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Are Boards of Directors the New "Target" in Data Breaches

September 17, 2014

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Today's Presenters

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  Partner
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  Aon Risk Solutions

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  Global Practice Leader: Network/Cyber Insurance
  Aon Risk Solutions

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Are Directors the New "Target?"

I. Industries & Sizes of Target Entities
II. Financial Statement Impact
III. Legacy Insurance Coverage
IV. Cyber value and exposures compared to Property and Casualty

"We ignore the risks that are hardest to measure, even when they pose the greatest threats to our well-being"

Nate Silver
The Signal And The Noise: Why So Many Predictions Fail – But Some Don't

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Industries and Sizes of Entities

Social Media

- Two distinct sources of risk: corporate and employee activity
- Network Security, Privacy. Social Engineering
- Defamation, product disparagement, IP infringement, harassment, and invasion of privacy.

Cloud Computing

- What are the risk oversight and security controls of the cloud provider?
- Where will the data be stored and will the provider make a contractual commitment to obey privacy laws?
- How is our data segregated from other data?
- How can I recover my data if disaster strikes?
- What if the provider goes out of business? How can I get my data back?

Mobile Device Payment Apps

- Mobile payment hardware, software, and mobile wallet technology is exploding globally
- Juniper Research study predicts mobile transactions will hit $1.3 trillion worldwide by 2015
- PCI Council guidance addresses account data security, mobile devices; hardware, software, usage, and customer relationship
- How is risk affected for all participants in the payment value chain?
- Mobile payments for online purchases predicted to skyrocket from $18 B (2012)

"Internet of Things"
Telematics, Device data collection, and location tracking, GPS.

International Laws and Regulations

Big Data Analytics

Recent Developments:

- Home Depot Catastrophic Breach
- August 2014: 1.2 billion user names & passwords hacked by Russian crime ring
- SONY $280 Million+ Breach
- October 2011 SEC Guidelines Re Cyber Risks
- Shareholder Derivative Actions Against Target Corp (2014), Heartland Payment Systems (2008), TJX settled 2010) and Wyndham Worldwide (2014) D's & O's
- Target Corp. $200 MM+ loss estimate to date
- SEC Commissioner, June 10, 2014: "Boards that choose to ignore, or minimize, the importance of cybersecurity responsibility do so at their own peril."
- National Institute of Standards and Technology's Framework for Improving Critical Infrastructure
- EU delay of Data Privacy Directive Amendments
- HIPPA "Business Associates"

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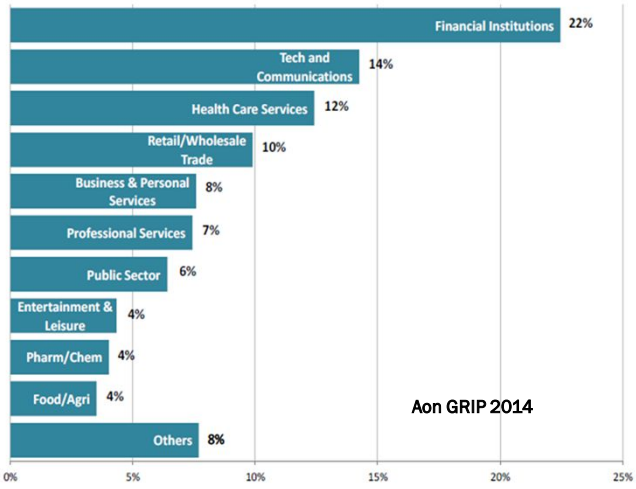
Industries and Sizes of Entities

A. Every industry
B. Every size organization
C. Every geography
D. Adoption of Cyber Risks by Sector (% of total premium by industry)



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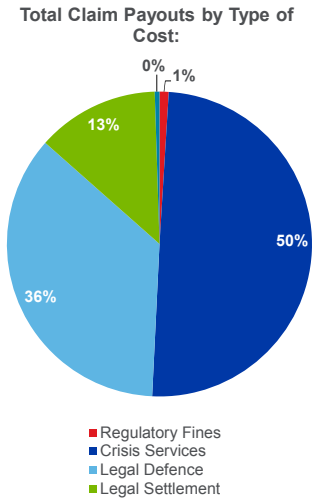
Financial Statement Impact



