Directors’ liability

D&O: Blurring the lines

A Survey conducted by Allen & Overy and Willis – September 2014
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Introduction

There is a growing acceptance amongst directors and high-ranking officers in public and privately-held corporations around the globe that they must operate under an unprecedented level of scrutiny as they go about their business. Shareholder pressure, perceptions of public interest, heightened regulatory vigilance and a hostile enforcement and litigation environment are some of the forces which corporate leaders have to confront and manage on a daily basis.

Under the Companies Act 2006 alone there are well over 200 offences for which directors in the UK can be held personally liable and there are whole systems of law and regulation both here and abroad under which individual directors can be held to account. As regulators and legislators seek and find new ways to render board members directly accountable for acts and defaults of the companies for which they work pour encourager les autres, it is apparent that the lines of defence traditionally available to directors are similarly coming under attack. Regulators the world over are actively seeking to hold individuals to account, operating under the premise that good corporate behaviour is best achieved by focusing on those in charge and by making those people feel more personally at risk.

These forces and trends are not new. They were apparent three years ago when international law firm Allen & Overy and global insurance broker Willis began to investigate how directors and officers felt about their exposures to risk, what issues kept them awake at night and how they felt their insurers were responding.

We have once again conducted our survey, which took place over the course of Spring and Summer 2014, and this document comprises our findings in a third annual report. Now that we have the weight of two previous reports behind us, we can begin to point to themes and trends that are common across our three surveys and identify emerging topics of interest or concern.

This time around we received more than 180 responses, making this our largest survey yet, from directors, non-executive directors, in-house lawyers, risk officers, compliance and other professionals. We thank them all for their assistance as we endeavour to create an annual reference point for the UK and international D&O market.

The large sample size enables us to draw out distinctions between the views of directors and non-executives, and between in-house lawyers, compliance experts and risk professionals, as we heighten our level of analysis.

Business leaders continue to tell us they are most concerned about regulatory investigations and inquiries, with anti-corruption legislation, criminal and regulatory fines and penalties and the risks of being sued abroad as their biggest worries.

The purchase of D&O insurance by companies provides a measure of comfort to these individuals that they will be protected in any litigation that might arise. Many companies also supplement these policies with the provision of an indemnity against liabilities that their directors may incur in the course of their duties. But both insurance and indemnification provide their own challenges. It is therefore perhaps unsurprising that, for the second year running, clear and easy to follow policy terms remains top of the wish list.

We hope you find our coverage and analysis useful. Should you require any further information on any of the issues raised here, please get in touch with your usual contact at either Allen & Overy or Willis. Alternatively, either Andrew or Francis will be pleased to hear from you directly.

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Executive summary

Blurring the directors’ defence – our key findings

In conducting our survey, we interviewed more than 180 individuals – our biggest sample yet – comprising directors, non-executive directors, in-house lawyers, risk experts, compliance and other professionals. We asked about their experience of claims, their current levels of protection, and their concerns around liability going forward. The vast majority of respondents were UK-based.

A number of key themes emerge from the statistics and analysis contained in this report:

- More than one in five respondents to our survey has experience of a claim or investigation involving a director of their company;
- Only one in three are aware of the proposals for a significant expansion of the directors’ disqualification regime;
- More than 85% did not know of proposals to permit the sale of claims against directors to third parties;
- Regulatory and other investigations and inquiries are again considered to be the greatest risks facing businesses and their directors, followed by anti-corruption legislation and criminal and regulatory fines and penalties; and
- When it comes to D&O policy coverage, the top concerns are that there should be clear and easy-to-follow policy terms; that the ability of insurers to refuse a claim based on non-disclosure should be restricted; and that cover should be available for the early stages of an investigation, prior to the main hearing.
BREAKDOWN OF MAIN CATEGORIES OF RESPONDENT*

- Director: 34%
- Risk: 25%
- In-house lawyer: 18%
- NED: 14%
- Compliance: 9%

*“Other” categories of respondents also participated in the survey and their results are included in the overall analysis figures.
The top five D&O policy coverage issues, year-on-year:

