Willis Towers Watson

# Directors' & Officers' Insurance

# Directors' and Officers' Liability explained

Directors have always been bound by many duties arising under jurisdictional laws. The difference in today's world is that stakeholders have far greater forms of remedy against directors and there is an increased willingness to pursue claims against them.

Whether or not you're ultimately held liable for such claims, the defence costs associated can be expensive, and the process can take months or even years. In practice, once a claim is alleged against a director for any wrong doing, they have two sources of protection –indemnification from the company or insurance under a Directors' & Officers' (D&O) Liability insurance policy.

## D&O Liability insurance - the basics

A D&O insurance policy is written on a claims made basis, meaning it covers claims made during the policy period (typically 12 months). Claims can be made for wrongful acts committed during the policy period or prior to the inception of the policy, subject to any exclusion (see Standard Exclusions) or retroactive date. The limit provided is often an aggregate amount to be shared between all directors and officers of the company, including directors and officers of any directly or indirectly owned subsidiary, and cover is usually written on a worldwide basis. Many policies contain certain additional limits, for example, cover for the non-executive directors once the main limit is exhausted. Some policies may alternatively be written on an "any one claim" or "AOC" basis, such that the limit applies for each claim, rather than in aggregate. However, that is less common in the current market (as of July 2020).

## How the policy works

Whilst policy wordings vary by insurer, typically wordings operate by paying the Loss of any Insured arising from a Claim made for a Wrongful Act.

**Loss** – includes defence costs, costs, awards and damages including settlements that the individual is legally liable to pay.

**Insured Person** – includes any director or officer and can be extended to include employees (in managerial capacities or named as co-defendants), lawful spouses, estates and liquidators. The term "director" will usually include executive directors, non-executive directors, shadow directors, prospective directors and de facto directors. Officers usually include company secretaries, risk managers and other senior managers.

**Claim** – includes any civil, criminal or regulatory proceeding or suit brought against an Insured.

**Wrongful act** – means any actual or alleged act, error or omission or any claim made against a director or officer solely because of their capacity as a director or officer.

### Why buy D&O insurance

**For the Directors** – a policy provides personal asset protection should the employer's indemnification fail for any reason.

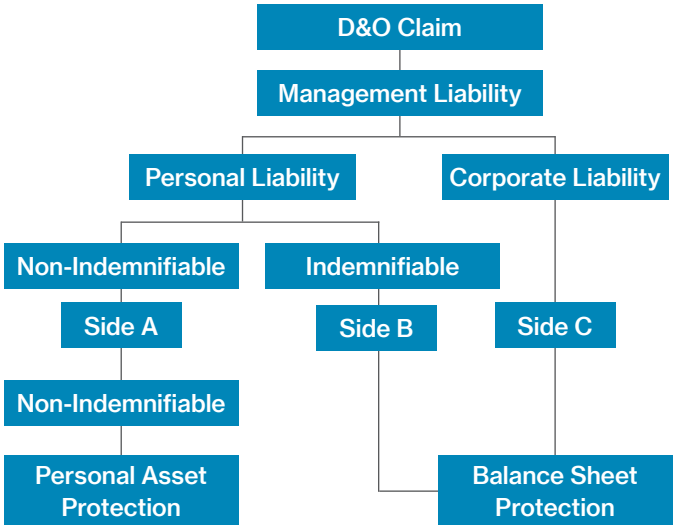
**For the Company** – a policy provides balance sheet protection where the company has indemnified its directors.

In the case of Side C Entity cover, the policy provides balance sheet protection for securities claims made against the entity.

