

Legal and Insurance Forum

Directors & Officers Liability Insurance

26th February 2015

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Vision • Excellence • Integrity



Why you need D&O Insurance

- D&Os need room to be able to make decisions
- Everyone makes mistakes, but management and D&Os can be held personally liable
- Other insurance classes do NOT cover D&O exposures
- Helps NFPs attract quality D&Os
- Protects the assets of D&Os
- Protects the company balance sheet
- Formalises the risk management process
- Satisfies requirements of investors, banks etc.
- Gives you access to Insurers' competent legal advice

D&Os claims can come from?

Suppliers

Stakeholders

Shareholders

Lenders

The Company

Employees

Laws

**Other
Board
Members**

Business Partners

Competitors



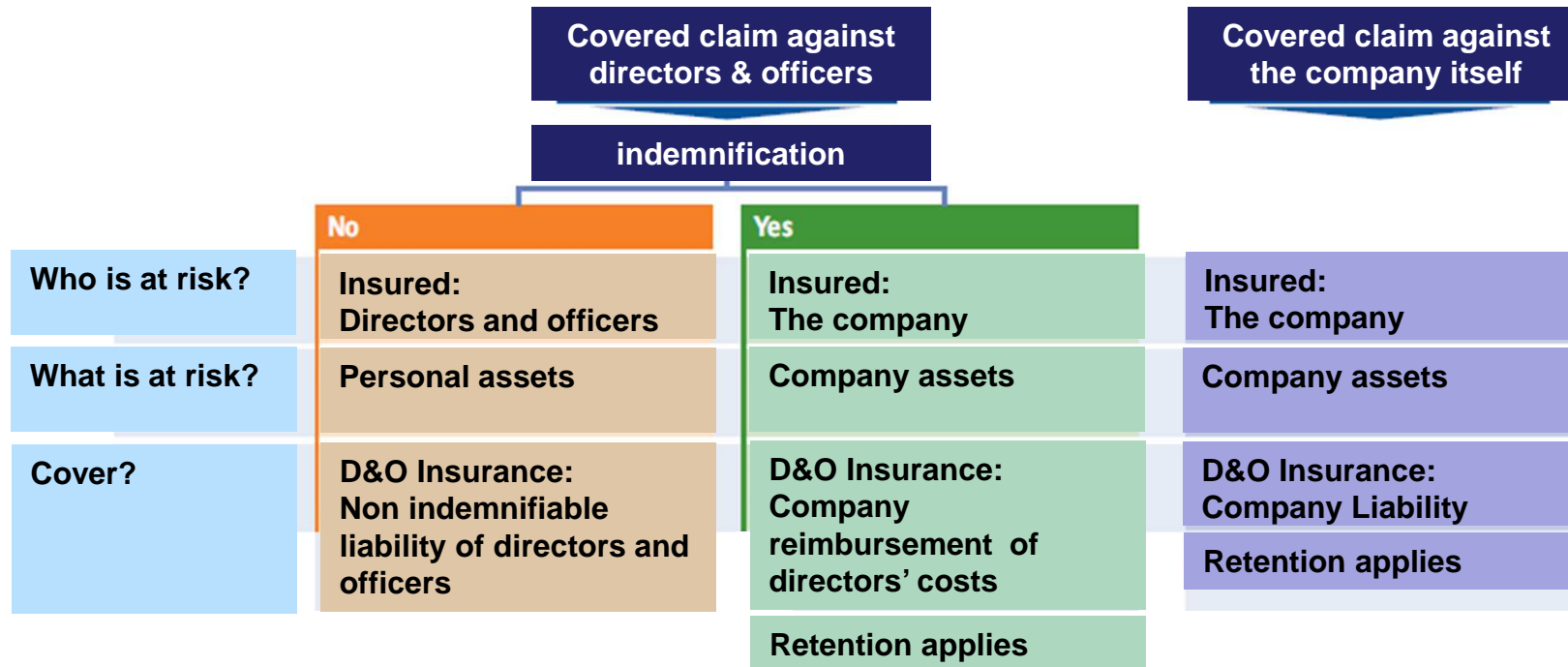
Vendors

Retirement fund beneficiaries

Executives

Regulators

D&O Covers



- Indemnifies the personal liability of D&O
- reimburses the Company if it has paid a third party claim on behalf of the D&O
- Entity Cover
- **Optional Extensions** - EPL, statutory, and commercial crime

Insured Persons (D&Os) Liability

- What is covered?
 - **Directors & Officers Liability**

Covers the personal liability of insured D&Os for any financial loss that they may incur for wrongful acts committed by them in the conduct of their duties as a D&O in circumstances where the company has not or is unable to indemnify the director.
 - **Company Reimbursement**

Covers the insured company's financial loss to the extent the company is allowed and has indemnified/paid the claim of a third party on behalf of its D&O in order to protect them.

