Allianz Insurance plc

Directors & Officers

Tough at the top - protecting your key people

DAC beachcroft

Allianz

Open Knowledge

At Allianz, our experts have a wealth of knowledge that can help our brokers and customers keep up to date with legislation, stay informed of industry developments and better manage their risks – thus enabling them to manage insurance costs, reduce personal risks and concentrate on running successful businesses.

DAC Beachcroft

DAC Beachcroft has considerable expertise in advising on D&O claims. Our team of specialist D&O lawyers acts for a variety of SMEs, both as entities and for their directors and trustees, with clients ranging from medium size enterprises, charities and residents associations to sports and social clubs and right-to-manage companies. Claims have arisen over issues as diverse as breaches of fiduciary and statutory duties, health and safety and/or environmental matters and official investigations to anti-competitive behaviour, defamation, and landlord and tenant disputes.

The team also advises on coverage disputes arising under the D&O policies on such areas as qualifying directors, capacity, allocation and advancement.

DAC Beachcroft has a dedicated EPL practice whose lawyers work closely with our D&O team to manage claims.

Introduction

In today's increasingly litigious society, being a company director could be regarded as a high risk occupation, given the set of duties and responsibilities that come with the role. If it is believed the director has breached these or has failed to safeguard the interests of a variety of stakeholders, they can find themselves in court facing legal action.

This can have serious financial implications for a director, potentially putting their own assets, including their home, car and savings, at risk. Among the costs they could find themselves having to meet are the legal expenses of defending a claim, awards for damages and regulatory fines.

A claim doesn't even have to reach court for a director to find him or herself out of pocket. Where a regulator or a body such as the Health & Safety Executive or HM Revenue & Customs suspects a failing within a company, it can launch an investigation. This can be costly and time consuming.

As well as the financial risks, directors also face significant reputational damage. Being found in breach of their duties will affect their career and could also mean they risk being disqualified from holding the position of director. Disqualification can prevent them from being a company director - or even being involved in setting up, running or marketing a company - for up to 15 years.

And these risks are growing. New legislation such as the UK Bribery Act puts additional responsibilities on directors to ensure their companies are not involved in bribery, holding them personally liable if they have in any way consented to the offence.

In addition, tougher stances from the regulators mean that the risk of investigation and fines is on the up. As an example, in 2013, fines from the Financial Conduct Authority totalled £474m - more than 50% higher than the £312m its predecessor the Financial Services Authority handed out the previous year.

As the economy continues to pick up and new opportunities for growth present themselves, companies and their senior executives need the confidence to make complex business decisions without the fear of financial and reputational repercussions.

"Directors and Officers face an unprecedented level of personal risks in today's litigious society. As the general public increasingly demand accountability, they cannot afford to be complacent about their personal exposures."

Stephanie Ogden, Speciality Lines Underwriting Account Manager, Allianz

Directors - the legal position

Senior executives within any business have usually achieved their position as a result of their skills, experience and knowledge of the sector.

But, as well as being required to be among the best in their field, by holding the position of director they must also understand the legislation that applies to them and the duties and responsibilities it places upon them.

