

A GUIDE TO

Directors' & Officers' Liability in Europe

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Introducing the D&O guide

Directors experienced three shockwaves from the 2008 global financial crisis: the immediate consequences, the knock-on effects and the new environment that emerged.

An immediate consequence was the huge financial losses on capital markets. Investors (particularly in financial institutions) demanded financial redress, or at least someone to pin responsibility on. Directors found themselves the target of investigations, along with civil and criminal proceedings, to establish their wrongdoing – and faced the gloomy prospect of litigation at the end of it.

The second wave included a global credit crunch, economic slowdown, European sovereign debt crises and weaker public finances that affected all industries. Businesses relying on debt and a benign economy were hit hard. Financial performance slumped. Some suffered dislocation of their balance sheets, others went bankrupt and directors faced an onslaught of mismanagement actions.

These actions were built on an array of allegations, from waste of company assets to illegal enrichment, and led to a growing number of personal bankruptcies. Early dismissals and settlements to quietly ease directors out become less frequent. Allegations based on forensic review of individuals' actions caused longer, more expensive and more traumatic proceedings.

In the third wave, the new global environment emerging from the crisis is affecting everyone. We have seen legislative change, empowerment of regulators and greater cross-border co-operation. Corruption has been in the spotlight as the UK passed its Bribery Act this year, and the US Department of Justice took a tough line enforcing the Foreign Corrupt Practices Act. Other areas were affected too: more scrutiny on antitrust practices, workplace health and safety, and environmental impairment.

The crisis also spawned new behaviours, such as a trend to zero in on executives with less leniency (even in moderate jurisdictions) as stakeholders tried to minimise loss and maximise financial redress. Barriers to litigation were reduced with changes to legal systems to facilitate collective actions and the emergence of litigation funding in Europe. Underlying it all, we have seen a general increase in valid claims as stakeholders, receivers and counsels across the world have a better understanding of directors' and officers' (D&O) liability and how to access it.

Defence costs can be considerable, compounded by inherent conflicts of interests between directors that increase the complexity and length of cases. Company indemnification may often be possible, but dangerous to rely on entirely: the company may not be solvent, legislation allowing company indemnification may change, and within the company new senior executives may not follow the same indemnification policies as their predecessors.

In determining the adequacy of their D&O insurance protection, directors need to consider their insurers' sustainability, the clarity of its policy language, and its ability to innovate and respond to changing conditions. They need to consider their insurer's global capabilities and longevity in the D&O space.

Perhaps most of all, they need to be confident of their insurers' claims delivery and the expertise of its claims teams – capabilities that are so essential to help executives deal with daunting allegations in the most hostile D&O environment we have ever seen. ■

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State of the market

- Despite the financial crisis, the directors' and officers' insurance market
- is stable, with plenty of insurers competing on price. But, as government
- austerity measures kick in, claims could increase and perhaps even force a
- hardening, finds Nathan Skinner

The business world is back in the headlines. And that means the people at the top of it are coming under closer scrutiny.

Correspondingly, the operating environment for directors and officers has only become more onerous. The prime responsibility of a director is to ensure their company is well run. Unfortunately, the number of corporate disasters and ensuing claims of negligence or incompetence against company directors since 2008 has risen steeply. Many European institutions have been the subject of litigation, both from investors and shareholders. And the cost of proceedings is skyrocketing in line with legal expenses and the scope of multi-jurisdictional regulatory investigations.

The need for companies to cut costs has meant large-scale redundancies, and with employees more aware of their employment rights, they are now more prepared to seek financial recourse against their previous employers and directors.

Added to this, regulation in numerous areas is becoming ever-more onerous and the regulators themselves are taking a more aggressive attitude in ensuring companies and their directors are acting within the law.

Good risk

So why do prices in the directors' and officers' (D&O) insurance market remain, for the most part, low, with ample capacity for even the largest commercial risk? The answer is that the much-hyped tsunami of claims in the wake of the financial crisis has not materialised. While the insurance market has experienced a

surge in activity, it is yet to harden significantly outside the financial services sector. Insurers still see D&O as a good risk.

And, as a result, the D&O insurance market remains competitive, with plenty of insurers displaying their wares. Even D&O buyers at financial institutions have enjoyed some softening of their terms and conditions over the last six months.

"Most insurers still deem D&O a profitable sector, and this is evidenced by new entrants to the market along with an increased focus on resource and capacity from incumbent insurers," Heath Lambert's director of financial and professional risks, Mark Burden, says.

Marsh D&O liability broker Chris Newell goes further: "The market in commercial D&O remains extremely soft. In London, we have access to in excess of £525m [€639m] capacity. There is more than enough capacity to accommodate every commercial risk that I've seen in the last three years."

Another D&O liability broker at Marsh, Frederic Boles, adds: "At the moment, the D&O market remains competitive for European companies. Capacity is available to cater for most firms' requirements as the majority of carriers are looking at growing their portfolio."

