DIRECTORS & OFFICERS LIABILITY INSURANCE (D&O)

FINEX
DIRECTORS AND OFFICERS LIABILITY - WHAT’S IT ALL ABOUT?

The business world is constantly changing. Corporate scandals, amendments to worldwide securities regulations, increased shareholder awareness and extended rules on corporate governance have made being a company director in the 21st Century an increasingly difficult task.

Directors have always been bound by many duties arising under jurisdictional laws. The difference in today’s world is that stakeholders have far greater forms of remedy against directors and there is an increased willingness to pursue claims against them.

Whether or not the director is ultimately held liable for such claims, the defence costs associated can be extremely expensive, and the process can take up months or even years of a director’s valuable time. In practice, once a claim is alleged against a director for any wrong doing they have two sources of protection – they can either turn to the company to seek indemnification or they can seek assistance from D&O policy.

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WHY BUY D&O INSURANCE?

For the Directors or Officers – a policy provides personal asset protection should the employer’s indemnification fail for any reason.

For the company – a policy provides balance sheet protection where the company has indemnified its directors or where it is itself the subject of a securities claim.
WHAT GIVES RISE TO CLAIMS?

CERTAIN ACTIVITIES OF A COMPANY SUCH AS OFFERINGS OF SECURITIES, ACQUISITIONS OR DISPOSALS ARE COMMONLY AREAS WHERE DIRECTORS CAN FACE ALLEGATIONS OF WRONGFUL ACTS OR MISREPRESENTATIONS WITH RESPECT TO THE BUSINESS. DIRECTORS MAY ALSO FACE A WIDE RANGE OF CLAIMS RELATING TO THEIR DAY TO DAY MANAGEMENT OF THE COMPANY.

In today’s difficult environment claims can arise from a variety of sources:

The company – in most jurisdictions directors owe their primary duty of care to their company, and may therefore face claims brought against them by the company.

Security Holders (Shareholders and Bondholders) – worldwide security laws usually provide courses of action for shareholders to pursue directors and the company where they have suffered a financial loss due to the wrongdoing of a director or the company. Claims are more common in the USA where defence costs can be extremely expensive.

Regulators/Government Bodies – most jurisdictions have numerous regulators whose objective is to govern industries and punish any wrong doings. Regulators are usually given powers to investigate and hand down fines and penalties.

Competitors – any breach of competition laws could result in competitors filing an action against directors.

Liquidators – in the event of liquidation proceeding the administrators can bring a claim on behalf of the company for any breach of duty, e.g. wrongful trading that took place once the directors ought to have known the company was insolvent.

Employees – directors and officers face claims by employees alleging employment practices violations such as harassment or unlawful termination.
DIRECTORS AND OFFICERS LIABILITY POLICY – THE BASICS

A D&O policy is written on a claims made basis, meaning it covers claims made during the policy period (typically 12 months, although longer periods may be available). Claims can be made for wrongful acts committed during the policy period or prior to the inception of the policy, subject to any exclusion (see Typical Exclusions). The limit provided is an aggregate amount to be shared between all directors and officers of the company, including directors and officers of any directly or indirectly owned subsidiary, and cover is usually written on a worldwide basis.

HOW THE POLICY WORKS

Whilst policy wordings vary by insurer, typically wordings operate by paying the Loss of any Insured arising from a Claim made for a Wrongful Act.

Loss – includes defence costs, costs, awards and damages including settlements that the individual is legally liable to pay.

Insured – includes any director or officer and can be extended to include employees (in managerial capacities or named as co-defendants), lawful spouses, estates and liquidators. The term ‘director’ will usually include executive directors, non-executive directors, shadow directors, prospective directors and de facto directors. Officers usually include company secretaries, employed lawyers, risk managers and other senior managers.

Claim – includes any civil, criminal or regulatory proceeding or suit brought against an Insured.

Wrongful act – means any actual or alleged act, error or omission or any claim made against a Director solely because of their capacity.

COMPANY INDEMNIFICATION

Most jurisdictions permit companies to indemnify their directors for any financial loss arising from an allegation made against them whilst acting in their capacity as a director of the company. Where permitted the indemnity is usually evidenced and outlined in law and/or within the company’s incorporation documents (Articles of Association in the UK).

Whilst a company indemnity is comforting, it is only as valuable as the company’s ability or willingness to pay.

If the company becomes insolvent or refuses to indemnify for whatever reason, then the director will have to finance their own defence. Legislation can also limit indemnification in certain circumstances, for example funding the defence of a claim alleging criminal acts, or a claim brought in the name of the company such as a derivative claim.

Where a director does not benefit from a company indemnity, a policy is essential to fund any defence. By having a robust D&O policy in place a company can attract the best talent and many directors are now insisting that an adequate D&O policy is in place before they will commit to joining a board.
D&O POLICY CONSTRUCTION

A policy will typically be broken down into two or three broad categories of cover:

- Side A (non-indemnifiable loss) provides cover for the individual insured’s – Side A pays when the company indemnification fails to respond for any reason and is not usually subject to retention.

- Side B (indemnifiable loss) provides company reimbursement – when the company has indemnified their director or officer, the policy reimburses the company subject to retention and so provides balance sheet protection.

- Side C – there is an additional insuring clause that can be purchased known as Entity Cover, although this is not suitable for all companies. Whereas a standard policy only covers claims made against individuals, Side C Entity Cover provides protection for claims brought against the company itself as a legal entity, this cover is usually restricted to claims for breaches of securities laws. The advantages and disadvantages of this cover can be discussed further with your Willis contact.
**TYPICAL EXTENSIONS**

While policies may differ from insurer to insurer we list below some typical extensions and exclusions which you might expect to see.

