



Directors' Liability Survey 2022

Regulatory exposures

Mandip Sagoo, Clyde & Co

While concern about regulatory risk has dropped this year amongst respondents when compared with last year's survey (though still remaining in the top 5), the level of risk posed to companies and their directors and officers is considerable. This is evidenced by 20% of respondents having experienced a regulatory claim involving a director, the figure rising to 34% for very large revenue companies. Companies in Europe, excluding the U.K., saw the largest percentage of such claims (26%) and, unsurprisingly, financial services firms experienced the most actions.

Regulatory requirements are ever-expanding and the chance of falling foul of the myriad of rules is considerable, especially in this era of accountability. Financial regulators in particular are taking a very proactive stance and are keen to stress any drop in activity related to the pandemic was temporary. They are focused on tackling traditional risks, such as market abuse and anti-money laundering failures, in addition to emerging issues, such as climate change-related risks.

Another area of focus is addressing the inadequacies highlighted by the pandemic, especially in relation to systems and controls, contingency planning and operational resilience.

Consumer protection remains a key priority in many jurisdictions with the Financial Conduct Authority (FCA) in the U.K., for example, proposing a new consumer duty. This presents not only an operational challenge and shift in approach to dealings with consumers, but the potential for further regulatory action against firms and senior management.

There is also growing pressure to expand current corporate criminal liabilities so wrongdoers are held to account and to encourage companies to take more responsibility for the culture they foster within their organisations.

In the U.K., this includes examining whether the identification principle needs to be reformed. This is where, in order for the company to be held liable, a prosecutor must prove the individuals involved in the crime represent the "directing mind and will" of that company, that is, the individual's actions are to be considered those of the company.

This is very difficult to establish and has led to a low number of convictions for which U.K. prosecutors, have been criticised. Reforms could pave the way for an increased risk of prosecution for corporates and directors and officers.

It is not just prosecutors such as the Criminal Prosecution Service and Serious Fraud Office, that are seeking to hold companies and directors and officers criminally accountable. The FCA recently levied significant fines on banks for AML failures, including pursuing a bank under its criminal powers, securing a conviction and imposing a fine in excess of £265 million. In addition, regulators such as the Pensions Regulator, are increasingly taking a forceful approach, armed with new powers that could see companies and their D&Os face significant penalties, including criminal sanctions.

Cyber risk and data loss remains a large regulatory/administrative exposure. Whilst cyber attacks do not always lead to data loss and data loss can occur without a cyber event, the two are often inextricably linked, especially given how cyber risk has evolved in recent years, with a sharp increase in ransomware attacks that now often feature exfiltration of data and extortion.

Record fines are being imposed by data protection authorities and cybersecurity failings are being identified and sanctioned by sector regulators. The U.K. is no exception – large fines are being imposed for data protection failings and sector regulators are striving to improve firms' cybersecurity and operational resilience, through close supervision and proactive enforcement.

With the crisis in Ukraine, there is the possibility of a rise in investigations and enforcement action linked to breaches of sanctions and other regulations.

All in all, the landscape remains a challenge for directors and officers and we expect this to increase as regulators continue in their endeavours to establish frameworks designed to encourage corporate and individual responsibility, in the pursuit of market confidence and consumer protection.



Regional views by Clyde & Co

Australia – Avryl Lattin

In Australia, we have now seen the implementation of the final tranche of legislation flowing from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Although there is sense of relief the reform agenda has slowed, participants in the financial sector will need to continue to adapt their product offering and customer approach to meet the new regulatory environment. Across all sectors, companies will need to take into account the increased frequency of regulatory enforcement action and higher penalty regimes.

Hong Kong – Rosie Ng

The Securities and Futures Commission's (SFC) proactive and "front-end loaded" approach in pursuing corporate misfeasance, led to a number of investigations and sanctions in 2021, including the Court of Appeal's success in obtaining a compensation order of HK\$622 million against former directors of a company for due diligence failures and large-scale misapplication of company funds. The trend continues upwards. As insolvencies continue to increase, stakeholders will likely continue to challenge management decisions leading to more shareholder activism.

The Stock Exchange of Hong Kong (SEHK) amended the Listing Rules (with effect from 3 July 2021) to impose secondary liability on "Relevant Parties", to include senior management (as newly defined), who by act or omission cause or knowingly participate in a breach of the Listing Rules. Further, the SEHK's new Corporate Governance Code on ESG and gender diversity, which came into effect in January 2022, has broadened the duties of directors of issuers and of IPO applicants in this regard.

Spain – Ignacio Figuerol

Criminal and regulatory investigations remain a major exposure in relation to bribery and corruption, health and safety, money laundering and environmental issues, and are increasing in relation to data protection and competition matters. In addition, the new scenario arising from the sanctions imposed by the U.S. and E.U. on Russia are likely to give rise to issues and investigations with a wider reputational impact.

India – Sumeet Lall

In India, various investigative agencies have been set up by the central government to ensure regulatory compliance. Active agencies include the Enforcement Directorate which is conferred with wide-ranging powers to investigate and prosecute corporates for offences relating to money laundering and violations of the Foreign Exchange Management Act.

The Enforcement Directorate has come down heavily on cryptocurrency exchanges, with seven ongoing investigations relating to cryptocurrency-related money laundering and the related attachment of assets over INR 135 crore (USD 17.7 million approximately).

Climate change has recently found a place in active discussions between the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI). The RBI has insisted on incorporating climate risks into commercial banks' risk and compliance strategies as one of its future goals. Further, SEBI has instructed the top 1,000 listed entities by market capitalization to implement new sustainability-related reporting requirements.

Companies need to carefully manage compliance with applicable rules and regulations that could open up an increased risk of inspection and prosecution by investigative agencies or regulator.

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