While there is no sign of insurers pulling away from the market at present, the expectation is that the current crop of 35 D&O insurers cannot continue to occupy the same space. "Mergers or withdrawals from some quarters are inevitable," Burden says.

As of yet, the financial crisis and ensuing recession has not given rise to the kind of

severity and frequency of claims that could be expected to force a brutal hardening of the D&O market. That has led to accusations that certain sections of the market were using the crisis to try to talk up rates. “We’ve not seen a flood of claims,” Newell confirms. “On the surface of it, it hasn’t panned out as many commentators were predicting.”

But the whole situation could be artificial, he warns. The torrent of rescue packages that governments around the world rolled out in the depths of the economic crisis have helped to significantly soften the blow. “It’s difficult to say how much bigger the D&O claims would have been in the absence of the unprecedented fiscal support that we’ve seen from central banks around the world,” Newell says.

Watch out

So what does the future hold? Newell believes there’s a real risk of some hidden monsters emerging as government support packages are withdrawn and austerity drives start to kick in.

As governments pull back their support and cut contracts with the private sector, some companies could be forced under. If it turns out to be true that cuts were undertaken too soon, before the recovery was fully off the ground, the private sector could be hit. All this, Newell believes, could create uncertainty for businesses, and when shareholders lose out because profit targets aren’t met, there’s likely to be a rise in D&O claims.

Further, a secondary boat of contagion from the European Economic Area, and a corresponding decline in economic activity, could also result in a rise in commercial D&O claims, adds Newell.

He emphasises the need for directors to be transparent and to satisfy disclosure requirements in a responsible fashion. “The need for timely communication and disclosure to shareholders and regulators has never been more important.” ■

What should European directors be most concerned about?

- Regulatory empowerment and enforcement
- Political determination for more regulation and enforcement in Europe and in the USA
- Regulatory investigations, domestic and foreign
- Market losses for shareholders, mixed with an evolving landscape in shareholder litigation
- Board changes after poor financial performance
- Investor relations and disclosure to markets and regulators
- Accurate forecasting and reporting
- Heightened insolvency risk and economic stress
- Bankruptcy proceedings on the back of the financial crisis, recession and ‘double dip’ recession
- Increasing environmental responsibility
- Cost cutting and social disputes
- Reputation risks
- Legal systems based on active and aggressive criminal courts and proceedings

Which sector is most at risk?

The table shows the percentage of companies from the S&P 500 that were subject to new securities class action filings (2000-2009)



Source: Cornerstone research

A buyers' guide

- As the pressure grows for companies to follow the rules, and enforcement
- authorities get serious, buying directors' and officers' insurance locally is
- becoming more popular. John Batch looks at the challenges of this approach
- and offers some advice

An increasing number of multinational companies are arranging local directors' and officers' insurance policies, as the efficacy of global policies comes under more scrutiny.

Cover for D&O liabilities for multinational companies can be arranged under a single worldwide policy, issued to the parent company. Under this scheme, the foreign operations are insured in the home country of the parent and no local policies are issued.

The advantages of adopting this programme structure are that you pay a single global premium, there is less administration and you tend to have greater control over coverage terms, insurance buying decisions and claims handling. A global policy also provides the lowest cost of pure risk transfer due to economies of scale and the absence of fronting costs, local commissions and other front-end administrative costs.

But these arrangements have come under closer inspection recently. One reason for this is that, unlike other lines of insurance business, D&O claims can affect an individual's finances, especially in countries where indemnification by the company is not always legally permitted.

Buy locally

Parent companies and risk managers are now considering purchasing locally admitted D&O insurance policies. Many countries insist that insurance held by companies operating in their jurisdiction is issued by local insurers, and subject to local laws and regulations. The consequences for breaching the rules vary

between jurisdictions, but generally speaking regulators are becoming more aggressive and co-operating across borders more often.

It is important to consider that local policy coverage terms may not be as good as the master policy and purchasing local policies often means increased administration for the company, broker and insurer.

There are steps that can be taken to mitigate the risks involved, such as seeking clauses that incorporate the broader terms of the master policy into a local policy. To get a local policy issued, risk managers will need to decide where they require cover, identify any country-specific issues, and provide appropriate information to the insurer in good time. Monitoring of insurers' performance is often prudent, and a thorough review of insurance premium tax compliance is also recommended. ■

John Batch is a senior vice-president in the financial and professional practice at Marsh

QUESTIONS FOR RISK MANAGERS TO CONSIDER

- What are the penalties for non-compliance?
- Are the directors and officers of foreign subsidiaries requesting D&O coverage?
- Do any of the company subsidiaries trade securities on a foreign stock exchange?
- What is the frequency of litigation brought against the directors and officers in the countries in which the company operates?

Eurozone

- The European D&O market shuddered with the impact of the economic crisis.
- Insurers braced themselves for a flood of claims targeting those believed to be
- responsible for corporate misfortune. The rest of this guide examines how this
- has affected coverage, pricing and legal issues in key European markets?