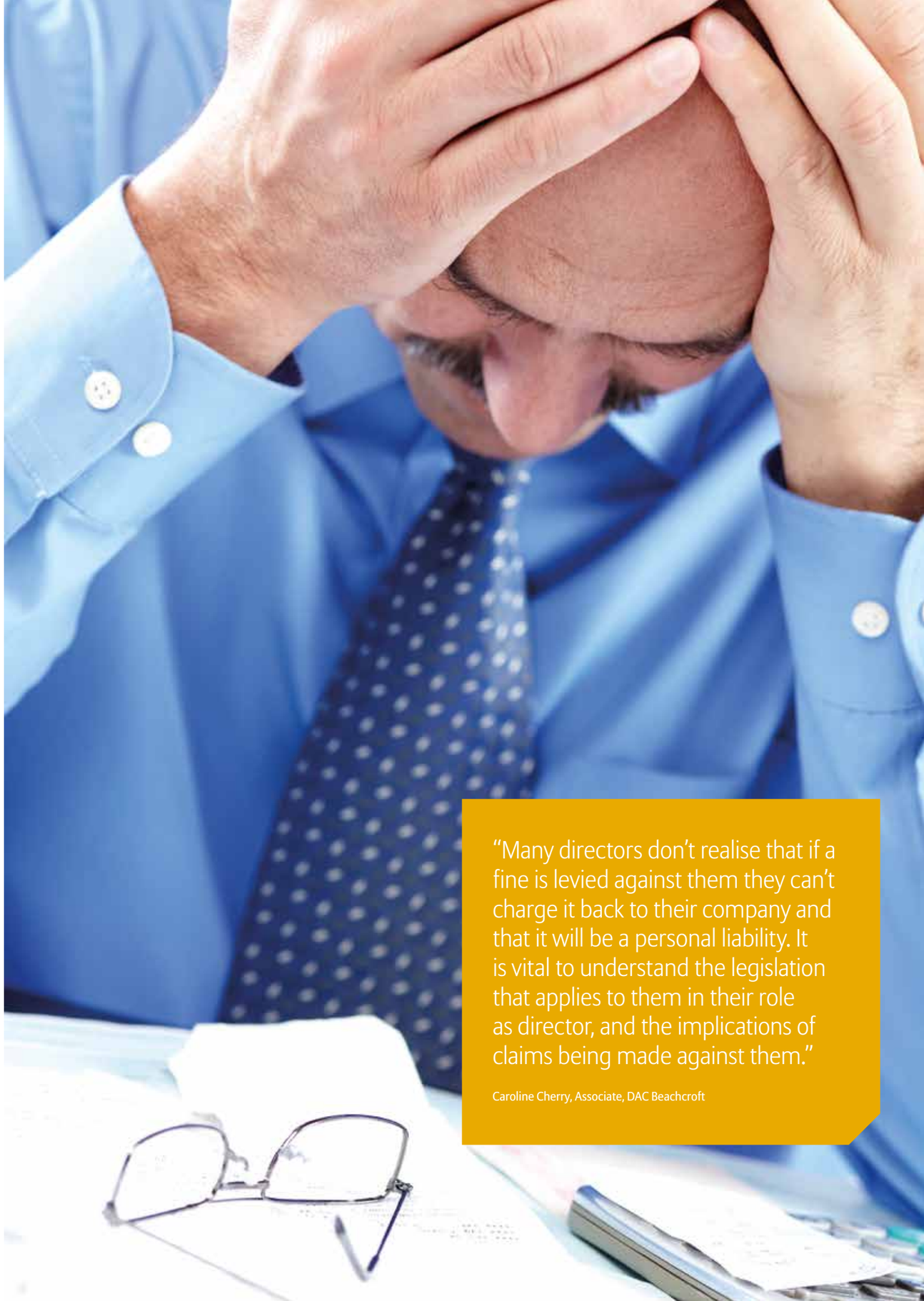
This legislation can cover a broad range of areas, including matters that may seem outside of their company's remit such as environmental damage, the protection of wildlife and defamation.

The legislation is also constantly changing, with the government's appetite for consumer protection putting further responsibilities onto directors' shoulders. As an example, the Department for Business, Innovation & Skills recently published the results of a consultation, *Transparency and trust: enhancing transparency of UK company ownership and increasing trust in UK business*, which aims to increase the accountability of directors.

Alongside more robust legislation, the world is also becoming increasingly litigious. Employees, shareholders, investors, creditors and other third parties know their rights and are much more likely to take action against a company and its directors.

And business is increasingly becoming global with more and more companies establishing themselves internationally. While this can be good for business, it also leaves directors exposed to risks associated with the legislation and regulation in the jurisdictions in which they operate.

Staying on top of these responsibilities alongside carrying out the duties associated with their role, can be a significant challenge for today's directors.



"Many directors don't realise that if a fine is levied against them they can't charge it back to their company and that it will be a personal liability. It is vital to understand the legislation that applies to them in their role as director, and the implications of claims being made against them."

Caroline Cherry, Associate, DAC Beachcroft

Legislative and regulatory risks

The following examples illustrate the variety and breadth of the legislation and regulatory action that can apply to directors individually.

Companies Act 2006

The key piece of legislation for directors is the Companies Act 2006. This sets out their duties and responsibilities, with sections 171 to 177 describing the scope and nature of their general duties. These are as follows:

- Duty to act within powers.
- Duty to promote the success of the company.
- Duty to exercise independent judgement.
- Duty to exercise reasonable care, skill and diligence.
- Duty to avoid conflicts of interest.
- Duty not to accept benefits from third parties.
- Duty to declare interest in proposed transaction or arrangement.

Of these the first two duties are the main areas that result in legal action being brought against directors.

As an example, if a director takes the strategic decision to pull out of a particular market and this area subsequently performs well, shareholders could make a claim against the director for failing to act in the interests of the company.

"The greatest exposure is the Companies Act 2006. With this we see the majority of claims brought against directors for failing to act within powers or in line with the company's objectives."

Caroline Cherry, Associate, DAC Beachcroft

Employment law

Employees can bring claims against directors under the Employment Rights Act and the Equality Act if they feel they have been treated unfairly. Claims can include unfair dismissal, which is usually brought against the company, and harassment and discrimination, which are brought against the individual director and have uncapped awards.

The changing face of employment means that legislation in this area is constantly evolving and directors need to be aware of the implications for their company.

For example, the introduction in July 2013 of fees for employees lodging tribunals has significantly reduced the number of cases being brought, although the potential exposure has increased as fees are also awarded if the defendant loses.

