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Directors and Officers Liability Insurance Guide 2020

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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.

Throughout 2020 we have seen the market for Directors & Officers cover harden beyond all expectation. This is partly due to the will of insurers who have been taking gradual action in preceding years, but Coronavirus has impacted the underwriting approach of insurers beyond all expectation and what was previously a very easy cover to arrange is now requiring far more diligence in presentation to market and greater degree of negotiation with underwriters.

Claims scenarios

NEGLIGENCE

Your organisation's senior leaders negotiate a contract with a business partner. However, your senior leaders misrepresent the company's finances in order to secure the contract. When the business partner discovers this discrepancy, they take legal action against your senior leadership team.

THIS WOULD QUALIFY AS A WRONGFUL ACT ON YOUR D&O POLICY, RESULTING IN REIMBURSEMENT FOR ANY LEGAL COSTS THAT ARISE FROM THE INCIDENT.

DATA BREACH

Your company stores sensitive customer information on-site, but your senior leaders fail to enforce adequate cyber-security measures to protect this data. Consequently, a cyber-attack takes place, publicly exposing customers' personal data. Numerous customers take legal action against your senior leaders for the damages that result from this security failing.

THIS WOULD QUALIFY AS NEGLIGENCE ON YOUR D&O POLICY, PROVIDING COVER FOR THE COST OF CUSTOMERS' LEGAL DISPUTES RELATED TO THE BREACH.

