

TRENDS
IMPACTING

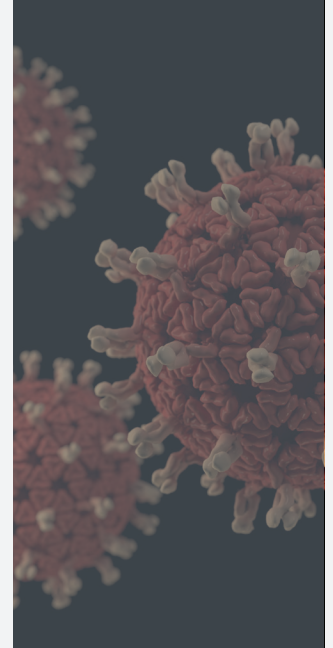
DIRECTORS & OFFICERS LIABILITY IN

2020

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C-Suite and Board of Directors around the world are being tested as they navigate through uncertain times. COVID-19 and other trends are being discussed to determine their impact on the organization. Consider your Directors and Officers Liability program and its ability to respond to each of these trends.

As you review the trends below, consider your Directors and Officers Liability Insurance Program and its effectiveness and response.



1

CORONAVIRUS (COVID-19)

As the situation evolves, it is too early to measure the full impact that COVID-19 will have on corporations and their shareholders, however, C-suite and Board of Directors should stay current on the overall risks that could have a material impact. Business interruption or contingency plans have already been enacted for most organizations, and where companies lack a clear plan it is not too late to develop one. Success of these plans should be regularly reviewed by the Board and Audit Committee to make adjustments where necessary. Canadian publicly traded companies should be considering disclosing the risks to the financials or operations posed by COVID-19 in their disclosure documents. The Securities and Exchange Commission in the US has already provided guidance on this matter. In addition to continuous disclosure requirements, Canadian publicly traded companies must be making “timely” disclosure of risks that are material to their operations and financials. Companies should consider whether existing risk factors in recent filings adequately disclose the risks they now face in light of the COVID-19 and review their related disclosures in subsequent filings to ensure that they remain accurate in light of the fluid situation.

A D&O policy would not likely cover direct claims from bodily injury due to an exclusion in the policy, however, the industry is beginning to see follow-on exposures and impact to financials that may result in personal liability of D&O's covered under a D&O policy. For public companies, financials may be materially impacted resulting in stock price declines. A chance of shareholder litigation and/or regulatory investigations by Securities Exchange or other agencies could include directors and officers personally. A failure to disclose or incorrect disclosures to investors regarding the pandemic's impact on the companies financials and operations may also lead to securities class action lawsuits. At the time of writing there were two securities class actions filed in the United States resulting from COVID-19.

2

SECURITIES CLASS ACTIONS UPDATE

Shareholder Class Actions have historically been a dominant concern for any company that is publicly traded in Canada and/or the United States. Most publicly traded companies purchase a Directors and Officers Liability Insurance program for their board and C-suite, to respond in the unlikely event their shareholders allege misrepresentation in public filings. Since personal liability can attach to securities laws, it is important to understand the current legal landscape. In Canada, the number of Shareholder Class Action cases filed in 2019 rose to 14, versus 8 in 2018. While the overall frequency may not seem alarming, the cost to defend and settle these types of claims is rising and can be crippling to a company's balance sheet. In contrast to Canadian statistics, the US finished 2019 with another record year of filings at over 400 securities class actions. While the higher numbers in the US are a function of the total number of publicly traded companies, it also speaks to the higher probability of litigation in the US. In fact, the litigation rate suggests that 1 out of every 11 US exchange-traded companies was hit with a securities class action claim in 2019.

3

REFORM TO THE CBCA IMPACTING PUBLIC COMPANIES

In 2019 the Canadian federal government enacted important changes to the Canada Business Corporations Act (CBCA) in their attempt to strengthen corporate governance practices in Canada. Amendments include:

- I. Codifying key elements of the Supreme Court of Canada's decision in BCE regarding directors and officers duties to act in the best interest of the corporation and consider the interests of shareholders, employees, retirees and pensioners, creditors, consumers and government, the environment, and the long-term interests of the corporation.
- II. Certain public CBCA corporations will now be required to disclose to shareholders, their approach to remuneration and hold annual non-binding shareholder "say-on-pay" votes. While many Canadian public companies have already voluntarily adopted advisory say-on-pay votes on executive compensation, it will now be required for prescribed corporations. Amendments have not yet been brought into force.
- III. Prescribed corporations will be required to disclose to shareholders information on diversity among directors and members of senior management, the well-being of employees, retirees and pensioners, and the claw-back of incentive benefits and other benefits paid to directors and members of senior management. Members of senior management has been defined in the regulation. The government's objective in introducing the diversity disclosure requirements is to promote diversity at the board and senior management levels to improve overall board quality.