As recession hit, insurers steeled themselves for a raft of claims against directors and officers as angry investors, employees and customers looked to blame those at the top. But the actual effect has varied enormously due to the differing cultures of individual countries.

The impact of regulation varies from state to state, even in Europe and despite the overarching bureaucracy of the European Commission. Concern over legal action has been highest among companies involved with the USA, as even those with the

remotest of connections find themselves open to claims.

Fifteen percent of all US securities class actions are against non-US companies and Advisen gives a figure of €59m for the average settlement in securities cases filed against European companies in US courts in 2005-2009.

As a result, more companies are taking out D&O insurance. Advisen says the D&O written premium in Europe reached €1.37bn in 2008, up from €1.01bn in 2004. ■

TRENDS FOR THE FUTURE

Companies turning in on themselves:

Supermarket chain Safeway (now part of the Morrisons group) was fined by authorities for anti-competitive practices and in turn the company sought to recover those costs from its own directors. It could pave the way for more claims from companies seeking to use their directors' D&O policies to cover the costs of penalties.

Stricter legislation: New pieces of legislation, such as the Environmental Liability Directive, as well as the Bribery and Corporate Manslaughter Acts in the UK, are increasing the pressure on D&O cover. Risk managers will want policies that respond to these developments.

Greater enforcement activity: On 25 September 2009, Mabey & Johnson, a company supplying bridging equipment, was the subject

of landmark prosecution for overseas corruption by the UK's Serious Fraud Office. The company was fined £3.5m (€4.3m) and was made the subject of a confiscation order in the sum of £1.1m. Expect more investigations, particularly involving multinationals whose geographic reach exposes them to a plethora of risks.

More shareholder suits: Shareholders are keener to press the litigation button, due to more awareness of their rights and changes in litigation funding models which makes it easier to launch a claim.

Fraud in the downturn: Corporate fraud has increased significantly in the last two years. Reported fraud in the UK exploded in 2009 and broke the £2bn barrier. In light of this, many directors are concerned about personal liability for actions carried out by their company.

United Kingdom

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- The tricky claims environment has done little to dent the appetite
- for D&O risk in the UK market, but regulators are teaming up and looking
- for personal accountability in the wake of corporate disasters
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UK insurers report more activity in the D&O market, reflecting the recessionary times. However, Chartis Insurance underwriter David Walters says the market is far from running scared. Instead, the number of players is steady and the appetite for risk is holding up well.

For insureds, the prospect continues of keenly priced premiums and improving terms and conditions. Insurers are updating wordings to, as Walters puts it, “modernise the product”. Chartis relaunched with new wordings in January.

So far, says Walters, the claims environment has done little to dent enthusiasm for business – and he cannot foresee major change.

Penetration of D&O cover is climbing, with businesses increasingly aware that protecting senior staff is affordable. Walters also believes there is more pressure from regulators and third parties “to find someone to blame”.

Regulation from other territories, notably the USA, is adding to the pressure.

“There is definitely a tendency building up,” Walters says. “One only needs to look at the NatWest Three [the British businessmen extradited from the UK then jailed in the USA in 2007] to see an aggressive assertion of US jurisdictions in other territories.

“US regulatory authorities are certainly looking for ways to protect the interests of shareholders suffering a loss.”

Walters points out that the authorities are learning from each other and

there is increasing co-operation between, for instance, the FSA in the UK and the Securities and Exchange Commission in the USA.

This development is worrying lawyers. Partners at Barlow Lyde & Gilbert, James Roberts and Roderic McLauchlan, believe the financial crisis has brought a profound change, with regulators looking to increase personal accountability.

McLauchlan says: “There is nothing to chill the mind like the images of former directors in orange jumpsuits being taken off a plane.”

He believes we will see more whistleblowing or self-reporting as companies look for ways to reduce potential penalties. This could also lead to more companies turning on their directors – for example, saying we had the systems in place but Mr X was failing to follow the rules.

Roberts says: “There is vastly increased

KEY POINTS

Regulators looking to increase directors’ personal liability

More companies ‘likely to turn on directors’

Manslaughter and bribery laws add to pressure on D&O

scope for tension between companies and directors.”

He points to a recent case where a company’s penalty was reduced after it showed it had let go of all the directors involved at the time of alleged corrupt practices.

Another UK court case involves the supermarket company Safeway, since acquired by Morrisons, which was fined for anti-competitive practices. Safeway is seeking to recover money from its own directors, who are insured. A verdict is expected in November.

Roberts says the case could pave the way for similar claims, with companies seeking to use directors’ D&O policies to cover the costs of penalties that are not insurable. He says: “As this is in the form of a claim for civil liability, the D&O cover is likely to respond, despite any express exclusion of fines.”

It may also lead to a change in wording as insurers move to close the loophole – though some may wait for the court verdict before acting.

