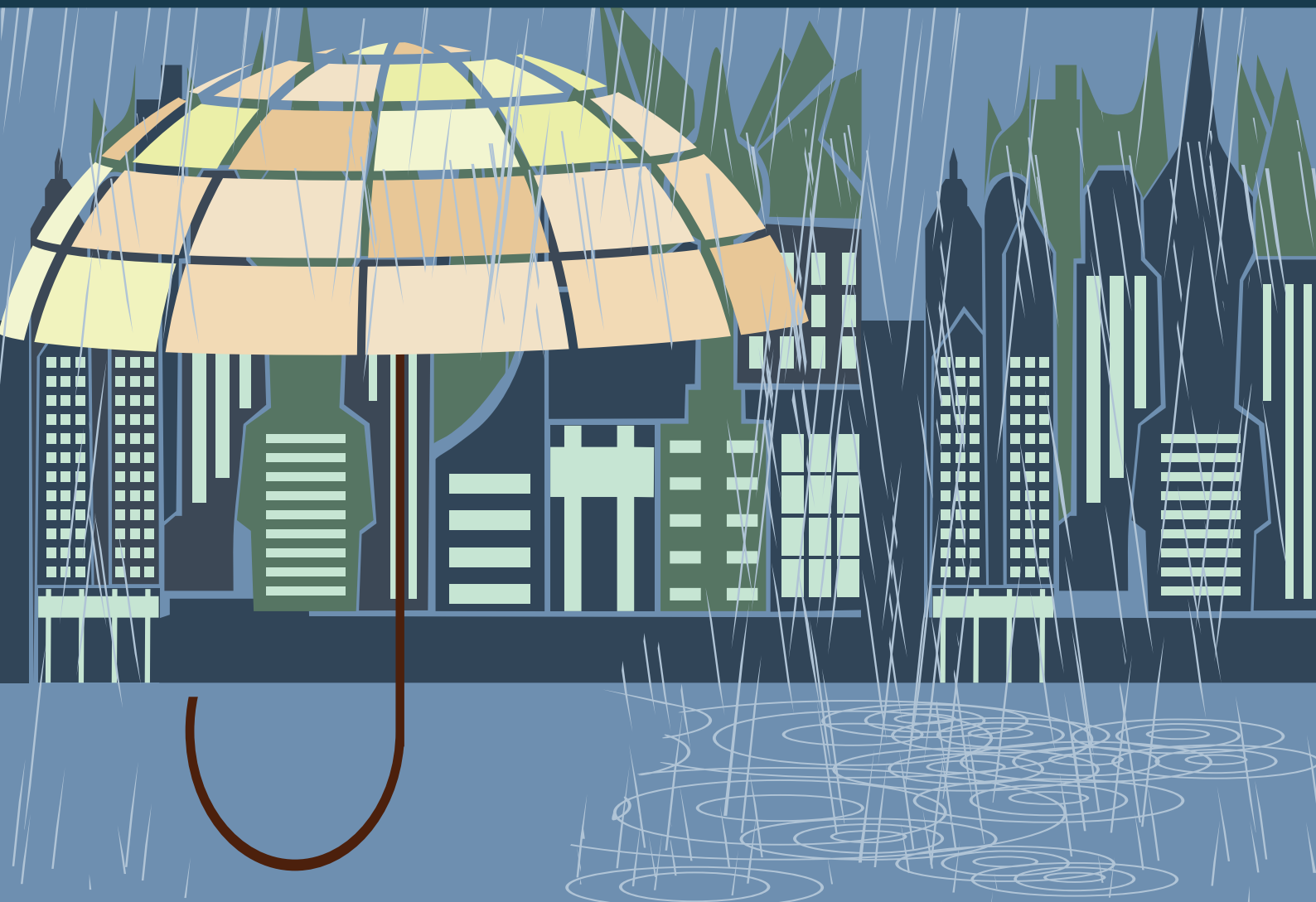


# Board Directors' Guide to D&O Liability Insurance

Special Report from *Board Agenda* in association with AIG



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# Foreword

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DIRECTORS AND OFFICERS looking to buy liability insurance are caught in a perfect storm. They face new and evolving risks at a time when the D&O insurance market is adjusting to a more hostile environment for directors, with increased litigation and regulatory actions. As a result, the cost and availability of D&O insurance cover is likely to be very different going forward.

