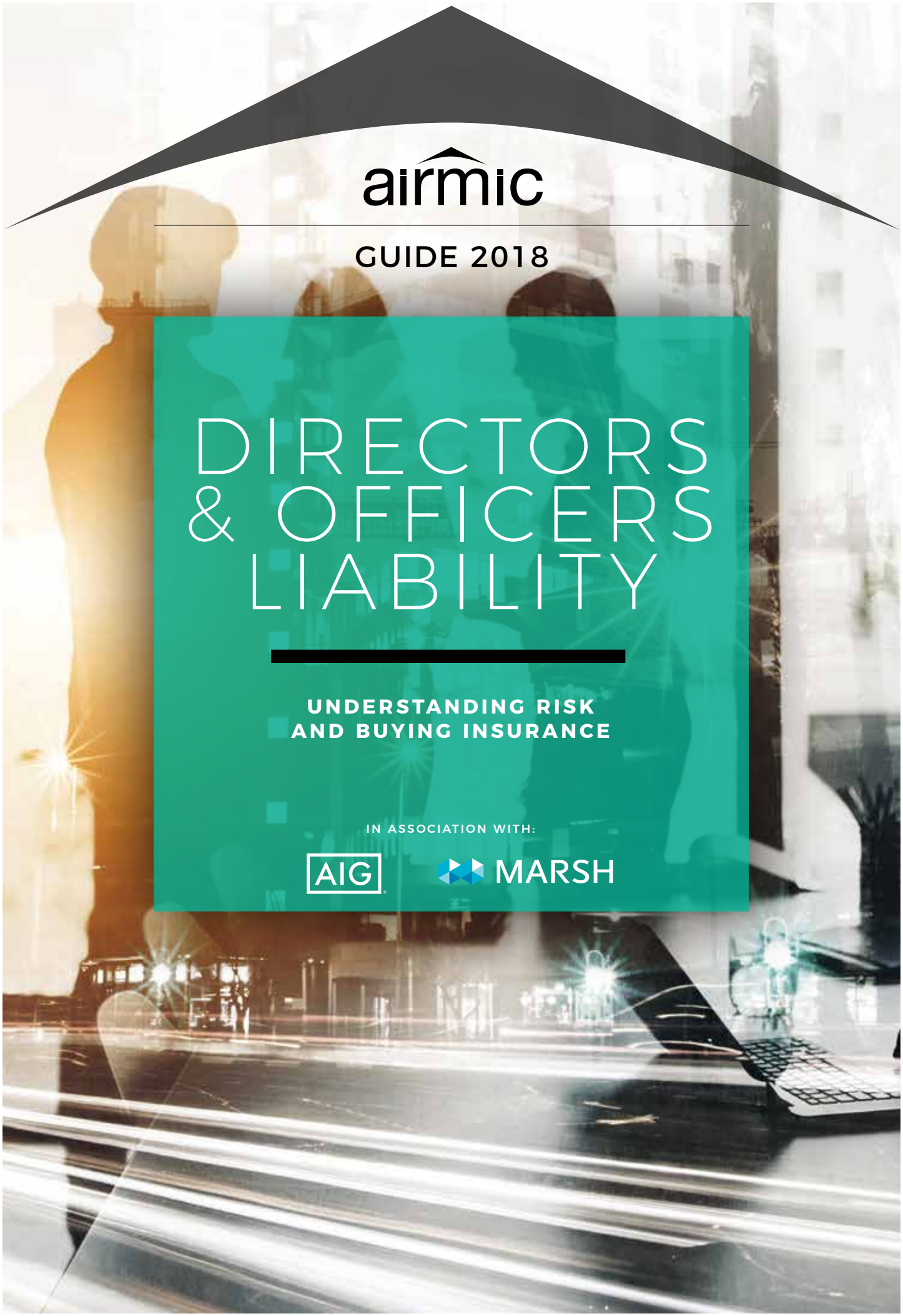

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GUIDE 2018

DIRECTORS & OFFICERS LIABILITY

UNDERSTANDING RISK AND BUYING INSURANCE

IN ASSOCIATION WITH:

AIG MARSH

AIG

American International Group, Inc. (AIG) is a leading global insurance organisation. Founded in 1919, today AIG member companies provide a wide range of property casualty insurance, life insurance, retirement products, and other financial services to customers in more than 80 countries and jurisdictions. These diverse offerings include products and services that help businesses and individuals protect their assets, manage risks and provide for retirement security. AIG common stock is listed on the New York Stock Exchange and the Tokyo Stock Exchange.

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AIRMIC

Airmic is the association for everyone who has a responsibility for risk management and insurance for their organisation. Members include company secretaries, finance directors, internal auditors as well as risk and insurance managers. We support our members through: training and research; sharing information; our diverse programme of events; encouraging good practice; and lobbying on subjects that directly affect risk managers and insurance buyers. Above all, we provide a platform for professionals to stay in touch, to communicate with each other and share ideas and information.

As organisations adopt emerging technologies, experiment with new business models and are increasingly rated by the value of their intangible assets – such as reputation, data or intellectual property – the greater is their need to update the way they assess, manage and finance risk. At a time of extreme change, businesses face new threats and opportunities. In this context, directors and officers of organisations face legal challenges, allegations and investigations which can be stressful, protracted and expensive.

It is some years since Airmic provided guidance on understanding and managing the risks and liabilities faced by directors and officers. This Guide does not replace the need to seek and take professional advice and opinion on the subject, but it does provide a good introduction and signposts on the subject for risk managers and other business leaders. Our thanks go to AIG and Marsh for their advice and technical excellence and to this panel of Airmic members who contributed to the production of the Guide.

Julia Graham
Deputy CEO and Technical Director, Airmic

Contents

DEFINITIONS:

Director An appointed or elected member of the board of directors of a company who, with other directors, has the responsibility for determining and implementing the company's policy. Directors act on the basis of resolutions made at directors' meetings, and derive their powers from the corporate legislation and from the company's articles of association.