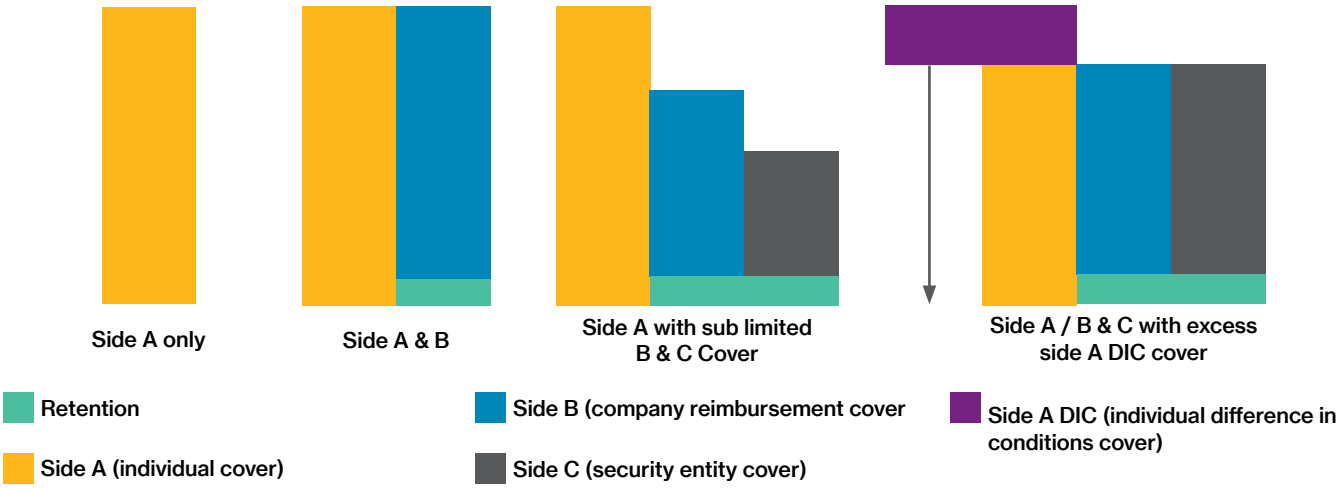
# D&O policy construction

A policy will typically be broken down into two or three broad categories of cover:

- **Side A** (non-indemnifiable loss) provides cover for the individual insured persons – Side A pays when the company indemnification fails to respond and is not usually subject to a retention.
- **Side B** (indemnifiable loss) provides company reimbursement – when the company has indemnified their director or officer, the policy reimburses the company subject to retention and so provides balance sheet protection.
- **Side C** – there is an additional insuring clause that can be purchased, in respect of securities claims, although this is not suitable for all companies. Whereas Sides A and B cover claims made against individual insured persons, Side C cover provides protection for claims brought against the company itself as a legal entity. The advantages and disadvantages of this cover can be discussed further with your Willis Towers Watson contact.




Different variations of D&O policies are available. Some companies opt to omit the Side B cover and have a Side A only policy, whilst others purchase different levels of Side A, B & C cover within a combined programme. Every company is different and we can help you design your programme for your needs. See diagrams below.




Another product in the D&O market is known as Excess Side A DIC (Difference in Conditions), which can be purchased in addition to the traditional Side A, B & / or C policy. This policy provides broader coverage with fewer exclusions. The policy works in two ways: first, it provides Excess Side A cover above the Side A, B &/or C policy and second, it provides Side A DIC cover where the underlying insurers refuse to pay, exclude a claim from cover or are unable to pay due to their insolvency.

# Typical exclusions

As with policy extensions, the exclusions can vary. Here are some examples:

- **Conduct/Fraud and Dishonesty** – excludes any claim where an insured makes a wrongful gain, or where there has been fraud or dishonesty, although the policy will usually provide defence costs until fraud or dishonesty is proven in final non-appealable judgement or by admission.
- **Insured vs. Insured claims** – this exclusion applies to claims brought by or on behalf of the company against the insured persons. It usually only applies to claims arising in the USA and can be subject to certain exemptions for claims such as derivative claims or employment practices claims.
- **Prior and Pending Litigation or Retroactive date Exclusions** - policies can contain a prior and pending date which excludes any claim arising from a litigation proceeding that commenced or was pending prior to the date stipulated in the policy. A retroactive date excludes any claim arising from a wrongful act that occurred prior to this date.
- **Prior Notice** – claims or circumstances notified under a previous policy can be excluded. In some policies, such as our DARCstar wording, this exclusion only applies to claims or circumstances notified and accepted under a previous policy.

# Typical extensions

While policies may differ from insurer to insurer here are some typical extensions:

- **New Subsidiaries** – automatic cover for any acquired company that falls within policy thresholds, usually based on size of total assets and exposure to US securities claims.
- **Investigation Costs** – cover for the legal costs in preparation for or attendance at an official investigation into the affairs of any insured and / or the company.
- **Outside Directorship positions** – cover for any director or officer appointed to the board of an outside company at the request of the policyholder. This cover usually applies in excess of any insurance or indemnification provided by the outside company.
- **Employment Practices** – Cover for any breach of employment practices e.g. sexual or racial discrimination in the workplace, where such claim is alleged against an insured person by an employee or prospective employee of the company.
- **Discovery Period** – should the policy not be renewed, it is possible to purchase additional periods during which claims can be notified to the policy but only in respect of wrongful acts committed prior to the expiry of the original policy. The periods can also be pre-agreed, especially for any former directors and officers providing them with comfort that they will have insurance protection for acts committed whilst they were serving, should the policy not be renewed after they have retired from the company.
- **Non-Executive Additional cover** – some insurers are now offering additional ring-fenced limits solely for the benefit of non-executive directors which are in addition to the limits purchased.
- **Extradition Costs** – defence costs cover to help fight an extradition proceeding and appeals.
- **Manslaughter and Health & Safety** – defence costs can be provided to help defend against claims alleging manslaughter or breach of Statutes in relation to Health and Safety.