Board engagement with D&O risk and insurance has never been so important. Directors need to stay informed of the risks that lead to claims, and work with their risk managers and brokers to understand the scope of D&O cover and how they should respond in the event of a claim.

# Section one

## Trends in D&O exposure

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### Increased accountability and scrutiny

Directors face an increasingly difficult job in today's uncertain world. They have to navigate rapid changes in economic sentiment, technology, consumer behaviour and geopolitical risks, while the globalisation of businesses and increasingly stressed supply chains expose their businesses to a range of overseas risks.

Meanwhile, the scrutiny of the decisions they make is intensifying. At a time when the business environment is more challenging, directors are increasingly being held to account and made personally liable for their actions. More than ever, business leaders can find themselves the subject of costly and time-consuming regulatory investigations or legal actions.

### Trends driving risks for directors

- Expanding bankruptcy exposure
- Increased regulatory scrutiny and accountability
- More aggressive pursuit of directors by stakeholders
- Rise in securities class action litigation
- Rising defence and settlement costs
- Growth in “event-driven” litigation
- New risks, including cyber, climate change and #MeToo

**“The role of directors has become riskier. They are under more scrutiny and are being held accountable for their decisions, but at the same time their responsibilities have been increasing in areas like cybersecurity and privacy; compliance, such as bribery and corruption laws; and with a heightened focus on corporate social responsibility.”**