1. Restricting insurers' ability to refuse a claim based on non-disclosure
2. Clear and easy to follow policy terms
3. How claims against the directors and officers will be controlled and settled
4. Will your D&O policy and/or company indemnification be able to respond to claims in ALL jurisdictions
5. The coordination of the D&O policy with your company's indemnification obligations

Additional points:
- Whether the policy will always respond if there is an investigation involving directors
- Will your D&O policy and/or company indemnification be able to respond to claims in ALL jurisdictions
- Whether there is cover for cost of advice at the early stages of an investigation, prior to the main hearing
- How claims against the directors and officers will be controlled and settled
- The coordination of the D&O policy with your company's indemnification obligations
- Will your D&O policy and/or company indemnification be able to respond to claims in ALL jurisdictions
An evolving regulatory landscape

In our last two reports we have drawn attention to the way in which regulators the world over have been focusing on company directors and officers. Driven by public and shareholder pressure and fuelled by high-profile instances of wrongdoing in the wake of the global credit crisis, rule makers and enforcement agencies have worked to find new ways to render board members responsible for the actions of the companies they work for.

As enforcement regimes have targeted individuals in a bid to personalise wrongdoing and force companies to comply, so new regulations have proliferated to put directors and officers on the hook. Directors can now be held personally liable in the UK for offences that include bribery, corruption and fraud; competition and antitrust matters; environmental law; health and safety; tax; international sanctions; money laundering; financial reporting requirements; and the Dodd-Frank Act and other long-arm US legislation.

More broadly, legal developments affecting the quantum of fines that magistrates’ courts can impose for criminal offences mean, in practice, that fines to directors summarily convicted under the Companies Act 2006 are no longer capped at £5,000.

In the UK, the principle that a company is a separate legal entity from its members and management remains a cornerstone of the legal system, but the same is not true everywhere and it is increasingly dangerous to equate the robustness of that principle with the assumption that directors enjoy the same protections from liability that they once did. This is especially so in a regulatory context where the corporate veil does not provide the same protection as in a civil liability context.

Given this backdrop, it is understandable that the top three concerns for the respondents to our survey have not changed in each of the past three years, being consistently: regulatory and other investigations; criminal and regulatory fines and penalties; and anti-corruption legislation.

**Director disqualification**

With compliance such a significant and growing challenge, and personal liability front of mind, the low level of awareness regarding the proposed expansion of the UK’s directors’ disqualification regime is perhaps surprising. The proposals, set out in a paper published by the Department for Business, Innovation and Skills and entitled ‘Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business’, have received limited attention in the media. However, the new rules demonstrate potential for significant change and will introduce “broader and more generic” provisions in relation to the matters determining the unfitness of a director. These proposed changes will set out a range of factors which could be used to justify disqualification, covering misfeasance, breaches of duty, legislation and sector regulations. In contrast, the relevant factors which currently apply are much more restrictive and prescriptive.

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The government also proposes to improve the channels of communication between the various sectoral regulatory regimes, by removing the barriers for information sharing and investigatory cooperation. This will also allow the Insolvency Service to share investigatory information with other regulatory and enforcement bodies. While regulators have not been given direct powers to bring disqualification proceedings, it would seem that the way has certainly been smoothed for future developments in this area.

Furthermore, under the new proposals, it would be possible to take a director’s overseas misconduct into account in disqualification proceedings in the UK. This will be of concern to directors of UK incorporated companies with global operations, as it would mean that the different risks facing directors overseas are now transported back into the UK.

Finally, and perhaps most radically, the government proposes that the Secretary of State be given powers to apply to court for compensatory orders to be made against a director who has been disqualified. This means that civil claimants can potentially get compensation orders on the back of disqualification proceedings, without needing to launch separate civil proceedings. This would provide a powerful new tool for third parties such as liquidators who turn against directors of insolvent companies.