# What give rise to claims?

Certain activities of a company such as offerings of securities, acquisitions or disposals are commonly areas where directors can face allegations of wrongful acts or misrepresentations with respect to the business. Directors may also face a wide range of claims relating to their day to day management of the company. In today's difficult environment, claims can arise from a variety of sources:

**The company** – in most jurisdictions, directors owe their primary duty of care to their company and may therefore face claims brought against them by the company, whether directly or derivatively.

**Example: If the company brings a claim against its directors, the directors may not be able to be indemnified by the company to defend themselves. Subject to the terms and conditions of the D&O policy, the policy could provide cover for the defence, settlements or judgements resulting from the claim.**

**Security holders (shareholders and bondholders)** – worldwide securities laws usually provide courses of action for shareholders to pursue directors and the company where they have suffered a financial loss due to the acts or omissions of a director. Securities claims are more common in the USA where defence costs can be extremely expensive.

**Example: If following a substantial offering of a company's securities there is a sudden significant price drop arising out of a misstatement or misrepresentation in the prospectus documents, this could give rise to claims against the directors who are signatories to it. Most D&O policies will pay the defence costs, settlements and judgements of civil claims brought against the directors for such alleged misstatements. It is also possible to buy a specific policy for public offerings (a POSI policy).**

**Regulators / Government Bodies** – most jurisdictions have numerous regulators whose objective is to govern industries and punish any wrongdoing. Regulators are usually given powers to investigate and hand down fines and penalties.

**Example: During an investigation into the affairs of the company or an insured by an official body, directors would have access to legal representation cover under a D&O policy for attendance at such investigations, although any subsequent criminal penalties would not be covered.**

**Competitors** – any breach of competition laws could result in competitors filing an action against directors.

**Example: A company acquires a competitor, the purchase is part funded by offering new shares to the selling shareholders. Shortly after the acquisition the company announces a profit warning caused by losses in an overseas subsidiary. Aggrieved new shareholders could bring a claim against the directors of the company alleging the directors were aware of the true financial position prior to issuing the new shares.**

**Liquidators** – In the event of insolvency, the insolvency practitioners (liquidators, administrators, etc) can bring a claim on behalf of the company for any breach of duty e.g. wrongful trading that took place once the directors ought to have known the company was insolvent.

**Example: Insolvency brings into play a number of potential exposures for directors from wrongful trading to misfeasance. As long as there is no insolvency exclusion, a D&O policy will usually pay the defence costs but will not cover any liabilities if there is any proven fraud or dishonesty.**