Company/Entity Liability

- What is covered?

Covers the company's financial loss arising from claims made against the company, including :

- ✓ Past, present and future subsidiaries
- ✓ Any foundation or charitable trust solely controlled or sponsored by your company or any subsidiary of company
- ✓ The debtor-in-possession of your company in the event of bankruptcy proceedings.

Employment Practices Liability (EPL)

- What is covered
 - ✓ An EPL extension provides cover for both D&Os and the company for employment based wrongful acts, including:
 - ✓ Discrimination
 - ✓ Wrongful termination
 - ✓ Harassment
 - ✓ Wrongful interference
 - ✓ Wrongful deprivation of career opportunity
 - ✓ Employment related defamation
 - ✓ Because EPL claims are more frequent, larger organisations should consider a separate EPL policy to avoid dilution of the D&O policy limits.

Statutory Liability (Optional extension)

- What is covered
 - ✓ Cover for the company, insured person, or employee for **loss**, including **penalty** and **defence** costs, for a **wrongful breach** of:
 - ✓ any Act of Parliament of the Commonwealth of Australia
 - ✓ any Act of Parliament of a State or Territory of the Commonwealth of Australia, including any subordinate or delegated legislation made under those Acts
 - ✓ any Consumer Protection Act, i.e. Fair Trading Act, Consumer Affairs and Fair Trading Acts, Consumer Affairs and Fair Trading Act, Trade Practices Act, Competition and Consumer Act,
 - ✓ including any amendments to any of the above.

Commercial Crime (Optional extension)

- What is covered
 - ✓ Covers the company for loss resulting from internal and external crime.
 - ✓ **internal crime** means any fraudulent or dishonest act(s) by an employee acting alone or in collusion with others to obtain an improper financial gain from the insured.
 - ✓ **External crime** means theft; forgery; fraudulent alteration; counterfeiting; computer fraud by a third party.
 - ✓ Cover is available for theft of your clients' personal property under your care, custody or control or for which you are legally liable.

The definition of crime varies significantly from Insurer to Insurer, with many Insurers only providing Fidelity cover – i.e. for employee crime

Things to look out for



Duty of Disclosure

- All persons covered by the D&O policy have a duty to disclose matters relevant to an insurer's decision whether to insure you or not, and if so, on what terms.
- It is vital that the information provided on the proposal form is complete and correct, otherwise the insurer can avoid or reduce its liability in the event of a claim.
- Once the information is ready for presentation to Insurers, D&Os should review the information being disclosed on the proposal form to ensure all matters that may give rise to a claim are being notified.

The importance of making appropriate disclosure should not be underestimated as failure to do so is a serious breach and is the main reason for contentious and disputed claims.

Limit of Liability (LOL)

Larger sophisticated businesses and businesses undertaking high risk activities such as acquisitions, divestments and mergers have higher risks and require a higher limit.

The LOL:

- ✓ Should be sufficient to cover a worse case scenario loss.
- ✓ Represents the level of protection your D&Os and the company have.
- ✓ Operates on an aggregate basis, is in addition to the deductible, and typically inclusive of defence costs.
- ✓ Is available to all insureds and all covers sections within the policy.
- ✓ Can be quickly eroded when more than one director is involved in a common claim, but each requires their own separate legal representation.

Deductibles

- ✓ Higher deductibles equate to cheaper premiums.
- ✓ Your deductible should not be larger than you can afford to pay in one quarter without hurting your company's earnings or cash flow.
- ✓ Companies with a sound balance sheet can afford to have higher deductibles, but should take into consideration that what seems acceptable in good times may be a big problem if there is a large loss or when cash flow has dried up.

