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Business Insurance

February 18, 2008

Global legal trends fuel D&O risks; Local policies seen as answer to fill coverage gaps for U.S. companies

BYLINE: GLORIA GONZALEZ

SECTION: NEWS; Pg. 4

LENGTH: 1020 words

NEW YORK-Global D&O insurance policies are insufficient to protect directors and officers from increasing liability created by the worldwide evolution of corporate laws expanding their duties and shareholder rights, according to D&O experts.

Solutions do exist for addressing any coverage voids for local directors and officers and subsidiaries of U.S. parent companies, including purchasing local policies in countries that do not recognize U.S. policies or adding specific endorsements to U.S. D&O policies, they say.

D&O claims activity outside the United States against U.S. companies and their overseas subsidiaries is increasing, making international exposures an important area of focus for the D&O liability sector, Sarah Robson, managing director for Marsh Inc. in New York, told attendees of the Professional Liability Underwriting Society's D&O Symposium in New York on Feb. 6-7.

Several countries have amended their corporate laws to expressly permit derivative and shareholder lawsuits, codify the duties of directors and officers and impose additional duties or establish new doctrines of liability, said Carol Zacharias, senior vp, **ACE USA** in New York. ``It's a train coming at you,' she said. ``Make sure you get ahead of it.''

In 2006, for example, the United Kingdom revised its laws to codify the duties of directors and officers and create a new requirement that they consider the future success of the company in making decisions, she said. In addition, shareholders are now allowed to file derivative actions based on negligence rather than just fraud, she said. ``It's...easier to file that complaint and sustain that action,' Ms. Zacharias said.

Spain, meanwhile, not only codified the duties of directors, but established joint and several liability for directors and mandated the appointment of independent directors.

In addition, Spain requires publicly listed companies to explain whether, and to what degree, they are complying with the recommendations of a white paper on corporate governance, an explanation that could be used by plaintiffs' lawyers when filing complaints, Ms. Zacharias said.

In cases launched overseas, directors and officers of both the U.S. parent companies and the local subsidiaries are often named, said Suzan Friedberg, assistant vp, American International Underwriters in New York, a unit of American International Group Inc.

Historically, North American companies have purchased global policies protecting all directors and officers working in their worldwide operations with very few companies purchasing locally admitted policies, Ms. Robson said.

When local directors and officers end up in court, though, they often find that their company's global D&O policy does not protect them because it is not admitted on local paper, said Vincent Vandendael, global practice leader, financial lines, for Zurich Insurance Co. in Zurich, a unit of Zurich Financial Services Group.

He cited one case where a local director of a Latin American subsidiary spent three weeks in jail because the D&O policy was on nonadmitted paper. ``Really this could have been avoided if this person had a local admitted policy,'' he said.

Global D&O policies issued in the United States only cover directors and officers in countries that allow nonadmitted paper, Mr. Vandendael said. About one third of countries worldwide, including Russia, China, Japan and Germany, do not allow nonadmitted policies, he said. ``You have to make sure your policy is compliant with all local laws and regulations,'' he said.

In addition, typical aspects of D&O policies may be problematic for policyholders with global subsidiaries, he said.

For example, insured vs. insured exclusions are common in U.S. policies, but the coverage is important for overseas claims because several European countries impose a duty on a company to bring an action against officials if their actions have an adverse impact on the company. If insurers do not provide coverage for employees who are legally required to sue their colleagues, they risk not selling many policies, Mr. Vandendael said.

In addition, several countries do not provide clear guidance on the ability to provide indemnification for directors and officers, said Edward Smerdon, partner with Reynolds, Porter Chamberlain L.L.P. in London.

For instance, local laws may stipulate that an exonerated director may be indemnified, but do not specify if the company can advance fees, creating a cash flow issue for directors and officers defending themselves against claims, he said.

Structuring a plan

When structuring a global D&O program, risk managers need to examine whether any of their company's subsidiaries are located in restricted countries and what the legal requirements are in those countries. ``Looking territory by territory is absolutely critical,'' Mr. Vandendael said.

Companies that have operations in local countries that do not recognize U.S. policies may decide not to purchase local coverage because they have limited operations in the country or they feel the risk of litigation is fairly small, the panelists said.

Parent companies may want to consider establishing a master D&O program with local policies in relevant jurisdictions and tie it in with the limits of their regular policies, Mr. Smerdon said. In theory, though, this could erode the limits of the main program, creating a significant coverage issue if a large claim emerges. ``As far as I'm concerned, the full limit applies to that local policy,'' he said.

Purchasing basic local policies in countries that do not recognize U.S. policies is an option that could make sense from a financial and logistical perspective, although those policies would not have access to the higher U.S. limits or coverage under U.S. endorsements, **ACE USA's** Ms. Zacharias said. ``That could be a problem if you have a significant claim,'' she said.

In response, some policyholders are purchasing endorsements to their U.S. D&O policies that would reimburse them for indemnifying a local subsidiary that experiences a loss related to its indemnification of a local director who experiences a claim, she said.

LOAD-DATE: February 22, 2008

LANGUAGE: ENGLISH

PUBLICATION-TYPE: Newspaper

JOURNAL-CODE: bi

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