All Values In USD

Averages	2011 Findings (117 Claims Studied)	2012 Findings (137 Claims Studied)	2013 Findings (140 Claims Studied)
# of Records Exposed	1.7 Million	1.4 Million	2.3 Million
Cost Per Claim	$2,400,000	$3,700,000	$3,500,000
Legal Defense	$500,000	$600,000	$574,984
Legal Settlement	$1,000,000	$2,100,000	$258,099
Crisis Services	$800,000	$1,000,000	$737,473
▪ Forensics	$170,000	$341,000	$104,740
▪ Notification	$201,000	$180,000	$126,703
▪ Call Centre	$15,000	$50,000	(not broken out)
▪ Credit Monitoring	$253,000	$345,000	$55,865
▪ Legal Counsel	$242,000	$66,000	$29,225

Source: NetDiligence Annual Cyber Liability & Data Breach Insurance Claims: A Study of Actual Claim Payouts

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Financial Statement Impact:
Sample Company 10–K

- **We are increasingly dependent on information technology systems and infrastructure; system inadequacies, operating failures, or security breaches could harm our business.** We rely to a large extent on sophisticated information technology systems and infrastructure. The size and complexity of these systems make them potentially vulnerable to breakdown, malicious intrusion, and random attack. Likewise, confidentiality or data privacy breaches by employees or others with permitted access to our systems may pose a risk that valuable trade secrets, personal information, or other sensitive data may be exposed to unauthorized persons or to the public. Such information security breaches may be very difficult to detect. To date, system breakdowns and, to the extent we have been made aware of them, security breaches, have been infrequent in occurrence and their aggregate impact on our operations and expenses has not been material. While we have invested heavily in the protection of data and information technology, there can be no assurance that our efforts will prevent breakdowns or breaches in our systems that could adversely and materially affect our business.
- **Reliance on third-party relationships and outsourcing arrangements could adversely affect our business.** We utilize third parties, including suppliers, alliances with other pharmaceutical and biotechnology companies, and third-party service providers, for selected aspects of product development, the manufacture and commercialization of certain products, support for information technology systems, and certain financial transactional processes. Failure of these third parties to meet their contractual, regulatory, or other obligations to us could adversely affect our business.

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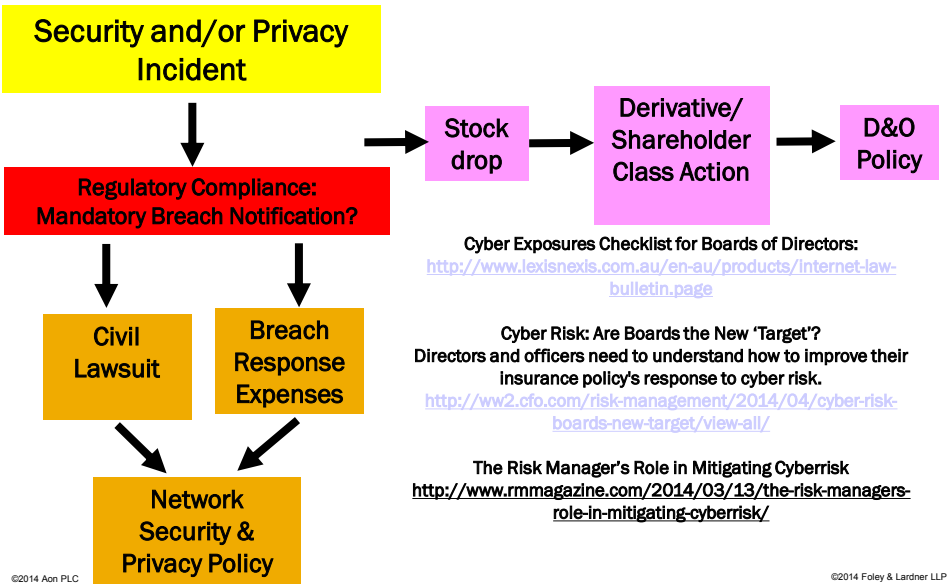
Financial Statement Impact