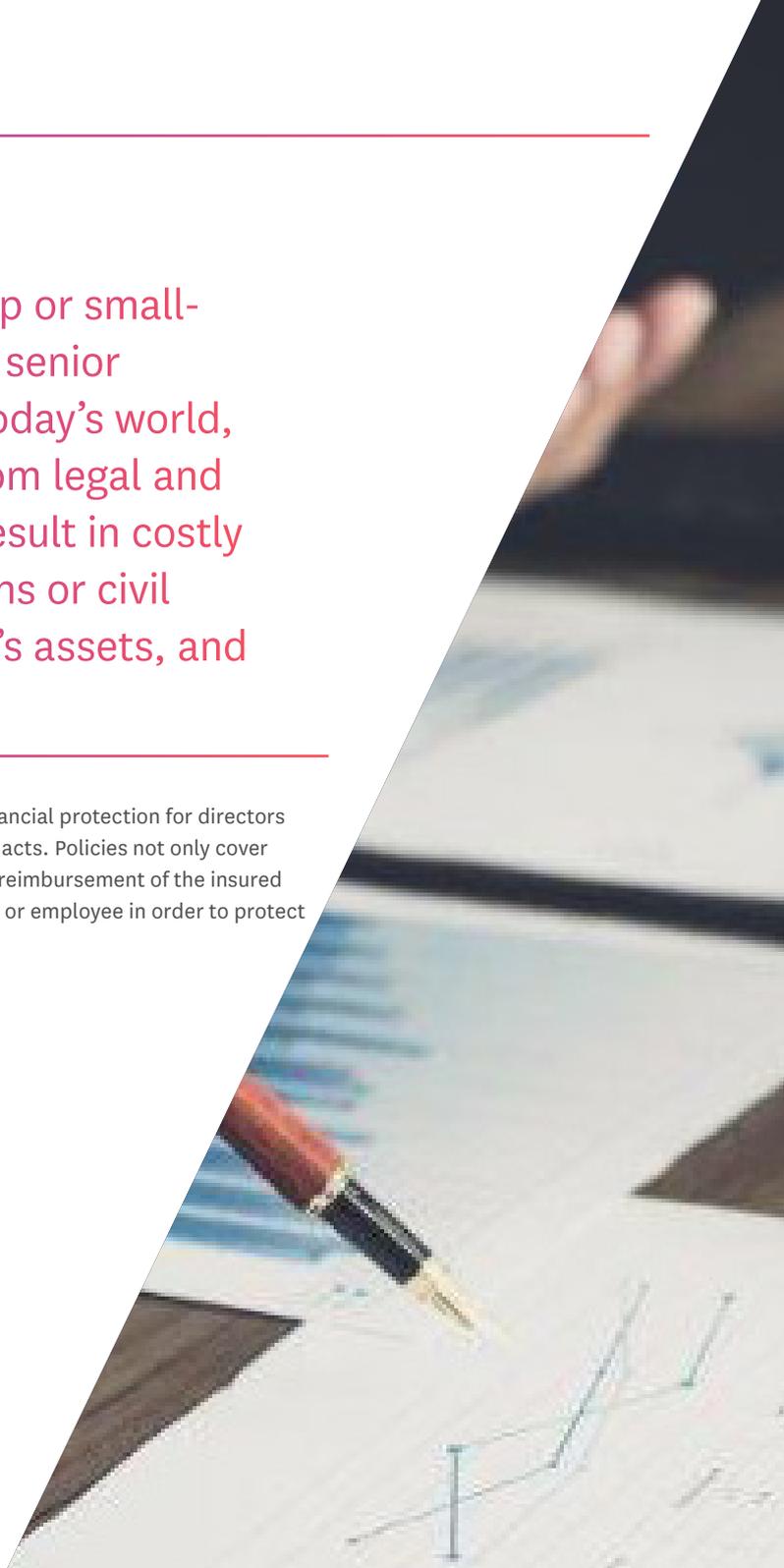
EMPLOYER'S LIABILITY

An employee was injured at work and brought an employer's liability claim against the Company. The solicitor also included the director responsible for Health & Safety.

YOUR D&O POLICY WOULD DEFEND THE OFFICER AND ALSO THE COSTS INVOLVED IN COMPLYING WITH THE INVESTIGATION BY THE HEALTH AND SAFETY EXECUTIVE (HSE).

Whether your company is a start-up or small-to-medium sized enterprise (SME), senior managers can make mistakes. In today's world, managers face a growing threat from legal and regulatory liabilities which could result in costly investigations, criminal prosecutions or civil litigation, which puts the company's assets, and their own, at risk.

Directors and Officers (D&O) Insurance policies provide essential financial protection for directors and officers against the consequences of actual or alleged wrongful acts. Policies not only cover the personal liability of company directors and officers but also the reimbursement of the insured company in cases where it has paid the claim on behalf of a director or employee in order to protect them from a third party.





At Aston Lark, we put together tailored insurance solutions for organisations of all sizes. This guide answers the most frequently asked questions from the clients we work with when it comes to D&O insurance.

1

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 and 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 of them, leading to directors frequently being held personally liable for claims of breaching duties or responsibilities that they were unaware of.

2

WHAT IS 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.

Individual D&O cover is also available, popular with individuals who have multiple directorships and wish to ringfence their own insurance limit to ensure it cannot become exhausted through actions unrelated to their own. Spouses and heirs can also be covered under this type of policy.

3

WHO IS IT DESIGNED TO 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 inclusion of 'Entity Cover' provides protection where claims are also made against the company and not just individuals.

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WHY SHOULD WE PURCHASE IT?

Statistics show that legal actions can be brought by many different parties including investors, shareholders, staff members, disgruntled customers or even liquidators. These claims may well be frivolous or malicious in their nature but will still require defending, which can involve significant quantities of both time and precious finances.



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HOW DOES IT WORK?

A D&O Insurance policy is designed to pay for any defence costs and financial awards up to the limit of the policy within the policy parameters. A typical D&O policy will normally be constituted with the insuring clauses below:

- **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.
- **Side C cover:** is typically reserved for publicly listed companies and protects the corporate entity from its own liability exposures. If a company is involved in a shareholder-related dispute then Side C cover can protect against legal and claim settlement costs incurred when defending its own corporate actions.

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WHAT ARE THE OPTIONAL POLICY EXTENSIONS?

Extensions include:

- Additional limits for non-executives, crisis loss or emergency costs cover and representation for investigations.
- Employment Practices (EPL) & HR issues such as employee discrimination claims including unfair dismissal, harassment, or failure to promote a person.

A hand holding a pen points to a line graph on a grid background. The graph shows three data points with percentage values: +32.69%, -24.98%, and -34.87%. The background is dark blue with a grid and dotted lines representing data trends. A red triangle is visible in the top-left corner.

+32.69%

-24.98%

-34.87%

A D&O Insurance 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

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WHO PAYS FOR IT?

D&O policies are funded by the company unless an individual chooses to purchase a policy to cover a number of directorships with a ringfenced limit.

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IS COVERAGE FOR PAST AND FUTURE D&Os INCLUDED?

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
 - Environmental Liability claim defence costs
 - Defence costs for the legal process
 - Outside board directorships and non-executive positions are also regularly covered.
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WHAT IS EMPLOYMENT PRACTICES LIABILITY INSURANCE?