In our survey, we found just 68 out of our 185 respondents, or 37%, were aware of the proposed expansion of the directors’ disqualification regime. On closer analysis, non-executive directors were more aware than executive directors (with half of them abreast of these proposals). This may reflect that NEDs have a wider portfolio of directorships, including smaller companies that may be more at risk.
Incentivising claims against directors

Changes to legislation in the UK that will permit the sale of claims against directors to third parties bring with them huge risks for directors and their firms, but awareness of this issue is again low. Only 14% of our respondents were aware of the proposals, even though litigation funders are now a much more established feature of the UK litigation market and no longer focus on low-level claims but instead increasingly figure substantially in significant litigation.

The government, as stated in the paper ‘Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business’, is supporting moves to allow insolvency office holders to sell or assign to third parties causes of action that arise on insolvency, including those for fraudulent or wrongful trading. This is intended to “ensure actions which provide redress are indeed brought forward” and may lead to an environment that is even more uncomfortable for directors.

Only 7% of in-house lawyer respondents, 8% of non-executives and 7% of risk professionals had this issue in their sights. There is certainly an argument that because the most likely application of the new rules is in a liquidation scenario, it is not an immediate concern for many. Whilst insolvency may be viewed as a remote risk, the need properly to guard against its consequences by securing the widest possible insurance coverage should be addressed well in advance.

The low level of awareness of the issue mirrors another of our findings relating to contingency fees, where only 9% of those surveyed thought that reforms to contingency fees in the UK, which permit the use of contingency fees for contentious work, were of significance to their business and its directors. Contingency fees, which are sometimes called damage-based agreements, allow lawyers in the UK to conduct litigation and arbitration in return for a share of any damages. Unlike the proposals permitting the sale of claims against directors, the contingency system is already with us and came into force on 1 April 2013 under the Legal Aid, Sentencing and Punishment of Offenders Act 2012.

Clearly this is an area that does not get the attention it deserves.

“Unlike the proposals permitting the sale of claims against directors, the contingency system is already with us... Clearly this is an area that does not get the attention it deserves.”
Expansion of sanctions regimes

One further development in the last 12 months that has proven to be of great concern to our respondents (and is likely to remain so) is the multiplicity of sanctions regimes and of affected countries. This year 42% of those that we asked pointed to sanctions regimes as a major risk to their businesses and to directors personally. It is a big issue on the agendas of the clients to whom we speak.

Over the past few years much of the focus of sanctions regimes has been on Iran. Now, with the escalation of tensions between Russia and the West over Ukraine, and the imposition of sanctions on both sides, there is even more of a commercial threat on this side of the Atlantic.

A number of large financial institutions have fallen foul of sanctions regimes globally in the past few years and high-profile instances of misfeasance have heightened concern amongst directors. Individuals to whom we speak are now very concerned about their risk of falling foul of specific sanction regimes, and insurers are equally concerned about the companies and individuals they are covering, to say nothing of the implications for themselves as insurers being in breach of the various regimes.

We have seen large organisations bolstering further their compliance and legal functions with the addition of sanctions specialists, reflecting an anxiety about the potential for a reputational hit, and there is a concern that the UK’s Financial Conduct Authority may yet start focusing on this area.
Addressing the risk of personal liability

A recurring theme of our findings year on year is the focus by regulators on individuals within large corporations. This is hardly surprising with frequent announcements from regulators here and abroad of their determination to pursue individuals.

Awareness of the risk in general terms may not be enough. When something goes badly wrong, be it a corporate act or a major pollution incident or a corruption scandal, there is a natural clamour to find out what went wrong and who is to blame. There is pressure on politicians and regulators to be seen to be in charge of events and punishing wrongdoing. Social media outlets add fuel to the fire very quickly. When this happens large corporations become concerned regarding the effect on reputation and shareholder value. Corporate leaders have not only to manage this combustible mix but also need to consider their own personal risks in the context of the many investigations which such major incidents would now routinely trigger. It is this dimension of personal accountability which is now gaining more attention. We are beginning to see a more sophisticated approach to these major liability risks by large corporates.