Cyber Exposures Checklist for Boards of Directors:
http://www.lexisnexis.com.au/en-au/products/internet-law-bulletin.page

Cyber Risk: Are Boards the New 'Target'?
Directors and officers need to understand how to improve their insurance policy's response to cyber risk.
http://ww2.cfo.com/risk-management/2014/04/cyber-risk-boards-new-target/view-all/

The Risk Manager's Role in Mitigating Cyberrisk
http://www.rmmagazine.com/2014/03/13/the-risk-managers-role-in-mitigating-cyberrisk/

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Sources of Claims After a Cyber Incident

- Customers
- Shareholders
- Regulatory Agencies
- Other Third Parties (e.g., Financial Institutions)

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Insurance Coverage for Third Party Claims

- Commercial General Liability Insurance
  - Property Damage
    - Limited to claims for damage to tangible property
    - Electronic data typically specifically excluded
    - "Personal Injury"
      - Requires "publication" of material that violates a person's right of privacy
    - New endorsements attempt to exclude all coverage for claims arising from access to or disclosure of confidential or personal information

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Insurance Coverage for Third Party Claims

- Directors and Officers Liability Insurance
  - Coverage for Individual D's & O's
    - Derivative Actions, Shareholder Class Actions
    - Regulatory Agency Claims
    - Claims by Other Third Parties
  - Coverage for Company
    - Publicly Traded vs. Non-Public
      - Securities claims only for publicly traded
      - Beware Anti-trust, Unfair Trade Practice and FTC exclusions

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Derivative Claims Analysis

- Derivative Action is a lawsuit brought by a corporate shareholder against the directors, officers and management of the corporation, for a failure by management.
- Procedure:
  - A demand is initially filed by a shareholder requesting the Board to bring a civil proceeding in a court of law against a Director or Officer.
  - Special Litigation Committees are typically formed and charged with investigating the merits of the shareholder's allegations and determining whether or not litigation is in the corporation's best interest.
  - If a plaintiff shareholder can prove a demand upon the Board would be futile, then the shareholder can bring a derivative action directly against the Board on behalf of the company.
- Derivative settlement amounts are typically non-indemnifiable, subject to individual state laws on indemnification.
  - Delaware allows for indemnification of defense costs, but not settlement amounts in derivate lawsuits.
  - Delaware Code permits the insuring of judgment or amounts paid in settlement of a derivative suit, as well as defense costs incurred even when a director has been adjudged liable in some respects

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D&O Claim Analysis – Data Breach Case Study

- Allegations include breach of fiduciary duty, waste of corporate assets, conspiracy and aiding and abetting.
- Named defendants include
  - CEO
  - CIO
  - Lead independent director
  - Other Directors
- In some cases, shareholders have also alleged via class-action lawsuits that directors and officers violated federal securities laws by failing to disclose material adverse facts about data breaches, which resulted in substantial shareholder losses following stock declines
- Certain security breaches require mandatory SEC disclosure requirements from businesses when a number of events occur

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D&O Claim Analysis – Data Breach Case Study

- "Risk Factors" excerpt from 10-K
  - *If our efforts to protect the security of personal information about our guests and team members are unsuccessful, we could be subject to costly government enforcement actions and private litigation and our reputation could suffer.*
    - The nature of our business involves the receipt and storage of personal information about our guests and team members. We have a program in place to detect and respond to data security incidents. To date, all incidents we have experienced have been insignificant. If we experience a significant data security breach or fail to detect and appropriately respond to a significant data security breach, we could be exposed to government enforcement actions and private litigation. In addition, our guests could lose confidence in our ability to protect their personal information.....The loss of confidence from a significant data security breach involving team members could hurt our reputation, cause team member recruiting and retention challenges, increase our labor costs and affect how we operate our business.

