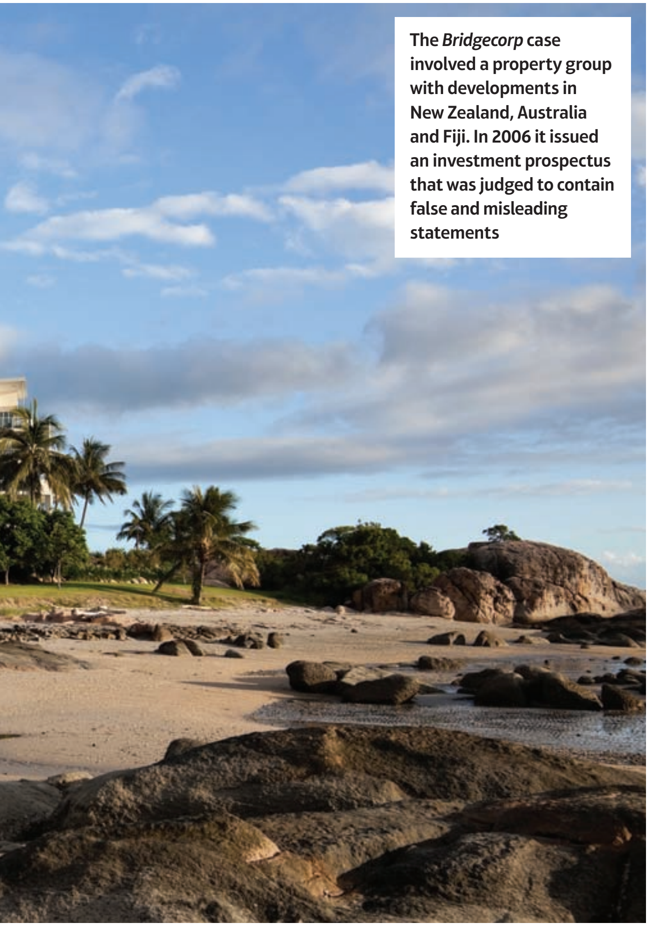
Bitter lesson of New Zealand property trio

Directors in Australia and New Zealand must prepare to fund their own defence

THE HIGH COURT OF NEW Zealand's recent decision in the *Bridgecorp* case has potential implications for D&O policies issued in Australia and New Zealand.

Steigrad v Bridgecorp Ltd concerns a New Zealand property group of companies that went into receivership in July 2007 owing NZ$490m (€285m) to 14,500 investors. Bridgecorp borrowed money from investors to fund developments in Australia, New Zealand and Fiji. In late 2006 it had issued an investment prospectus that



The *Bridgecorp* case involved a property group with developments in New Zealand, Australia and Fiji. In 2006 it issued an investment prospectus that was judged to contain false and misleading statements

The High Court ruling prevented Bridgecorp's D&O insurer from advancing defence costs

was judged to have contained false and misleading statements.

This included a declaration that the company had never missed an interest payment and had adequate funding in its accounts for loans that might be unrecoverable. It also omitted details of a substantial loan relating to a development in Fiji vulnerable to the country's political instability.

In April 2012 the court found three of the company's former directors guilty on 18 separate Crimes Act, Companies Act and Securities Act charges. The Crown prosecutor said that he would be seeking a "substantial term of imprisonment" that exceeded previous sentences related to other casualties of the financial sector downturn.

The charges carry penalties of up to five years' imprisonment or a fine of up to NZ$300,000 under the Securities Act; a similar maximum jail term or a fine of up to NZ$200,000 under the Companies Act; and up to 10 years' imprisonment under the Companies Act.

The decision has potential consequences for directors of Australian and New Zealand companies reliant on their company's D&O policies to fund their defence costs in civil and criminal proceedings.

The High Court ruled that a statutory charge existed in favour of a potential claimant over monies payable to directors under a D&O policy. Consequently, Bridgecorp's D&O insurer in New Zealand was unable to advance funds to the New Zealand directors for their defence costs. **SR**

Netherlands next stop for non-US plaintiffs' securities fraud suits

The Supreme Court's Morrison *ruling has cast foreign stakeholders adrift*

TWO MAJOR COURT DECISIONS within the past two years have had significant impact on D&O insurers and on claims.

The US Supreme Court decision of June 2010 in the case of *Morrison v National Australia Bank* is regarded as seminal. It decreed that US securities laws did not permit so-called 'f-cubed' cases – or securities claims against foreign-domiciled companies and brought by foreign-domiciled claimants who bought their company shares on foreign exchanges – in US courts.

US securities laws, the Supreme Court decided, relate solely to "transactions in securities listed on domestic exchanges" and to claims relating to "domestic transactions in other securities". As Ann Longmore of Willis notes: "Non-US stakeholders were basically told to go home to their own jurisdictions."

Before the *Morrison* case, the "conduct and effects" test decided whether plaintiffs trading in non-US stocks had an implied right of action under the federal securities laws. It permitted eligible US investors trading in non-US stocks on non-US exchanges to sue for securities fraud under federal law.

Reuters

French SCOR chief executive and chairman Denis Kessler at the Converium AGM, 2007

Since the decision, investors outside the US have been seeking alternative jurisdictions where they might lodge claims for securities fraud. The Netherlands has recently emerged as a front runner, following a January 2012 decision by the Amsterdam Court of Appeal in the *Converium* case.

The case concerns Swiss reinsurance company Converium, which is listed on the Swiss stock exchange and also, through American depository shares (ADRs), on the New York Stock Exchange. Converium's shares fell sharply in September 2004 when the group announced a heavy loss, an increase in its loss reserves and plans to put its North American operations into run-off; resulting in securities class actions in the USA by both US and non-US investors.