Officer A person who acts in an official capacity on behalf of an organisation, such as a company secretary, executive or manager.

Please note these definitions are for the purpose of this guide and may not reflect the legal definitions of these terms nor the use of these terms in any given policy wording.

THE PURPOSE OF THIS GUIDE

Responsibilities for risk managers and their senior management in an increasingly unforgiving operating environment

The purpose of this Airmic guide is to consider:

- Evolving and emerging directors and officers liability (D&O) risks and liabilities
- D&O claims trends
- The risk strategy and buying process
- The role of D&O insurance
- Who is at risk: What is an officer/director/non-executive director (NED)/outside director?
- How to get the most from your insurance
- The purpose and value of corporate indemnities and how they dovetail with insurance as part of the risk management strategy organisation

Much has changed since the Airmic Guide to Directors and Officer Insurance was published in 2012. The risk environment internally and externally has changed materially in recent years and continues to change at an escalating pace. Specifically, more demanding governance responsibilities, new regulations and evolving risk challenges have informed this new and updated Guide. The risk manager must address a world of more complex and connected risks and the challenges this presents.

Risk managers, especially those operating in a multinational environment, face a growing raft of compliance responsibilities, indicative of an increasingly unforgiving regulatory environment. Investigations are taking longer, fines and penalties are rising and in many instances, regulators have demonstrated their ability to work together across borders to achieve significant outcomes.

Where regulators have limited resources, whistle-blowing and self reporting is being encouraged. In the UK, Deferred Prosecution Agreements (DPAs) were introduced by the Crime and Courts Act 2013 as a means through which an organisation could avoid prosecution for economic offences by entering into an agreement on negotiated terms. However, such self reporting does not protect directors and officers from future prosecution (see case study box).

Since the Global Financial Crisis (GFC), there has been increased scrutiny on the decisions and culpability of senior management. Post-crisis there was a sense that the individuals behind the problems leading to the crisis had not been held to account. Since that time, regulators such as the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) in the US, and the Financial Conduct Authority (FCA) in the UK have indicated an intent to focus more on the activities of individuals.

One of the more common questions for senior managers in the post-GFC world is whether sufficient systems and controls are in place to prevent wrongdoing or errors from occurring. This has been enshrined within new laws.

In the UK, for instance, the Senior Managers Regime published by the FCA requires senior individuals within financial institutions to demonstrate they are taking reasonable steps to do the right thing. Proposals are currently underway to extend the regime to nearly all regulated firms. In the US, the Yates Memo published by the DOJ focuses on individual misconduct in corporate organisations. Recent company failures have also put senior management conduct in the spotlight.

Data Protection law also comprehensively changed when the European Union General Data Protection Regulation (GDPR) came into force in 2018. The purpose of the law is to protect individual privacy by placing increased responsibility on organisations that collect, store or use personal data relating to EU and UK citizens. To ensure that data protection becomes a board-level issue, the penalties for non-compliance are strict - up to 4 per cent of global turnover. In the event of non-compliance, as well as a company's reputation being at stake, its directors could face criminal charges, or suits from company shareholders alleging that they failed to exercise reasonable care and diligence.

Furthermore more generally, shareholder plaintiffs are using a company's cybersecurity practices as a foundation for asserting allegations against the company's directors and officers in the wake of a data breach disclosure, and with corresponding drop in the company's stock price.

While the tort environment remains the most punishing in the US, litigiousness is spreading globally, evidenced by the latest wave of collective actions across Europe. In 2013, the European Commission published a recommendation that those Member States that had not yet done so, adopt a framework for collective redress by no later than 11 June 2018.

> "CLAIMS STATISTICS SHOW A STEADY RISE OF EX-US SHAREHOLDER ACTION AGAINST EUROPEAN DIRECTORS AND OFFICERS

The rising tide of European collective actions

A quick look at the headlines shows the rising severity of collective action against companies and their directors. The €1.2bn settlement announcement in March 2016 of claims against Ageas (formerly Fortis) made by shareholders group Stichting Investor Claims Against Fortis (SICAF) was enabled by the Dutch collective settlement procedure known as 'WCAM'.

In December 2016, lawyers representing claimants against the Royal Bank of Scotland (RBS) reached a partial settlement whereby RBS agreed to pay £800m. It was followed, in early June 2017, by a £200m agreement to settle with a further 24,000 corporate and individual investors. The successful lawsuit is expected to pave the way for similar group litigation cases to be brought against banks and other large corporates in the future.

Claims statistics show a steady rise of ex-US shareholder action against European directors and officers. This is partly driven by an increase in litigation funding throughout Europe, which migrated from Australia, where it has been very successful. Litigation funding is provided to claimants in return for either a multiple of the funds advanced or a percentage of recovery, if the litigation or arbitration is successful. >

Case study A

Impact of company insolvency on directors

Directors may face allegations of wrongful conduct in the event of insolvency of their company

On 15 January 2018, one of the UK's biggest construction firms collapsed, going into liquidation.

Issues are reported to have arisen from high risk contracts that proved unprofitable, as well as payment delays. This has led to allegations that governance at the company was inadequate and that its board may not have exercised appropriate oversight prior to the collapse, possibly acting in its own interest rather than for the benefit of the company. It has been reported that there was a relaxation of clawback conditions for executive bonuses in 2016 which has led to some top executives continuing to receive substantial salaries and benefits long after their departure from the board. There are also allegations of a significant company pension deficit.

One of the fundamental duties of a director is to act in good faith, for a proper purpose. The collapse of a company will almost certainly raise questions about the intentions, motives and beliefs of the directors and whether they put the interests of the company first. Directors may be held to have abused their powers if it is proved they used them to benefit themselves or if they have damaged the company. Breach of such duties can result in directors being held personally liable for the demise of the company, as well as to being disqualified from acting as a director.

