



REPRINTED FROM EXCLUSIVE ONLINE CONTENT PUBLISHED IN:
NOVEMBER 2011

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A photograph of a conference room with several black leather chairs around a long table. In the foreground, three red dice are scattered on the table. The text is overlaid on the left side of the image.

TalkingPoint: PERSONAL RISKS FACING BOARD MEMBERS IN THE MIDDLE EAST

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FW moderates a discussion looking at the risks facing board members in the Middle East between Alexander Blom at Chartis, Imtiaz Shah at Hogan Lovells, and Richard Wynn at Howden Insurance Brokers LLC.

Alexander Blom
Financial Lines Manager
Chartis

Alexander Blom joined Chartis MEMSA Holdings in Dubai in January 2010 as the Financial Lines Manager for the Middle East. The Financial Lines unit underwrites risks in relation to Directors' and Officers' Liability (D&O), Professional Indemnity (PI) and Bankers Blanket Bond (BBB) and other related financial lines insurances for the various licensed Chartis entities throughout the Middle East, on a direct or reinsurance basis. With a team of six underwriters and local claims support, the Financial Lines unit is excellently positioned to service the growing demand for Financial Lines insurance amongst commercial and financial related businesses. He can be contacted on +971 4 601 4420 or by email: alexander.blom@chartisinsurance.com

Imtiaz Shah
Corporate Partner
Hogan Lovell

Imtiaz Shah is a corporate partner at Hogan Lovells' Dubai office. With over 12 years' experience working in the GCC, Mr Shah has developed a deep appreciation and understanding of a wide range of corporate transactions across in the region. He has built a strong regional practice advising international corporates and financial institutions on transactions throughout the region. He has advised on multiple transactions in every GCC country and regularly speaks at seminars and conferences on regional corporate issues involving the GVCA and others. He can be contacted on +971 4 377 9222 or by email: imtiaz.shah@hoganlovells.com.

Richard Wynn
Executive Director
Howden Insurance
Brokers LLC

Richard Wynn is an executive director at Howden Insurance Brokers LLC, Dubai. Mr Wynn has worked in the insurance industry for 20 years and has been at Howden since 1997. He has specialised in financial lines insurance – director's & officer's liability, professional indemnity insurance, and crime insurance – throughout his career. He has been based in the Middle East since 2008. Mr Wynn can be contacted on +971 4 357 3835 or by email: richard.wynn@howdendubai.com.

FW: To what extent have you seen an increase in the personal liability risk facing directors and officers (D&Os) in the Middle East?

Wynn: The financial crisis and the drive towards implementing corporate governance has led to an increasing awareness of the responsibilities of D&Os in the Middle East. This in turn has highlighted the personal liabilities these D&Os face. As companies are under greater scrutiny there is much more of a spotlight on managerial actions. Investors in underperforming companies are looking to hold D&Os responsible for their unsatisfactory performance. Company directors, officers, and senior management can be held personally liable and be banned from taking future management positions.

Shah: Changes to the way in which corporate governance and directors' liabilities are viewed, greater definition by the authorities of the concepts of directors' responsibility and liability and greater scrutiny by more proactive regulators mean that D&Os are increasingly facing a personal liability risk.

Given that these increased levels of regulation are relatively new in the region, the true extent of the impact cannot be foreseen. It does appear that D&Os are aware of the new risks facing them and are looking to act to limit their personal liability.

Blom: Traditionally, Arabic business culture takes a more pragmatic approach to disputes and has proven to be much less litigious than the Anglo-Saxon/American business model. However, with a multitude of highly publicised business dispute cases in the regional press recently, a transformation in the legal attitude is evident. This has raised the awareness of corporate and individual responsibility. As organisations become more international as part of the overall globalisation of doing business, directors and officers (D&Os) are faced with greater accountability for their actions and/or failure to act. Historically D&Os were mainly focused on servicing shareholders' interests. These days D&Os are increasingly required to act more in accordance with the interests of other stakeholders, such as employees, creditors, customers, and suppliers. As a result we have witnessed several cases brought against D&Os in local and international courts.

FW: What types of claims are being brought against D&Os?

Shah: The extent to which a company or a shareholder can pursue a director or officer has not been subject to substantial case law or legal commentary. It appears that

a shareholder who suffers loss as a result of a director or manager failing to carry out tasks which the Commercial Companies Law of the UAE (CCL) requires him to do, or indeed is required by the company's constitution, may give rise to a claim against him. The primary civil remedy against directors for a breach of their duties is damages; injunction orders are not common. D&Os can also be criminally liable, particularly for any abuses of power involving fraud or embezzlement which can result in prison sentences, although any breach of the CCL is a criminal offence for which the director could be liable to at least a fine.

Blom: As a consequence of the global financial and economic crisis, D&Os are more closely scrutinised by stakeholders and regulators, their decisions are more frequently challenged, and they are being more frequently named and brought to account. The main sources of actions against D&Os are regulators, in particular financial regulators. We are witnessing increased investigations requiring D&Os to attend hearings and answer questions without any wrongdoing alleged against them. The majority of claims are for breach of fiduciary duty such as unauthorised withdrawal of company cash. Many companies in the Middle East have evolved from small local companies into internationally listed corporate entities. In some instances the management continue to run the business as if it were still a small local company.

