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Management liability

13 February 2025 Marlene Henderson

In the dynamic landscape of 2024, shareholder activism has evolved into a multi-dimensional force, presenting both opportunities and challenges for Directors and Officers (D&Os).

As ESG considerations firmly entrench themselves in the corporate world, companies like Shell and BP find themselves at the crossroads of investor demands and environmental commitments. This era has also witnessed the emergence of 'green hushing,' a phenomenon where companies downplay their environmental initiatives, potentially leading to reputational damage and legal implications due to inconsistent or misleading disclosures.

Amidst these evolving challenges, the UK has seen significant corporate governance reforms aimed at enhancing transparency and accountability. The introduction of the revised UK Corporate Governance Code in January 2024, along with the draft audit reform and corporate governance bill, signals a shift towards more stringent reporting and regulatory requirements. These changes, coupled with the establishment of a new regulatory body, the Audit Reporting and Governance Authority (AGRA), underscore a heightened scrutiny on D&Os.

The D&O insurance market, meanwhile, has experienced a period of softening rates through 2024, driven by competition and ample capacity. However, as we look towards 2025, the landscape appears poised for a gradual shift, with expectations of a moderated decline in rates and an increased appetite among insurers to explore policy enhancements.

Trends in shareholder activism, governance reform, and director and officers risks for 2025

Shareholder activism and ‘green hushing’

In 2024, shareholder activism was multifaceted and is now becoming an increasingly complex area for directors and officers to navigate. Last year, Shell faced another challenge from minority shareholders to align its medium-term emissions with the Paris Agreement. In contrast, BP faced pressure from its investors to scale back its green commitments, allowing the investors to redirect profits into more viable renewable energy ventures.

Environmental, social and governance (ESG) principles are here to stay; however, some early adopters are now seeking to downplay their environmental credentials and ambitions in what is known as ‘green hushing’. This risk avoidance strategy poses a risk to companies, their directors and officers, both in terms of reputational damage and potential claims being brought against the company if such an approach has led to inconsistent disclosure practices or misleading disclosures.

Directors and officers (D&O) insurers will be mindful to consider the increased risk of claims when underwriting, especially for large corporations and those in industries often seen as harmful to the environment, such as oil and gas. We have also recently seen an increase in the availability of specialist policies designed to cover activist shareholder claims. It will be interesting to see the level of uptake of such policies.

Corporate governance reform

January 2024 saw the Financial Reporting Council (FRC) publish a revised UK Corporate Governance Code (2024 Code) for companies in the closed-ended investment funds category and the commercial companies category for financial years commencing on or after 1

January 2025. The main changes of the 2024 Code are in relation to reporting on internal controls, with the FRC taking on board earlier concerns from stakeholders in relation to the potential introduction of requirements similar to those in the US's Sarbanes-Oxley Act 2002 (SOX). Such changes have been welcomed by stakeholders such as the Institute of Chartered Accountants in England and Wales (ICAEW).

The opening of parliament in July 2024 included a legislative provision for audit and corporate governance reform with the proposal of the Draft Audit Reform and Corporate Governance Bill. We will have to wait to see how the draft bill develops in relation to annual reporting and whether it brings in similar requirements to SOX. The proposal will bring a new regulator, the Audit Reporting and Governance Authority (AGRA), to replace the FRC, with new and broader enforcement powers, including powers to investigate and sanction directors for breaches of corporate reporting, neglect, and audit-related duties. Going forward, directors and officers will need to be aware of the increased risk of claims, particularly from shareholders. Equally, underwriters will have to be mindful of the enhanced obligations and may want to update their underwriting guidelines accordingly.

Pricing

The D&O insurance market has been soft for a prolonged period now. Throughout 2024, rates steadily fell aided by surplus capacity and healthy competition. How long can this trend continue? Our prediction for 2025 is that D&O rates will continue to fall but at a slower pace. We expect there will continue to be new entrants looking to take on more risks and build their market shares and, for buyers, this will mean greater scope to explore policy enhancements and better pricing.

UK insolvencies and economic challenges

Businesses continue to navigate challenging and uncertain economic conditions. According to statistics published by the Insolvency Service in early 2024, UK corporate insolvencies reached a 30-year high at the end of 2023. Recent monthly statistics tentatively suggest that the number of corporate insolvencies may now have peaked but, overall, the numbers remain much higher than those before and during the COVID-19 pandemic. Many claims against directors and officers arise out of insolvency situations, and while insolvency rates continue to remain high, we expect related claims to follow suit.

The 2024 Autumn Budget introduced some significant changes for the industry, including increased taxes and workforce costs. While organisations are adapting to these changes, the full impact is yet to become clear. At the same time, businesses continue to navigate their ESG responsibilities, tackle growing cyber security challenges, and keep pace with an evolving regulatory environment. If they struggle and stakeholders become unhappy, the decisions and conduct of D&Os come under scrutiny which, in turn, can lead to more D&O claims.

Looking ahead: New technologies and Artificial Intelligence (AI)

The AI landscape is changing at a remarkable pace. Companies looking to bring AI into their operations will need to stay ahead of these changes, making sure they fully grasp the many risks involved. This includes understanding the regulatory requirements, cyber security implications, intellectual property considerations, operational challenges and the need for transparency. Staying informed and agile will be key to managing these risks effectively.

There is also an increasing focus on the ethical implications of AI, including issues of bias, privacy, and accountability. Companies and their directors could face legal and reputational risks if they are found to use AI in ways that are considered unethical or discriminatory. Similarly, although businesses will want to incorporate AI into their critical operations, any failures in those systems could lead to significant business interruptions and financial losses. We anticipate seeing more AI-related claims in 2025 and beyond.

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