Litigation funding has been behind some of the largest non-US D&O claims in recent years. The net effect of this is that, if claimants have a strong case it makes it much easier (and less risky) to pursue claims. There is also potentially an increase in claims severity, as funder-supported claimants are more likely to pursue companies and their directors more aggressively.

Meanwhile, an era of social media and instant communication can make or break reputations or send share prices spiralling. The new Gender Pay Gap reporting rules may also have an impact on a company's reputation (see Gender Pay Gap Reporting Box) This, along with the rise of activist shareholders, litigation funders and collective action frameworks, are producing enhanced exposures for companies and their directors. In addition, issues arising from mergers and acquisitions (M&A), employment liability and cyber risks means directors and officers of organisations are exposed D&Os to litigation in a way they were not in the past.

The FRC Corporate Governance Code places the onus firmly on the board of directors to set the appropriate tone for their organisation and to take on greater personal accountability. Issues such as risk and company viability, workforce interaction, culture, executive pay, board composition and duration of board tenure have risen up the agenda and all the while the corporate world continues its steady march towards a more globalised and interconnected operating environment.

In this more complex, uncertain and risky world, organisations are less immune from global upheavals on the other side of the world. Multinational exposures have never been more relevant to management liability and there has never been a greater need for consistency in an organisation's global approach to managing, mitigating and transferring their management liability risks.

By partnering with AIG and Marsh to produce the guide, Airmic intends to equip risk managers with the information, tools and guidance they need to address the liabilities of the directors and officers of their organisation.

Gender Pay Gap Reporting

Under the Gender Pay Gap Reporting Rules, employers in the UK with 250 staff or more are required by law to report the difference in pay between men and women by 4 April 2018. The Gender Pay Gap records the discrepancy between the average and mean wage earned by men and women at a company, regardless of their position. This is different to equal pay, which is the legal requirement that men and women be paid the same amount for equal roles under the Equal Pay Act 1970. Failure to comply with equal pay laws is deemed "an unlawful act" and the Equality and Human Rights Commission can take enforcement action against offending organisations.

Gender pay reporting will further heighten awareness of equal pay issues. The statistics are likely to be used by employees to question things such as whether they are being paid equally and whether their bonus payments are tainted by sex discrimination.

As well as potentially facing claims under the Equal Pay Act, companies reporting a gender pay gap could face reputational damage, leading to disgruntled shareholders claiming that senior management failed to properly manage the risk.

We could also see a rise in claims against those employers stemming from perceived gender discrimination, lack of work/life balance, or pregnancy/maternity leave discrimination. As well as claims against the corporation itself, disgruntled employees may bring claims again senior managers personally alleging that they failed to put appropriate procedures in place.

Case study B

Car manufacturer: A test case for deferred prosecution agreements

The Deferred Prosecution Agreement (DPA) with a car manufacturer covered 12 separate counts of conspiracy to corrupt, false accounting and failure to prevent bribery spanning a period of 24 years across seven jurisdictions. The activities related to the manufacturer's energy and civil aerospace businesses and involved senior management at the time. Bribes were paid by both employees and through a network of intermediaries to a variety of public officials and employees of state owned entities, which resulted in the company receiving gross profits of in excess of £250m. Following the initial approach of the Serious Fraud Office (SFO) in early 2012, the company conducted internal investigations and reported its findings to the SFO, disclosing wider offending. However, in a deviation from previous DPAs, the company secured the agreement in circumstances where they did not proactively self-report.

The company was praised for its "extraordinary cooperation" and agreed to pay a total settlement of £671m. However, it has not ended there. More recently, the SFO case team that took on the company investigation announced it was pursuing senior individuals implicated in the scandal, who it claims were the "decision-makers" and "controlling minds" behind the wrongdoing.

Cyber Risk Management

Cyber risks are a key topic in many boardrooms and are driven onto the agenda by high profile data breaches, distributed denial of services (DDoS) attacks and rising ransomware and cyber extortion attacks. The risk of cyber attack is a constantly evolving threat and for most companies, there is a recognition that it is not "if but when" their organisation will be impacted by a substantial cyber attack.

Global companies often have multiple regulatory regimes to take into account when determining their legal obligations. Although many boards understand that cybercrime is a risk management issue that affects the entire organisation and requires board oversight, it is becoming clear that managing risk must be more than a box-ticking exercise – it needs to be an intrinsic part of day to day life for a board of directors and their employees.

When a cyber security breach does take place, the actions of the board may be under scrutiny. Senior management or the board of directors may breach their fiduciary duties to the company and its shareholders if they fail to implement any reporting or information system or controls; or having implemented such systems and controls, if they fail to monitor or oversee these. Therefore, it is important that senior management focus their attention on establishing responsibilities for implementing and managing cyber issues within a company, both before, and after, a cyber event.

Some boards have done this by appointing a director who comes from a security background. The cybersecurity board member can help the management team make difficult risk management decisions as well as increase the general level of cybersecurity knowledge and awareness on the board. Some boards also create a separate committee for cyber risk management. However, senior management must consider which matters should be approved by the board of directors, and which matters can be delegated.

THE RISK PROCESS:

Why collaboration is essential

As described, boards of directors of organisations are operating in a difficult and evolving regulatory landscape in many jurisdictions. This is reflected in the steady growth of regulatory action and litigation taken against organisations and their board for failing in their duties under corporate governance codes and other relevant legislative frameworks.

The responsibility of risk managers is to consider these exposures and work collaboratively with their senior board to ensure that the most effective risk and insurance solutions are in place. A focus on collaboration will raise the profile of the organisation's risk function and ensure senior management have the risk insights they need to make strategic daily decisions without compromising their own position.

It is important to identify all stakeholders within the organisation who should be involved in risk mapping and risk strategy. A common challenge, particularly from a D&O perspective, is that risk strategy work is typically carried out by individuals such as risk managers or company secretaries. Such an approach is short-sighted if it does not involve the most relevant stakeholders, i.e. those most likely to be impacted by a claim, and will be identified in the underwriting process with consequent impact on cover and cost.