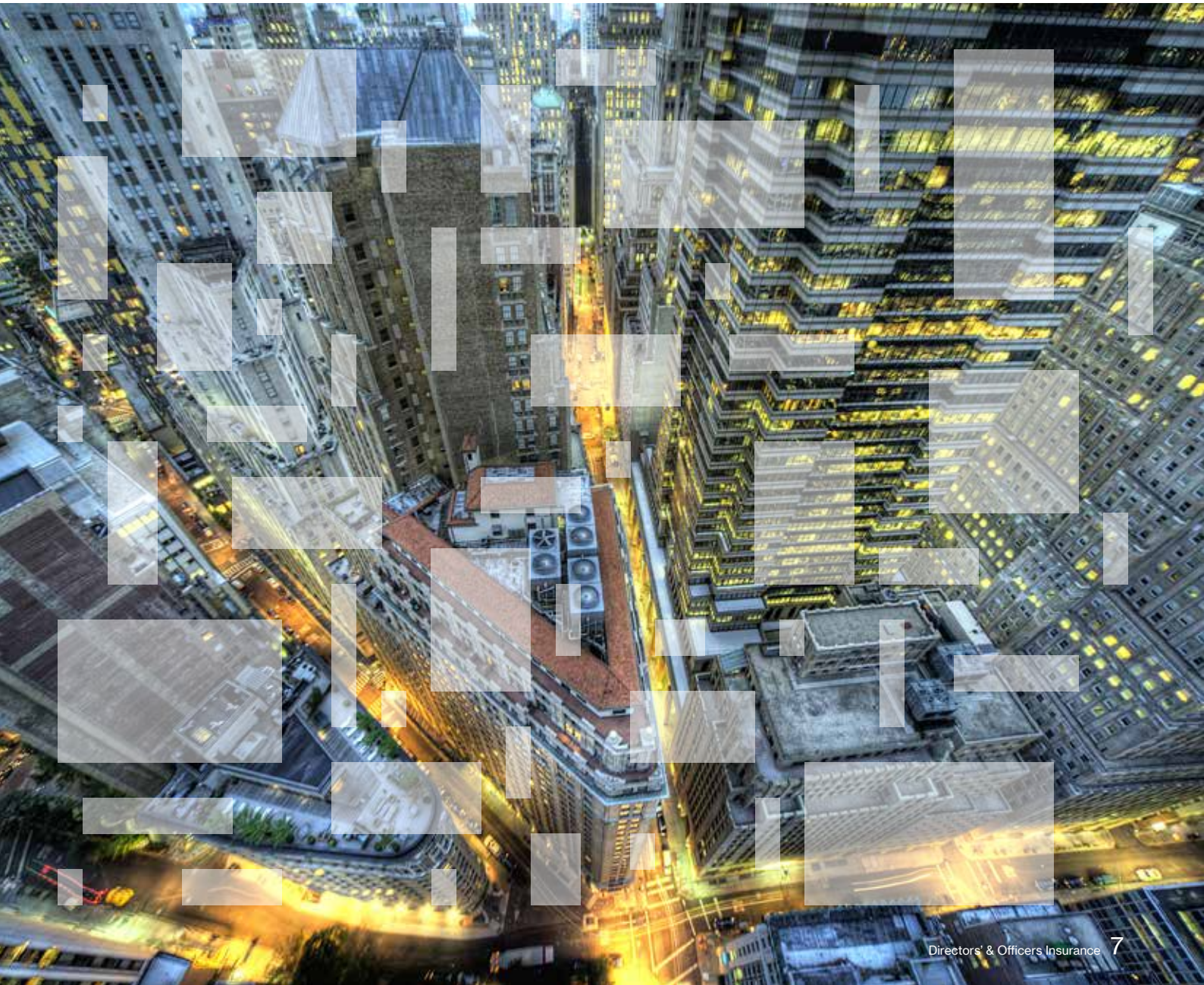
# Company indemnification

Many jurisdictions permit companies to indemnify their directors for any financial loss arising from an allegation made against them whilst acting in their capacity as a director of the company. Where permitted, the indemnity is usually evidenced and outlined in law and/or within the company's incorporation documents (Articles of Association in the UK). It may also be a specific contractual arrangement in some cases.

Whilst a company indemnity is comforting, it is only as valuable as the company's ability and/or willingness to pay.

If the company becomes insolvent or refuses to indemnify for whatever reason, then the Director will have to finance their own defence unless there is D&O insurance in place. Legislation can also limit indemnification in certain circumstances, for example, a claim brought in the name of the company such as a derivative claim.

Where a director does not benefit from a company indemnity, a Directors' and Officers' Liability (D&O) policy is essential to fund any defence. By having a robust D&O policy in place, a company can attract the best talent and many directors now insist that an adequate D&O policy is in place before they will commit to joining a board.



# Introducing DARCstar

Directors' All Risk Cover (DARCstar) is designed to simplify and improve the protection available to directors and officers. First launched in May 2011, the DARCstar policy is exclusive to Willis Towers Watson.

## The DARCStar concept

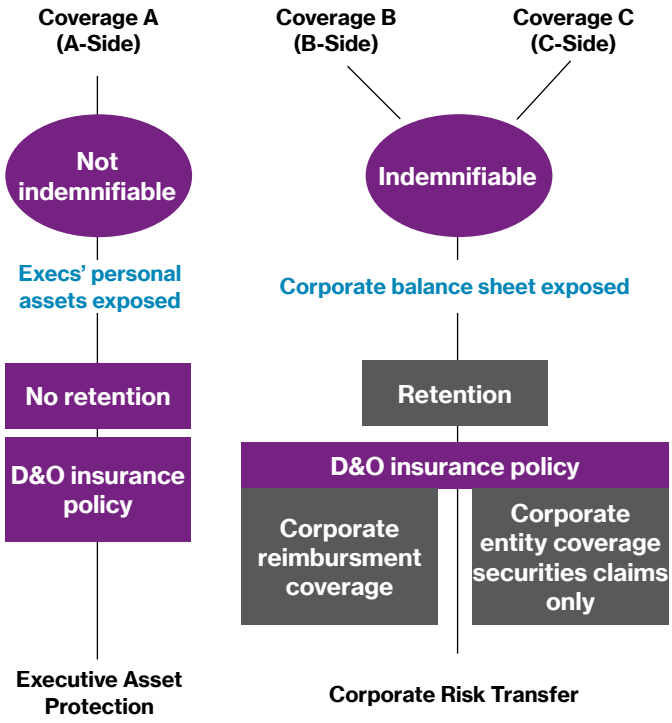
DARCstar is based on the premise that many D&O liability insurance policies are too lengthy and cumbersome. Just 10 pages long, it confronts the paradox that more complex terms often do not deliver better cover.