An additional change to the rules around tribunals was also brought in in April 2014 with the introduction of early conciliation through the Advisory, Conciliation and Arbitration Service (Acas). While this will help to resolve some cases before they reach court, there is a risk that if the employer does not follow the procedures laid down, they could inadvertently weaken their position.

Insolvency Act 1986

Although the number of insolvencies has fallen significantly since the peak in 2009, there were nearly 4,000 compulsory liquidations and creditors' voluntary liquidations in the first quarter of 2014.

The threat of insolvency has ramifications for directors. Although their focus may be on safeguarding the future of their business, to avoid legal action being taken against them, directors need to be aware of their responsibilities, and particularly how these change once there is a risk of insolvency.

Under the Insolvency Act, directors can find themselves dealing with claims from creditors if they do not act in their best interests. This is because, once there is a risk of insolvency to a business, the director's responsibilities switch from the shareholders to the creditors. They will want to ensure their interests are protected and may pursue legal action if, for example, they believe a director has sold off assets at an undervalued price to raise capital to support the company. Another example could be if they have been involved in wrongful trading, knowing the company had no future but continued to operate. This type of action can result in lengthy and expensive investigations.

Defamation Act 2013

Directors can also find themselves facing claims under the Defamation Act if their company is found to have said or written anything that causes harm to an individual or corporate body.

Although claimants will have to show they have suffered 'serious harm' before they can take legal action, the risk of a claim is increasing as a result of the internet, which makes it much easier to put potentially defamatory statements into the public domain.

Where these types of claims are brought, understanding how to retract the statement quickly with no admission of guilt is essential.

Environmental damage

Under the Environment Act 1995 and the Wildlife and Countryside Act 1980, there is a responsibility to protect the environment including wildlife and wild plants.

A company doesn't even have to be directly involved with the environment for one of its directors to find him or herself charged under either of these acts.

Examples include the disturbance of some bats during an office refurbishment and the mowing of a lawn that was home to a protected species of newt. In both cases the director was arrested under the Wildlife and Countryside Act as bats, and their roosts, and this particular type of newt are endangered species and, therefore, legally protected.

Regulatory investigation

An increase in the appetite for regulatory investigations over the past few years means it is increasingly common for directors to find themselves having to pull together responses for regulators. This can be an expensive, time-consuming and disruptive process, especially when deadlines are short and there is a lack of awareness of the regulator's rules.

"Regulatory investigations are becoming more common and meeting the requirements can seriously distract a company's decision makers. D&O insurance, as well as providing cover for damages, also provides access to expert legal support and can take away the worry."

Terry Fitzgerald, head of Commercial D&O, Allianz Global Corporate and Speciality

Protection for directors

Given the risks faced by directors in the course of their work, protection is available. This ensures that, if a claim is brought against them, they will have access to legal representation and their personal assets will not be at risk.

Directors & Officers insurance is designed to protect a company's senior executives from the financial implications of legal action associated with their role, covering the cost of defending a claim and any compensation that is awarded.

It also provides access to expert legal advice, which can help to ensure a director follows the correct procedures as well as defending them against any legal claims brought against them. Taking advice as early as possible in a claim is required under a D&O policy and can significantly help to limit damages.

Policies will also cover the cost of investigations that may be brought against a director by a regulator or similar body such as the Health & Safety Executive, HM Revenue & Customs or the Office of Fair Trading.

State of the D&O market

The scope of the risks that directors are facing means that take up of D&O policies has increased significantly over the last 20 years. Today, most directors in the FTSE 250 space will have cover with a growing number insisting it is in place to protect their interests before they would even consider a directorship.

But, although it is almost ubiquitous in the FTSE 250 space, there is much lower penetration among smaller companies. Datamonitor's SME Insurance Survey, which was conducted in August 2014, found that only 23.3% of respondents had D&O cover – remaining static from 2013, and down from the previous year's figure of 26.7%. The figures are even lower in the micro-SME sector, with just 10.6% of those surveyed having D&O cover.