By involving the board and senior management in discussions surrounding risk strategy, risk mapping and risk transfer, organisations can ensure management is aware of its responsibilities and the mechanisms in place to protect them. While Executive and Non Executive Directors (NEDs) can be extremely sophisticated in their knowledge of the management liability risk landscape, they are often unaware of what D&O insurance provisions their company has made on their behalf.

Inevitably different boards have differing levels of knowledge, experience and sophistication. Discussion between risk professionals and board members should be focused on building awareness of the risks they face and considering how those risks should be best dealt with. For instance:

- Are the right frameworks in place to prevent incidents occurring that could result in claims?
- Can the board demonstrate that demonstrate these processes were in place?
- Has implementation of the procedures been audited to determine whether they have actually been put in practice throughout your organisation?

Against an ever-shifting risk landscape, senior individuals need sufficient expertise to effectively deal with emerging risks and fulfill their responsibilities in the eyes of a regulator. From a cyber risk and data protection perspective for instance, senior management must demonstrate (for instance to the UK Information Commissioner's Office) that they have taken necessary steps to prevent the loss of sensitive data and have put in place a tried-and-tested breach response procedure, or risk facing fines and regulatory action.

The Components of Enterprise Risk Management

Governance & Culture | **Strategy & Objective- Setting** | **Performance** | **Review & Revision** | **Informaion, Communication & Reporting**

Integrating with Strategy and Performance clarifies the importance of enterprise risk management in strategic planning and embedding it throughout an organisation—because risk influences and aligns strategy and performance across all departments and functions. COSO ERM is a set of principles organised into five interrelated components.

COSO ERM 2017
https://www.coso.org/Documents/2017-COSO-ERM-Integrating-with-Strategy-and-Performance-Executive-Summary.pdf

THE RISK STRATEGY AND BUYING PROCESS

AIG's review of large losses from 2008-2017 reveals that no one industry stands out as a "target" of D&O claims. In fact, it is clear that a wide range of industries are impacted by D&O claims, increasingly emanating from a wide range of jurisdictions. It is no longer possible for a company to believe they will not be impacted by claims against their senior staff or board of directors.

The management environment is not static but constantly changing. Risk managers should not assume that just because they carried out a local policy needs analysis last year, next year will be the same. The D&O liability landscape can change dramatically from one year to the next and hence the risk and insurance needs of an organisation must be continually assessed, with help and guidance from Airmic, underwriters and brokers.

From a D&O insurance perspective, an organisation should review the claims environment carefully in countries where they have directors and officers on the ground or have significant operations. Buyers, their underwriters and intermediaries, should be aware of the regulatory and litigation environment in those territories as it can change quickly and a territory that was previously benign for D&O liability can turn quickly if there is a change in regulatory environment, a change in government, or the entrance of litigation funders for instance.

> "Today's business environment is more complex than ever and company executives are facing an unprecedented amount of scrutiny into their actions. Working with a broker that has an expansive global footprint from which to provide a local insight and perspective to clients, together with industry-leading capabilities in advising on and placing international D&O insurance programmes, can enable companies to shape corporate priorities around effective risk governance.
>
> Paul Moody, CEO UK Specialities, Marsh

RETAIN OR TRANSFER?

The first step risk managers need to take when assessing their exposures is to consider what risks they are willing to keep on their company's balance sheet and manage internally, and which are best transferred to the insurance market, if cover is available. Most companies purchase D&O cover and most directors and NEDs demand that it is in place.

It might seem like an obvious point, but risk managers must ensure they have a programme of insurance that will actually respond when losses occur. For instance, if claims arise outside the country of domicile or the country where the board of directors or centralised risk function sits, is it covered within the scope of a multinational programme or under a local policy? This can be best determined through scenario testing during the placement process.

The need for risk managers to consult with colleagues and senior managers outside their immediate sphere of influence, both to understand the exposure and the concerns of the people on the ground locally, has arguably never been stronger. This will provide a clearer understanding of what cover needs to be in place in each jurisdiction in order to best respond to those risks.

Brokers and insurers should be advising risk managers on how to avoid potential gaps in cover, for instance taking out local policies in territories where global programmes are non-admitted. With D&O in particular, there is also the question of whether or not a company can indemnify its directors in any given country. In the UK for instance, it is written into the Companies Act and in most circumstances companies are able to indemnify their directors.

In other jurisdictions, the law may be silent on the issue or D&O indemnification may be specifically prohibited. Even if indemnification is allowed, buyers should consider whether the local organisation is sufficiently capitalised to fund potentially expensive litigation and understand the hurdles to getting sufficient funds in-country quickly if needed by a local director or officer.

Some questions for risk managers to consider and discuss with their D&O insurers and brokers are:

- Even if the centralised risk function is in a country where it is possible to have a master programme, does it actually provide sufficient comfort to the local directors in other jurisdictions who may have no other means of recourse?
- Would they prefer a policy in their local language?
- Would they rather speak to local claims handlers, rather than someone in London or the US?

It is important to understand the regulatory environment in every location in which your organisation operates and to appreciate the obligations and liabilities of individuals within each jurisdiction. This is particularly important when taking out D&O insurance.

Within territories where there is no personal liability for certain actions, there is no guarantee that local directors and officers or employees will not be exposed to other kinds of liability. By being clear about what those exposures are, they can be risk mapped and policies can be tested to ensure insurance is in place that responds to these risks. This is an important aspect of disclosure to insurance partners, particularly in light of new disclosure responsibilities under the Insurance Act 2015 .

