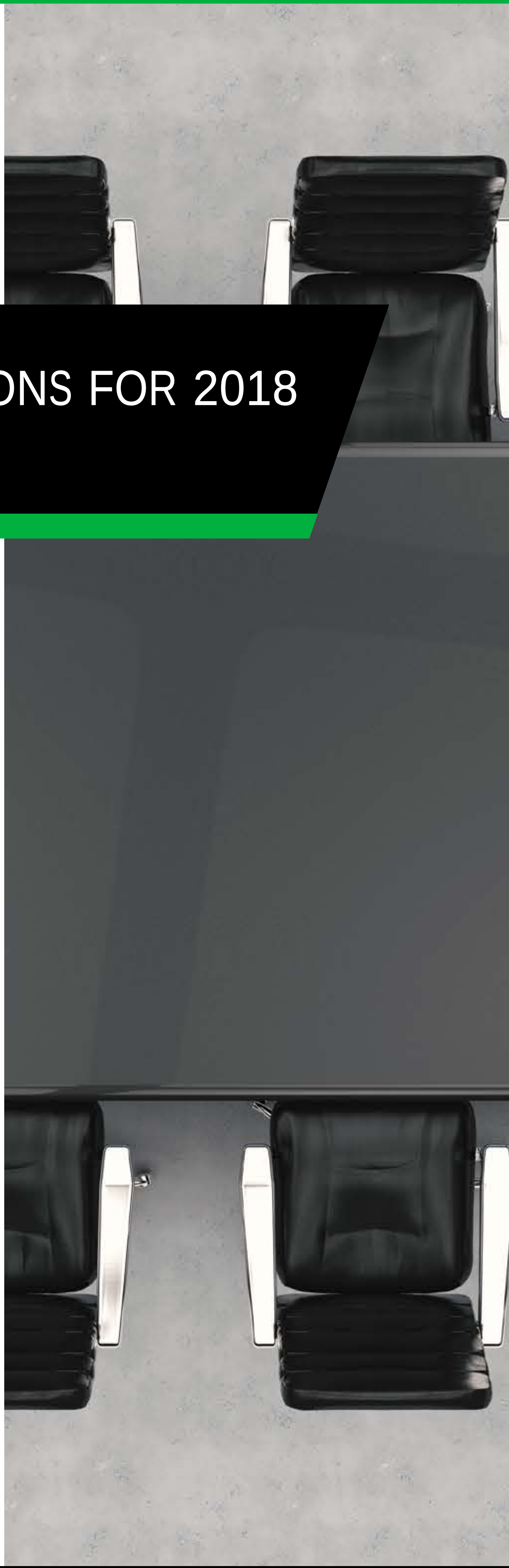
D&O TRENDS AND PREDICTIONS FOR 2018

March 2018



Regulators and policymakers continue to implement legislation and regulations with the aim of improving corporate behaviour. This increased scrutiny of corporate leaders means the number of risk areas in which directors can be held personally liable continues to grow.

We take a look at the current trends and what we expect to see more of in 2018 - including the increasing pressure on directors and officers to strengthen cyber security and protect corporate data, limit bribery and corruption - as well as looking at the less common exposures in the climate and environmental damage risk space.

CYBER AND DATA RISK

There has been increasing pressure on company officers and directors over recent years to enhance cyber security and vigilance, as the number of reported data protection breaches steadily increase each year. The introduction of the EU's General Data Protection Regulation (GDPR) in May 2018 will only intensify directors' and officers' liabilities in this area. The GDPR places onerous accountability obligations on data controllers to demonstrate compliance and introduces tougher financial penalties for non-compliance.

Serious breaches of the GDPR by companies could result in fines of up to €20 million, or 4% of the company's worldwide annual turnover (whichever is higher). The responsibility for compliance with the GDPR will ultimately fall on the company's directors, as a claim could be brought against a director for failing to take reasonable measures to adequately protect data.