Regulatory investigations

The risks considered to be of greatest significance to directors remain regulatory and other investigations and inquiries, anti-corruption legislation and criminal and regulatory fines and penalties. These three risks have comprised the top three concerns in every one of our three surveys to date and show little sign of diminishing as time goes on. We increasingly see regulators beginning major investigations by targeting the lower ranks within an organisation with a view to working their way up towards board level. What is notable is that awareness of these risks continues to increase, as people appreciate the liabilities they now face, and risk managers are responding by seeking out cover for advice in the early stages of any investigation. As the focus moves towards individuals, this is where costs now tend to rack up.

By contrast to this bottom up phenomenon, the attestation procedure introduced by the Financial Conduct Authority (FCA) is an example of top down regulation. The FCA is now requiring senior executives within the regulated sector to make quite sweeping statements, or attestations, on a variety of subjects including the adequacy of their firm’s systems and controls. In doing so, the FCA is seeking to bridge the evidential gap should failings be uncovered down the line and proceedings be launched against senior management. It is also increasing the length of time over which it can rely on such statements.

The problem for companies in regulated sectors is that while the legal basis for attestation requests may seem unclear, a refusal to sign them attracts unwelcome attention and likely investigation. With attestation letters now being used much further down the levels of seniority within institutions, it is little wonder management feel threatened by regulatory risks. It is also the case that non-U.S. and UK regulators are also increasingly flexing their muscles. In July 2014, for example, the Indian securities regulator, the Securities and Exchange Board of India, ordered the former executives of Satyam Computer Services to repay over $300 million of improper gains plus $200 million in interest for their role in falsifying the company’s financial statements.

The adjacent tables analyse the survey responses by reference to the position or occupation of the respondents.
Conflicts of interest between individual directors and the company
Pensions related liabilities
Environmental claims
Insolvency and corporate collapse
Employment practices claims (harassment, age and sex discrimination)
Class actions
Corporate Manslaughter/Gross Negligence/Involuntary Manslaughter
Criminal and regulatory fines and penalties
Regulatory and other investigations and inquiries
Anti-Corruption Legislation (including the Bribery Act)
Multiplicity of sanctions regimes and of affected countries
Extradition of Company Directors
Proposed reforms to introduce (non-civil) compensatory awards against directors in the UK
Impact of reforms to permit contingency fees in the UK
Risks associated with foreign directorships
Risk of being sued abroad
Directors disqualification proceedings

ANALYSIS OF TOP BUSINESS RISKS: DIRECTORS AND NEDs

ANALYSIS OF TOP BUSINESS RISKS: COMPLIANCE, RISK AND IN-HOUSE LAWYERS
“over twice as many executive directors as NEDs rate anti-corruption legislation including the Bribery Act as of concern. This may be due to a (perhaps dangerous) assumption on the part of NEDs that they are less likely to be called to account”

The breakdown of the survey responses contains some interesting findings for example, over twice as many executive directors as NEDs rate anti-corruption legislation including the Bribery Act as of concern. This may be due to a (perhaps dangerous) assumption on the part of NEDs that they are less likely to be called to account than management for the company’s systems and controls to prevent bribery in the event of a corruption investigation or proceeding. By contrast, NEDs seem considerably more attuned to the potential for conflicts of interest with the company than executive directors. That is perhaps not surprising and mirrors the responses of compliance departments which also seem alive to this issue.

**Being sued abroad**

Beyond the primary risks being thrown up by regulators and criminal investigations, the respondents to our survey continue to worry about the risks of being sued abroad. Some 47% ranked this risk as significant, while 26% were concerned about the risks associated with foreign directorships, and 19% about the risk of extradition of company directors, mirroring the extraterritorial threat.

Certainly we are seeing these kinds of cross-border actions a lot more of late, with private foreign criminal prosecutions against directors of global companies gaining leverage when it comes to bringing civil claims in this country. Ten years ago extraterritorial claims were brought against the directors of Parmalat but, with today’s more sophisticated global litigation techniques, both regulators and claimants are more alive to the potential. Antitrust regulators, for example, are considerably more joined up in their approach to wrongdoing across borders.