New legislation is also adding to pressure on D&O cover. The corporate manslaughter act has been in force since 2008 and, again, the first cases are under way.

Lawyers at Herbert Smith warn: “Individuals within a corporate entity can be prosecuted for manslaughter contrary to common law.”

They say that the conviction of Sussex fireworks company owner Martin Winter “provides a recent example of the type of conduct which constitutes gross negligence leading to convictions for manslaughter”.

Meanwhile, the latest companies act increases the responsibility and liability of directors, while the new bribery act is also expected to have an effect.



The greatest fear is that the UK authorities may start waging war on companies in a bid to “clean up” business. McLauchlan says: “The UK is playing catch-up on the crusade against corruption that the USA has waged.”

He worries about the long reach of the new bribery act, under which any company with overseas interests is expected to ensure its practices worldwide are conforming to the UK standard. Any company with overseas interests is a potential target of the regulator and McLauchlan fears this will lead to more tension between a company and its directors.

It is no wonder that, as Walters reveals, the limits for cover are rising. “There was a time when companies would not pay for more than £1m (€1.18m) of cover whereas the average cover is now £5m. For those with US exposure, it is much higher – we see limits of about £100m.”

Financial crisis aside, it seems there is a growing list of risks to keep UK directors awake at night. ■

Germany

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- A new law in Germany attempts to force directors to assume more responsibility for the actions of their company – plus liability may be on the crest of a wave
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The financial crisis hit Germany as hard as anywhere else in Europe. So far the wrath of the public and regulators has been aimed at financial institutions rather than individuals.

Company bosses, however, should not feel too safe. For example, in a bid to make directors take a personal responsibility, the government has legislated on limiting the D&O cover that a company can buy.

Last year, the government introduced an executive compensation act as a consequence of the financial crisis and high bonuses.

Bach, Langheid & Dallmayr partner Reinhard Dallmayr says that, as far as D&O is concerned, this introduces a mandatory minimum retention for insured members of a management board of 10% of the loss. The retention is capped to one-and-a-half times the board's yearly income paid by the company.

The retention only affects a claim for compensation, not defence costs. Both figures can be higher by stipulation in the insurance contract but not lower.

The mandatory retention applies only to D&O insurance contracts made since last August and it only applies to claims of the company against a board, not to claims brought by third parties.

Dallmayr says: "Although not clear, from the language of the law it seems that the retention itself can be assured but most likely not by the company. The premium must be paid by the director not the company."

The act is an attempt by the government to force directors to take a more personal interest in company decisions, and may have been introduced before a wave of D&O claims. Such claims are expected and he believes many parties are waiting to see if public prosecutions are successful before following up with their own claims against individuals.

As far as D&O is concerned, one industry expert says: "There are exclusions for intentional behaviour and that may apply to some cases. My fear, however, is that most of these guys didn't know what they were doing."

German reinsurers do not believe there will be any big claims resulting directly from the financial crisis, and the feeling is that insurers are hoping to escape relatively unscathed.

KEY POINTS

New law aims to encourage personal responsibility

Big D&O claims are hitting the market

Parties wait to see if official prosecution succeed

Insurers hope to escape relatively unscathed

The German market knows exactly how painful big claims can be. One of the best-known cases involved allegations of corruption against Siemens, the electrical engineering company. Siemens then tried to claim €250m on managers' D&O policies, eventually settling with a group of insurers for €100m.

The Siemens case is not an isolated incident and, for the past few years, German companies have had a hard time recruiting senior directors without the security of a comprehensive D&O policy. This has made the new act an even more interesting development and has led to questions over how it may affect recruitment.

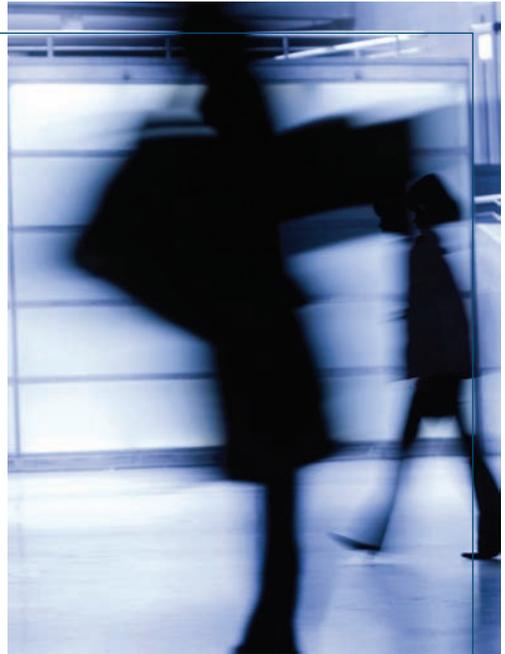
The D&O market has also had to absorb claims totalling almost €60m involving a media company. Constantin Medien had originally sued 20 ex-managers for damages, for a total insured sum of €102m.