Case study C

Cyber Hack of Major Retailer: At the height of the shopping season, cyber criminals broke into the retailer's computer network using stolen log-in credentials, by way of an email phishing scam. Millions of customer credit and debit cards were compromised, and many were subsequently sold on the digital black market. Sales, and the company's share price plummeted following the breach. Shareholder plaintiffs filed at least 2 shareholder derivative suits against the company's directors and officers and the company as nominal defendant alleging failure to take steps to prevent a breach and that the defendants "aggravated the damage to customers by failing to provide prompt and adequate notice to customers and by releasing numerous statements meant to create a false sense of security to affected customers".

Ultimately, the court did not allow the derivative litigation to move forward, but had it done so, the potential exposure to the company's directors and officers and to its D&O insurers would have been enormous, given the magnitude of the data breach.

THE ROLE OF D&O INSURANCE

> “D&O INSURANCE INDEMNIFIES MANAGEMENT AND THE BOARD OF DIRECTORS FOR CLAIMS WHICH MAY ARISE FROM THE DECISIONS AND ACTIONS TAKEN WITHIN THE SCOPE OF THEIR DUTIES AS DIRECTORS AND OFFICERS

There is no single solution for protecting management and the board of directors from the liabilities it faces. The best approach is a combination of strong corporate governance, broad corporate indemnification, and D&O insurance to protect companies and their senior management.

As the stakes for directors and officers continue to rise, all directors - in partnership with their risk managers and legal counsel (internal or external) - should perform regular reviews of their D&O liability insurance. It is important to note that D&O policy terms and conditions that are presented as “standard clauses” may be open to negotiation, particularly for larger insureds. Or non-standard terms may be available for additional premium.

Policies should be reviewed at a minimum annually, with an eye toward ensuring the policy remains fit for purpose and responds to emerging risks and the changing operations of the organisation. Should the risk profile of the company or board change—for instance following a merger or acquisition —more frequent reviews may be needed.

Brokers are ideally placed to demonstrate the benefits of appropriate cover from an experienced insurer. Risk managers know what keeps them and their senior management awake at night, but insurance brokers and insurers know where claims actually arise and can help businesses prepare for the unexpected.

What is D&O insurance and who does it cover?

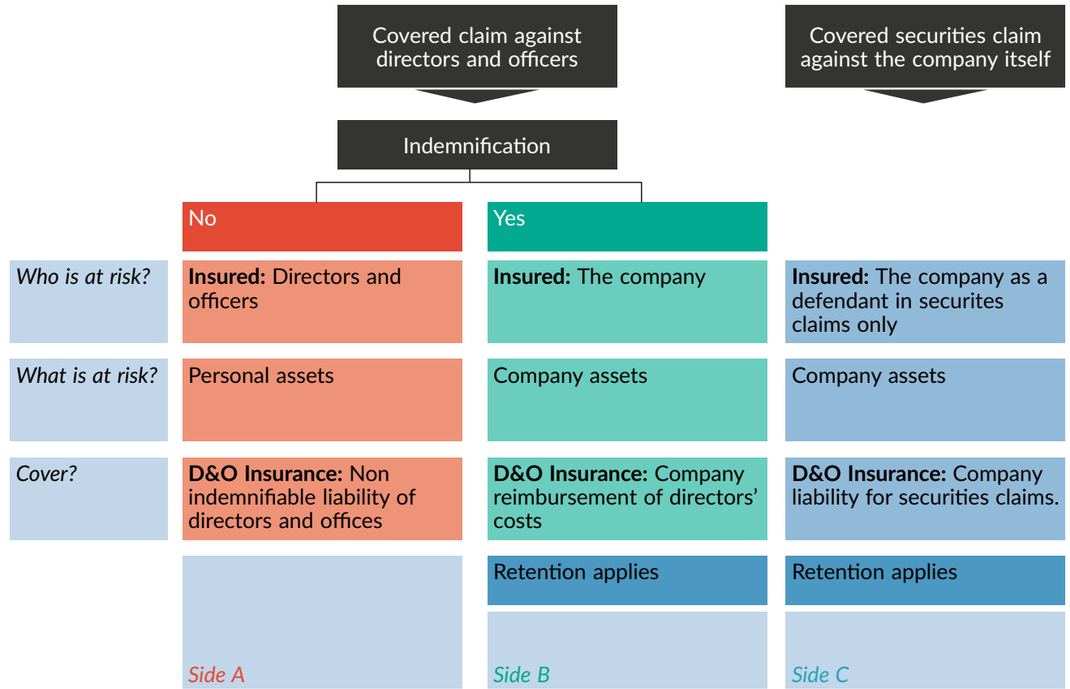
D&O insurance offers liability cover for all current, future and past directors and officers. Typical policies cover directors and officers to protect them from investigations and claims which may arise from the decisions and actions taken within the sscope of their duties as directors and officers. As well as covering the personal liability of company directors and officers, D&O policies also provide company reimbursement in the event the company has paid a claim on behalf of its directors and officers. Listed companies can also take out D&O insurance for claims against the company itself for wrongful acts in connection with the trading of its securities.

Outside Entity Directorship (ODL) Cover

ODL cover is provided to directors by their own company to protect them from liability for directorships they have taken on at the request of their employer for another company (the “outside” company). The expectation is that the “outside” company will also have its own D&O insurance to protect all its directors, and that policy will respond first to any claims, before any ODL cover responds. For instance: Director (D) is on the board of company A. For business reasons, company A asks D to sit on the board of company B. All the directors of company B, including D, are sued for wrongful acts committed in their capacity as directors of company B. Initially, company B’s D&O insurance should respond to that claim. If for some reason it does not, or if the limits are exhausted by the claim, the ODL coverage in company A’s D&O cover will be triggered to protect D. But only D, not the other directors of Company B.

TYPICAL STRUCTURES OF D&O POLICIES

Structure of a primary D&O policy



Key terminology

Side A: Provides coverage solely for the directors and officers. Side A is triggered if the company refuses or is unable to protect or indemnify its directors and officers. Side A coverage operates as personal asset protection.