With litigants no longer put off by the multijurisdictional nature of claims and sometimes quite keen to pursue aggressive tactics, directors are right to be wary. The best advice is to ensure that the D&O policy coverage concerned is sufficiently broad and that in the wording of the functions that are covered, foreign officers and appointments are clearly taken into account.
Only 13.5% are worried by the threat of environmental claims

Other risks

One risk that appears to fly below the radar, worrying only 13.5% of respondents, is the threat of environmental claims. In fact this is a topical issue and one that should perhaps be moving up the agenda: in May 2014 Greenpeace launched a campaign from the Netherlands aimed at the senior executives of some of the largest fossil fuel and utility companies around the world and their D&O insurers.

Greenpeace claims the risk of climate-related lawsuits is on the rise, and its campaign takes the form of “Dear CEO” letters inviting answers from business leaders to specific questions relating to their exposure and coverage for these types of claims. The premise appears to be that, as the threat of litigation increases, so too does the threat that company executives will be made personally liable and that their insurers will be vulnerable to large pay-outs.

Some D&O policies in fact exclude cover for clean-up and pollution costs, and those exclusions can also extend to the provision of defence costs in relation to allegations of pollution. It may now be the case that these exclusions cannot safely be ignored and that Greenpeace has highlighted a risk more directors and risk managers should be alive to. We are aware of at least one case in the US in which allegedly misleading statements about the company’s compliance with environmental regulations sparked a derivative claim against its directors.

We also note a lack of concern from respondents about the risks associated with insolvency and corporate collapse, which worried just 22% of those we spoke to. On closer inspection it is interesting to note this response as one where there is most divergence between directors and non-executive directors, with more than a third of NEDs considering insolvency a significant risk to them. This may be because NEDs may feel more removed from the day-to-day workings of the companies on whose boards they sit, and thus more concerned about their failing.

Finally, only 12% ranked pensions related liabilities as a top five risk, even in light of changes that the Government introduced in the last budget. The relative lack of concern could be reflective of how huge the other challenges facing corporates are.
Protecting directors and officers

With directors and officers facing increased personal exposure, it is no surprise that D&O policy coverage and related company indemnities are becoming more and more a focus of attention.

We asked our respondents what they considered to be the most significant policy coverage issues for them and their businesses.

There are some interesting contrasts to be observed regarding D&O policy coverage when analysing the position or occupation of the individuals responding.

Clear policy terms

For the second year in a row, we found that clear and easy-to-follow policy terms were our respondents’ number one priority. Given the heightened risk environment, it is no surprise to find individuals wanting their level of protection spelt out in plain language.

It is, perhaps, surprising that the directors themselves as the end users of the policy (and especially the NEDs) rank this rather lower than do the risk or compliance functions or in-house lawyers. It may suggest a lack of familiarity with the issue for directors.

Non-disclosure

One coverage issue that has moved up the agenda this year is a call to restrict insurers’ ability to refuse a claim based on non-disclosure. Respondents worry that they might not have been asked the right questions at the time the policy was taken out, or that they may not have thought something was relevant that later turns out should have been disclosed. The level of concern on this issue – with 50% seeing it as a major worry – is interesting. In fact, we are aware of only very few instances of rescission for non-disclosure involving D&O policies. Well-drafted wording should in any event protect innocent directors from the consequences of non-disclosure or deliberate misrepresentation by others.

When we look more closely at the constituencies most concerned about non-disclosure invalidating policies, we see that NEDs are slightly more concerned than executive directors about this issue. That may signal an understanding on their part that a threat to the existence of the D&O insurance programme is of greater concern for them than it is for the executive directors who may (rightly or wrongly) take more comfort from the company indemnity. There is also a noticeable spike of concern on this issue from risk managers when compared with in-house legal (and also to a lesser extent compared to compliance), but that is likely to have more to do with the risk managers’ knowledge of the existential threat posed to insurances of all classes by non-disclosure issues.