Nepo Loesti, head of financial lines Europe, AIG

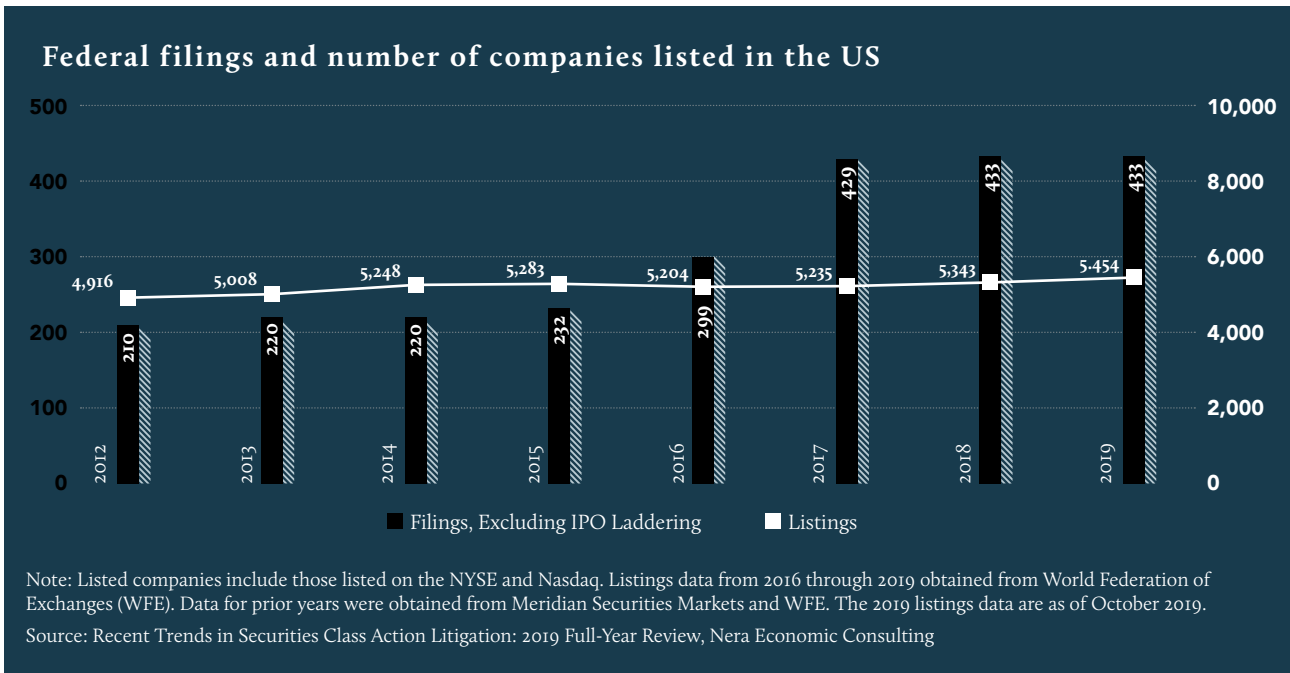
## Litigation trends

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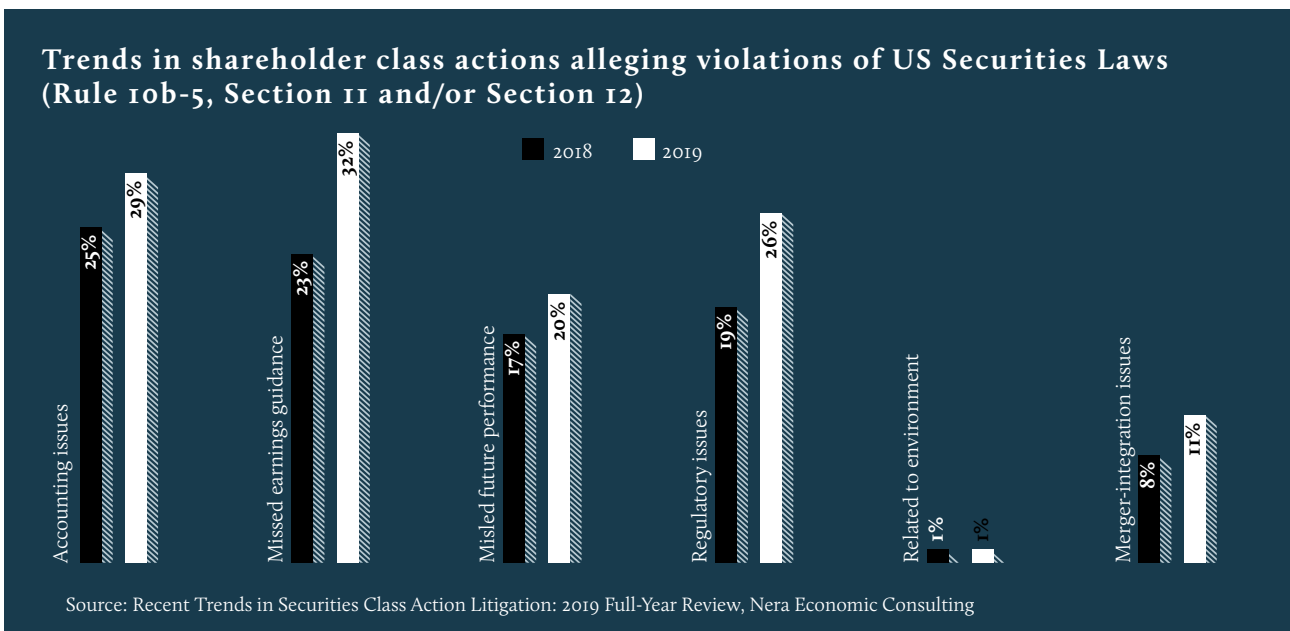
### US securities class actions hit new highs

US securities class actions remain one of the biggest threats to directors and are an important factor in the cost of D&O insurance cover. Directors of public companies in the UK and Europe should be concerned about the threat of US litigation, which is typically expensive, time-consuming and requires a degree of knowledge and understanding of the US legal system.

The chances of being hit by a US securities class action are now greater than at any time in the past: there were more than 433 US federal securities class actions filed in 2019, the third consecutive year with more than 400 filings, according to NERA's latest Trends in Securities Class Action Litigation report. This was almost double the level observed in 2014 and far above historical annual filing levels. According to NERA, the ratio of filings against the number of companies listed in the US (the litigation rate) is also higher, primarily due to the increase in new cases filed.



The drive in legal action from shareholders is derived from ‘missed earnings guidance’, which in 2019 accounted for 32% of all claims, followed by ‘accounting issues’ at 29%, ‘regulatory issues’ at 26%, ‘misled on performance’ at 20% and ‘merger integration issues’ at 11%. Only ‘environment issues’ showed no increase year on year at 1% of all securities claims.



## Foreign firms targeted

Shareholders are filing a record number of securities class actions against companies based outside the US: the rate of class actions against foreign filers in 2019 was 23.6% of total core filings, yet foreign filers only make up approximately 17% of all US listed companies. Europe is the top foreign location for filings with 23 filings in 2019. Impacted companies are headquartered in Belgium, Bulgaria, Denmark, Finland, France, Germany, Ireland, Russia, Sweden, Switzerland and the UK.

### Key litigation trends

- Increase in securities class actions
- Increase in claims against non-US firms
- Increase in event-driven claims
- Increase in non-US class actions

### Evolving ADR exposures

One area of potentially significant increased exposure for foreign companies comes from the evolving situation for US American Depositary Receipts (ADRs). An ADR is a certificate of a stock issued and held by a US bank. They have many of the same characteristics as stocks: for example, they pay dividends and include voting rights for the ADR holder.