However, in line with the *Morrison* decision, the US District Court declared that it lacked jurisdiction to consider the claims of non-US investors. Converium then settled the action brought by US investors and instead settled the potential claims of non-US investors with two Dutch representative organisations: the Hague-based Stichting Converium Securities Compensation Foundation and Dutch shareholders' association VEB. This enabled the Amsterdam Court of Appeal to declare an international collective settlement agreement binding, even though the case overall had only tenuous links with the Netherlands.

"The *Converium* decision appears to go quite the other way from *Morrison* and could see the Netherlands become the home port for non-US shareholders in future cases," Longmore suggests. "We already know that the Dutch are quite adept at litigation and can form trusts of shareholders to get around the general lack of class actions in Europe."

The Amsterdam Court of Appeals has previous form: in May 2009 the Court approved a €288m securities fraud class action settlement between shareholders and Royal Dutch Shell based on allegations that the group had deliberately exaggerated its reserves estimates. **SR**

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'The Converium *decision could see the Netherlands become the home port'*

Ann Longmore Willis

The big guns are out for private companies and individuals

What the regulatory and litigation landscape holds in the next decade

President Abdullah Gul of Turkey visits the Bombay Stock Exchange in 2010

Key points

01: US concepts such as bounties for whistleblowers are spreading to Europe

02: Regulators are stepping up interventions in emerging economies

03: Litigation is increasingly targeted at individual directors

04: Reforms may limit access to UK and Italian courts on employment

A NUMBER OF ALREADY EVIDENT trends are likely to impact on European companies and their directors and officers over the years ahead, shaping the future market for D&O insurance. Already more than 25 countries worldwide have introduced some form of group litigation rules for class action lawsuits, up from only three in 2000. They range from European countries such as the UK and Italy, to Israel and emerging market nations such as Bulgaria and Indonesia.

Among the developments anticipated over the years ahead, Géraud Verhille of Chartis mentions the following:

More claims against executives of private companies: The frequency has already risen sharply since the global financial downturn, so that it now outnumbers the volume of claims brought against their listed counterparts. Regulatory and criminal actions, claims brought against executives by their own company, claims brought by competitors or clients naming executives as co-defendants, and bankruptcy actions are all likely to increase in frequency.

Further actions brought by regulators and public prosecutors: The trend will further accelerate if US concepts such as deferred prosecution and whistleblowing gain momentum in Europe; the US Securities and Exchange Commission (SEC)'s policy of offering significant bounties to whistleblowers could be copied by other countries. The strong growth taking place in the emerging economies of Latin America and Asia will be accompanied by an expansion of regulatory activity.

The increasing co-operation between national regulatory bodies, such as the UK's Financial Services Authority (in its current and future forms) and the SEC, is likely to further increase – as is collaboration between EU member states.

Legislation such as the UK Bribery Act came into force only recently and its

full impact has yet to be felt. The Corporate Manslaughter Act has been longer in force but has to date produced only one conviction: a fine of £385,000 (€470,000) imposed on Cotswold Geotechnical in February 2011.

European businesses will also be affected by the proposed new General Data Protection Regulation that the EU intends to introduce to achieve greater harmonisation of data protection laws across member states. The regulation has significant implications for business and companies failing to comply face significant fines.

Further securities-related claims from civil plaintiffs in Europe: Avenues for more litigation in Europe are being facilitated by changes in legislation regarding collective or group actions in Europe, and also by the European domiciliation of litigation funding and law firms with a US plaintiffs' bar heritage. The *Converium* case decision in the Netherlands of January 2012 is a prime example of this trend.

More bankruptcy litigation: Continuing sovereign debt issues and a macro economic slowdown in Europe will unfold over the near term, and a further liquidity crisis looms. The impact will fall most heavily on smaller businesses, distressed sectors and on companies with high gearing and/or heavily reliant on state funding or procurement. Subsidiaries and affiliated companies, or larger, more financially healthy groups could also be vulnerable.

In such cases, attempts to recoup creditor losses by bringing allegations such as asset stripping may be particularly vigorous.

A litigious culture against individual executives may be developing: In the past the company was typically the sole target and claims against individual directors were comparatively rare, but no longer. A culture of zero tolerance and fear of bringing liability on oneself is becoming prevalent.

There are also likely to be more claims from stakeholders seeking accountability for corporate losses or from commercial partners or competitors naming executives as co-defendants.

The impact of social media: The rapid growth of online services such as Facebook and Twitter is potentially beneficial to companies, and many are examining how to use them as an advertising medium. However, social media can also focus unwelcome attention on a company or its management, and sites are increasingly used to drum up support either for or against corporate strategies. A campaign against a company can gather support very rapidly.

Exposure relating to cyber-attacks: In the USA the SEC issued guidance – as yet non-binding – in October 2011 on the need for companies dependent on digital technologies to disclose their cyber-security risks and any cyber-attacks they have suffered. As such incidents can potentially affect the company's turnover and financial health, claims based on alleged non-disclosure may well proliferate.

'A litigious culture against individual executives may be developing'

Géraud Verhille Chartis

Exposure arising from increasing business activity in growth economies: The compulsory licensing decision related to a pharmaceutical product and plans to legislate retroactive tax on foreign asset purchasing are two recent illustrative examples in India of situations that the business community would probably find highly unexpected. Such situations may make it more difficult for directors and officers to bring predictability to investors on their overseas operations.

Pro-business reforms born out of the European sovereign debt crisis: The crisis may lead some member states to structural reforms to facilitate growth and entrepreneurship.

Reform has, for example, been envisaged in the UK and Italy with respect to employment legislation, and may consequently limit access to courts and curb a trend of rising employment-related legislation. **SR**


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is on the agenda.