The new Insurance Bill which is likely to reach the statute books in 2015 should further limit insurers’ remedies with respect to non-disclosure. The Bill provides that the existing duty of disclosure will be replaced with a duty of fair presentation. Breach of this duty will give the insurer a remedy only if the insurer shows that, but for the breach, the insurer either would not have entered into the contract of insurance at all, or would have done so only on different terms.
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**Conflicts of interest between individual directors and the company**

**Pensions related liabilities**

**A broad definition of who is insured**

**Will your D&O policy and or company indemnification be able to respond to claims in ALL jurisdictions**

**How claims against the directors and officers will be controlled and settled**

**Understanding how disputes between your company and your insurers will be dealt with**

**Restricting insurers' ability to refuse a claim based on non-disclosure**

**Whether there is cover for cost of advice at the early stages of an investigation, prior to the main hearing** (e.g. regulatory visits, notification obligations)

**The sharing and hence rapid depletion of aggregate limit**

**What cover applies in the event of a conflict of interest between director and company**

**What happens to the cover when I retire?**

**What happens to the cover if the company becomes insolvent?**

**How cover will be maintained following a change of control, including run-off cover for matters occurring prior to the change**

**There is coverage for claims brought by the company against the directors**

**The coordination of the D&O policy with your company's indemnification obligations**

**Understanding how disputes between your company and your insurers will be dealt with**

**How claims against the directors and officers will be controlled and settled**

**Will your D&O policy and or company indemnification be able to respond to claims in ALL jurisdictions**

**A broad definition of who is insured**

**Price**
Coverage for investigations

Every year we find our respondents concerned about coverage for the cost of advice incurred at the early stages of an investigation, prior to any main hearing. Here we are talking about regulatory visits and notification obligations where, from an insurer’s point of view, it can often be difficult to distinguish between routine investigations and those where the personal liability of directors is a realistic possibility. The costs that can be racked up for legal advice for individuals at the start of investigations can be substantial. With regulatory and enforcement so heavily focused on senior management, this is a growing area of expense, particularly as matters become more and more complex and increasingly international.

Nevertheless, insurers do not like covering the pre-claim stage of an investigation because they worry about the potential for them to have to sign a blank cheque for legal fees up to the policy limit. It can also prove tricky to distinguish between the costs of defending the entity (which would not typically be covered by D&O insurance) and the costs of defending the individual before formal proceedings have been issued. This is where we see a classic blurring of the lines between entity and individuals in a coverage context. Individuals can potentially find themselves caught in a gap between the two.

The trigger point for investigation cost coverage under a D&O policy has long been identified as an area giving rise to controversy, and has been a top three issue in each of our surveys. It becomes more of an issue as regulators drive deeper into organisational hierarchies in search of scalps. Any individual, whether they have given an attestation or work in a control function, will want to feel they are covered to seek private advice if they come under particular scrutiny from regulators. Policies are now available that cover the early stages of investigations, but the limits of that cover tend to be specific and delineated. Often cover is limited to £50,000, which provides little reassurance, and often it requires the individual to be specifically identified as the target of the investigation. Moreover, the sub-limit is often shared between all insureds making it much less valuable.

Finally, some policies allow for particular bolt-on elements to cover directors and officers in the event of a dawn raid or an early request for documents or an interview. Again, this emergency cover for the very early stages of a process tends to come with very specific and various wording restrictions, but it is nevertheless available and insurers are willing to negotiate coverage, up to a point.

Looking at the breakdown of responses in more detail, cover at an early stage of an investigation has been identified as a key issue for the compliance respondents and for the NEDs. There is indeed a strong and interesting correlation between these findings and those relating to conflicts of interest in which the compliance functions and the NEDs also signal the greatest concern. This suggests that for both these classes of respondent there is a clear focus on the potential need for separate legal representation. 42% of executive directors rate this cover as a priority, which is less than the proportion of NEDs who do so and also well below the proportion of executive directors who rank regulatory investigations and anti-corruption legislation as areas of key concern, suggesting it may not have the attention from executives that it deserves.

