D&O LIABILITY AND INSURANCE FOR U.S. MULTINATIONAL COMPANIES

Executive Summary

Most multinational companies now are accustomed to insurance programs that combine a global master policy and local policies to insure their global property and casualty exposures. Local policies may be required by insurance regulations in many countries, and may offer tax benefits as well as the advantages of local claim management.

Risk managers should thoroughly assess the risk to their companies and the directors and officers from foreign exposures, and work with a broker with global D&O experience to develop a program that provides optimal protection within the company’s risk appetite and financial objectives.

The benefits of a similar program for Directors & Officers (D&O) exposures is not always self-evident, however. Companies with subsidiaries in foreign countries, or those with securities traded on foreign exchanges, may be good candidates for local D&O policies, but other companies may not perceive a need for anything more than a D&O policy issued in their home country with worldwide coverage. However, unexpected circumstances can result in an incident in a foreign country that could potentially trigger D&O coverage. Risk managers should thoroughly assess the risk to their companies and the directors and officers from foreign exposures, and work with a broker with global D&O experience to develop a program that provides optimal protection within the company’s risk appetite and financial objectives.

Introduction

A D&O policy typically provides worldwide coverage. In the past, this was deemed adequate for many multinational companies, and for some companies today it still may be an acceptable choice. Other companies, however, may find that it is necessary to assemble a more complex insurance program that combines worldwide coverage through a master policy with policies issued by local carriers in select countries.
A single policy providing protection wherever a claim is filed has the advantage of simplicity. Insurance, however, is regulated on a country-by-country basis, meaning that a multinational company may need to assemble an insurance program that conforms to a patchwork of local laws while still providing adequate, uniform protection. Many countries require policies to be issued by a local insurer licensed in that country – so-called admitted insurance. Without an admitted policy, an insured may not be able to receive insurance claims payments in the country where the loss occurred.

Brazil is an example of a country where a non-admitted policy cannot be used to provide payment for a locally incurred loss. Brazilian law also permits the government to freeze the assets of a director or officer when a claim arises. Since directors and officers may not have access to their own funds, under some circumstances the only source available for payment of defense costs may be an admitted insurance policy.

Tax laws are also a consideration when evaluating local insurance coverage. Tax laws in the United States and elsewhere can make it difficult for companies with multinational insurance programs to receive indemnification from insurers or to finance insurance losses at foreign locations without incurring significant tax liabilities. In the United States, the IRS may treat claim payments made in the United States for losses that occurred in a foreign country as income. Additionally, money transferred into a country by the parent company to pay for losses at a subsidiary may be treated as taxable by the foreign country.

Whether required by law or not, local policies may also have the advantage of being tailored to country-specific insurance standards, exposures and business practices. It can also be advantageous to have local claims managers who are more experienced with the laws, the court systems, and the litigation practices of a particular country.

In the case of property insurance, for example, the choice may be clear. If a company owns a distribution facility in a country that requires admitted policies, and that facility burns to the ground, the company may be barred from receiving indemnification under its global master policy in that country, or may incur significant tax penalties by using insurance proceeds paid in the company’s home country to rebuild the foreign facility. A local property policy may very well be a clear choice.
Every organization needs to assess its specific circumstances, and make decisions concerning D&O coverage based on its exposures, risk tolerance and financial objectives, while addressing the concerns of board members and executives at home and abroad.

The decision to buy a local D&O policy may be less obvious.

D&O experts advise that local coverage may be essential for the directors and officers of foreign subsidiaries. The benefits of local D&O policies are less clear under other scenarios. If, for example, a company has only sales offices in various foreign countries, is it advisable to have local D&O policies for each of those local offices? A cursory assessment of the exposure may suggest that local D&O coverage is not necessary, but a more thorough examination may suggest otherwise. Every organization needs to assess its specific circumstances, and make decisions concerning D&O coverage based on its exposures, risk tolerance and financial objectives, while addressing the concerns of board members and executives at home and abroad.

A changing D&O threat landscape

The risk landscape for corporate directors and officers outside the United States has grown more precarious over the past decade. Higher or more specific standards of care for executives have been put into place in many countries, with more countries enacting corporate governance rules. Additionally, many countries have liberalized their legal systems to make it easier for aggrieved shareholders and other stakeholders to access the courts.

While few countries have enabled U.S. style class actions, various forms of collective redress are now available to plaintiffs in many countries. These include a number of European countries as well as Canada, Australia, India, Mexico and Brazil among others. The rise of litigation funding companies makes legal remedies far more accessible to plaintiffs in some countries where lawyer contingency fees are not allowed.

Despite these changes, there has not been an avalanche of shareholder suits outside the United States. These suits are expensive to mount and often difficult to win. Actions against companies and their directors and officers nonetheless are on the rise.

The economic environment in many parts of the world continues to make it more likely that directors and officers will be targeted in investigations and lawsuits. Many companies are under heightened regulatory scrutiny, and are more likely to be subjected to enforcement actions. Corporate insolvencies increased sharply in some regions and bankruptcy remains a major D&O exposure. Suits by employees against a company and its directors and officers are a significant source of claims in some countries.
Many countries have laws under which individuals can be charged for criminal activity for their actions as corporate directors or officers. Germany especially has been inclined to use the threat of criminal liability to motivate director behavior. A report by Deloitte prepared for the UK Office of Fair Trading found that criminal penalties was first on the list of factors that motivate directors to comply with competition rules.¹

Of growing concern to directors and officers are allegations of violations of anti-bribery and anti-corruption laws such as the U.S. Foreign Corrupt Practices Act (FCPA), the UK Bribery Act and the recently enacted Brazilian Law to Combat Corruption. Governments are increasingly prosecuting individuals, not just corporations, for violations of these laws.