With such large fines at stake, as well as the reputational damage associated with a data breach or personal data misuse, we are likely to see more class-action lawsuits brought against directors and officers holding them responsible for failing to uphold their fiduciary responsibility to protect shareholders and consumers from the impact of a cyber breach. Social engineering frauds/fake president scams are also likely to continue. The result will be more claims made on D&O policies for cyber related claims.

FCA - SENIOR MANAGERS REGIME

Following a parliamentary investigation into professional standards and culture in the UK banking sector in 2013, the Senior Managers and Certification Regime (SM&CR) was introduced in March 2016. The existing rules apply to banks, PRA investment firms and some insurers, however the government announced in 2015 that all regulated firms will become subject to SM&CR later in 2018. Broadly, the Senior Management Regime has built on pre-existing regulatory expectations surrounding accountability and governance in the banking sector by increasing the onus on individual accountability. The regime introduces a statutory duty of responsibility requiring senior managers to take reasonable steps to prevent regulatory breaches from occurring, or continuing to occur, in their area of responsibility. Senior Managers could otherwise be held accountable by the regulator if their firm breaches an FCA requirement.

This increased focus on individual accountability, will mean that Senior Managers and their D&O insurers may face an increased exposure. We also expect that the expanded Senior Mangers Regime will result in an increased uptake of D&O insurance. The FCA has set out a number of areas it intends to focus on in 2018 e.g. asset managers' fees, pensions/annuities and in particular fair treatment of customers with-profits products, TCF in retail banking, the wholesale insurance market sector (principally broker practice and whether unfair competition between brokers in various sectors) and e-money regulation. Insureds in these sectors can expect increased scrutiny and the possibility of claims against them and their senior people.

ANTI-CORRUPTION LEGISLATION

The Bribery Act 2010 came into force in 2011 and introduced a new offence of "failing to prevent bribery" which has resulted in various prosecutions by the Serious Fraud Office (SFO) of both companies and their directors. UK directors can be convicted of the criminal offence of bribery, regardless of where in the world the offence is committed. An individual found to have committed an offence under the Bribery Act is liable to imprisonment of up to ten years and/or to an unlimited fine. The number of prosecutions under the Act has been steady and is likely to continue to increase.

It is important to note that Deferred Prosecution Agreements with the SFO for Bribery Act breaches can only be entered into by entities and not individuals and there are often conflicts as between the company's position and those of its directors/senior managers and staff. D&O Insurers will be aware that potential conflicts between the company and its directors, or between multiple directors at a company, may mean that each director may require their own legal representation, resulting in increased defence costs.

CRIMINAL FINANCES ACT

The Criminal Finances Act 2017 (CFA) came into force in September 2017 and imposes a new criminal liability on UK and non-UK businesses that fail to prevent the facilitation of tax evasion by an 'associated person'. The CFA contains the largest expansion of UK corporate liability since the Bribery Act. It provides a significant overhaul of money laundering and proceeds of crime legislation.

As with the Bribery Act, the CFA targets organisations that fail to prevent the crimes of those who act on their behalf. It makes businesses liable for the actions of associated persons, who are very broadly defined, and includes any persons or entities that provide a service for the business or on its behalf (thereby capturing, for example foreign tax advisers, employees, agents and sub-contractors). Non-UK businesses will also be captured by the legislation if they fail to prevent the facilitation of

UK tax evasion if some or all of the facilitation happens in the UK, or if the foreign firms conduct business in the UK.

Directors will need to conduct thorough risk assessments in order to create prevention policies and procedures if they are to avoid criminal liabilities, as the only defence available under the CFA is to have such reasonable prevention procedures in place. If directors fail to engage properly in establishing appropriate prevention procedures, it may be difficult for the company to rely on the statutory defence in the CFA if facilitation of tax evasion occurs. If a company is found guilty of the offence, the penalties include unlimited fines and confiscation orders.