Experts say the German D&O market is estimated to amount to €300m to €500m premium income annually, so these big claims are making an impact.

However, Dallmayr says it is the claims involving the USA that really scare the market.

Two recent cases have involved the chief executives of major corporations making inadvertent remarks in published articles that have led to billion-dollar claims against the individuals.

In a third case, directors of a car company faced massive costs relating to a Securities and Exchange Commission investigation. It is perhaps no surprise that many German D&O policies specifically exclude US coverage.



€100m

The amount Siemens' insurers agreed to pay on D&O claims following a bribery scandal. It amounts to around one-third of all estimated D&O premiums in Germany

On the domestic front, Chartist' Geraud Verhille says they are watching closely as a number of settlements are made. The trouble with such settlements, he says, is that they are not leading to legal clarity, which would help insurers determine the direction of policies.

"We need to build some case law," he says. "Right now the market is relying on history."

Local bankruptcies are leading to claims, he says, but so far so good in terms of the market's ability to cope. ■

France

- The demand for D&O protection in France is higher than usual, even in a market that is traditionally tough on company directors. There is also the spectre of French class action lawsuits. Insurers are expected to become much more risk averse unless the situation changes

According to Chartis' Geraud Verhille, directors and officers in France face one of the toughest regulatory environments in Europe, backed by some of the most aggressive criminal courts. Typically, regulators or the state will take action that is then followed by cases in the civil courts.

All this makes legal counsel expensive and, says Verhille, D&O policies have to reflect this. The high number of bankruptcies means the demand for D&O is greater than normal.

Action against former directors has been muted so far, but such cases take time to filter through the system. A double-dip recession in France is likely to trigger further bankruptcies, possibly prompting more action against former directors.

Verhille says experienced players at the primary layer understand the risks well but while competition for business is healthy, there are concerns.

Some immediate impacts on the French market are put down to:

- regulatory investigations. These can be domestic, foreign or multijurisdictional (which can be particularly costly);
- regulatory/administrative proceedings following investigations;
- criminal proceedings;
- defence costs of single plaintiff/minority shareholder associations;
- defence costs of securities litigation, US securities class actions; and
- defence costs of derivative actions against boards, often former boards, for

mismanagement and defence costs in bankruptcy proceedings.

But the market, says Verhille, remains soft. While that is the case, the primary layer is not necessarily getting the required remuneration and needs other players to come in to share the risk. Unless this situation changes, Verhille foresees insurers choosing to reduce the capital available at the primary layers – so taking on less risk.

But he also points out that established primary players have the experience to help them navigate otherwise tricky waters, reducing costs as much as possible.

The US dominates the French perspective. Lawyers at Steptoe & Johnson point to a recent case in which Technip, a French engineering and services provider for the oil and gas industry, agreed to pay \$338m (€263m) to the US government to settle charges under the Foreign Corrupt Practices Act (FCPA).

Earlier this year, another French company, telecommunications giant Alcatel-Lucent,

KEY POINTS

Country known for its tough regulation

Class action laws likely soon

French companies pay to settle charges brought in US

announced that it had reached agreements in principle with US authorities to settle FCPA charges for \$137.4m.

The lawyers say both cases reflect a trend towards use of the FCPA to prosecute foreign companies with only tangential ties to the USA.

For the D&O market, the bad news is that, in both instances, the US Department of Justice (DoJ) has been pursuing criminal charges against non-US individuals involved.

Steptoe & Johnson says: “The prosecutions of Chodan, Tesler, Stanley, Sapsizian and Acosta in connection with the Technip/KBR and Alcatel matters highlight the increasing focus by DoJ on the prosecution of individuals, including non-US persons, in FCPA matters.”

To emphasise the point, in June US Attorney General Eric Holder described individual prosecutions as “a cornerstone of [US FCPA] enforcement strategy”.

Steptoe & Johnson warns that facts giving rise to FCPA liability often create exposure under other laws. It states: “Class action and shareholder derivative suits, sovereign damages actions and US prosecutions for other crimes – money laundering, false records and statements, racketeering, export control violations – are rising.

“Consequences can be severe, including substantial civil damages, criminal fines and convictions, and debarment from contracting with governments and international organisations.”

Meanwhile, French companies are facing new risks closer to home as well, following the US example. Over the past few years, various French administrations have flirted with class action legislation.

Advisen senior industry analyst John



\$338m

The amount French engineering firm Technip paid US authorities to settle corruption charges

Molka says the latest regime is no exception. “When president Nicolas Sarkozy took office, he instructed the economy minister to create ‘a French-style class action’, but also said he would ‘avoid any excess similar to the US-style class action’.”

Since this comment, several bills have been introduced to the National Assembly but failed.

D&O insurers are yet again left waiting for greater clarity, facing a market-changing event or yet more years of political uncertainty.

