



European D&O Claims Trends among Private (unlisted) Companies

Few people have a better understanding of the existing and emerging claims trends under Directors and Officers (D&O) insurance than our claims adjusters.

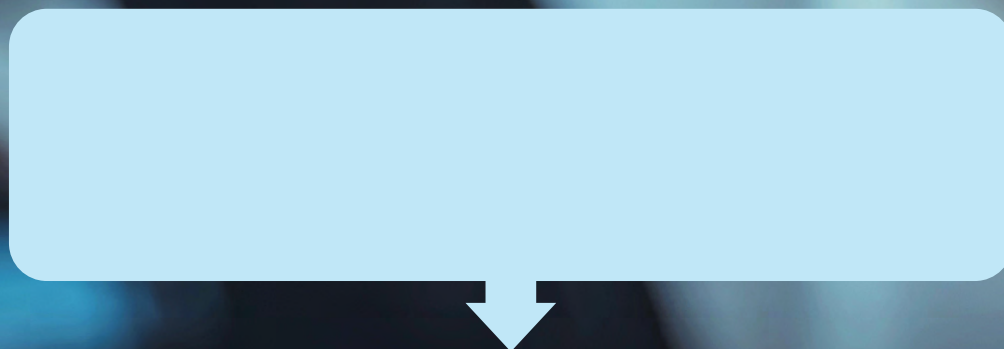
This paper provides a deep dive into some of the main claims trends that we see in the private (unlisted) segment in Europe, and their impact on companies and their directors and officers. The external environment has a significant influence on the type of claims faced. Companies, and their directors and officers, are being impacted by increasing defence costs, macroeconomic changes, and a landscape in which reputational issues can easily escalate in a social media driven world. We look closer into the most common types of D&O claims that we see across Europe and their potential effect on directors and officers.

To find out more click on the relevant part of the diagram, or simply read on.

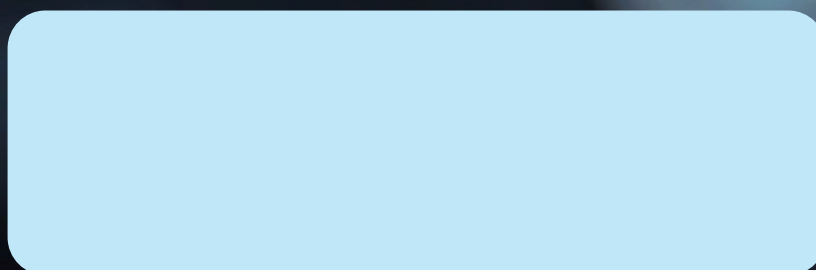
External
Environment



Key Types of
D&O Claims



Impacts



Typical Claims
Scenarios



The External Environment



Emerging Risks

Companies are now exposed to a wide range of ‘emerging’ risks in a way they were not before. Some, such as globalisation and digitalisation have led to increased vulnerability to social engineering fraud and cyber-attacks. Criminal activity is not slowing down and companies are exposed to external threats at a higher degree than before. Others will need to prepare for a potentially more litigious consumer class action environment in 2023 since EU Member States are implementing procedural mechanisms to facilitate collective redress litigation, in accordance with the new EU Directive on Representative Actions. The Directive will allow collective actions to be brought on behalf of consumers, against companies for breach of EU laws. It will empower law firms to bring collective actions and seek injunctive relief and/or redress on behalf of groups of EU consumers who have been harmed by ‘illegal practices’ that breach EU laws. Companies operating in industries with large amounts of customer/sensitive data, such as the telecom, transportation, and retail industries, will likely be the ones most under scrutiny under the new Directive.

Finally, Environmental, Social and Governance (ESG) has evolved over the years and is expected to continue to be a focus area for companies and their stakeholders. More emphasis is put on companies to prioritize the environmental impacts of their businesses, emphasise the social responsibility they have, and create strong governance frameworks. Not only are governments scrutinizing companies with respect to ESG topics, but also shareholders, non-profit organizations and customers are now putting more emphasis on how companies approach ESG related topics. These emerging risks add to the other past, present and future exposures that companies, and their directors and officers, have to navigate through in an increasingly more complex environment.



Geopolitical Risks

Geopolitical risks are defined as risks where political, socioeconomic, and cultural factors affect companies; sometimes to the point where they prevent companies from being able to operate normally.

Geopolitical risks also affect macroeconomic factors which potentially could lead to supply chain disruptions, inflation and potential recession, putting pressure on directors and officers to successfully navigate through. Directors and officers may be held responsible for the way they manage, or mismanage, these situations such as e.g., finding alternative supply chain solutions to minimize disruption, or proactively taking decisions that will mitigate the potential negative effects of increased geopolitical exposure.



