5 risks company directors and officers must look out for

With corporate management under the spotlight like never before, a new report - *Directors And Officers Insurance Insights 2020* highlights five mega trends which will have significant risk implications for senior management in 2020 and beyond.

Image source: Getty/Gallo

1. More litigation coming from “bad news”

Claims are growing against directors & officers (D&Os) emanating from ‘bad news’ events not necessarily related to financial results. Scenarios include product problems, man-made disasters, environmental disasters, corruption and cyber-attacks.

These types of “event-driven” cases often result in significant securities or derivative claims from shareholders after the bad news causes a fall in share price or a regulatory investigation. Of the top 100 US securities fraud settlements ever, 59% are event-driven. There has also been a spike in claims resulting from the #metoo movement, where it is alleged D&Os allowed a toxic culture to take hold and endure within companies. The other prevalent types of events are cyber incidents, securities class actions, derivative actions and regulatory investigations and fines, including from the EU’s General Data Protection Regulation (GDPR).

2. Climate change litigation on the rise

Failure to disclose climate change risks will increasingly result in litigation in future. Climate change cases have already been brought in at least 28 countries around the world to date with three-quarters of those cases filed in the US. There are an increasing number of cases alleging that companies have failed to adjust business practices in line with changing climate conditions. Environmental, social and governance (ESG) failings can cause brand values to plummet. Directors will be held responsible for how ESG issues and climate change are addressed at a corporate level. Increasingly, they will have to consider the impact of these when looking at strategy, governance, risk management and financial reporting.

3. Growth of securities class actions globally

Securities class actions are growing globally as legal environments evolve. There is increasing receptivity of governments around the world to collective redress and class actions, particularly across Europe but also in other territories such as Thailand and Saudi Arabia. At the same time the level of filing activity in the US has been at record highs in recent years with over 400 filings in both 2017 and 2018, almost double the average number of the preceding two decades. This increased activity is impacting both US and foreign companies which have securities listed directly in the US.

A risk map in the report wassesses the risk of a company being subject to a securities group action in a particular jurisdiction, taking into account the availability and prevalence of third party litigation funding, which is regarded as a strong factor in increased group action activity around the globe. While countries such as the US, Canada and Australia see the highest activity and most developed securities class action mechanisms, overall, such mechanisms are developing and strengthening around the world with the Netherlands, Germany, England and Wales showing notable development and increased activity in recent years.

4. Bankruptcies and political challenges impact

Insolvencies are expected to increase, which may potentially translate into D&O claims. Business insolvencies rose in 2018 by more than 10% year-on-year, owing to a sharp surge of over 60% in China[. In 2019, business failures are set to rise for the third consecutive year by more than 6% year-on-year, with two out of three countries poised to post higher numbers of insolvencies than in 2018. Political challenges, including significant elections, Brexit and trade wars, could create the need for risk planning for boards, including revisiting currency strategy, merger and acquisition (M&A) planning and supply chain and sourcing decisions based on tariffs. Poor decision-making may also result in claims from stakeholders.

5. Litigation funders spread across the world

All of these mega trends are further fueled by litigation funding now becoming a global investment class, attracting investors hurt by years of low interest rates searching for higher returns.

Litigation funding reduces many of the entrance cost barriers for individuals wanting to seek compensation, although there is much debate around the remuneration model of this business. Recently, many of the largest litigation funders have set up in Europe. Although the US accounts for roughly 40% of the market, followed by Australia and the UK, other areas are opening up, such as recent authorizations for litigation funding for arbitration cases in Singapore and Hong Kong. India and parts of the Middle East are predicted to be future hotspots.