Wynn: There is an increase in regulatory related claims as government departments and regulators try to bring more discipline into the marketplace. Also, a lot of claims relate to fraud or bribery which has been rife in the Middle East region. Claims frequency in this respect is increasing, particularly against financial institutions. Other regulatory claims against non-financial Institutions include claims for unauthorised transactions with the company's money, where directors have failed to disclose transactions or gain approval for them from shareholders.

FW: Have there been any recent legal and regulatory changes in the Middle East which affect the personal risks of D&Os?

Blom: Regulatory bodies in the Middle East are developing from infancy, implementing more rigorous regulations similar to other advanced regulatory environments like the UK. The Saudi Arabian Monetary Authority (SAMA) and Central Bank of Bahrain (CBB) have recently imposed very tight regulation on companies, with Kuwait soon to follow suit. Regulators are determined to use their authority to impose strict penalties on those companies and individuals who abuse their positions. Regulators, supported by local governments are issuing penalties

to local business executives at all levels. The Capital Markets Authority (CMA) of Saudi Arabia recently fined a prominent Saudi businessman for insider trading. SAMA also recently decided to freeze the accounts of some prominent family business groups which were embroiled in familial disputes, showing that regional regulators are baring their teeth and sending out strong signals to domestic and international investors and businesses.

Wynn: It is not just changes in Middle Eastern legal and regulatory systems which affect the personal risks of D&Os. Regulations and laws in other jurisdictions, such as the UK Bribery Act will also have an effect on D&Os in the Middle East. The Dubai Financial Services Authority (DFSA) has also been active in enforcing its rules on regulations on their regulated companies, leading to financial penalties and bans from acting as a director of companies within the Dubai International Financial Centre (DIFC). A separate court has also been established within the DIFC to deal with insolvency cases involving Dubai World and its subsidiary companies.

Shah: Public joint stock companies (JSCs) in the UAE are subject to the requirements of two relatively recent decisions. Ministerial Decision No.32/R of 2007 (Decision 32) requires that directors of all public JSCs act in a loyal manner, taking into account the interests of the shareholders and the company as a whole; exercise such due care, diligence and skill as a normal person would exercise in similar circumstances; and act in accordance with all applicable laws, regulations, and decisions, in addition to the corporate documents of the company. Ministerial Decision 518 of 2009 (Decision 518) provides corporate governance rules and standards to all companies and institutions whose securities are listed. An important aspect of Decision 518 is the additional accountability that is placed upon the board of directors. The board is required to develop procedural rules for corporate governance and supervise their application. The board must also provide a Code of Conduct in order to set down processes and procedures to enable compliance.

FW: What kinds of prosecutions, settlements and penalties have you seen imposed upon D&Os in the Middle East? Are there any particular cases worth highlighting?

Wynn: The DFSA have imposed sanctions against a financial services company for breaching its licence, dishonest conduct, and failing to exercise proper corporate governance. In this matter the directors were personally fined several thousand dollars and banned for five years from the DIFC. On top of this, the company was also fined and forced to pay compensation to its clients. In another case a trading company was sanctioned by the DFSA

for failing to exercise proper corporate governance. The directors were personally fined and banned for 10 years.

Shah: Regulators are increasingly working with the police to investigate corporate mismanagement, which in turn has increased the prospects of criminal prosecutions as well as civil claims. The DFSA has shown itself to be an active regulator. It sees enforcing good corporate governance as one of its major roles. One clear example is the action taken by the DFSA against the alleged market manipulation of Shuaa Capital (Shuaa) in which fines totalling \$950,000 were handed out along with other penalties and enforcements, including the requirement to appoint a chief risk management officer. More recently the DFSA has brought action against Damas International Limited, including fines against the company, and significant fines of over \$3m for the majority owners and directors, the Abdullah brothers, as well as enforcing their resignation.

Blom: D&Os can face investigation as well as regulatory, civil, and criminal proceedings and litigation. This can lead to expensive defence costs, potential damages, fines and penalties. Regulatory bodies and criminal courts are now more prevalent sources of action against D&Os in comparison to actions brought by plaintiffs. For example, one of our clients has gone into administration and all their D&Os have been put under investigation by the regulator. Consequently, all the D&Os have been interviewed by the public prosecutor and the case is currently developing before the criminal court. In general the allegations are that the company provided inaccurate or false information and failed to provide relevant information pertaining to its financial position to its regulator. A defence cost claim is currently presented, pending final judgment. In addition to the defence costs that will materialise in future as criminal proceedings develop, as of today \$500,000 has been incurred.

FW: What affect is the general increase in corporate regulation, and associated penalties, having on D&O liability insurance?

Shah: D&O liability insurance has not been widely purchased in the Middle East over recent years. With the exception of Oman, where it is compulsory for publicly traded companies, there has been no significant demand for the product. Private companies have typically considered themselves not at risk from litigation. However, increased regulation has ensured that D&Os are becoming increasingly aware of the need for insurance coverage and subsequently the demand and range of available policies is increasing. D&O insurance is available with respect to onshore, free zone and DIFC entities in the UAE. Insurance of this kind is becoming increasingly

common, particularly as a result of recent legislation, such as the DIFC Companies Law 2009 and Decision 518, imposing a higher standard of duty on directors.