More regulation is not necessarily good for insurers. Verhille sums it up: “France is probably the most feared for its regulation already. The current political climate should bring about further empowerment and resources.” ■

Southern Europe

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- The Mediterranean economy has taken the biggest knock from the global slowdown. There's much bad blood between companies and their directors.
- Will insurers harden their prices or run scared?
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Southern Europe is among the regions hardest hit by the financial crisis. Italy, Spain and Portugal have seen property prices and the building market collapse as investors disappeared.

This has been quickly followed by bank and shareholder litigation against the many bankrupt companies and their former directors. There have been plenty of criminal investigations and proceedings against those involved, with directors calling on D&O policies to provide defence costs.

Italy, in particular, has been dogged by scandal since the Parmalat collapse in 2003, which was said to be "one of the largest and most brazen corporate financial frauds in history" by US securities regulators.

Some people have added to the mire with unfounded claims, but each allegation has to be investigated, and so defence costs are spiralling.

Misuse of public funds is also under intense scrutiny and the authorities are pouring over every previous transaction to see if there are opportunities to recoup costs. Again, this is adding to defence costs and creating bad blood between companies and directors.

It is the primary layer that is facing most of these claims and it is the increasing amount of attritional losses that are of concern to insurers as the aggregated total begins to affect profitability.

For now the insurers are paying for

defence costs and Chartis' Geraud Verhille expects it will still take another two years before it is decided whether to fight or settle many of these cases.

"It is creating a bit of a tail, as in France, and for many of the same reasons," he says. "It is creating an interesting dynamic." The question is whether primary insurers start to harden prices or run scared of the competition.

In Spain, the number of investigations so far remains "within normal parameters", says LC Rodrigo Abogados partner Jorge Angell.

Last year, the Bank of Spain took action against 12 entities and 43 members of management bodies. Most cases resulted in an undisclosed fine, although some directors were disqualified.

Investigations have particularly affected valuation societies, which, says Angell, reflects the nature of the subprime crisis.

He says a groundswell of claims is building

KEY POINTS

Flurry of shareholder and bank litigation in Italy

Increasing allegations push up defence costs

Groundswell of action is building up in Spain

against directors and more claims will be brought by third parties.

“Generally speaking, it is not a litigious society and people normally look to companies rather than individuals,” he says. “Derivative actions can only be brought by shareholders with a minimum 5% stake. It is uncommon for companies to bring actions against their own directors.”

The number of claims being notified is rising, but Angell says it will take time for these to come to court – again reflecting Verhille’s point about the increasing number of claims or defence costs.

Government action in bailing out banks has helped enormously, according to Angell. This has allowed corporations to move forward without having to seek anybody to blame.

As a result, the D&O market is soft. Angell points to one case in which the policy has a €9m limit for a €4,000 premium. “My impression is that is too low,” Angell says, “and it remains very competitive in the market.”

While the absence of a wave of claims has fuelled competition, the market is being affected by a steady trickle of claims that are building into a costly and dangerous aggregate.

Southern European markets could turn to class actions in the future. Italy in particular has been moving towards such legislation as it seeks to clean up its corporations.

Four years ago, the Italian stock exchange published guidelines aimed at providing more demanding corporate governance, including the promotion of independent directors over chief executives or other single individuals.



12

The number of entities against which the Bank of Spain took action last year. In most cases, an undisclosed fine was paid

The Association of Italian Insurance Companies was among those that resisted the move, but the financial act was passed in December 2007, creating a new “collective action for damages”.

Two deadlines for implementation were missed before it became law last January – though its terms have been watered down in the interim.

In Spain, the civil procedure law passed in 2000 created group litigation. This allows collective claims by consumer associations through an opt-in system. ■

Central Europe

- The Netherlands has one of the most litigious environments in Europe.
- Belgium, meanwhile, follows the French example and Austria is more like Germany. US risk, however, looms as large as in any other international market

In central Europe, it is the Netherlands that is most important in the D&O market. There is a two-tier board structure, and unions and employee representatives must have a voice.

This is backed by the Tablaksblat code for good corporate governance, introduced in 2004. This requires companies to use their annual report to list how they have complied with the code's principles and best practice.

This transparency and accountability has resulted in one of the most litigious environments in Europe – and some of the numbers are staggering.

Three cases quoted by Advisen include:

- Dexia, the Franco-Belgian Bank, settling in Dutch courts for €400m in 2007. Investor associations had sued for alleged mis-selling of investment products.
- Unilever settling in German courts for €305m in 2007 following a dispute with the Netherlands Investors Association.
- Royal Dutch Shell settling in Dutch courts in 2009 for €270m for overstating oil reserves. The case had been brought by European shareholders.

The good news for D&O insurers is that not all of these three large claims were covered under a D&O policy.

Chartis' Geraud Verhille is among those convinced by the strength of the Dutch bar. "Netherlands is probably the most litigious," he says, "and also

the notion of class action is strong there, so the potential for severity [in claims] is particularly high."