Side B: Reimburses the company for costs it pays on behalf of a director or officer (typically legal defense costs, settlements, or judgments). Side B operates as balance sheet protection for the company’s obligation to indemnity its directors and officers.

Side C: Protects the company if it gets sued for a securities claim. Side C operates as balance sheet protection for the organisation’s own securities exposure.

TYPICAL STRUCTURES OF D&O POLICIES

The protection afforded by D&O policies on the market can vary significantly; however, most follow a common structure. A standardised format means that policies can be easily read, understood, and compared by policyholders and their brokers. Outlined below are the typical components of a D&O policy.

Insuring Clauses

Insuring clauses specify the degree of coverage afforded by a policy. They summarise the promise by the insurer to indemnify the policyholder directors and officers from losses incurred from an insurable event or circumstance. A standard D&O policy generally has two primary insuring clauses, Side A and Side B, with an optional third, Side C:

Extensions to cover

Policy extensions broaden a policy's coverage out from its standard insuring clauses, providing additional benefit and protection for the policyholder directors and officers. Many extensions are automatically included, while some are optional. Extensions can vary significantly from one policy to the next depending on what has been negotiated and the breadth of the standard insuring clauses.

Policy exclusions

D&O policies contain a range of exclusions to limit the insurer's exposure to undesirable claims. Typical exclusions include deliberate fraud and claims for or circumstances for which other insurances apply, such as bodily injury.

General Policy and claims conditions

Policy conditions address the parameters of cover, and identify the requirements, circumstance notification and claims processes relevant for a policyholder, director or officer seeking indemnity under the policy.

What is Side A DIC Coverage?

Traditional D&O insurance provides coverage for both indemnifiable loss of directors and officers (Side B), loss to the company itself for securities claims (Side C) and non-indemnifiable loss of directors and officers (Side A).

Together, all three coverages provide broad protection for individuals and the company.

It is important to note, however, that traditional coverage can be exhausted by company entity losses and/or indemnifiable losses (for example, securities claims against the company and the directors). As a result, more than 90 percent of publicly-traded companies purchase Side A difference-in-conditions (Side A DIC) coverage. Difference in conditions coverage for non-indemnifiable claims against individual directors and officers. This type of coverage provides additional limits dedicated to individuals—only directors and officers are covered insureds under the policy, not the company.

The policy sits on top of a traditional D&O policy and fills in several important potential gaps. It:

1. drops down to provide coverage if the company refuses to indemnify, such as where there are reputational issues at stake; or where it is financially unable to indemnify.

2. provides excess Side A D&O insurance that picks up coverage once a company's traditional D&O tower is exhausted.

3. drops down to fill in gaps in a company's D&O tower when any underlying insurer fails or refuses to pay, attempts to rescind coverage, or becomes insolvent.

4. has a broad scope of coverage and can drop down to fill in coverage gaps in the underlying policies. For example, it will have fewer or narrower exclusions that is found in traditional primary D&O policies. Some side A DIC policies may also provide cover that is unavailable in other policies, such as cover for internal inquiries for purely internal investigations where individuals are asked to provide information to an inquiry conducted by or on behalf of the company for which they act or acted.

Therefore, in addition to triggering coverage for large claims that exhaust a company's traditional D&O policy limits, or accessing broader coverage, a director or officer can usually also trigger its Side A DIC policy by showing that any underlying insurer in the tower failed to indemnify a Side A claim.

This important safety net can help attract and retain qualified board members who desire broader protection that their personal assets will not be put at risk if and when claims are brought against them.

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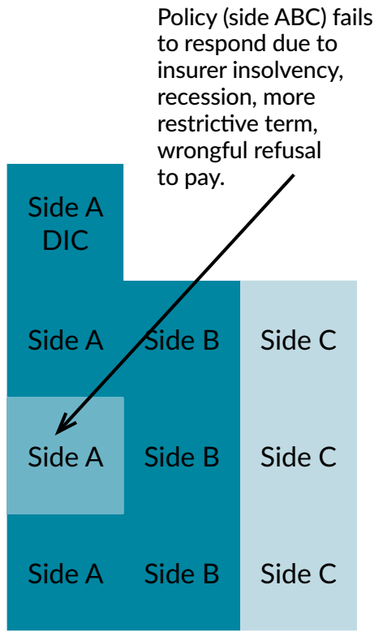
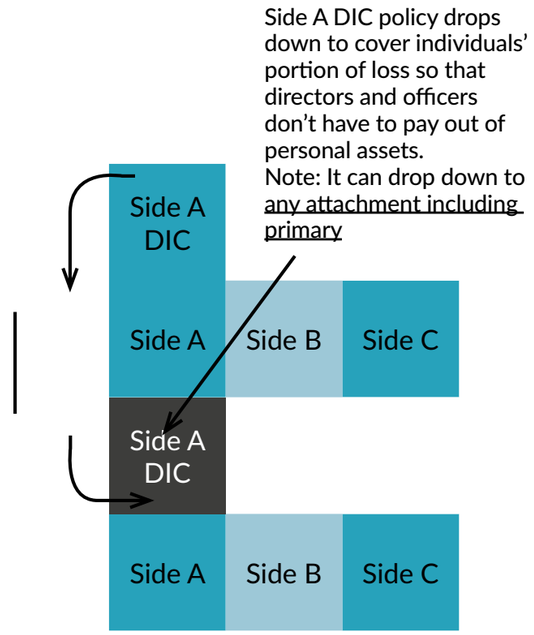
GUIDES

Side A- DIC insurance - the D&O Safety Net

How does Side A DIC Work?





DIC
Difference in conditions coverage for non-indemnifiable claims against individual directors and officers

TEN-POINT INDEMNIFICATION AND INSURANCE CHECKLIST

1 Review indemnification language

Directors should understand the indemnification provisions of the company set out in its Articles of Association and ensure the indemnification language provides the maximum protection permitted under the law.