Excess LOL for D&Os Extension

- ✓ The excess LOL for D&Os extension, typically \$1,000,000, is in addition to the policy LOL.
- ✓ The excess LOL is available after the exhaustion of:
 - ✓ The D&O policy LOL, including the policy aggregate LOL for all sections of cover, and
 - ✓ any other cover available to the D&O.

You should check your policy to ensure cover provided by this extension is for all D&Os as many Insurers limit this extension to non-executives D&Os only.

Definition of claim?

- ✓ D&O policies have a requirement of a **wrongful act** or a **wrongful breach** to trigger the policy.
- ✓ You should ensure the definition of a claim includes:
 - ✓ written demands for monetary and non-monetary relief and compensation;
 - ✓ cover for civil, criminal, administrative and counter-claims;
 - ✓ cover for unannounced visits by regulators and regulatory investigations **even if there is no alleged wrongful act**; and
 - ✓ representation and prosecutions, mediations, arbitrations and extradition proceedings.

Advancement of Defence Costs

Without an advancement of defence costs provision the Insurer is entitled to deny indemnity and defence costs under an exclusion of the policy, even though the “**disentitling**” conduct hasn’t been proven, established or admitted.

- Ensure your policy provides for advancement of defence costs until indemnity is denied.
- If there is an allegation of excluded conduct, defence and other costs are paid in advance and the exclusion will only apply once the excluded conduct has been established.
- The Insurer has the right to recover defence costs from the D&Os or the company if it is established that they were not entitled to a claim under the policy – i.e. criminal act.

Insured vs Insured Exclusion

- Directors' duties are owed to the company.
- This exclusion denies cover for claims if one insured, i.e. a director sues another insured director or the insured entity. These events are a significant source of claims.
- If you want your policy to respond to claims by one insured against another insured, we recommend the deletion of the Insured versus Insured exclusion to provide insured versus insured cover.
- Where this exclusion can't be deleted we recommend the policy be amended so that:
 - employment practices and whistle-blower insured versus insured claims are covered.
 - The exclusion contains language that allows for coverage of claims brought on behalf of an organisation in bankruptcy or by the examiner, trustee, receiver or liquidator of the organisation.

Notification

Notification of a claim should be made within the prescribed period and should include:

- ✓ details of the claim
- ✓ details of a circumstance that may lead to a claim
- ✓ nature of the alleged or potential damage
- ✓ names of the actual or potential claimants
- ✓ date and manner in which the company or insured person first became aware of the claim

Notification of an investigation or circumstance should include:

- ✓ Nature of the investigation
- ✓ The name of the official body conducting the investigation, and
- ✓ The date and manner in which the company or insured person first became aware of the investigation.

Severability Clause

- Severability clauses in both the insurance application and misconduct exclusions are essential.
- A severability clause protects innocent directors who have not been involved in notification misrepresentations or misconduct committed by other directors, which could potentially void their cover.
- When disclosing information to Insurers consideration should be given as to whose knowledge will constitute the knowledge of the company.
- Insurers are prepared to endorse the policy to limit such knowledge to a small number of top level executives and/or D&Os.

Deprivation of Asset Clause

- A director who is the target of a claim or an investigation can also face proceedings to:
 - freeze their assets
 - restrict their liberty, or
 - restrict their ability to act as a company director.
- A deprivation of asset extension provides cover for defence costs as well as prosecution costs to oppose such proceedings.

Preservation/presumption of right to indemnity

- Many policies state that the company is presumed to indemnify insureds to the full extent permitted by law.
- You should ensure your policy provides cover to insured persons in the event and to the extent that the company or an outside entity is permitted or required to indemnify insured persons but fails or refuses to do so.
- In these circumstances the company is responsible for payment of the deductible applicable to the entity cover.

Occurrence Based versus Claims Made

Occurrence based wordings

- ✓ Responds to claims that **occur** during the period of insurance even if they are reported after the policy has expired or has been cancelled.

Claims made wordings

- ✓ D&O insurance policies are written on a 'claims made' basis and provide cover for **claims made and reported during the policy period**, irrespective of the date when the cause or circumstances (wrongful act) occurred.
- ✓ A broad D&O policy will also provide cover for **notifications** in writing of facts or circumstances likely to give rise to a claim, and consequently provide cover for claims made outside the policy period if **notification** took place within the policy period.