Combine that with the willingness of the Dutch courts to give shareholders access to legal redress, and there is a potentially unpalatable cocktail of large and frequent claims.

Despite this litigious environment, insurers can be cheered by the fact that there is less regulatory or criminal investigation than in many other jurisdictions, so legal defence cost claims are often lower than elsewhere.

Verhille says: "The Dutch seem to want to facilitate shareholders to seek redress while in Germany, for example, they want to rely more on the supervisory boards to keep on the backs of their executives."

The Belgians tend to follow the French example, says Verhille, although he adds that, thankfully, "we see less regulatory activity than in France", while

KEY POINTS

Transparency in Netherlands leads to high level of litigation

Legal defence costs claims are often lower than elsewhere

Polarised market in Austria results in less litigation

the Austrians have a legal system more akin to Germany.

One of the major differences in the Austrian market is that there is polarisation in terms of the business model. The country is home to extremely large corporations alongside thousands of very small, often family-owned, businesses; the middle sector is much smaller.

The result is less litigation on a domestic level, and for D&O insurers less chance of internal claims – though the US risk looms as large as on all international markets.

In terms of class action activity, the Netherlands has the most established rules. Advisen's John Molka says: "The Dutch civil code came into effect in 2005 and allows collective actions by associations and foundations on behalf of injured parties for securities, competition, and product liability claims.

"Associations and foundations can initiate negotiations on settlement with defendants, which then may be approved and declared binding by the Amsterdam Court of Appeal.

"Individuals cannot act as plaintiffs in collective actions, as this function is reserved for associations and foundations.

"These groups represent themselves and if cash settlements are awarded, then the organisation decides how to divvy up the cash among its members.

"Cash settlements are awarded only if the court approves the settlement. Interestingly, it is an opt-out system like in the USA. This means that all affected parties that choose not to opt out are represented by the collective action case, and are bound by the decision." ■



€400m

The settlement by Dexia following alleged mis-selling of investment products.

Eastern Europe

- The first case against a Russian company director came only a few years ago.
- For that reason D&O remains rather exotic here, although it is developing.
- Governance regimes in countries like the Czech Republic, Poland and
- Romania, are being brought in line with their western European equivalents

In Russia, the situation is very different to the rest of Europe and the USA. The concept of a company director is relatively new and legal action against directors was virtually unheard of until recently.

Anna Arkhipova, a partner in Sokolov, Maslow & Partners, says the first case against a director was heard in 2004. She says that, for the most part, demand for D&O is limited to those involved in international business.

She stresses that, just because action is not taken against directors, the rule of law is still upheld, with a tough penal system.

She says: "There are some companies who buy D&O policies for their directors but it remains slightly exotic. If you have a policy, it is more likely that you work for a major or have international connections."

Arkhipova says there is little history of D&O cases coming to court – and relatively few out-of-court settlements – but it is a developing area that is worth watching.

One of the barriers to bringing a claim is that the standards of proof are strict. "It is quite difficult for claimants because of these standards," she says. "Even when a company considers action, it is difficult to find the evidence."

The concept of the regulator behaving as the FSA does in the UK "seems something

KEY POINTS

D&O in Russia is mostly limited to those with foreign exposure

Strict standards of proof are a barrier to claims

Other countries adopting Western-style regulation

The concept of a Russian regulator behaving as the FSA does in the UK 'seems something quite fantastic'

quite fantastic", says Arkhipova. The Czechs, Poles and Romanians have all moved toward the western European model by joining the EU, but Russia remains apart and is likely to remain so.

World Trade Organisation talks may, in time, make a difference but, for the short term at least, Arkhipova expects Russia to remain a very different place in which to do business.

D&O offerings in Russia look set to stay within the international sector – providing cover for Russians operating abroad, especially those with US exposure, and foreigners moving into Russia. ■

Scandinavia

- The Danish system is different in that the government funds action it thinks
- is in the public interest, and there have been class action suits against some
- collapsed banks. Elsewhere in Scandinavia, issues tend to be resolved with
- negotiation rather than legal action

The Danish market is one of the most active in Scandinavia thanks to relatively new class action legislation, according to Plesner law's Torben Bondrop. The administration of justice act has been in place for two years and provides access to courts for individuals with claims too small to litigate separately.

There are two major class actions in progress, including one that concerns shareholder dissatisfaction over a bank takeover.

The major difference with the Danish system, says Bondrop, is government funding for cases in the public interest. Although ongoing cases are against companies rather than individuals (so not affecting D&O directly), they do show how class action behaviour is developing.

There are also three large D&O cases before the courts and two of these concern failed banks. In one case, loss-making parts of one bank have been swept into one company, which is now suing the former board and management.

The D&O market is awaiting the outcome, but whatever the court decision, the case is unlikely to have a bad effect. Bondrop says the D&O policies involved should fall well short of overall liability, but the court interpretation is likely to influence policy wordings.