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D&O Claims Analysis

- Damages alleged
  - Costs incurred from defending and paying any settlement in consumer class actions filed against the Company;
  - Costs incurred from regulatory investigations into the data breach, including but not limited to, liability for any potential fines;
  - Costs incurred from the Company's internal investigation into the data breach, including but not limited to expense for legal, investigative, and consulting fees;
  - Costs incurred from expenses and capital investments for remediation activities; costs incurred from notifying customers, replacing cards, sorting improper charges from legitimate charges, and reimbursing customers for improper charges;
  - Costs incurred for company fulfilling its promise to provide free credit monitoring to victims of the data breach;
  - Loss of revenue

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D&O Underwriting Considerations

- Carriers are increasingly asking cybersecurity and cyber breach questions as part of the D&O insurance underwriting
  - May inquire on specific risk factor disclosure;
  - May inquire if determination was reviewed by outside counsel;
  - May inquire about controls around cyber security and how much attention and investment this matter receives within the company;
  - May inquire about incident response and crisis management program

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D&O Public Company Policy Considerations

- Entity coverage only applies for securities claims
- Investigative coverage typically only applies for individuals
- Derivative claim triggers coverage
- Definition of typically loss excludes fines and penalties
- Bodily injury / Property damage exclusion
  - Best practices – ensure no privacy exclusion
- Professional Services exclusion
  - Not standard but best practices would be to obtain exception for
    - Securities claims including derivative claims
    - Non-indemnifiable claims
- Side A DIC policy may provide broader coverage

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Insurance Coverage for Third Party Claims

- Cyber Liability
  - Breach Notification
  - Credit Monitoring
  - Liability for Disclosure
  - Regulatory Actions
    - Fines and penalties likely still excluded

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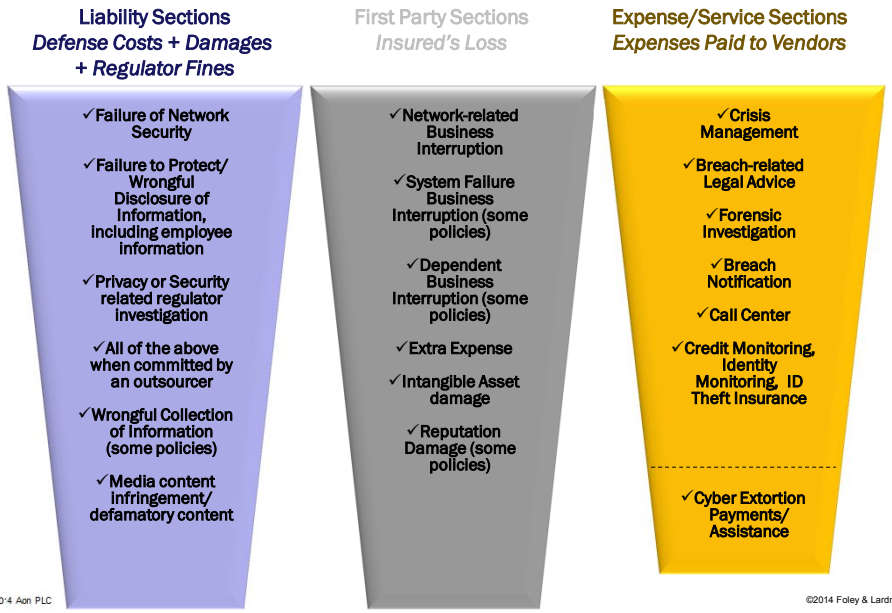
Scope of Cyber Insurance Coverage



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Cyber Insurance: Major Exclusions

- Breach of contract (unless liable in absence of a contract)
- Patent/Trade Secret
- Return of Fees or Recall Expense
- Direct Bodily Injury or Property Damage
- False/Deceptive Advertising
- Known network security vulnerabilities
- Unsolicited communication
- Unauthorised or wrongful collection of information (coverage varies)
- Breaches or security failures that began prior to retro date
- Intentional acts or fraud by management
- Liquidated damages
- Coupons, discounts, or incentives to Insured's customers
- System upgrades or repairs
- Unencrypted Devices/Information