Employment Practices Liability Insurance, also known as EPL Insurance or EPLI, provides coverage to employers against claims made by employees alleging:

- Discrimination (based on sex, race, age or disability, for example)
- Wrongful termination
- Harassment
- Other employment-related issues, such as failure to promote

Typically, EPL is provided as an optional extension to D&O Insurance.

Large corporations typically have substantial EPL coverage in place and are prepared to deal with just about any employment lawsuit. However, small or growing businesses are often the most vulnerable to employment claims because they usually lack a legal department or employee handbook detailing the policies and procedures that guide hiring, disciplining or terminating employees.

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WHAT IS NOT COVERED

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

- Proven dishonest, fraudulent, criminal or malicious acts
- Criminal fines and penalties
- Bodily injury
- 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. Additional exclusions may apply depending on the cover purchased.

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WHO NEEDS D&O?

Historically, it was larger corporations who were the first to purchase D&O insurance on a major 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 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 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 do not want to expose their own personal assets.

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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, tax authorities, government departments and regulators.



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WHEN YOU MIGHT NEED TO MAKE A CLAIM

- Regulatory & Criminal actions including investigations and proceedings brought by regulatory bodies.
- Bankruptcy actions including claims brought by receivers for continued trading whilst insolvent, or asset stripping.
- Company versus 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.
- Co-defendant actions including claims brought by third parties against the company for anticompetitive behaviour or misrepresentation and naming a director or officer as co-defendant.
- M&A actions including claims brought by minority shareholders alleging unfair treatment or valuation in a sale, acquisition or merger.

CLAIMS SCENARIOS

- 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 a significant five figure sum.
- 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.
- A managing director and several senior staff faced a criminal prosecution for allegedly breaching health and safety legislation. These alleged actions resulted in the accidental deaths of two employees.
- 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.
- 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.
- 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 Insurance policy.



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HOW MUCH WILL D&O INSURANCE COST?

Prior to 2020, D&O products were relatively inexpensive and represented excellent value for money considering the size of the indemnity limits insurers were prepared to put at risk. More recently, insurers have been seeking to adjust their approach following large losses in the corporate D&O space. However, throughout 2020, Coronavirus has had a significant impact on insurers' approach and rating has increased considerably along with restrictions in the level of cover that insurers are prepared to offer.

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

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WHAT LIMITS OF COVER ARE REQUIRED?

The limit of indemnity that should be chosen depends on the perception of the exposure faced and how much a company is prepared to spend to mitigate the risk. It is worth bearing in mind that this type of coverage protects the personal assets of the directors and officers.

Many smaller companies purchase a limit from £1m up to £10m. The limits required can vary greatly and is one of the key factors in underwriting such a policy. Aston Lark is well-placed to offer informed and independent advice to ensure you don't pay for an unnecessarily high level of cover.

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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 period. This limit is the total amount the insurer is willing to pay out regardless of the number of individual claims and the accumulation of 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.

The policy limit is shared amongst executive and non-executive directors who receive the same treatment in the event of a claim. Extensions are now available which give additional segregated limits for non-executive directors in the event of policy limit exhaustion. Recently, some D&O policies for 'commercial' companies (i.e. non-financial) have been written on 'any one claim' limits (compared with aggregate limits) which are capable of paying up to the limit of the policy for multiple claim events during the policy period.

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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.

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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 regulation. Extensions are now available which give additional segregated limits for non-executive directors in the event of policy limit exhaustion.

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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.

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IF 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 occurred, or until there is a final adjudication. This means that a settlement without an admission of wrongdoing usually does not trigger the exclusions.

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GLOSSARY

'Claims Made' policy means that claims are covered if notified 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 Excess 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.

A Prior & Pending Litigation Exclusion precludes coverage for claims from litigation that was brought prior to, or was pending at, the inception of the policy.

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HOW CAN I GET A QUOTE?

Get in touch with us to arrange an initial discussion or visit our website where you can find out more on what we offer, how to contact our specialists, or complete our online form.

The more information you can provide on your business, the better we can present to our wide network of D&O Insurance providers and negotiate both cost-effective and superior terms.

Information that will be required includes but is not limited to:

- Name of the entity to be insured
- Establishment date
- Country of registration
- Description of business activities
- Revenue for the last financial year and forecasted revenues
- Geographical location of revenue

For further information, please contact us on

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This publication is designed as a guide only. For specific advice surrounding D&O Insurance, contact Aston Lark.



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