2 Ensure sufficient limits of liability

While there is no formula to determine the perfect amount of D&O insurance to buy for any particular year, an examination of a wide variety of factors should be considered, including:

a. Large loss data;
b. Industry-specific claim trends;
c. Benchmarking against peer companies;
d. The company's considered risk profile;

3 Check insolvency protection

For most company directors the most significant litigation scenario is an insolvency event. Because a company may not be able to indemnify its directors in insolvency, it is critical to ensure that:

a. The D&O insurance policy does not require directors to pay a retention before coverage applies when no indemnification is available;
b. Claims brought by a insolvency administrator or creditors committee are not barred under "insured vs. insured" exclusions, and
c. The policy includes a priority of payments provision that expressly provides that insured individuals seeking payment of loss have priority of claims for coverage over payment to the entity.

4 Consider Side A coverage

Dedicate some component of the D&O insurance programme to losses that are not indemnified by the company (see separate box ... Reference the section of side A DIC here)

5 Obtain coverage for regulatory investigations

The policy should allow for recovery of costs associated with expenses relative to interviews or document production costs of individuals relating to their positions as directors or officers. Requested by regulators or other official bodies with the ability to bring an enforcement action against directors and officers

6 Check for locally admitted insurance coverage for multinational companies/ securities

Directors of multinational entities (including but not limited to companies with securities listed on overseas exchanges), should obtain locally admitted insurance coverage in higher risk jurisdictions, eg Brazil and India.

7 Review cyber insurance coverage

Ensure D&O insurance coverage responds in the event of litigation alleging traditional claims for breach of fiduciary duties related to cyber issues.

8 Review exclusionary wording

It is also important to review exclusionary wording. For example, ensure that any fraud exclusion only applies in the event of a final, non-appealable adjudication. Also, the breadth of both the preamble language and the wording of each exclusion should be considered.

9 Review the proposal form, severability language

Make sure to review the answers to the proposal form in detail and consider their potential impact on future claims and coverage. Policies subject to English law will be bound by the Insurance Act 2015 which requires policyholders to comply with a duty of fair presentation of the risk. In addition, consider the severability language in the policy so you understand whose knowledge will be imputed to other directors or the company. Review any avoidance language in the policy to understand the circumstances in which the policy can be avoided and discuss the available options with your broker

10 Select insurers carefully

Insurer selection and programme structure are important considerations for risk managers and brokers. It matters which insurer leads the insurance programme and where each participates or attaches. There are a number of insurers to select from and a number of factors to be considered, including pricing, consistency of underwriting in the product, claims payment reputation, flexibility with coverage terms and conditions, and financial ratings. Which insurers participate are equally important in claim situations.

*(SOURCE: MARSH)

CLAIMS SCENARIOS

1. Breach of contract
The policyholder received a claim alleging that two former directors had beached a long term contract, three years into the agreement. The claimants sought loss of profits and lost investment costs. The lawsuit, filed in Poland, alleged that the two former directors (both based in the UK) failed to exercise a reasonable degree of care while they were on the board. Relying on guidance from the local Polish claims adjusting team, local Polish legal advice was retained on behalf of the directors, and the Polish legal advisor concluded that liability should be denied entirely, given the fact that the claimants had, waived the right to claim at the time the insureds were dismissed from the management board. Based on that discovery, the insured persons refused to settle the claim and the matter was ultimately dismissed, with modest legal fees incurred. Litigation can arise anywhere a company does business, has premises or has a connection. It is important to ensure that there are policies in place that can respond, including local policies where they are required by law.

2. Private Equity/ODL Claim
A private equity company (PEC) put some if its directors on the board of a company it acquired (Company A). Company A went bankrupt and the public prosecutor commenced proceedings against the directors of Company A, including the outside directors. Company A had a D&O policy, which responded initially to the claim but was quickly exhausted. PEC's policy, which provided coverage for outside directors, then began to respond. Although ODL claims are quite rare, it is critically important to ensure that, if the company asks a director to sit on an outside board, there is sufficient coverage to deal with claim.

3. Price-fixing probe
After a significant investigation into possible bribes paid by a number of directors, the regulator brought criminal proceedings. However, the insurer defended the directors, throughout the process, incurring over £7.5m in defence costs. The trial collapsed shortly after it started, when it became apparent that the regulator had failed to disclose key information to the defence. The insurer was was successful in recovering some of its costs from the regulator. As a director, it is important to bear in mind that frivolous or unjustified claims may be brought against you. Although a director may be comfortable she or he has done nothing wrong, the cost of defending these claims can be enormous and often disproportionate to the underlying claim. It is important to have a policy that responds and acts as a "fighting fund" to defend against these unfounded allegations.

4. Multiple regulators investigating around the world
Following the discovery of a potential wrongdoing, the insured company self-reported to the regulator and, at the regulator's instructions, conducted interviews of multiple internal employees, directors and officers. Prosecution of one director followed, during which activity another director signed a non-prosecution agreement with the regulator and gave evidence against his former colleague. At that point, the insurer took the position that the costs for the lawyer to represent the director through the NPA and the testimony were not "defence costs" as defined in the policy and therefore not covered under the policy. It is important to bear in mind that defence costs generally have a very clear meaning under the policy and any other legal costs incurred by a director (i.e. bringing a claim against the policyholder, bringing a counter claim against a party suing the director) will not be covered under the policy.

5. Product liability investigation
Not all D&O claims are straightforward shareholder/ securities actions. Claims or investigations can arise from any aspect of a the activities of a director or officer, including corporate manslaughter (death of employees in the workplace) or many other aspects of your business. In a recent claim, allegations of product liability against an insured, the manufacturer of a cleaning product alleged to cause serious health issues, led to an investigation of the company's general manager. As the investigation continued, it expanded to include eight other individuals, with three of the directors facing extradition to South Korea at the time of writing. Budgeted defence costs are £15m.