**“The chances of being sued in the US are greater for foreign companies than domestic firms yet European directors do not always appreciate the threat from US regulators and litigation. We often see directors are not fully aware of and do not understand their US exposures. For example, some do not know if they have ADR programmes, let alone what it means for their exposure.”**

Nima Rafiee, underwriting manager, financial lines Europe, AIG

Recent court rulings in the US have shown that foreign companies with ADRs (including unsponsored level one ADRs, whereby shares are sold by banks in the US without the issuer’s direct involvement) may be more exposed to securities class action litigation than previously thought. In January 2020, the Central District of California held that a securities action against Toshiba can proceed and that the Japanese electronics group had sufficient connection to the unsponsored Level 1 ADR transactions to sustain the claims. The case could represent a significant change in exposure for non-US companies, as US securities claims are the most severe category of D&O claim and firms with unsponsored ADRs were previously thought to be beyond the jurisdiction of US courts.

### Class actions expand beyond the US

The most costly D&O claims are typically associated with US class action litigation, but recent years have seen the emergence of collective actions elsewhere. Australia, for example, now has a hostile litigation environment to rival the US, while large securities class actions have been filed in Europe and the UK.

A growing number of European countries have some form of collective redress available to shareholders, most notably The Netherlands, which has hosted some of the largest investor class action settlements in Europe to date. In the UK, collective redress provisions in Section 90 of the Financial Services & Markets Act have been tested in a number of high-profile cases against listed companies, while in Germany investors are able to launch collective actions under the KapMuG (Kapitalanleger-Musterverfahrensgesetz) law.

**“In Europe we see the emergence of a claims culture and a general desire to blame directors and seek compensation. It is not yet mainstream but there are signs that that this is the direction of travel.”**

Nima Rafiee, underwriting manager, financial lines Europe, AIG

Moves are also afoot at an EU level to provide an effective collective redress mechanism, albeit initially focused on consumers. At present, only 19 member states provide some form of collective redress but the proposed EU Representative Action Directive would require all member states to establish collective redress mechanisms. Other EU legislation, notably the GDPR, also allows consumers to seek redress for a breach of privacy or data through collective actions.



## Event-driven litigation

Event-driven litigation has emerged as a major trend in D&O claims over the past decade and is one of the biggest drivers behind record levels of US securities class actions. An adverse corporate event—such as a cyber-attack, a large product recall or allegations of executive misconduct—can trigger costly securities class actions. Such claims, even where they are ultimately not successful, take years to resolve and defence costs can quickly run into the tens of millions of dollars.

Law firms in the US are becoming more inventive and aggressive in their pursuit of directors. Specialist plaintiff law firms and litigation funders are also now more active in the UK, Europe and Australia, proactively looking for ways to litigate, create groups and file collective litigation. Such groups have filed collective actions following data breaches and motor emissions cheating allegations in Europe.

Investors and other stakeholders are also more active and willing to hold companies and their directors to account, made easier by an increase in non-financial reporting and regulations such as the GDPR. Non-financial statements can serve as a roadmap for claimants that may challenge the steps taken by directors to adequately address risks.

# Regulatory trends

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## Tougher governance rules and regulatory requirements

Regulatory actions have emerged as a major source of D&O exposure and claims can, in some circumstances, rival securities class actions as the top cause of loss. In fact, in many European countries, regulatory investigations and criminal prosecutions are the single biggest driver for D&O claims on a severity basis.

### Key regulatory trends

- Number of regulatory actions is increasing
- More active and aggressive enforcement
- International regulatory cooperation
- Nature of investigations changing with more self-reporting, Deferred Prosecution Agreements and whistleblowing

Over the past 10 years, directors have been under increased scrutiny and subject to tougher governance rules and regulatory requirements. In particular, regulators no longer look to only hold companies accountable, but individual directors too. This has been particularly evident in financial services, where regulations such as the UK's Senior Managers and Certification Regime have expanded the obligations and responsibilities of directors and introduced large fines and/or custodial sentences for serious breaches.

Recent years have seen the introduction of tougher rules and reporting requirements in a range of areas—including modern slavery, cyber/privacy and gender pay—adding to the duties and responsibilities of directors. Tougher bribery and corruption laws

and enforcement, for example, has led to a notable increase in related D&O claims. Such claims typically take 3–5 years to resolve and rack up large bills for defence costs. In one claim, the cost of defending a single director against bribery and corruption allegations in Brazil was almost \$20m.

