



Directors' & Officers' Liability Insurance Guide

Directors' and Officers' Liability Insurance Overview

Increasing scrutiny of corporate behaviour and a claim-friendly legal environment have accelerated claims for Wrongful Acts made against directors in recent years. There have been many allegations including breach of duty, neglect, breach of contract, breach of employment legislation and breach of health and safety legislation.

What are the duties and responsibilities of directors and officers?

Company directors and officers now face unlimited personal liability for their actions and this personal liability exposes them to a potential loss of personal assets.

The Companies Act 2006 codified certain common law and equitable duties of directors for the first time. The Act sets out seven general duties of directors which are:

- to act within powers in accordance with the company's constitution and to use those powers only for the purposes for which they were conferred.
- to promote the success of the company for the benefit of its members.
- to exercise independent judgement.
- to exercise reasonable care, skill and diligence.
- to avoid conflicts of interest.
- not to accept benefits from third parties.
- to declare an interest in a proposed transaction or arrangement.

It is increasingly difficult for directors to keep up to date and fully understand all the responsibilities and duties required from them leading to directors frequently being held personally liable for claims of breaching duties or responsibilities that they are unaware of.

Directors' & Officers' (D&O) Liability Insurance

Company Directors' & Officers' Liability Insurance (also known as D&O) provides financial protection for the directors and officers of a company in the event of an action being brought against them.

Personal D&O cover is also available, popular with individuals who have multiple directorships and wish to ring-fence their own insurance limit to ensure this cannot become exhausted through actions un-related to their own.

What does it cover?

A D&O Insurance policy provides directors and officers with financial protection against alleged or actual "wrongful acts" when carrying out their duties. The policy is designed to pay for any defence costs and financial losses that occur up to the limit of the policy within the policy parameters.

A typical D&O policy will normally be constituted of the below Insuring Clauses:-

- Side A cover provides cover for the individual directors and officers for those situations where they have been accused of committing a Wrongful Act and their company is either unwilling or unable to indemnify them.
- Side B cover operates where an individual has been or may be indemnified by their company. This Insuring Clause benefits the company by reimbursing the indemnification and thus acting as balance sheet protection.

Policy Features:

All current, future and past directors and officers of a company and its subsidiaries are typically covered for:

- Wrongful acts which include reporting errors, inaccurate or inadequate disclosure of company accounts and failure to comply with regulations or laws.
- Shareholder actions where claims are filed on behalf of shareholders for improper management.
- Employment Practices (EPL) & HR issues such as employee discrimination claims including unfair dismissal, harassment, or failure to promote a person.
- Environmental Liability claim defence costs.
- Defence costs for the legal process.
- Outside board directorships and non-executive positions are also regularly covered.

Policy Terminology:

- “Claims Made” policy means that claims are covered if made whilst the policy is in effect or within a contractually agreed extended period.
- Period of coverage is usually 12 months or an Extended Reporting Period (ERP) can be negotiated to extend to up to 72 months.
- Premium is the cost of insurance determined by domicile, activities, public/private, assets etc.
- Aggregate Limit (typically purchased in £1m denominations) denotes the total amount that the insurer is prepared to pay under the policy during the period of coverage after which the policy is exhausted.
- Deductible is the amount borne by the insured for each and every claim. This is usually £Nil if the claim is brought against the individuals, but normally has a Side B “Company Reimbursement” amount which will be recovered by insurers if the Company is able to fund it.
- Extensions include additional limits for non-executives, crisis loss or emergency costs cover and representation for investigations.

What is not covered?

Standard exclusions that are not covered by a D&O policy include:

- Fraudulent acts.
- Criminal or intentional non-compliant acts.

Innocent directors remain fully covered if they are co-defendants, even if the acts of their colleagues were intentional or fraudulent.

Who needs D&O?

Historically, it was larger companies who were the first to purchase D&O insurance on a large scale. In more recent times it is the directors of SME companies that are now widely purchasing this type of protection as it is becoming more relevant to them in this ever-increasingly litigious environment.

The purchase of D&O insurance may also be driven by investors in the company, particularly at venture capital stage, who will usually require the company to put D&O cover in place at the time, or shortly after the investment is made.

It is now quite commonplace that when directors are appointed (executive or non-executive) they will request that D&O insurance be in place as a condition of employment, as they would not want to expose their own personal assets.

Who can make claims?

D&O claims can be made by internal parties (internal liability) as well as third parties (external liability).

Potential sources of internal claims include the company itself, subsidiaries and other insured individuals (D&Os).

Potential sources of external claims include creditors, employees, shareholders, customers, suppliers, competitors and tax authorities.