Key Types of D&O Claims



Insolvency actions

Unprecedented volatility across certain business sectors has taken place during the past few years, and this continues today. Many companies were financially stressed following the pandemic and were dependent on receiving government subsidies to survive. These subsidies are now reducing or have stopped. Furthermore, with geopolitical tensions affecting supply chains (that have already been strained for the last couple of years), in combination with rapidly increasing inflation, many companies now find it difficult to anticipate what the future holds. Financial distress and insolvency are significant drivers of D&O claims across Europe as more questions are asked in relation to the conduct of directors. Should Europe move into a recession, the number of bankruptcy related claims will likely increase.

Furthermore, directors' responsibilities and conduct are under greater scrutiny than in the past as they are subject to new local legislation in several countries.



Criminal Investigations

Criminal investigations and prosecutions are often complex, lengthy, and require specialist legal advice. A criminal sanction could have serious personal and reputational consequences for the individual(s) concerned.

Criminal investigations affecting directors or officers may arise from a wide variety of situations, including but not limited to insolvency, environmental crimes, workplace safety investigations, tax evasion, insider dealing or corruption.

Criminal proceedings are personal and will impact the director's personal assets. Criminal proceedings are a very common type of D&O claim, especially in Southern Europe. In certain countries, criminal complaints can also be initiated by a private party, and it is possible for such party to seek civil damages within the framework of a criminal proceeding.



Breach of Contract

There are increasing levels of D&O claims activity in relation to contract disputes, with clients embroiled in disagreements with suppliers or customers. These disputes can also involve directors and officers as defendants.

We see a wide range of contract dispute claims, including those about the terms of supply contracts or whether contract terminations are in line with the terms and conditions. They can range from complex supply contracts through to event cancellations, a significant feature in recent years. Unsurprisingly in light of today's global procurement, it's not unusual for these claims to have an international dimension as well.



Insured vs Insured

In many European countries D&O exposure can manifest itself in the form of Insured vs Insured claims. As the name suggests, these types of claims refer to a situation when one, or multiple, insured(s) under a D&O policy file a claim against another, or multiple other, insured(s). Such situations can appear when certain persons are alleged to have caused a financial loss to the company through their actions, or inactions. This type of internal mismanagement claim is common across most countries in Europe, but most prevalent in countries with a two-tier board system such as Germany. These types of claims create friction between, and immense pressure on, the individuals involved. They can lead to protracted litigation due to difficulties to achieve settlements.



Other Common Claims

Directors have an array of fiduciary duties and we are seeing a general increase in D&O claims alleging directors' **mismanagement** or breach of one or more of these duties. In addition, there are more general 'mismanagement' claims from a wide range of sources. Directors have a range of duties to their company and its investors, which are in some cases very general such as the duty to 'promote the success of the company'. We see a regular flow of claims regarding alleged breaches of these responsibilities, from conflict-of-interest allegations, to the pay out of allegedly unlawful dividends. Increasingly, we are seeing directors or shareholders within the same company facing disputes and falling out amongst themselves, most likely due to the extraordinary financial pressure organisations have been put under recently.

We also see an uptick in claims against directors and officers related to **social engineering fraud and cyber attacks**. As companies are more global and connected than ever, greater attention needs to be given to external and internal security and protection systems.

Directors and companies are also held to very high standards when it comes to protecting the **health and safety** of employees and of the public. Failure to uphold these standards can have disastrous effects on the company and its directors and officers, whom can be held personally liable, and must respond to a claim.

Tax related issues represent a growing concern for directors, especially for certain countries in Europe where the law may impose personal liability for corporate tax, especially when the company is unable to settle unpaid taxes due to e.g., an insolvency situation.



Impacts



Increasing defence costs

The overall cost of defending D&O claims against companies and their directors is continuing to increase. Directors are often surprised to be on the receiving end of claims when they believe they have done nothing wrong. In our experience it does not matter how blameless the insured person is; it is the attitude of the claimant that drives the claim. An aggressive and determined litigant can lead to millions in costs and can consume months – even years – of staff time, even when their case appears to have no legal merit.

Companies who find themselves part of a formal investigation often experience that it is an expensive procedure. As electronic communication is the standard way of communicating today, the cost of reviewing documents in the underlying litigation, as well as the preparation of defence, has escalated over the years. The preparation of expert reports to support the defence strategy are also a driver of higher costs in conjunction with preparing for investigations.

The highly competitive legal market continues to show a rise in professional fees year-on-year, and there is no question that these costs are here to stay. While some courts have embraced remote hearings post pandemic, not all courts are adopting this approach and there is a lack of predictability in terms of timings. Procedural timetables have been extended over the past year for various reasons (e.g., unavailability of key individuals, preference for in person meetings). As a result, prolonged disputes are adding to overall litigation costs.



Unwanted PR and reputational exposure

PR support is more important than ever in helping insureds manage their external messaging when they face a claim.