“There is a significant and interesting correlation between concerns about potential conflicts of interest and separate legal representation”
“Companies will naturally want to consider covering more people, but at the same time need to recognise that it is not always necessarily desirable to cover everyone having regard to the risk of a stretched aggregate limit.”

Who is insured and depletion of aggregate limits

Given that regulators are increasingly interested in more junior staff, a broad definition of who is insured will need to be considered. One in five of our respondents identified this as an issue, while a similar number expressed concern about the sharing and hence rapid depletion of the aggregate limit.

Where policies provide cover for amounts in the tens of millions of pounds (or more) this might appear more than adequate. What tends to be missed though is that this is almost always an aggregate shared limit, covering all directors. That is also the case with the new breed of D&O policies which are underwritten on an “any one claim” basis. Therefore, if there are many individuals who need legal representation in the context of the same claim, that limit can be quickly exhausted.

This important point seems to have fallen below the radar of many of our respondents and is particularly low on the list of concerns expressed by in-house lawyers and risk managers. This can be a big issue and can present, if not a conflict of interest, at least a tension in the buying process. Companies will naturally want to consider covering more people, but at the same time need to recognise that it is not always necessarily desirable to cover everyone having regard to the risk of a stretched aggregate limit.

Taking control

Concerns about how claims will be controlled and settled will (or should) be of significance to any director or officer who finds himself in a tight spot and naturally wants to have as much control over his defence as possible. If insurers can call the shots with regard to claims conduct this may result in an early and hence less costly settlement either with regulators or claimants which leaves the director dissatisfied. As a result, the degree to which an insurer can control the conduct of a case remains a big issue, and different policies have different approaches. While it is usual for the insurer to require, as a minimum, consent before incurring significant legal fees, and before agreement of a settlement, beyond that there is room for negotiation and policy terms vary.

It is interesting that risk managers are much more aware of the need to focus on control of the claims process than directors. This may suggest that directors have not had much direct experience of the issues which can arise. There is also the intriguing question as to whether, when risk managers talk about control of the claims process, they have in mind the same type of control which the directors in their personal capacities would wish the company to exercise on their behalf. In other words, the interests of the company may not always be the same as those of the directors themselves.

There is a further echo of this concern as to the existence of D&O insurance for NEDs in answer to the question as to what happens when the company becomes insolvent. Nearly 40% of NEDs are worried about this compared with just 20% of executives although this discrepancy cannot, in this case, logically be explained by any comfort the executives take from the company indemnity which would be worthless in these circumstances. Perhaps instead it is simply based on a greater confidence among the executive directors that their companies will not become insolvent or the fact that for NEDs this concern is multiplied by the number of directorships they hold.
Coordinating with indemnification

In addition to D&O insurance policies, the other main way in which directors and officers can obtain protection against the costs of legal representation is if their company chooses to indemnify them. There are legal restrictions governing what risks businesses are allowed to indemnify their directors and officers against, but indemnities covering the costs of legal representation at regulatory investigations and some liabilities to third parties are permissible.

Where such indemnities exist, questions of who pays legal expenses may in practice arise where directors find themselves in situations adverse to the company. A well-advised director will want to see what is covered specified clearly so that the indemnity provides an effective additional layer of protection to complement D&O insurance.

This year, a third of our respondents identified the coordination of the D&O policy with the company’s indemnification obligations as an issue for them. Ensuring this coordination works requires someone to have looked at both policies together, to understand that they will operate effectively in tandem.

Some practical tips

In our experience, the interaction between D&O insurance and contractual indemnities tends to give rise to confusion in circumstances where a need for cover has actually arisen, with directors often believing they have coverage despite having given scant attention to indemnity terms on the way in. When issues arise, it can be difficult for directors to accept weaknesses in their indemnity provisions and, conversely, companies can find themselves dealing with people with broad indemnities given upfront who have not behaved as good corporate citizens.