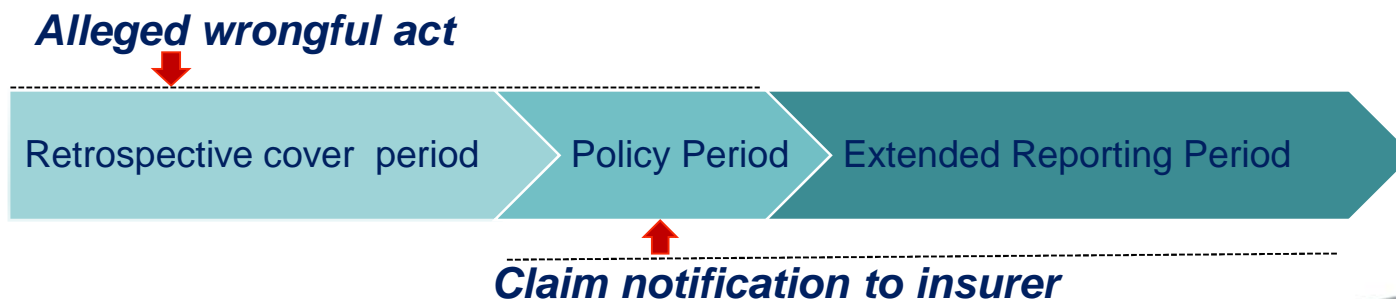
What don't claims made policies cover

- x Claims made D&O policies do not cover:
 - x events or circumstances that occurred before the retroactive date stated in the policy schedule.
 - x claims or circumstances known to the insured prior to or notified to another insurer prior to inception of the policy with the existing insurer.
 - x claims or circumstances notified after expiry of the policy irrespective of the date the claim occurred.
 - x Claims arising from criminal, unlawful activities.
 - x Fines and penalties resulting from excluded activities.

IMPORTANT – IF IN DOUBT NOTIFY!

Retroactive Date

- ✓ Claims made policies include a retroactive date from which you first inception and have had continuous, non-interrupted `claims made' cover of the policy.
- ✓ Claims where the act, error or omission took place before the retroactive date are not covered even though a policy is in place when a claim is filed.
- ✓ D&O provides retrospective cover for wrongful acts committed prior to inception of the policy period.
- ✓ Retroactive dates must be maintained when policy is renewed or moved to another Insurers.



Prior and Pending Date

- D&O policies also have a prior and pending date.
- The prior and pending date restricts cover for claims that have occurred before the prior and pending date specified on the schedule.
- The insurer will not be liable for claims that are:
 - initiated prior to the date of continuous cover
 - from the same or essentially the same facts as alleged in such prior or pending litigation.

Before switching insurers you should investigate and notify all possible claims to the holding Insurer prior to expiry of the policy.

Run off cover

- ✓ Run-off insurance should be purchased and maintained until your liability as a director or insured person runs off and is largely determined by the statute of limitations applicable to the jurisdiction in which an action can be brought.
- ✓ Directors' agreements can cease to exist following a merger, acquisition, change in corporate structure or winding up of a company and it is in these circumstances 'run off insurance' can be purchased to provide protection for claims arising years after an alleged wrongful act took place.
- ✓ The 'claims made' nature of D&O policies means that a D&O policy must be in force at the time you become aware of a circumstance which could lead to a claim.
- ✓ If your policy is not renewed or is allowed to expire, run-off cover can not be purchased and a claim can not be lodged.

Summary

- D&O insurance covers vary from Insurer to Insurer.
- The absence of uniform policy wordings from year to year and between insurers requires those involved in the placement of D&O insurance to understand the risks facing the insureds as well as the coverage available.
- Ensure defence costs are payable in advance, including the defence of criminal allegations, until final adjudication.
- The insuring clause should be broad enough to cover D&Os personal liability exposures not covered by their Deed of Access and/or Deed of Indemnity and you should ensure your D&Os have Excess D&O cover in the event the company refuses or fails to indemnify D&Os.
- Your Insurance Broker should know your sector, understand the covers available to your sector, and have the expertise to design and structure your D&O policy to cover areas of exposure not provided for by your company's deed of indemnity and/or access, so far as allowed by law.

NOTIFY! NOTIFY! NOTIFY!

Thank You



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