Some events behind a D&O claim (e.g., investigations, adverse events, and serious accidents) can attract intense media scrutiny. News, misinformation, and speculation can be shared instantly via traditional and social media platforms reaching customers, suppliers, and employees very quickly indeed. We have known insureds to be so preoccupied in dealing with the crisis at hand that they have not communicated effectively with these vital stakeholders – with detrimental (even fatal) impacts on their business. This is why PR support is necessary as part of a D&O insurance offering in order to mitigate the potential adverse effect on an Insured Person's reputation.

At what may be a critical time for their business, companies may need professional expertise to guide their communication strategies and help build specific messaging for their customers, press and employees. With the accelerating speed of social media and on-line news platforms this trend is set to continue.



Squeeze on management time

Any kind of investigation, allegation or dispute is often highly disruptive to the company in question. These situations are time sensitive and are often a drain on directors' and senior managers' time and can affect productivity. It is not just the senior leaders of the company who are affected – support staff are often required to provide additional documentary and/or administrative support connected with the situation in question. There is also the issue of opportunity cost. It almost goes without saying that company resources would be better spent pursuing growth strategies to drive increased profitability and longer-term direction of the business during this period, as opposed to responding to the situation or incident in question.



Typical Claims Scenarios

Small and mid sized companies can be more exposed to D&O claims as their company structures are often less sophisticated compared to larger multinationals who have more extensive support departments such as compliance, risk and Health & Safety.

Insolvency Claim

Sector:

Manufacturing company

Dispute:

Claims by Suppliers

Two suppliers of goods directed a EUR 1.5 million claim against former members of the board of our insured, a manufacturing company. The company had filed for bankruptcy and the suppliers claimed that the former members of the board were liable for the company's debts. The claim alleged that the former members of the board did not act in accordance with the Companies Act as they did not prepare a balance sheet for liquidation purposes on time. The suppliers claimed that the former members of the board had failed to comply with the Act, resulting in their personal liability.

Total policy limit was EUR 1 million and the claim exceeded the policy limit. Cover was confirmed under the D&O policy for defence costs incurred by the insured persons. A proceeding was initiated against the insured persons and writs were exchanged for a period of time. Following this, the parties engaged in settlement discussions, and they finally agreed on a settlement before the main hearing that was scheduled to take place. AIG was involved in the settlement discussions and worked closely with the defence counsel. The settlement amount was EUR 400,000 which, considering the circumstances in this matter, was considered a reasonable outcome.

Total defence costs reimbursed under the policy amounted to around EUR 300,000.

Timeline begins

Management observed that the financial strength of the group of companies was close to a situation where the company's equity was half of what was registered

7 months later

A restructuring of the company was initiated

5 months later

The company filed for bankruptcy

2 months later

A claim was made against the management by two suppliers who argued that the balance sheet for liquidation purposes should have been prepared and that the management were personally liable

1 month later

Notification to AIG

Timeline ends, 24 months in total

Settlement reached where AIG paid the settlement amount and the insured persons' defence costs

Viewpoint: In a lawsuit where the claimed amount is exceeding the policy limit and a number of insured persons are involved, it is important to make sure that the defence is handled as cost efficiently as possible.

The claim scenarios described herein are for general informational purposes only. These statements do not amend, modify or supplement any insurance policy. Whether coverage exists for any particular claim under any policy depends on the facts and circumstances involved in the claim and all applicable policy wording. Consult the actual policy for details regarding terms, conditions, coverage, exclusions, products, services and programs which may be available to you.

Typical Claims Scenarios

Contractual Claim

Sector:
Construction

Dispute:
Failure to deliver in accordance with contract

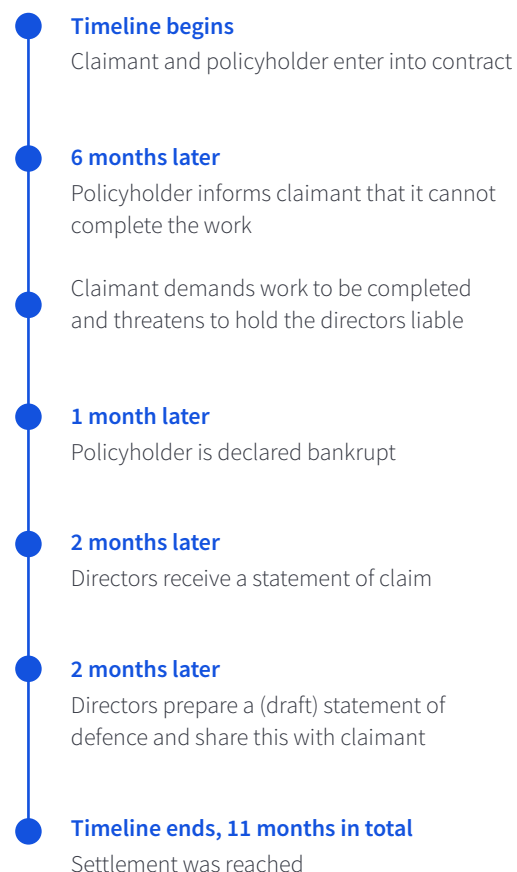
The policyholder entered into a contract with the claimant based on the policyholder agreeing to design, deliver and install construction materials for a project. The contract price was EUR 525,000 excluding VAT taxes and was to be paid in five installments.

