

What to look for in a directors' and officers' liability insurance policy

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A checklist setting out the key terms that insureds should review when notifying a claim or negotiating the terms of a directors' and officers' liability insurance policy.

About this checklist

This is a checklist of the key provisions to be considered when reviewing a directors' and officers' (D&O) liability insurance policy, whether in the context of negotiating the terms of a future policy or considering a potential notification or claim under an existing one.

Overview of D&O coverage

D&O insurance is intended to cover specified losses suffered by a business or its directors and officers stemming from actual or alleged breaches of corporate duties by the directors or officers.

The precise nature of the losses covered will depend on how many of three potential insuring agreements are included in the policy:

Side A cover insures losses suffered personally by directors and officers (often referred to as 'insured persons') as a result of claims brought against them in relation to an alleged wrongful act in their capacity as directors or officers.

Side B cover insures losses suffered by the business who holds the D&O policy (often referred to as the 'policyholder' or the 'company') in indemnifying its directors or officers.

Side C cover relates to losses suffered by insured persons or the policyholder as a consequence of securities claims. It is more commonly seen in policies covering entities with a U.S. connection.

Who is covered?

The critical starting point is to check which individuals are covered by the policy. A D&O policy typically provides cover for losses arising from claims against senior individuals within a business. This will generally include its directors and officers but may also include other employees.

Some key points to consider:

- A D&O policy will almost always cover directors and officers. But consider whether it also covers shadow directors, senior employees, employees acting in a supervisory capacity, or other named individuals within the business.
- Look at whether the policy covers those who become or cease to be directors and officers within the policy period.

- Where a business is made up of more than one corporate entity, check which entities' directors and officers are covered. A typical D&O policy will cover the directors and officers of a named policyholder entity or entities plus those of its subsidiaries. Alternatively, the policy may insure the directors and officers of the 'company', where 'company' is defined as a number of specified entities within a corporate group. Again, check the situation regarding acquisitions and disposals of subsidiaries during the policy period. Also check whether any entities or jurisdictions are specifically excluded from cover. If they are, look to see if there are local policies for those entities, as there may be a local law requirement that D&O insurance be issued by an insurer in the same jurisdiction as that entity.

What is covered?

An example insuring clause of a D&O policy might read:

"In consideration of the payment of the premium by the Policyholder on behalf of the Insured Persons, the Insurer will pay Loss in respect of any Claim first made against the Insured Persons during the Period of Insurance for any Wrongful act."

The key definitions to review in interpreting a D&O policy, therefore, relate to the words 'loss', 'claim' and 'wrongful act' (or their equivalents):

- 'Loss' will set out the recoverable heads of loss in respect of a claim. This may include, for example, investigation costs, defence costs, awards of damages, costs and interest, amounts payable pursuant to settlement agreements, appeal costs and PR costs.
- 'Claim' will be defined by reference to a list of potential claims against an insured person, including civil, criminal, extradition, regulatory, employment tribunal or arbitral proceedings, written demands for payment, compensation or damages, or notices before action, in connection with a wrongful act.

- 'Wrongful act' may be defined as any wrongful act or omission, error, misstatement, misleading statement, neglect or breach of duty committed, attempted or proposed to be committed (or allegedly committed) by an insured person while acting in his or her capacity as an insured person (that is, as a director or officer) or by reason of their serving in such a capacity. Critically, it will not normally extend to anything done outside that capacity (for example, the director of an investment advisor giving negligent advice to a client is not acting in his or her capacity as a director and so the consequences of that advice are not covered under a D&O policy but might be covered under a professional indemnity policy).

Note that D&O insurance will not cover losses to individual directors and officers that result from fraudulent or dishonest acts by those directors and officers (other directors and officers who were non-fraudulent will generally still be covered). Property damage, death and bodily harm are also often excluded.

What else is covered?

In addition to covering losses resulting from claims, most D&O policies will cover losses resulting from some or all of the following:

- Investigation costs, including costs of responding to or participating in regulatory or criminal investigations.
- Defence costs, including legal fees and expert fees, incurred in relation to the investigation, defence, settlement or appeal of a claim.
- Legal representation costs, including legal expenses incurred in defending a claim or in connection with an investigation or enquiry.

- Ancillary costs, including costs incurred in bringing proceedings to overturn a regulatory or judicial order imposed on an insured person.

The consent of insurers is often required before incurring some of these categories of loss.

Check whether these costs are covered in addition to the main limit of liability under the policy (see How much cover is there?) or whether they will erode the limit of liability available. There may be specified sub-limits that apply in respect of each category.

How much cover is there?

Check the limit of liability and whether it is per claim or aggregate. If cover is provided on an aggregate basis, during the policy period, insurers will pay up to the limit of indemnity regardless of the number of claims. An additional limit for non-executive directors is sometimes included. Also check whether there are any sub-limits.

Finally, check what deductible(s) might apply. The deductible is the amount that the insured has to pay before insurers will step in to cover the balance of the loss. Deductibles are often higher for Side B and Side C than they are for Side A.

What is the policy period?

The policy period refers to the duration of the policy. That is, the period between inception of the policy and its expiry or cancellation. The policy period of D&O policies is usually one year. D&O policies are generally issued on a claims-made basis, meaning that the critical question in terms of timing is when the insured became aware of a claim, potential claim, investigation or enquiry, rather than when the alleged wrongful act to which that claim, investigation or enquiry relates took place.

Claims will only be covered if they are notified to insurers during the policy period or an agreed extended reporting period. If negotiating a policy, consider how long the policy period should be. If seeking to notify a claim, check that the policy period is still active (including whether it has been extended by any endorsements) and how much time remains before it expires. Remember that you may have to act quickly to notify a claim or circumstances that may give rise to a claim – late notification can be fatal to recovery.

Are there any relevant exclusions?

As noted above, What is covered?, D&O insurance will not cover losses to directors and officers that result from fraudulent, dishonest or criminal acts by those directors and officers. Property damage, death and bodily harm are also often excluded.

D&O insurance will also not respond to claims that commenced prior to the period of insurance or that could have been notified to previous D&O policies.

Policies may exclude cover for losses arising from claims brought or maintained in particular jurisdictions. There may also be specific exclusions from cover that are included by way of endorsement to the policy.

What are the notification requirements?

Check the requirements for notification:

- It will generally have to be in writing.
- Notification by email may be expressly permitted; if it is not, it is advisable to notify by email and by post.
- A time limit for notification may be specified, for example, “as soon as reasonably practicable after the Policyholder has become aware of the Claim” or within 30 days of the policyholder – or a named person within that business – becoming aware of the claim or circumstances that would cause a reasonable person to believe that a claim was likely.

- Notification may also need to include certain details to be valid. For example, the name of the insured person against whom the claim is made or in respect of whom the circumstance has arisen and the nature of the claim.
- Requirements for notifying a claim may be different from the requirements for notifying a circumstance that could give rise to a claim.

Check whether an address is given for the notification of claims. If a broker is to make a notification on the insured’s behalf, ask that the broker ensures notification is made to the correct address.

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