Regulators today tend to be more sophisticated, better resourced and aggressive in their pursuit of companies and their directors. Cross-border regulatory cooperation has also increased, so an investigation in Latin America into the operations of a European company, for example, can easily spread as it is picked up by regulators and prosecutors in the US, UK, Europe and elsewhere. As a result, investigations are typically more complex, take longer to resolve and are more expensive to defend. Defence costs for a typical Serious Fraud Office prosecution today has doubled and can be as much as £4m per director in the UK. AIG recently handled a claim where the budget for a single director was £16.5m.

Another area that has notably increased exposure for directors and officers has been the active use of whistleblowers by regulators. In the US, the Securities and Exchange Commission rewards whistleblowers with between 10% and 30% of monetary sanctions collected. At present only 10 EU member states have whistleblower protections, but an EU directive will require all member states to create safe channels for internal and external reporting from 2021.

**“For large claims with regulatory investigations in the US or UK, total claim pay-outs of \$10m to \$15m for defence costs are not uncommon, and are double the cost of 10 years ago. The hourly rate for a lawyer has risen by as much as 40% over the past decade, while dealing with an investigation takes more resource— investigations are much more granular and prosecutions are far larger.”**

Jose Martinez, vice president, financial lines major loss claims EMEA, AIG

## Insights from D&O insurance losses

### Increased frequency and severity

Insurers have experienced a steady increase in the frequency and severity of D&O claims over the past decade, in large part driven by a trend for greater regulatory scrutiny and litigation, as well as higher defence costs. In particular, large claims have increased in severity as claims have become more complex, involving multiple directors, regulators and litigation, often in more than one country.

#### Claims trends

- Non-US exposures becoming more material
- Litigation and regulatory actions drive severity
- Claims arising from new and emerging risks
- Defence costs and legal fees rising
- D&O claims are now more complex

### Many and varied causes of claims

Globally, US securities class actions are the biggest cause of D&O loss by severity and are the largest risk for UK and European companies with US securities exposures. Regulatory investigations and bribery and investigation probes are the top cause of D&O claims in terms of cost for companies in a number of European countries, and have risen to become a significant cause of loss globally. In terms of frequency, bankruptcy claims are the most common cause of D&O loss, and it is, and will be, an area of increasing severity.

### International exposure

Historically, D&O insurance claims and pricing have been driven by US exposures, most notably securities class actions. However, this is changing and insurers have witnessed a significant rise in D&O losses from outside the US, where claims were previously considered benign. Around a third of claims from UK and European policyholders now emanate from a location outside the company's home state.

