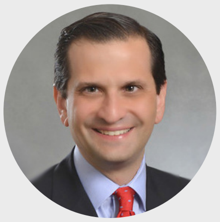
Global Risk Spotlight

Why Multinationals Must Carefully Consider Local D&O Policies: For Directors & Officers, It's Personal



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With nearly 20 years in the insurance industry, Mr. Schlesinger currently has responsibility for running the Public Company Management Liability business within Chubb's North America Financial Lines Division. He also has previous career experience as a banking associate with J.P. Morgan Securities and as a practicing attorney specializing in commercial litigation. Mr. Schlesinger holds both a J.D. from The Benjamin N. Cardozo School of Law and an MBA in finance from The Kellogg School of Management of Northwestern University.

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U.S.-based multinationals should be well aware of the need to protect individual directors and officers in liability claims. In 2019, the likelihood of litigation involving a core filing (those excluding Merger & Acquisition filings) for U.S. exchange-listed companies increased for the seventh consecutive year.[1] Less known, however, are the nuances of the global legal and compliance landscape that can make it difficult, if not impossible, for Directors and Officers (D&O) Side A coverage to respond directly and protect directors and officers confronting similar litigation originating outside of the U.S. Put another way, when it comes to Side A exposures, issuing a single policy with a worldwide coverage territory may be detrimental to some individual directors and officers facing litigation.

Heightened Risk

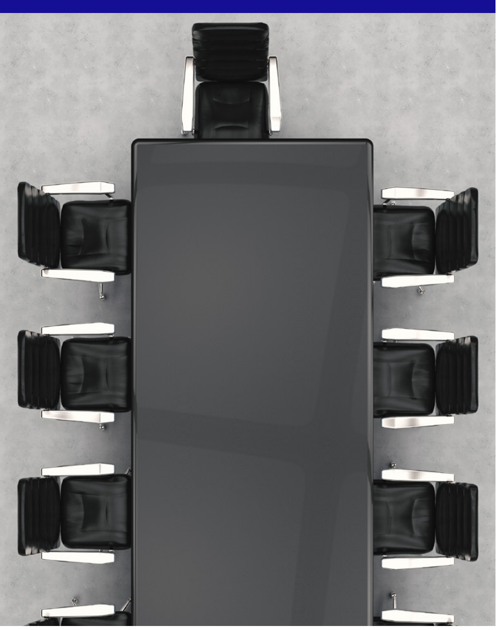
U.S.-style D&O litigation has been rapidly migrating around the globe; the number of filings against companies headquartered or with principal places of business outside the United States has been trending upwards over the last decade.[2] With companies continuing to expand into new geographies, the risks to directors and officers personally are continuing to grow.

The Single Policy Approach

Some organizations attempt to cover all of their directors and officers around the globe under a single policy, issued in a single country, that provides coverage on a worldwide basis. This approach may have its advantages - it's simple; economical (no need to buy local policies); there is one set of terms and conditions; and it allows for centralized efficiencies. However, there are limitations to this approach. Most notably, the potential inability of the carrier to directly adjust and/or pay claims on a worldwide basis, especially in certain jurisdictions that do not permit non-admitted insurance. Accordingly, careful analysis is needed to address the potential limitations inherent in a single worldwide policy approach for a multinational D&O insurance program.

1 Cornerstone Research, Securities Class Action Filings - 2019 Year In Review
2 IBID

In many places, multinationals must have local policies in place to have claims paid locally. With D&O insurance, it can mean the difference of whether Side A coverage can respond for individual directors and officers–or not.



Impacts on Side A Coverage

There has always been a need for multinationals to have local insurance policies in place so that claims can be paid locally (and also to avoid potential unforeseen issues, such as unexpected tax liabilities). However, the need for locally admitted D&O insurance is likely more urgent due to increased litigation and regulatory scrutiny. A decision whether to procure local policies can determine how and whether Side A coverage can respond when the personal assets of individual directors and officers are at stake.