The claimant partially paid the first and second invoices, and then later, paid the third invoice. According to the claimant, the third invoice was not due yet, but the policyholder asked for the payment because they needed the cash to pay its suppliers for the materials needed. Two years later, the policyholder informed the claimant that it would not be able to finish the work due to its deteriorating financial situation. The policyholder was declared bankrupt.

After the policyholder informed the claimant that it would not be able to finish the work, the claimant held the directors of the policyholder liable. Under local law, a director can be liable if obligations on behalf of the company were entered into while it was known that the company would be unable to fulfill their obligations. The threshold for such liability is high.

The directors retained defence counsel and argued that (i) the policyholder did in fact provide work for the invoices that had been paid, (ii) that claimant did not sufficiently substantiate why the directors should be liable, (iii) that, at the moment of contracting, there were no indications that the company would not be able to meet its obligations, and (iv) that the directors acted as any reasonable director would do.

The case was eventually settled with the claimant for EUR 80,000 with EUR 20,000 in defence costs incurred, a figure that could have been much higher were it not for an effectively negotiated outcome.



Viewpoint: Despite the fact that a director should be protected by the corporate veil, creditors will often try to recover from a director if the company cannot meet its obligations. The threshold for liability is high, but a director will still need to defend a claim. Even though the quantum may not always be sizeable, as this example illustrates, defence costs can quickly rack up and would have been substantial in this case had it not been for the early cost-effective resolution.

Typical Claims Scenarios

Company vs Insured Person

Sector:
Energy

Dispute:
Company claims against former managing director

AIG was notified of a claim that was brought by the company, an energy operator, against a former managing director.

The company argued that certain energy contracts were not properly billed and invoiced to customers leading to loss of profit of more than EUR 1.5 million. The allegations centred around the lack of implementation of proper controls and supervising mechanisms within the company's controlling and collections department. AIG swiftly confirmed defence coverage to the insured person and established a well-founded defence strategy in collaboration with the insured person's defence counsel.

The insured company was expeditious in bringing the claim against the insured person before court while leaving limited time to explore the possibility of an out of court resolution. By swiftly retaining knowledgeable defence experts and covering their fees of more than EUR 90,000, as well as utilizing AIG's vast experience in similar claims, the claim could be resolved with a settlement. The settlement included a full release of the former managing director's obligations by the insured company against a settlement payment of EUR 100,000 by AIG.



Viewpoint: In claims where the insured entity is filing proceedings against an insured person, it is key to build a robust legal defence for the insured person. Based on the joint evaluation of the legal and financial exposure faced by the executive, it may be advisable to explore an amicable solution with the company out of court. This compromise can be achieved in the form of a full and final settlement which protects the insured person, while saving valuable management time and mitigating risk to the insured person's personal reputation.

Typical Claims Scenarios

Criminal Investigations

Sector:
Food

Dispute:
Criminal investigations by the Public Prosecutor's Office

Three insureds were investigated by the Public Prosecutor for an alleged misappropriation of public funds. The fund was part of a European initiative to support the food industry. The insureds, in their capacity of directors, requested these funds on behalf of the policyholder.

Coverage was confirmed with respect to the legal fees incurred by the directors. Once the investigations were completed, the directors were all acquitted. Legal fees incurred by the directors amounted to EUR 800,000.

The criminal proceedings lasted only 9 months and the Public Prosecutor requested the dismissal of the proceedings for the directors, whose innocence had been proven. AIG's claims adjuster carried out a detailed evaluation of the legal fees which were deemed excessive. After negotiations between AIG and the defence lawyers we managed to reduce the legal fees to the benefit of the directors.



Viewpoint: This case shows how legal fees incurred in criminal proceedings can be significant. In cases where we are involved at an early stage of the claim we have a better opportunity to negotiate the legal fees, which is very important in criminal proceedings where they can exhaust the entire policy limit.



Our advice for insureds:

- Although a D&O claim may be a new experience to you, your insurer has probably seen numerous similar lawsuits before. Take advantage and add that expertise to your defence team by working collaboratively with your D&O insurer
- Notify any issues and/or emerging claims as soon as possible for early guidance and a more efficient approach
- Make sure your insurer has an experienced claims team who are actively involved, take decisions quickly, have an international footprint and are up to date with the latest external developments

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