Blom: The UAE Institute for Corporate Governance, Hawkamah, has recently set forth new corporate governance guidelines for SMEs. Similarly, the Mudara Institute of Directors in the UAE promotes director excellence by advocating the interests of boards and facilitating professional development. Through its director development programme, the Mudara Institute of Directors offers several courses which meet training needs in specialist areas and address specific topics such as those earmarked exclusively for chairpersons, government entities and family owned businesses. We are seeing an increase in first time D&O insurance buyers together with a greater analysis regarding policy coverage. With the increased penetration of D&O insurance in the region we are experiencing an increase in absolute claims notifications.

Wynn: The increase in corporate regulation and associated penalties is raising awareness of the need for D&O liability insurance. At present the penetration of this insurance is very low, but the demand is slowly increasing. Premiums remain very competitive, among the lowest in the world, as claims are yet to negatively affect insurers' underwriting results. As corporate governance increases and boards take new composition, the trends and buying habits of the west – where D&O insurance is much more commonly purchased – are slowly starting to take root. Also, companies are now seeking to buy higher D&O limits to reflect their true exposure.

FW: What advice would you give to D&Os on selecting a policy that is appropriate for both the individual and the company? How important is it to properly assess the terms, coverage and pricing of available policies?

Blom: The policy needs to respond when a claim happens with minimal disruption to the insured's business. With this in mind my advice would be to ensure that the D&O policy complies with local insurance law. Often a global policy issued to a parent company in another jurisdiction may not accurately reflect local laws and customs. The policy should be carefully reviewed. D&O policies have not been standardised and coverage does differ from one policy to the next. You should ensure that the policy has been tested by prior claims and that the intention of the insurer is in line with its policy wording. You should pay close attention to the severability clause which could have dramatic consequences for the availability of coverage between the individuals insured. Additionally, the definition of 'investigation' should be very broad and not sub limited.

Wynn: It is still very common to see companies make a decision to purchase a D&O policy primarily on a price basis. Price should be just one of the components of the decision coming after areas of coverage, exclusions, deductibles, and so on. Full assessment of coverage is vital but is often overlooked. It is important that the policy responds to litigation in all territories and jurisdictions where the insured or its subsidiaries operate. Also, it is essential to consider the size of the limit of indemnity purchased to match the potential exposures. Coverage should also be provided for the costs incurred in the defence of regulatory investigations against the directors. A specialist D&O insurance broker should be employed to advise the company and its directors on these and other factors.

Shah: The majority of D&O claims come from two sources: shareholders and employees. Shareholder claims tend to arise from mismanagement, non-disclosure or poor performance. Employee claims tend to revolve around wrongful dismissal and termination claims. A number of factors should be considered when selecting a policy, including: establishing what claims the policy covers; establishing what losses are covered, since fines and punitive and exemplary damages are often not covered; and the fact that liability arising from the 'provision of professional services' is often excluded from coverage and in some cases professional indemnity insurance is a better option.

Looking ahead, do you expect to see more Middle Eastern companies taking a proactive approach to risk management tailored specifically to protecting board members?

Wynn: Middle Eastern companies are already starting to take a proactive approach to risk management. We are seeing the recruitment of more in-house legal counsel and chief risk and compliance officers within companies. These individuals are employed specifically to advise the companies and their board members on corporate governance requirements and best operating practice. These best practices are taken from all over the world and implemented locally. The roles of D&Os are becoming better defined so that their performance can be measured accordingly. While this increased risk management should protect the individuals and the company, a good D&O policy can act as a back-stop should any failures occur.

Shah: The UAE is aiming to bring corporate governance more in line with internationally accepted standards. A draft of the new UAE Companies Law to replace the CCL suggests that soon all companies will be required to adopt corporate governance rules, although this law has not yet been implemented. The emergence of two

organisations within the UAE which are designed to investigate corporate governance is an indication of the new attention being paid to corporate governance. Given the difficult economic climate, corporate governance is receiving increasing amounts of attention. In particular D&Os are increasingly concerned about their own personal liability as shareholders are more likely to be scrutinising management. It is likely therefore that this will be an area where companies become ever more proactive, which will also tie in with the recent development of a more sophisticated approach to the regulation of corporate governance.

Blom: Due to the recent financial crisis, which has shed the light on several lapses of internal controls and breaches of

duties, it is evident that Middle Eastern corporate entities are now focusing on strengthening their internal controls and ensuring compliance with internal and external requirements. While these measures are expected to protect the board members, they are also expected to bring into perspective the true extent of their duties which, as a result, will increase their awareness and the need for D&O cover. Furthermore, the vast majority of companies in the Middle East are privately owned family held businesses. In order to attract both expertise and investment from foreign partners, these companies will need to enhance their corporate governance standards and bring them up to par with international standards. This in turn will lead to enhanced risk management, including protection of board members. ■