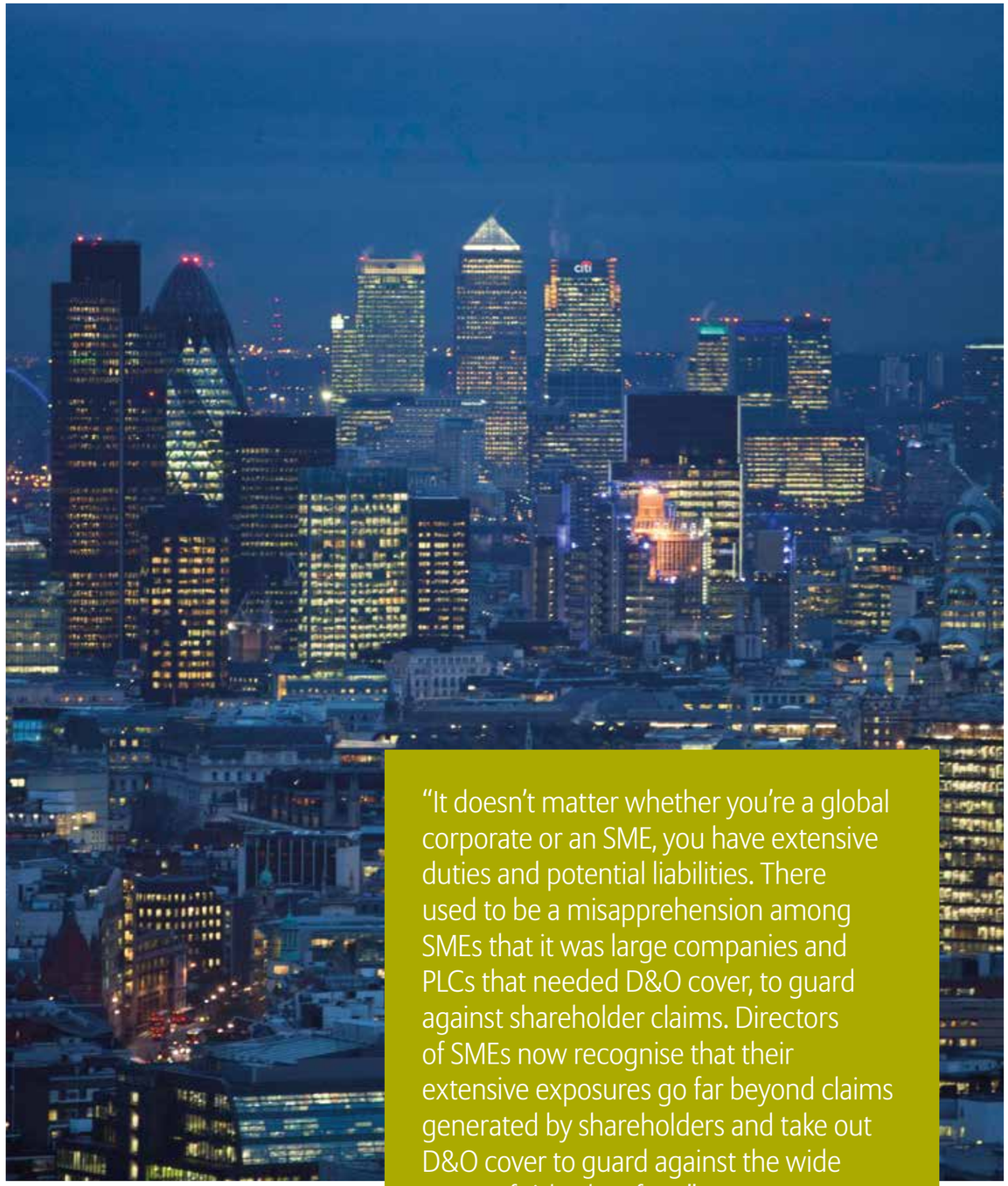
Figures from the Department for Business, Innovation & Skills show just how many SMEs could be exposing their directors to the risks covered by D&O insurance. Based on figures from November 2014, there were an estimated 5.2 million businesses in the UK - of which 99.9 were SMEs. This means that around 1.2m SMEs had cover.

This low penetration rate may be down to lack of awareness of the risks or of D&O insurance, but SMEs face exactly the same risks as their larger peers. Regulators view the activities of SMEs in the same way as those of their larger peers and will seek to take action against a company of any size if it suspects it is acting inappropriately. Similarly, employees of small companies are just as aware of their rights as those in large multinationals and will take action against an employer if they feel they have been treated unfairly.

While the risks are the same, SMEs face a further challenge. Without the in-house legal and HR teams common in large companies, defending a claim or dealing with a regulator's investigation can be time-consuming and complicated.

D&O insurance provides valuable access to specialists including lawyers and communication consultants. Having this support not only ensures they deal with the challenge successfully but it also helps to reduce the disruption to management time and allows them to focus on the needs of the business.

Against a backdrop of increasing regulation and litigation, D&O insurance is a must for a business of any size. As well as indicating that it values its senior executives - and helping to attract high calibre directors - D&O insurance enables a business and its employees to focus on being successful.



"It doesn't matter whether you're a global corporate or an SME, you have extensive duties and potential liabilities. There used to be a misapprehension among SMEs that it was large companies and PLCs that needed D&O cover, to guard against shareholder claims. Directors of SMEs now recognise that their extensive exposures go far beyond claims generated by shareholders and take out D&O cover to guard against the wide range of risks they face."

Caroline Cherry, Associate, DAC Beachcroft

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