SHAREHOLDER PROCEEDINGS HIGHLIGHT CLIMATE CHANGE RISKS FOR DIRECTORS

On 8 August 2017, shareholder proceedings were filed in Australia against the Commonwealth Bank alleging that the company failed to disclose its exposure to climate change risk in its 2016 Annual Report.[1]

This is tangible evidence that Climate Change [CC] is a real and present risk for all companies and, in particular, listed companies. Directors need to pay special attention to the wider implications of the topic.

It highlights that Environmental, Social Governance [ESG] compliance is increasing and must now be addressed at board level. This is not only an Australian issue, the NZX is requiring specific disclosure from the 1st October 2017.

The risks related to climate change, and the opportunities for transitioning to a low-carbon economy, can have a significant impact on corporate strategies. In this evolving business landscape, companies face pressure to understand and disclose the effects of climate-related risk on financial performance. Boards of directors, in their role as risk overseers, must ensure that climate-related threats are being considered and addressed as part of an enterprise risk framework.

Directors and Officers need to understand how they are protected, or not, under a Directors & Officers (D&O) liability policy for climate change exposures.

D&O POLICIES – PERSONAL ASSET PROTECTION

While D&O liability insurance policies are designed to protect the personal assets of directors and officers, they might not always respond to a climate change risk in the manner expected.

In a worst case scenario, the consequences of any type of regulatory breach can include:

- Criminal prosecutions against the company and its directors and officers.
- Fines and penalties against the company and its directors and officers.
- Disqualification or imprisonment of a director or officer.
- Follow-on civil proceedings.
- Significant legal costs and expenses.
- Damage to reputation and brand.
- Disruption to business.

Where your D&O policy does not respond, your company and personal assets are exposed.

In February 2017, Australian Prudential Regulation Authority (APRA) Executive Board Member Geoff Summerhayes said APRA's view is that "climate change risks are no longer a future or non-financial problem and that many of these risks are foreseeable, material and actionable now".[2]

"An issuer should provide non-financial disclosure at least annually, including considering material exposure to environmental, economic and social sustainability risks and other key risks. It should explain how it plans to manage those risks and how operational or non-financial targets are measured."

NZX CORPORATE GOVERNANCE CODE REQUIREMENTS FROM 1 OCTOBER 2017[3]

BREADTH OF D&O COVER

A typical D&O policy covers individual directors for acts, errors or omissions arising from their conduct as directors and therefore includes matters relating to climate change risks.

Some of the allegations that may trigger a D&O policy include:

- Breaching your fiduciary duties in not considering the financial risks associated with climate change.
- Failing to comply with legislative reporting requirements.
- Failing to disclose climate change liabilities.
- Disseminating false or misleading or incomplete information on climate risks.
- Mismanagement of climate related risks.
- Negligence in allowing the company to emit greenhouse gases into the atmosphere.
- Failing to protect the company's assets.

If the D&O policy contains Company Securities Cover (commonly referred to as Side C cover), coverage may also be available for the entity itself in the event of shareholder litigation. This is a real risk as share prices have been known to plummet following adverse news on climate change exposures.

In most D&O policies, critical definitions such as 'claim', 'loss' and 'wrongful acts' are broadly defined so far as coverage for directors and officers is concerned. In responding to the increasing visibility of climate change exposures, some D&O insurers are now expressly covering these risks both for directors and officers, as well as any securities related claims made against the company.

Given the evolution of exposure, CC risks do not fit neatly within existing definitions and exclusions, leading to potential gaps in cover. Significantly most D&O policies contain a pollution exclusion, with some applying in absolute terms. In addition, other common exclusions in D&O policies could affect the extent of cover available, including:

- Bodily Injury
- Property damage
- Asbestos
- Fines & penalties
- Non-indemnifiable losses

Policy definitions of what 'pollutants' mean should also be reviewed, as greenhouse gases are considered as 'pollutants' in some jurisdictions including Australia.

Newer D&O policies now remove this ambiguity by expressly defining pollutants. Wider coverage, such as pre-investigation costs, can also be provided.

MORE COMPREHENSIVE SOLUTIONS FOR INDIVIDUAL DIRECTORS AND OFFICERS

Marsh has developed a cutting edge Side A product for Marsh clients called ALPHA®. This is enhanced D&O coverage for individual directors and officers, covering them for non-indemnifiable losses. These include shareholder derivative actions and claims in bankruptcy. It acts as a safety net when the company is either not permitted or not required to provide indemnification to its directors and officers.

It may be offered on a purely excess basis or on a 'difference in conditions' (DIC) basis, dropping down to respond if the underlying insurer rescinds the policy, becomes insolvent or excludes a specific coverage granted in the side A cover. It may cover all directors or officers or only non-executive directors.

Some of the benefits of an ALPHA® policy include:

1. **Multiple limits dedicated to individuals which cannot be impaired by corporate liabilities.**
   An ALPHA® policy will provide dedicated and exclusive limits for claims made against directors and officers that cannot or will not be indemnified by a company, even if the rest of the D&O programme has been exhausted by indemnifiable or entity losses.

2. **Broader coverage terms.**
   Since the vast majority of claims covered under a D&O policy are indemnified by the company, a ALPHA® policy allows insurers to afford broader coverage terms than generally possible under a traditional D&O policy. Importantly, the policy contains fewer and less onerous policy exclusions. For example, there are no exclusions for alia pollution, prior litigation, defamation or other personal injury in an ALPHA®policy.

3. **Less likely to be frozen as an asset of the corporation in the event of a corporate insolvency, since the company is not an insured under the policy.**

The popularity of the ALPHA® policy continues to increase. Given some of the high profile bankruptcies, notable cash settlements of D&O claims and the increase in significant shareholder class actions, ALPHA® policies have no doubt become a tool to attract and retain directors and officers. They offer additional comfort to directors and officers in carrying out their duties in today's political and regulatory environment where they face unprecedented scrutiny. This is a product that can be added to your existing Director's & Officers programme for additional director comfort and security.

MORE AND MORE COMPANIES INTERNATIONALLY AND IN NEW ZEALAND HAVE NOW ELECTED TO PURCHASE AN ALPHA® POLICY.

CONCLUSION

The increasing focus on climate change and the requirements for Environmental, Social Governance present new and different challenges for directors and their companies, with the threats of class action lawsuits, significant remediation costs and irreversible damage to the corporate and personal brand growing ever more likely.

Adequate protection for directors and officers in today's climate essentially requires three items:

1. Good corporate governance practices.
2. Properly worded indemnification provisions and/or deeds of indemnity from the corporation.
3. An appropriate insurance programme.

Directors and officers should carefully analyse their own risk profile to ensure a D&O programme is structured to meet their needs. While insurers provide standard policies, terms and conditions can be negotiated to improve the scope of cover.

NEXT STEPS

If you wish to understand what coverage you currently have to protect you in case of a climate change actions, please contact your Marsh client Executive for a coverage review.

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[1] http://www.mondaq.com/australia/x/623076/Shareholders/Australian+Shareholders+Push+For+Climate+Change+Risk+Disclosure

[2] http://www.smh.com.au/business/banking-and-finance/climate-change-a-material-risk-for-the-financial-system-apra-20170217-guffhm.html

[3] https://www.chapmantripp.com/publications/new-nzx-code-gives-significant-boost-to-shareholder-rights