The three planks on which the DARCstar concept rests are:

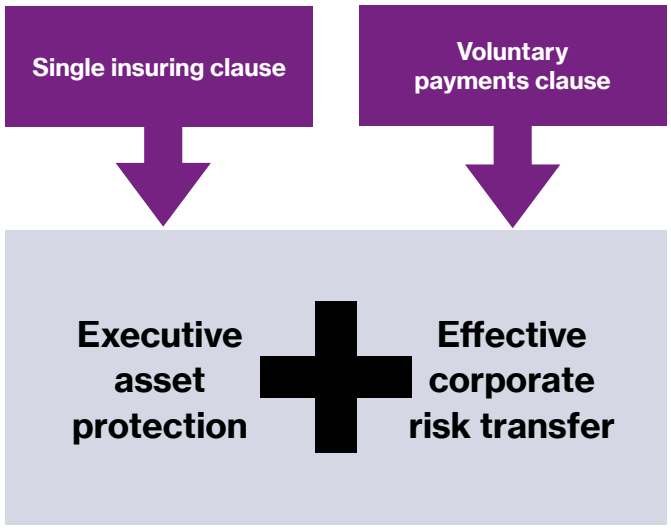
1. A single insuring clause covering directors regardless of whether loss is indemnifiable by the company.
2. Focused and comprehensive cover for investigations and enquiries.
3. A clear and transparent approach to claims conduct and control.

## DARCstar: Not your conventional D&O cover

*Conventional D&O claim*




*DARCstar D&O Claim*



# DARCstar D&O liability insurance

| Features | Benefits |
|---|---|
| One insuring clause | Instead of the conventional twin insuring clause approach, with indemnification being the barrier between the two, there is a single insuring clause providing direct access for the directors to insurers |
| D&O cover on an 'all risks' basis | Rather than an insured perils/affirmative cover approach, the assumption is that the risk is covered unless excluded |
| Waiver of right of subrogation by insurer against policyholder and subsidiary in all circumstances | A commitment from the insurers that they will not seek recovery from the policyholder for indemnifiable loss |
| Nil deductibles | No compulsory deductibles or retentions other than with respect to securities claims |
| Clear triggers for investigation costs cover across a broad spectrum of external and internal investigations and enquiries | Legal costs protection tailored to the needs of directors and officers |
| Simple and transparent claims handling provisions | Greater certainty for directors in the coverage and claims handling process |
| A policy that is easy to understand | Clear, simple and concise terms |

## Additional enhancements in DARCstar as standard:

- Advancement of all directors' costs in the event of an allocation dispute
- No absolute exclusion in relation to the gaining of profit or advantage
- Full defence and investigation costs cover for death
- Fully integrated Outside Directors Liability (ODL) cover
- Loss mitigation protection
- Suspended claims reporting requirements where legal restrictions apply

# Next steps

For further information or to obtain a quotation, please contact your Willis Towers Watson Client Advocate or a member of the Willis Towers Watson Directors and Officers team.


**Eve Richards – GB Head of FINEX D&O**
+44 20 3124 8122
Eve.Richards@WillisTowersWatson.com

**Angus Duncan – Coverage Specialist**
+44 20 3124 8386
Angus.Duncan@WillisTowersWatson.com

**Daniel Porras Dalmau – LATAM/ Intl**
+44 20 3124 8367
Daniel.Porras@WillisTowersWatson.com

**Mitch McBain – UK/ Intl**
+4420 3451 9211
Mitch.Mcbain@WillisTowersWatson.com

**Robert Greenwood – USA/ Intl**
+44 20 3124 8406
Robert.Greenwood@WillisTowersWatson.com

**Duncan Wash – National**
+44 1473 223867
Duncan.Wash@WillisTowersWatson.com



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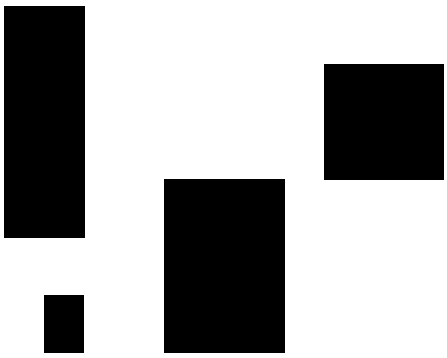

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