As elsewhere in Europe, policy limits are generally low for domestic concerns. It is only when US exposures become an issue that the limit needs to rise substantially.

Chartis' Geraud Verhille says that outside banking issues, "we are seeing some

KEY POINTS

Class action legislation relatively new in Denmark

Court cases may affect D&O policy wording

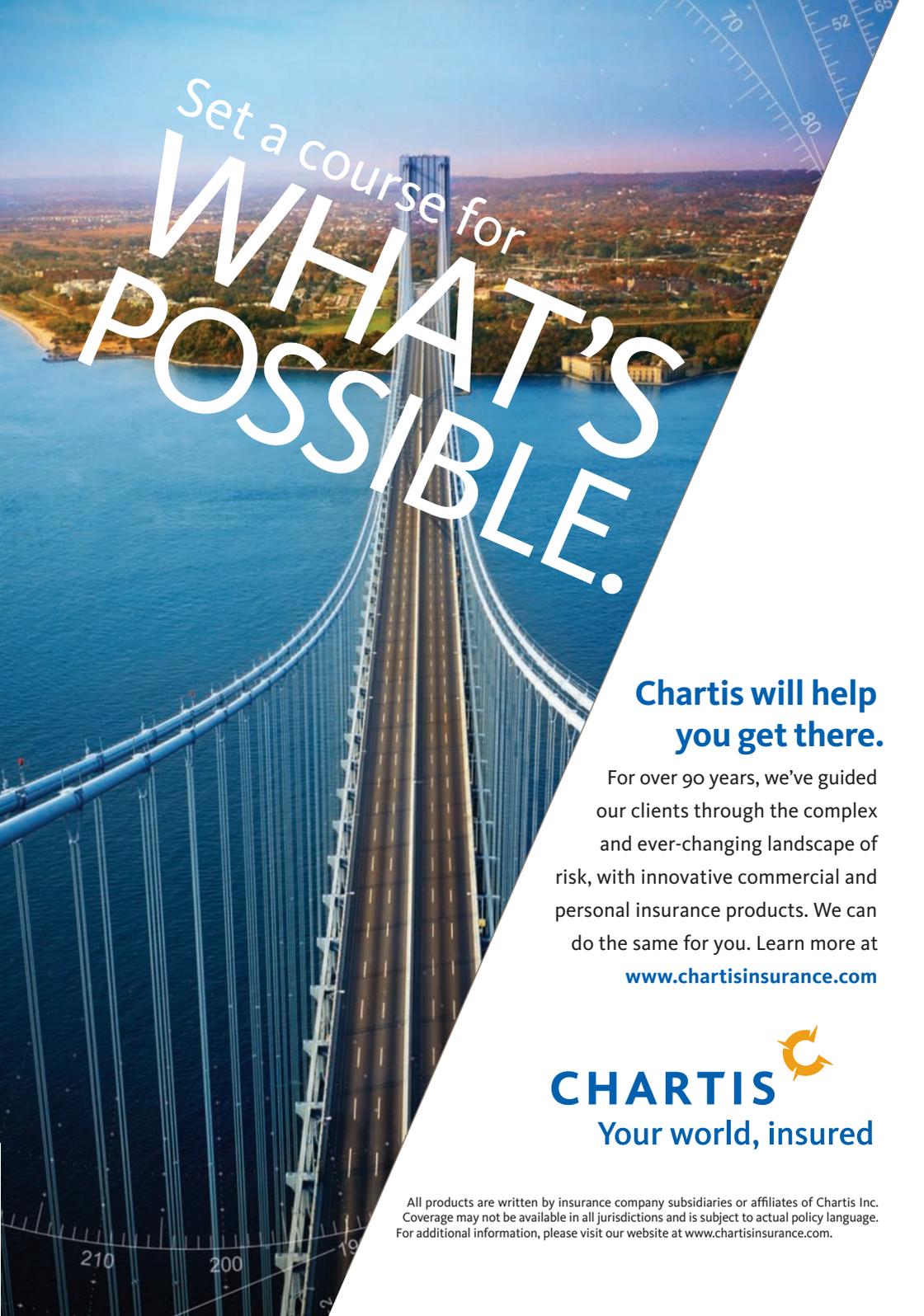
Some governments fund cases in the public interest

bankruptcy activity along with some criminal and regulatory proceedings – but to a lesser extent than elsewhere in Europe".

He adds: "It is a slightly softer environment and things get dealt with differently. We see issues being settled through negotiation and lobbying rather than through the courts. We are seeing bankruptcies but we are not seeing a volume of claims."

The well-established regulatory and legal environment may be playing its part. In designing its new class action rules, Denmark looked closely at its neighbours. Norway has long allowed representative litigation and in 2008 expanded the rules still further through the dispute act.

In Sweden, the group proceedings act of 2002 instituted broad group litigation rights. There are no major banking cases in Norway or Sweden, says Bondrop, as their financial sector has been less hard-hit than Denmark. ■



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