Claims examples:

- 1) The directors of a company were sued by an ex-director for allegedly conspiring to deny him the pension benefits that he was entitled to. Defending the claim personally cost the directors of the firm and significant five figure sum.
- 2) The directors of a company allowed their company to continue to trade although they knew that insolvency was inevitable. During this period a significant VAT liability was created which could not be collected by HM Customs & Revenue as a result of the insolvency.
- 3) A managing director and several senior staff faced a criminal prosecutions for allegedly breaching health and safety legislation, these alleged actions resulted in the accidental deaths of two employees.
- 4) A business was being investigated for polluting a waterway, a senior member of the organisation was required to give evidence resulting in significant legal representation costs.
- 5) An investor had been given certain representations about the trading position and solvency of a company which transpired to be misleading. The investor subsequently brought an action against the directors for misrepresentation.
- 6) An employee was sacked immediately for racially abusing and being physically violent to a colleague resulting in an unfair dismissal claim against the employer. The employer's legal costs were covered by a D&O liability policy.

Trends in Claims

2000-2008 saw a steady increase of claims activity brought against directors and officers. The global financial crisis accelerated this trend, which continues to date. Notification levels of claims brought against directors in 2011 onwards has been consistently 20% above the peak years of 2009 and 2010.

Top 5 sources of exposures by nature of loss:

- 1) Regulatory & Criminal actions including investigations and proceedings brought by regulatory bodies.
- 2) Bankruptcy actions including claims brought by receivers for continued trading whilst insolvent, or asset stripping.
- 3) Company v Insured actions including claims brought by or on behalf of the company by shareholders for breach of fiduciary duty resulting in a depletion of assets.

- 4) Co-defendant actions including claims brought by third parties against the company for anti-competitive behaviour or misrepresentation and naming a director or officer as co-defendant.
- 5) M&A actions including claims brought by minority shareholders alleging unfair treatment or valuation in a sale, acquisition or merger.

Frequently Asked Questions

How much will this insurance cost?

D&O products are relatively inexpensive and potentially represent good value for money considering the size of the claim limits that insurers put at risk.

D&O insurers calculate the premium based on various aspects of the business for example industry sector, company size and profit, prior claims record, domicile and international activity (particularly US exposure) and debt levels.

Sector	AUM/Revenue	US Exposure?	Limit	Deductible	Premium
Financial Services	GBP1 m	No	GBP1m	GBP5,000 Company Re-imbursment	GBP1,500
Technology	GBP5m	Small turnover	GBP2m	GBP Nil	GBP1,800
Investment Management	GBP100m	Yes	GBP5m	GBP15,000 Company Re-imbursment	GBP5,000

What limits of cover do I need?

The limit of indemnity that should be chosen depends on your perception of the exposure you face and how much you are prepared to spend to mitigate the risk. It is relevant to bear in mind that this type of coverage protects the personal assets of the directors and officers.

Many smaller companies purchase a limit of up to £10 million. The limits required can vary greatly and is one of the key factors in underwriting such a policy. Protean is well placed to offer the informed and independent advice which you may need to ensure you don't pay for an unnecessarily high level of cover.

How does the policy's limit of liability apply?

Typically the policy limit is an annual aggregate that applies for all claims that fall within the policy terms. This limit is the total amount the insurer is willing to pay out regardless of the number of individual claims and the accumulation of the defence costs. If claims and defence costs accumulate to the amount of the limit, any further costs on existing/new claims are not covered by the policy.

Why don't companies indemnify their directors and officers?

Some companies do indemnify their directors and officers. However, in certain situations companies may have insufficient funds to do so, as many claims against directors are from investors and/or creditors which are more likely to arise when the company becomes insolvent.

Without corporate indemnity or insurance, directors and officers would be left to use their own personal assets to pay for their defence and any settlement due.

What about non-executive directors?

It is the assumption held by some that non-executive directors cannot be held liable for their actions in the way executive directors can. This is, in fact, incorrect and non-executive directors receive the same treatment as executive directors. This is due to non-executive directors becoming increasingly accountable for their actions under changing legislation and regulatory framework.

What if the company merges or is bought?

Most D&O policies include a “change in control” provision. If the company is merged or bought, the policy will stay in force for the remainder of the policy period, but only for claims based on wrongful acts before the change goes into legal effect.

The D&O policy does not cover fraudulent acts, how will a director defend a fictitious claim?

Defence costs incurred for such a claim are typically covered by the policy until such time as the wrongful conduct is determined to have “in fact” occurred, or until there is a final adjudication. This means that a settlement without an admission of wrongdoing usually does not trigger the exclusions.

Steps to purchasing cover

Requirements for placing cover are usually a completed and signed proposal form supported by recent financials, although underwriters reserve the right to ask for additional information.

With over 50 insurers offering D&O cover (at the last count), each of them offering coverage in a combination of geographies and many specialising in different sectors and industry verticals, it may appear a difficult choice to decide which is most appropriate for your company.

Protean can help with this choice as we have experience, expertise and insurer relationships built over three decades enabling us to help you navigate the myriad of providers and to advise you on structuring the D&O insurance programme that is right for your business today, and capable of dealing with whatever tomorrow brings.

For more information please contact:

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