In many jurisdictions, locally admitted D&O coverage may be required to ensure that individual directors/officers can be indemnified locally for a covered loss. This is especially true in jurisdictions where non-admitted insurance is prohibited or D&O coverage is compulsory. In those jurisdictions (e.g., Brazil, Russia, India, China), the need for direct and local Side A coverage is likely the greatest. Consequently, in these jurisdictions, a company without a local policy (that provides Side A coverage) may risk an inability to directly pay indemnity or defense expenses locally. This means that individual directors and officers may be required to pay defense costs and indemnity sums themselves or make other arrangements for coverage.

To illustrate the potential complexity of the situation, consider a U.S.-based company that faced claims after an explosion at a subsidiary's factory in Germany. Local authorities conducted an extensive criminal investigation of the company's directors and officers for failure to implement proper safety procedures that could have prevented the explosion.

A local policy was in place in Germany for the subsidiary's directors and officers. Responding to the German authorities cost more than €1millon in defense costs. Without the local policy in place, the adjustment, defense and payment of legal fees would have been exponentially more complicated and perhaps even impossible, as the company's U.S. master D&O policy did not provide coverage for legal fees during investigations. However, the local D&O policy included an additional provision that covered legal fees insured individuals incurred during investigations.

In another case, a director at an Italian subsidiary of a U.S. company faced a criminal investigation by the tax authorities in Italy. Investigators were questioning whether certain transactions shifted profits from Italy to a low-tax Swiss entity and whether the "anti-avoidance rule" applied to these transactions. The parent company's U.S. policy had a single aggregate limit of liability of $25 million with a $25 million retention. There was also a local policy with a $3 million limit and no SIR. Defense costs were covered outside of the local policy limits.

After evaluating terms and conditions under the two policies, it was determined that the local policy would respond first. And since defense costs were outside the limits, the U.S. policy would have been impacted only if a settlement or judgment exceeded $28 million. Without the local policy in place, coverage for the individual director and subsidiary would have been much more complicated.

The Usual Backstops May Not Work

Companies should also be aware that typical 'backstops' contained in multinational programs may not work for all individual directors and officers—a fact that further underscores the need for analysis and diligence to ensure local policies are in place where potentially needed.

For example, Difference in Conditions (DIC) and Difference in Limits (DIL) coverage clauses can potentially be triggered when there is an actual local policy in place. However, without a local policy in place, the value of this coverage may be be substantially diminished. Additionally, even when a local policy is in place and Side B and C losses may be covered and paid under the master policy, complications still exist for Side A claims—especially in jurisdictions where non-admitted insurance is not permitted.

Moreover, any financial interest coverage, which can be included in the master policy to insure the parent company's financial interest in another country, only applies when there is no local policy in place. In addition, it faces the same limitations as DIC/DIL cover for Side A claims, since financial interest coverage is designed to cover the financial interest losses of the master policy insured, not claims personal to individual directors or officers outside the U.S.

Rules and regulations governing local insurance are constantly evolving, as are the exposures of directors and officers. With so many intricacies to multinational D&O coverage, and so much at stake for individuals, risk managers and other corporate decisionmakers should carefully consider the structure of their global D&O program, with special attention to the potential implications Side A coverage may result in for individual directors and officers.