FINANCIAL REPORTING COUNCIL

In the wake of financial irregularities in various organisations (e.g. Tesco) the FRC is proposing to extend its sanctions regime to all directors of UK listed companies who are in office when serious accounting irregularities take place. That is, they will not limit sanctions to the FD, auditors or actuaries, who the FRC can already discipline. The wider scope of these sanctions is likely to lead to an increase in the number of potential claims in this arena.

DIRECTORS' DISQUALIFICATION

Proceedings continue under the Company Directors Disqualification Act 1986 (the CDDA) as they have since the CDDA was introduced. A director can be disqualified under the Act for a number of reasons, including wrongful trading, fraudulent trading or 'unfit' conduct. The trigger is generally liquidators reporting on insolvency situations. Any director who is found liable under the CDDA faces a ban of up to 15 years. Director's disqualifications are, however, still relatively rare (there are only around 1,000-1,500 per year). Failing to adhere to duties as a director will result in an investigation by the Secretary of State, which may trigger cover under a D&O policy and potential disqualification.

CORPORATE MANSLAUGHTER & HOMICIDE ACT 2007

The number of criminal charges brought against companies for corporate manslaughter since the CM&HA was enacted is now approaching double digits. The CM&HA is aimed at making it easier to prosecute companies for deaths caused by gross negligence and breaches of duty of care by their senior management resulting in death. The liability of individuals is specifically excluded under the CM&HA but a director or senior manager whose failings led to a death may be found liable for gross negligence manslaughter at common law, and/or under Section 37 of the Health and Safety at Work etc Act 1974. Directors may also face disqualification for up to 15 years under the CDDA 1986.

Directors, particularly in certain industries such as construction, will wish to look closely at the wording of their D&O policies to ensure cover is adequate. The Grenfell Tower disaster is likely to result in potential prosecutions of senior individuals following the outcome of the inquiry which is now underway.

MODERN SLAVERY ACT

The Modern Slavery Act 2015 (the MSA), consolidates existing offences relating to slavery and human trafficking and introduced a new reporting requirement for organisations with a global turnover of at least £36 million that conduct any business in the UK. Organisations falling within this category must prepare a slavery and human trafficking transparency statement detailing the steps it is taking to ensure that slavery and human trafficking are not taking place within its business or its supply chains. Organisations' directors must sign off on the transparency statements. Whilst failure to comply with reporting requirements does not currently attract any fines or penalties, directors are unlikely to want the reputational damage that could flow from any perceived negligence when signing off on the transparency statement.

D&O policies may be expected to respond to the increased exposures presented by the MSA in terms of both criminal prosecutions and civil claims arising from offences under the MSA. Allegations may be brought against directors for breach of duty under the legislation, such as failing to act with reasonable care when signing off on a transparency statement, or failing to take steps to ensure modern slavery is not taking place within its company.

CLIMATE CHANGE

Directors' and officers' liability exposure continues to grow in the climate risk space. The Companies Act 2006 imposed various duties on directors to act in a way that promotes the success of the company. One such duty is to have regard to the impact of the company's operations on the community and the environment. Whilst we are yet to see directors being held liable to their shareholders under this provision, it may only be a matter of time as the insureds at risk extend beyond the obvious (such as oil and gas companies). Last year, minority shareholders in the Commonwealth Bank of Australia (CBA) issued proceedings alleging failures by CBA to disclose risks associated with climate change to their shareholders, and probed CBA's association with a controversial coal mining project. We anticipate that more actions such as these will surface in the coming year and beyond against an array of different companies.

ENVIRONMENTAL DAMAGE

Environment activists are increasingly targeting companies and directors for not disclosing environmental data or risks to investors. The Environmental Act 1995 and the Wildlife and Countryside Act 1980 impose obligations on organisations to protect the environment, including the protection of wildlife and wild plants. We have already seen directors arrested under the Wildlife and Countryside Act for disturbing the natural environment of wildlife, so directors should be advised to ensure that adequate and appropriate cover is in place.

FURTHER INFORMATION

To find out more about our services and expertise, and key contacts, go to: **kennedyslaw.com**

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