The exposures of directors and officers of multinational companies

Though cases are rare, directors and officers of U.S.-based multinational companies should be aware that they are potentially exposed to shareholder suits brought outside the United States. Some Canadian courts, for example, have implied that Canadian securities laws can apply to foreign securities purchases. In one recent case, the Ontario Superior Court rejected a British oil company’s attempts to stay Ontario proceedings with regard to Canadian-based shareholders who had purchased their shares on non-Canadian exchanges.²

The directors and officers of foreign subsidiaries may be more directly exposed to shareholder actions. In one well-publicized 2007 incident – dubbed the “Nigeria’s Enron” – the board and the auditor of the Nigerian subsidiary of a UK company were sued by shareholders over alleged accounting irregularities which led to a $102 million restatement.

Directors and officers of foreign subsidiaries also may be exposed to local regulatory investigations, as well as local suits brought by employees, vendors, competitors or customers. Additionally, they may be subject to allegations of criminal misconduct.

Anti-bribery and ant-corruption laws are a growing source of potential liability for directors and officers around the world. In the U.S., enforcement of the FCPA is shared by the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC). Both have significantly ramped up enforcement activities. The FCPA makes it illegal for a company, its employees, its directors or officers, or agents to give anything of value to any foreign governmental official in order to obtain business in a country. The law has broad extraterritorial reach, and most of the largest settlements to-date have involved non-U.S. companies.
For a growing number of companies, doing business in foreign countries is more than an opportunity – it is a competitive necessity. The UK’s Bribery Act 2010 also is a source of concern. This legislation is much broader than the FCPA as it also applies to private companies and personnel, whereas the FCPA applies to government officials. The Bribery Act extends jurisdiction to offenses committed in the UK as well as those committed elsewhere that retain a “close connection” to the UK. Thus far, enforcement activity has fallen below what many expected, but a change in leadership at the Serious Fraud Office may signal more robust enforcement in the future.

Brazil’s new Law to Combat Corruption went into effect on January 29th of this year. The law focuses on the corruptors, which can be any firm operating in Brazil, including foreign ones without a permanent presence. Fines under the law can reach 20 percent of a company’s gross annual revenue.

Directors and officers should be aware that they cannot take U.S.-style corporate indemnification for granted in suits brought outside the United States. Most states’ codes permit indemnification as long as a director or officer acts in good faith, but that is not the case in many jurisdictions outside the United States. An Aon study of 147 countries found indemnification provisions similar to the United States in only 5 percent of those countries. Over one-third had narrower indemnification provisions or prohibited indemnification entirely.

Structuring D&O protection

For a growing number of companies, doing business in foreign countries is more than an opportunity – it is a competitive necessity. Companies with foreign subsidiaries or branches, or perhaps even those simply having suppliers, customers or business partners overseas, need to be aware of their loss exposures, and must be certain that their insurance programs are appropriate to those exposures and structured in accordance with the company’s risk appetite, tax circumstances and financial objectives.

With the frequency of suits outside the United States on the rise and corporate indemnification unclear, weak or prohibited, directors and officers increasingly expect their insurance programs to provide airtight coverage around the world. Many of the most significant emerging markets such as Brazil, China and India require local policies, making it imperative that risk managers carefully assess the exposures of their companies and their directors and officers, and assemble insurance coverage that provides adequate protection. However it is necessary for risk managers to balance comprehensive, compliant protection against what sometimes may be significant insurance costs.
Knowing how much local coverage to purchase is also an issue. A U.S. multinational company often may have an excess tower providing significant limits, and it may have various endorsements unique to that company to make the coverage more robust. Local D&O policies, on the other hand, typically have comparatively low limits and often provide only basic coverage. It may be possible to build a significant tower with local capacity, and even to replicate many of the endorsements found on a U.S. program, but insurance buyers will have to decide if it is worth the cost for multiple standalone limits around the world.

Carol Zacharias, Deputy General Counsel, ACE Insurance, offers the following list of questions for risk managers of U.S. multinationals to ask as they consider D&O insurance for their company and its non-U.S. subsidiaries.6

- Where does a company have local subsidiaries and hence local boards to protect? It is not necessarily always relevant where you have a product, but where you have directors and officers.

- Is your U.S. D&O policy allowed to apply in those countries?

- If it doesn’t apply in a given country, do you want to protect insureds locally? They may feel that the liability arena in that country is such that it is so unlikely for directors or officer to get sued, or for the regulators to bring proceedings against the executives.

- If you do want coverage, can an FOS policy apply? (FOS = “Freedom of Services,” the right to insure a company with a single policy form throughout the European Union, Norway, Lichtenstein and Iceland).

- If not, then turn to qualitative issues to evaluate local insurance policy choices. Look at the insurance companies: Which have operations in the countries where you need policies? Can you get service? How effective and efficient are they at policy issuance locally? Does the insurance company have local claims expertise and international resources? When you have a claim in a country that has really seen very few D&O claims, you want to make sure that the carrier can handle a D&O claim.

- Decide on limits, term and conditions.
Conclusion

Companies of all sizes – both public and private – are participating in the global economy. As they expand into new countries, they need to assess their exposure to actions by foreign shareholders, regulators, customers, suppliers and employees, and to purchase D&O protection appropriate to their needs and the expectations of executives and board members. Although D&O policies typically provide worldwide coverage, local insurance regulations and corporate indemnification laws may make it necessary to purchase local policies as well.

Insurance buyers should work with a broker experienced in global D&O programs to identify their exposures and to design a program that most effectively meets their requirements.

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