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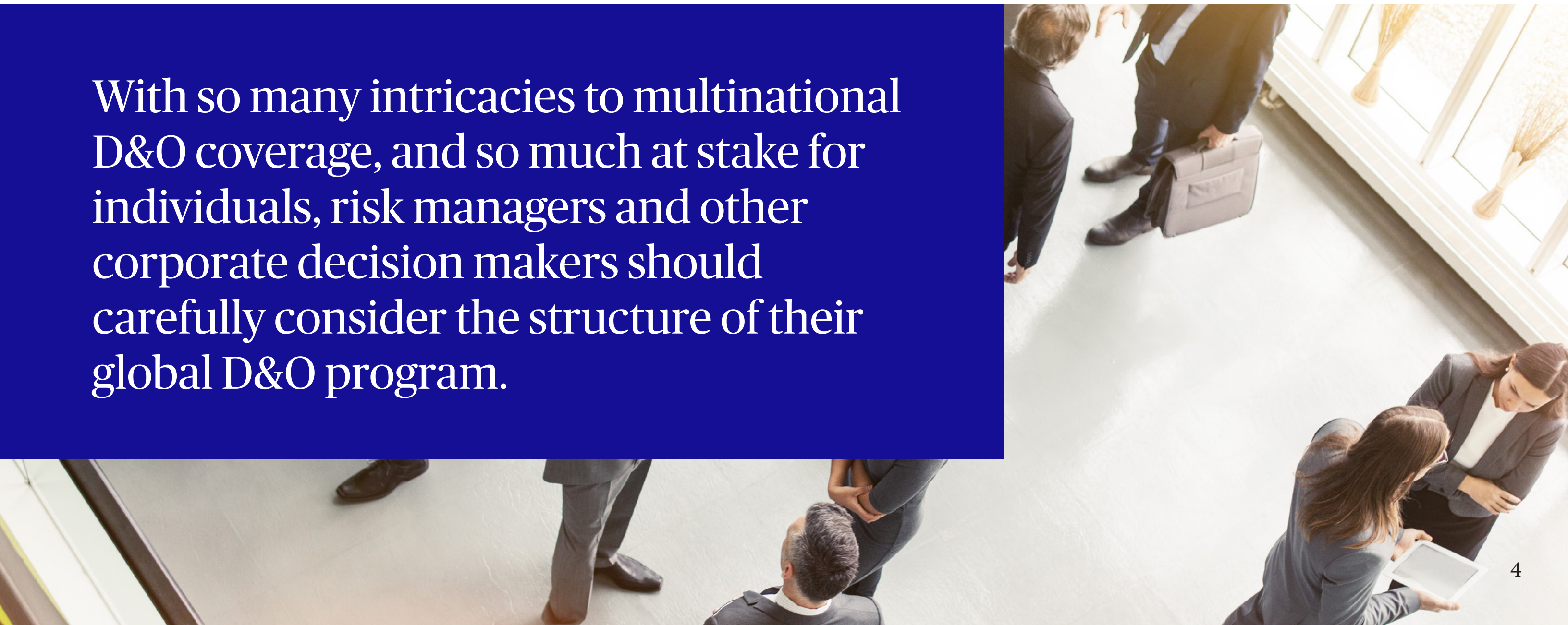

Chubb Data & Insights:

Local policies can be critical to ensure D&O liability coverage can respond effectively for directors and officers facing claims in foreign jurisdictions.

Where are these policies most used?

According to Chubb data, the following five countries witnessed the most local financial lines policies issued for our customers placing global multinational D&O programs in the period between July 1, 2019 and June 30, 2020.

Country local policy	Frequency of a local policy by top countries
China	9%
Canada	6%
Brazil	5%
India	5%
Mexico	5%

Leading the Way, Locally and Globally

With Chubb, companies and directors and officers can be confident that they have a highly experienced global insurer in their corner when they face a claim virtually anywhere in the world. Chubb's global organization spans more than 630 offices worldwide. We also have a long and consistent track record as a reliable insurance partner that businesses can count on to successfully manage multinational insurance programs.

Chubb Global Services is a dedicated team of 350 professionals worldwide, which includes centralized, multinational-dedicated leadership and specialists in local markets. This group works diligently for Chubb clients every day, customizing programs and services and keeping our clients' programs in step with local legal and regulatory developments and client expectations and preferences.

Our multinational clients also benefit from Worldview®, Chubb's proprietary online service platform that provides instant updates and comprehensive reports on virtually all aspects of a multinational program. Worldview makes it easy for users to bring clarity to local language D&O policies, with quick and easy translation services. And when there are questions about local D&O coverage rules and regulations around the globe, Worldview's Multinational Research Tool puts the answers keystrokes away for Chubb insureds.

Elevating multinational risk management.

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