A key piece of advice based on our experience of these situations is that companies should make every effort to ensure there is a clear decision regarding who should and should not benefit from D&O insurance and/or indemnification and that this is made clear (and kept up to date) in the relevant documents. As well as statutory directors, a D&O policy will typically cover “officers” and senior employees who operate in a “management or supervisory capacity”. If it is desired to extend cover to particular individuals where it is not clear whether or not they fall within the generic descriptions, it is possible to single out and name individuals as beneficiaries in the policy.

A similar issue can arise on indemnities. Where these are implemented by means of bilateral indemnity agreements with each relevant individual, it will be clear who does and does not benefit. Sometimes, however, for convenience, a single umbrella indemnity is drafted to provide standing cover to a category of individuals (usually done by implementing a deed poll naming the relevant categories). It is not unusual for indemnity deed polls to state that indemnification is provided to “directors and officers from time to time” – in which case it will be very relevant to know to whom this is intended to refer.

This means paying attention not just to directors but also to officers in D&O policies and indemnities; it is often clear who are the statutory directors benefiting from cover, but the term ‘officers’ can be applied and interpreted much more broadly. Again, this means having a process in place properly to record changes in directorships, job titles and roles, and to ensure individuals are given full information on their cover when they assume new positions or move through the organisation. Consistency of approach to individuals of the same rank within a business can often get lost as people take on new roles and contracts are not renewed, but should be given careful consideration.

On the part of individuals, there is often a risk that directors assume they are covered by indemnities automatically because they hold directorships, but in fact the Companies Act focuses on what directors can be indemnified for, rather than stipulating that they must be covered. For directors, making sure up-front that they are properly covered by their contractual indemnity is important, rather than waiting until the day comes when cover needs to be tested.
Only a D&O insurance policy can provide protection in the form of:
- defence costs cover (civil, regulatory and criminal proceedings), with no repayment risk in the event of the director being found to have acted wrongfully unless they are found to have acted dishonestly or fraudulently;
- cover for director/officer liability to the company or an associated company. The law precludes a company from providing a director with indemnity protection in respect of liability to the company itself, so a D&O insurance policy can provide a broader range of indemnity protection than a company indemnity can;
- a source of indemnity protection that is independent of the company, thus removing the conflict problems that arise when the company is involved in the claim against the director; and
- a source of indemnity that is available even if the company has become insolvent (rendering any corporate indemnity valueless).

However a D&O insurance policy will be subject to policy exclusions and an aggregate policy limit that does not appear in typical indemnity arrangements and a D&O policy is subject to an annual renewal and renegotiation process.

Only an indemnity agreement can, subject to its terms, provide protection in the form of:
- an uncapped indemnity;
- no policy exclusions (though most indemnities do include a number of conditions);
- no insurer payment refusal/default/insolvency risk; and
- a long term indemnity assurance, which is not subject to annual renegotiation, and thus to the risk of change or cancellation. However restrictions imposed by law on the scope of what is permitted by way of indemnification to a director mean that an indemnity contract for a director is likely to be more limited in its scope, and that defence costs are only available as incurred on the basis of a loan, which could potentially have to be repaid if the director’s defence fails.

Neither a D&O insurance policy nor a corporate indemnity will provide a director or officer with indemnity protection against:
- liability arising by reason of the director’s dishonest, fraudulent or criminal conduct; or
- criminal fines or regulatory penalties.

In the event that claims are made under contractual indemnities, we often see issues arising in circumstances where clawback provisions apply over when it is appropriate for the company to demand repayment of costs in the event of a successful prosecution. In these cases it often falls to remaining directors to decide how to react, balancing the costs against the threat of damaging the company’s reputation in any publicity that may surround the situation. Better drafting of contracts on this point can alleviate some of the confusion when the business is in the spotlight.

The key message for both individual directors and officers and their employers is the great value that should be placed on getting D&O policies and indemnifications correct at the outset, and keeping them up to date through the course of an individual’s career. Things that are overlooked in the good times can cause big problems should problems arise, not only for the individual left exposed, but also for the company, which will never benefit from a messy and confused situation with its own employees in an instance of regulatory investigation or litigation.
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