4

CYBERSECURITY AND PRIVACY LIABILITY

Cybersecurity incidents and Privacy Liability continue to represent a corporate risk exposure for companies, especially as Canadian Securities Administrators make cybersecurity a priority area of focus. The costs and reputational harm associated with a cyber breach, or the possibility of regulatory fines (both corporate and personal) for violations under the GDPR or other jurisdictional Acts can be debilitating to a corporation and its directors and officers. As class actions related to security breaches become more common in Canada, boards should continue to assess and quantify cyber risk within the organization and look to develop sophisticated crisis management plans as part of their cyber preparedness.

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SHAREHOLDER AND SHORT-SELLING ACTIVISM

Activist campaigns can lead to M&A activity, removal of a board and key management, and costly litigation for companies. Reports suggest that in 2019 proxy battles were down from 2018 numbers, however shareholder activism continues to pose a concern for Canadian boards. Boards should be prepared "before an activist emerges" with a detailed shareholder engagement program and a program to monitor trading activities and share accumulations.

Once an activist emerges, the board should be actively involved with the response process and should ensure external communication is timely and accurate. Similarly, short selling activism has also been on the rise in Canada, most often targeting poor corporate governance or reasons why a share price is inflated. Published news by a short-seller can be devastating to a company's share price and reputation, and response costs can be high.

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ESG AND CLIMATE CHANGE DISCLOSURE

Environmental, Social and Governance issues are on every boards heatmap. Climate change in particular is rising to the top of the list, and current securities legislation in Canada requires disclosure of certain material climate change related risks in an issuer's regulatory filings. In August 2019, the Canadian Securities Administrator issued further guidance on mandatory reporting of climate related risks. While progress is being made by corporations to improve the quality of climate-related financial information to avoid vague or boilerplate disclosure, management has been tasked with ensuring it has implemented effective systems and procedures to gather reliable and timely climate-related information, in order to assess materiality and disclosure to investors, regulators and other stakeholders. Although the vast majority of climate change related litigation has been brought in the United States, actions in Canada and other jurisdictions are becoming more common.

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EMERGING SECTORS

The cannabis, cryptocurrency and blockchain sectors continue to grow in popularity, and D&O Insurers are cautious in their approach to each. The legalization of cannabis in Canada has resulted in both a high number of cannabis companies listing on a public exchange as well as an inflated number being hit with a “stock drop” securities class action claim after posting negative news or disappointing results. Directors and officers must also be aware of the Federal and Provincial Cannabis Acts that extend further personal liability for breaches under the acts. Insurers have unfortunately responded with restricted capacity, terms and conditions, and higher than average premiums.

Cryptocurrency and blockchain are backed by significant technology and face a real threat of cybersecurity. Insurers are closely monitoring fraud and theft claims surrounding the sector, and similar to cannabis, are carefully underwriting each risk and managing their D&O liability offerings.

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DIRECTORS AND OFFICERS LIABILITY INSURANCE MARKET UPDATE

Following a prolonged period of competition, pricing reductions and expanded coverage, 2019 marked a turn to a more disciplined approach to Directors and Officers Liability insurance offerings. D&O insurance buyers will continue to experience a disrupted market in 2020. All insurers, on both primary and excess insurance programs, are seeking rate and deductible increases as they manage escalating claims and loss ratios that in many cases have resulted in unprofitable results. The industry also continues to see a handful of Insurers and Lloyds of London Syndicates exit Directors and Officers Liability insurance in 2019. We expect this trend to continue in 2020.

Contact a Mitchell & Abbott Advisor with any questions you have regarding your D&O coverage



ABOUT DANIELLE GORST

Danielle has more than twenty years in the insurance industry, with a focus on Management Liability. She has advised and placed some of the largest D&O programs in Canada, and she assists clients as part of the account team to provide advice on coverage and claims advocacy.

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