Briefing

BURGES SALMON

Insurance

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A guide to D&O policies

In many industries directors and other senior company officers face an increasing risk of:

- civil claims brought against them personally as a result of their decisions/actions; and
- civil and/or criminal investigations brought by regulators with extensive powers.

In both these scenarios, the individuals in question will often require independent legal advice, the costs of which can be considerable.

One way for directors to protect themselves from personal financial liability or legal costs exposure is by means of a company indemnity. It should be noted that the Companies Act imposes certain restrictions on the indemnities that can be provided.

Another increasingly important protection is Directors & Officers (D&O) insurance. This briefing gives a short overview of D&O polices: why they are placed and what they should include.

Overview

D&O policies:

- are an increasingly important commercial consideration for both companies and senior management;
- are particularly important in industries with a powerful regulator (e.g. the financial services industry); and
- should be tailored to ensure cover appropriate to the relevant legal and regulatory framework.

Purpose of cover

The central purpose of D&O insurance is to cover directors/officers in respect of:

- personal financial liabilities arising from the discharge of their duties; and
- the legal costs associated with defending any civil claims or regulatory/criminal proceedings.

Companies are also typically covered to the extent that they have indemnified the relevant individual directly.

Why protect individuals?

Many directors/senior officers, particularly those working in heavily regulated industries, will want the company to purchase cover for them under a D&O policy.

This is particularly true in the financial services industry where:

- the potential exposure to significant civil claims is particularly high;
- there is considerable applicable criminal law, e.g. in relation to insider dealing; and
- the regulator (the PRA/FCA) has, over recent years, become increasingly concerned about senior management responsibility and has an array of investigatory powers at its disposal.

Companies also typically perceive it to be in their best interests for directors/officers to have a clear ability to meet legal costs at an early stage in whatever proceedings they face. This is also important in the regulatory context where skilled legal advice is crucial in terms of dealing with the regulator in an appropriate manner.

Example Case study

The FCA believes that an officer of an investment management company has breached certain regulatory rules and initiates an investigation which ultimately results in a formal interview process (the requirement to attend a formal interview is a typical trigger for legal costs cover in the regulatory context). The senior employee will face an interviewer skilled in extracting information of all kinds about the investment management company's business.

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Regulated entities and individuals need to deal with the FCA in an open and honest manner irrespective of whether they are represented legally. However, without legal representation there is a greater risk that an innocent individual will respond in a manner that gives entirely the wrong impression about their role/behaviour, potentially compromising the chances of resolving swiftly the investigation.

Most investment management companies in this situation would want the officer to have appropriate independent legal representation paid for by an insurer so that s/he understands how best to approach the interview process from both a legal and practical perspective.

We have used the example of the FCA, but similar principles apply in respect of investigations carried out by other regulatory bodies, e.g. the Health and Safety Executive.

Key issues

These are some of the key issues/questions that typically arise when considering D&O cover.

What types of claim/wrongdoing should be covered?

This will depend on:

- the specific roles played by the individuals covered; and
- the relevant regulatory, civil law and criminal law context.

However, it will not be possible legally to cover all types of wrongdoing, e.g. fines imposed for criminal behaviour or regulatory fines for PRA/FCA regulated entities.

What is the relevance of the policy period?

D&O polices are 'claims made' policies. This means that the relevant policy period is the one in which the claim in question is first 'made'[1], which may be different from the policy period in which the alleged wrongdoing took place. This is why directors/senior officers are often concerned to ensure cover extends past the time of their resignation/retirement in the event that the D&O policy is not renewed. Such cover is often available, typically for 6 years which is the standard limitation period for civil claims.

Cover will lapse once the stated policy period expires. However, there may be an express unilateral right for the company to purchase further cover <u>after</u> the expiry date in relation to claims made in relation to wrongful acts committed <u>prior</u> to the expiry of the policy period.

In addition, circumstances that may give rise to claims may also be covered in respect of claims that are made after the policy expires, if notified properly before the policy expires (see our July 2013 briefing on this topic).

In what circumstances will cover be lost or legal costs become repayable?

There are general considerations, e.g. the failure to notify the insurer of a claim in accordance with the notification mechanism prescribed by the policy.[2]

More specific considerations include:

- exclusion clauses, e.g. a clause excluding cover for any 'finding'[3] of fraud or dishonesty. Such clauses also typically make monies advanced for legal costs repayable upon such a finding. A D&O policy should make it clear that the fraud of one director/officer does not vitiate cover for other innocent insured individuals. Indeed a non-vitiation clause is an important element of any D&O policy more generally;
- limitation clauses, e.g. an aggregate upper monetary limit for claims against all individuals covered under the policy. This can be problematic because it may result in a situation where one individual uses up the majority/all of the available cover leaving others covered inadequately or not at all. When considering adequacy of insurance limits companies and their directors should, amongst other things, give consideration to the number of group companies insured and the fact that defence costs can quickly erode available limits and are invariably part of (as opposed to in addition to) the policy aggregate limit; and
- insurer consent clauses, e.g. the requirement to gain the insurer's prior consent before a director/officer incurs any legal defence costs or settles a claim.

Conclusion

The importance of D&O cover will increase still further if the Government follows through with recently announced plans to enable the Courts to make directors of insolvent companies, who are subsequently disqualified as a result of their actions, personally liable to creditors.

Meanwhile, companies should seek as far as possible to tailor their D&O policies to provide cover suitable to the particular commercial/legal/regulatory framework in which they operate.

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[1]Careful consideration needs to be given to what this means in practice (see our July 2013 briefing).
[2]This may reduce or preclude cover for the claim.
[3]Specific consideration must be given to what constitutes a finding of fraud. This should usually be a formal court judgment or official determination by a regulatory body.

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