6. Notification Issues
The insured became aware of circumstances that could give rise to a claim, but did not report the circumstance to the insurer. Subsequently, the insured changed insurers. A claim was reported, which clearly arose from the prior circumstances, and the new carrier denied coverage for the claim. Ultimately, a compromise was reached, but it is important to make every effort to notify claims or circumstances in a timely fashion – there is no downside to reporting, but many of downside in not reporting.

Source: AIG

GETTING THE MOST FROM YOUR INSURANCE

Consider the factors insurers will want to know when underwriting your company's D&O risks. Your carriers and brokers will be able to offer specific advice on what information they need. Typically, however, D&O proposal forms request information about board composition, compliance procedures (anti-money laundering, insider trading policy, bribery and corruption training) and company financials.

Take the time to meet with a claims representative before you have a claim. Often insureds form great relationships with an underwriter or a business development partner, but never meet a claims handler until a claim arises. It makes a great deal of sense to establish the relationship beforehand, so the first interaction with the claims team is not at a time of high stress or crisis.

When undertaking scenario analysis consider including a D&O insurance claim scenario. This can focus minds on stakeholder roles and responsibilities and lead not only to improvements in the notification and claims process but achieve better engagement and ownership by senior management in the overall risk management and insurance processes.

As previously mentioned, such meetings also provide an opportunity to carry out scenario testing. Having a pre-loss workshop and running through hypothetical claims scenarios can help you to better understand the claims process, identify the risks in failure to adhere to policy conditions, e.g. notification of circumstances and can also help set clear expectations on both sides.

Often one of the biggest challenges arises from the simplest of issues. Insureds are often reluctant to report claims or circumstances for a variety of reasons. This could be due to concerns surrounding confidentiality, concerns about increasing premiums or uncertainty over whether an evolving situation will become a claim. None of these are good reasons for not reporting.

It is much better to "overshare" with your insurer than to keep quiet. There is no downside to reporting a claim or an unfolding circumstance. This ensures that you are protected against late notification issues and also means that you can benefit from the insurers' expertise in selecting defence counsel if necessary, and providing strategic guidance. Although a claim may be new to you, your insurer has probably seen numerous similar claims, so it is good practice to take advantage of that resource.

WHAT TO EXPECT FROM INSURERS AFTER MAKING A CLAIM

In many instances, insurer will be willing to use a claims protocol agreement (often bespoke for larger insureds) to set out expectations for claims handling, timescales, payment and what must be approved by insurers prior to payment and who will be involved and why (e.g. pre-agreed legal representatives, nominated director to represent the company and accept any settlement offered). This is especially relevant where there are multi-line programmes or multinational policies in place. For larger insureds, a claims protocol is a great way of ensuring that all parties understand their obligations in the claims process.

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HAVE REALISTIC EXPECTATIONS

Take the time to understand what coverage is provided by your insurance policy. Insureds often say they did not report a claim in a timely fashion because they did not think there would be coverage under a policy. However, as stated above, it is better to notify brokers and carriers immediately in order to clarify what is covered and to put the wheels in motion on a claim.

D&O policies require, in most cases, insurer's prior written consent before defence costs are incurred. However, insureds can pay surprisingly little attention to defence costs. Directors often require separate or multiple solutions, particularly if larger and more complex claims are brought across multiple jurisdictions involving both defence and investigation costs.

All these facets of a claim work to erode the available policy limit. It can therefore become a significant issue for directors in the long run if an organisation's defence counsel does not consult with and gain prior written consent from carriers and claims handlers about the legal costs likely to be incurred. Risk managers should request regular detailed reports of progress and expenditure, a strategy and budget. Consider whether the board needs separate side-A cover.

Insurers regularly deal with confidential or privileged information. Most insurers are happy to sign non-disclosure agreements (NDAs) but those agreements must be realistic and not overly restrictive. If insureds cannot divulge the full details of the claim in a timely fashion, may not be able to adjust the claim or make payments when they are needed, due to lack of information.

> "Take the time to understand the coverage that is available under the policy and the need to work collaboratively with your carrier in the event of a claim, wherever that may be in the world. Dealing with a claim can be an enormously stressful experience for a director, so take advantage of your insurer's expertise and experience in claims. You should expect the right insurer will have handled similar situations to yours before
>
> Noona Barlow, Head of Liability & Financial Lines Claims, AIG Europe Limited

DO'S AND DON'TS CHECKLIST FOR DIRECTORS:

- Do be aware of the provisions of the UK Insurance Act 2015 and how these might affect you.

- Do understand what coverage is available under your policy, including the ODL coverage available for any outside directorships;

- Do have realistic expectations;

- Do report potential claims in a timely fashion in accordance with the agreed policy notification clause; if in doubt consult your broker or legal advisers;

- Do ensure that you get prior written consent from your replace carrier with insurer before incurring investigation or defence costs if required and /or as required by the policy wording;

- Don't assume that the solicitor who did your real estate transaction or the company's legal counsel is the right person to handle a complex white collar crime matter. Ask your insurer for guidance about appropriate counsel and agree on their appointment at inception / before a claim;

- Don't ignore how much your defence counsel is eroding the available insurance. Ensure that you understand how your lawyer is spending money. Are the costs reasonable? Is there a strategy in place?

- Do keep lines of communication open with your broker and insurer and keep both updated about the progress of a claim;

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- Do share relevant information with the insurer or their appointed legal representatives so that your insurer can understand the claim;

- Do have a frank conversation with your insurer if you have concerns about confidentiality of information. Most insurers are very pragmatic and able to come up with commercial solutions;

- Do remember that insurers deal with highly-confidential information every day;

- Don't hide behind confidentiality as a way to avoid sharing claims information with your insurers. If the insurer does not receive the information it requires to adjust the claim, the insurer may be unable to provide coverage on the grounds of failing to meet policy terms and conditions;

- Don't settle or admit liability without prior consent from your insurer and agree sensible limits for day to day payments that do not require a lengthy approval process, particularly if the policy has a significant deductible.

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