- **New Subsidiaries** – automatic cover for any acquired company that falls within policy thresholds, usually based on size of total assets and exposure to US securities claims.
- **Investigation Costs** – cover for the legal costs in preparation for or attendance at an official investigation into the affairs of any insured and/or the company, prior to a wrongful act being alleged.
- **Outside Directorship Positions** – cover for any director or officer appointed to the board of an outside company at the request of the policyholder, cover applies in excess of any insurance or indemnification provided by the outside company (known as double excess cover). Joint Ventures may be treated as outside companies or as subsidiaries.
- **Employment Practices** – Cover for any breach of employment practices, e.g. sexual or racial discrimination, wrongful termination or failure to employ, where such claim is alleged against an insured person by an employee or prospective employee of the company.
- **Discovery Period** – should the policy not be renewed, it is possible to purchase additional periods during which claims can be notified to the policy but only in respect of wrongful acts committed prior to the expiry of the original policy. The periods can also be pre-agreed, especially for any retired directors and officers providing them with comfort that they will have insurance protection for acts committed whilst they were serving, should the policy not be renewed after they have retired.
- **Non-Executive Additional Cover** – some insurers are now offering additional ring fenced limits solely for the benefit of non-executive directors which are in addition to the limits purchased.
- **Extradition Costs** – defence costs cover to help fight an extradition proceeding and appeals.
- **Manslaughter and Health & Safety** – defence costs can be provided to help defend against claims alleging manslaughter or breach of statutes in relation to Health and Safety.

**TYPICAL EXCLUSIONS**

As with policy extensions, the exclusions can vary. Of the list below, only the fraud and prior notice exclusions will not be negotiable.

- **Fraud and Dishonesty** – excludes any claim where an insured makes a wrongful gain, although the exclusion should only operate once the fraud has been established though a formal court decision – the policy will still provide defence costs until such judgement is handed down.
- **Insured vs. Insured Claims** – intended to prevent collusive claims and hence abuse of the policy, the exclusion is nevertheless usually only applied to claims arising in the USA, subject to certain exemptions for valid claims such as derivative claims or employment practices claims.
- **Prior and Pending Litigation or Retroactive date Exclusions** – policies can contain a prior and pending date Exclusions – policies can contain a prior and pending date which excludes any claim arising from a litigation proceeding that commenced or was pending prior to the date stipulated in the policy. A retroactive date excludes any claim arising from a wrongful act that occurred prior to this date.
- **Prior Notice** – claims or circumstances notified under a previous policy are specifically excluded.
PROGRAMME STRUCTURES

Different variations of D&O policies are available, some companies opt to omit the Side B cover and have a Side A only policy, whilst others purchase different levels of Side A, B & C cover within a combined programme. Every company is different and we can help you design your programme for your needs. See diagrams below.

Another product in the D&O market is known as Excess Side A DIC (Difference in Conditions), which can be purchased in addition to the traditional Side A, B &/or C policy. This policy provides broader coverage with fewer exclusions. The policy works in two ways, firstly it provides Excess Side A cover above the Side A, B &/or C policy and secondly it provides Side A DIC cover where the underlying insurer(s) refuse to pay, exclude a claim from cover or are unable to pay due to their insolvency.
CLAIM EXAMPLES

INVESTIGATIONS
During an investigation into the affairs of the company or an insured by an official body, directors would have access to legal representation cover under a D&O policy for attendance at such investigations, although any subsequent criminal penalties would not be covered.

CLAIMS BROUGHT BY THE COMPANY – SHAREHOLDER DERIVATIVE CLAIMS
If the company brings a claim against its directors, the directors may not be able to request an indemnification from the company to defend themselves. The D&O policy provides cover for the defence, settlements or judgements resulting from the claim.

INSOLVENCY
Directors can be found guilty of wrongful trading during an insolvency proceeding. The D&O policy will pay the defence costs but will not cover any liabilities if there is any proven fraud or dishonesty.

POLLUTION
Claims arising from any pollution events are usually excluded from a D&O policy; however, D&O policies can provide full limit defence costs, cover for non-indemnifiable loss, and losses associated with shareholder derivative claims.

OFFERINGS OF SECURITIES
If, following an offering of a company’s securities, the investors suffer a financial loss attributed to a misstatement or misrepresentation in the prospectus documents, this could give rise to claims against the directors who are signatories to it. The D&O policy will pay the defence costs, settlements and judgements of civil claims brought against the directors for such alleged misstatements.

ACQUISITIONS/MERGERS
A company makes an acquisition, the purchase is part funded by offering new shares to the selling shareholders. Shortly after the acquisition the company announces a profit warning caused by losses in an overseas subsidiary. Aggrieved new shareholders bring a claim against the directors of the company alleging they were aware of the true financial position prior to issuing the new shares. The D&O policy will pay the defence costs, settlements and judgements of civil claims brought against the directors.

EMPLOYMENT VIOLATIONS
One or more employees could bring a claim against the directors alleging a violation of their employment rights, for example discrimination or wrongful termination of contract. The D&O policy would provide defence costs to the directors and officers, as well as settlement amounts attributed to them personally.

INFORMATION REQUIRED TO OBTAIN A QUOTATION

- Completed Proposal Form
- Latest Report and Accounts
- Latest Prospectus Documents (if applicable)

NEXT STEPS

For further information or to obtain a quotation, please contact your Willis Client Advocate or a member of the Willis Directors and Officers team.

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