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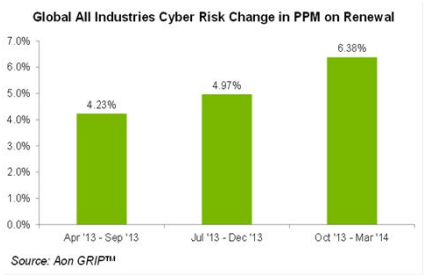
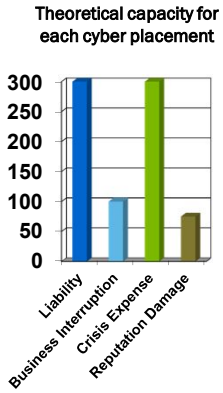
State of Cyber Insurance Market

Year	Gross Written Premium
2002	<$75M
2004	$200M
2006	$350M
2010	$600M
2013	~$1B = 1/151th of P & C





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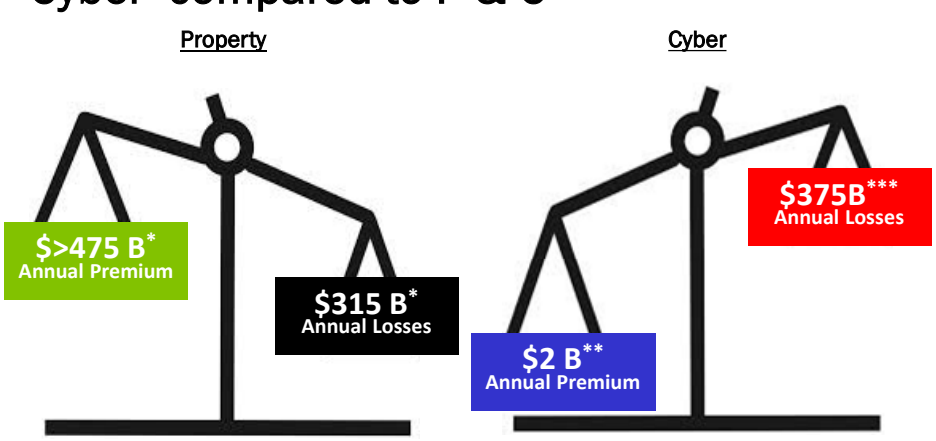
Cyber compared to P & C



*ISO P&C Industry Results for 2013
** Betterley Report 2014 (Aon estimates approximately ½ this amount based on our % cyber placements)
*** CSIS – McAfee Report 2014 (Range estimated is $375B - $575B)
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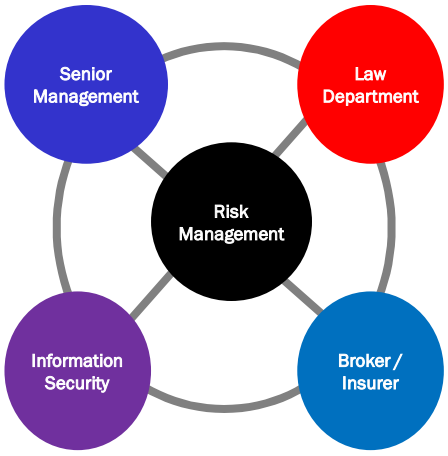
Cyber Risk Mitigation

Understand the top risks to your company and communicate to management the risks that are and are not insurable. If not insurable, then identify alternative options.



Understand your contracts with your customers. What risks are your company assuming? What insurance are you required to maintain?

Know and meet regularly with your Information Security / IT Team. Understand incidents or "near misses".

Review your risks with your insurance broker and insurer continually. Insurance coverage is negotiable.

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Questions & Answers

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- Director of the Year Awards
  - **November 5, 2014** — Chicago IL
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- Save the Date! NDI Executive Exchange
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Thank You

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