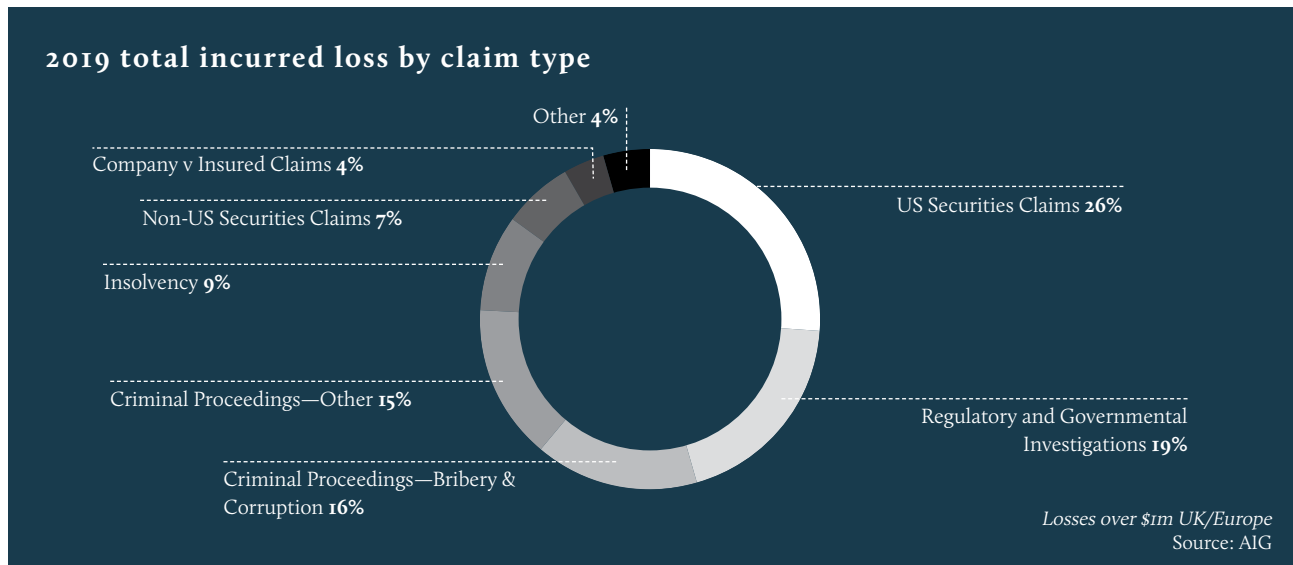
#### Specific triggers for D&O claims

- Bribery and corruption
- Antitrust law
- Regulatory activism
- Insolvency
- Tax evasion
- Mergers and acquisitions
- Event-driven claims



## New risks

Traditional D&O claims continue to drive frequency, but insurers now see claims emanate from a wider range of areas, such as cyber-related incidents, #MeToo and climate change. Event-driven litigation claims can see almost any event that affects a company share price result in legal action.



## Defence costs

The cost of D&O claims has been rising with the increase in the size and complexity of claims, as well as rising defence costs. Litigation can involve complex and technical issues while regulatory investigations are now more intrusive and sophisticated, involving burdensome information requests and documentation just to defend a claim against the company.

Legal costs have risen with growing demands on solicitors and experts as well as higher fees: top lawyers can charge as much as \$1,500 per hour in the US and \$1,000 per hour in Europe. At the same time, the numbers of directors drawn into investigations and litigation has increased exponentially—a large regulatory investigation typically involves 20-30 insured persons—requiring insurers to fund separate legal teams to avoid conflicts of interest.

**“The cost of defending a D&O claim is increasing all over the world. We see more and more claims where multiple directors are sued, which means more insured persons per claim at a time when legal fees are rising.”**

Michael Unglaub, manager, financial lines claims, DACH Cluster, AIG

### Factors driving increased cost of D&O cover

- Increased complexity, frequency and severity of claims
- Increase of number of insured persons involved per claim (e.g. Supervisory Board)
- Claim cost inflation has risen with specialised lawyers
- Duration of proceedings has increased

# Five D&O risks to watch

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## Insolvency claims

As the near term economic and political outlook grows ever more uncertain, D&O liabilities linked to company insolvency are likely to increase.

D&O claims resulting from insolvency—traditionally one of the biggest sources of losses by frequency—typically rise in times of economic uncertainty. Even before the pandemic, insolvency rates had been increasing in Western Europe and North America due to slowing global trade, political threats such as Brexit and trade wars between the US and China.

A number of sectors—including automotive and retail—are also under pressure from technology disruption, changing consumer behaviour, climate change concerns and competition. When companies fail, questions are asked about the actions and decisions of directors. Recent high-profile insolvencies have seen directors come under scrutiny from regulators, while directors are aggressively targeted by administrators and creditors seeking to recoup losses.

**“Insolvency risk is still a significant exposure for directors and we have seen an increase in insolvency claims pursued. Bankruptcy trustees are now more aggressive in their claims against directors and they may target their personal assets as a source of recovery.”**

Jose Martinez, vice president, financial lines major loss claims EMEA, AIG

## Cyber incidents

Cyber incidents and data breaches have already triggered D&O claims in the US where investors have pursued directors in a bid to recoup losses following a cyber incident, such as a data breach or service outage. As data and IT infrastructure becomes even more vital, and cyber and privacy liability increases, investigations and lawsuits are likely to increase.

**“Many companies see cyber as an operational issue but it is really a question of governance. This is an exposure that directors should take more seriously and seek external advice and regular briefings.”**

Paul Sterckx, head of financial lines,  
France, AIG

Typically directors can face shareholder class actions (there was a notable increase in US cyber class actions in 2019, according to NERA) following a cyber incident and where they are thought to have failed in their duty to manage the risk, such as ensure proper security controls or backups were in place and up to date. There have also been a number of cases where companies and directors have been sued for their failure to disclose cyber risks, such as GDPR exposures. So-called "fake president and CEO impersonation fraud" is another

related threat that has led to D&O claims, whereby employees and executives have been tricked into transferring funds to criminals' accounts.

## Climate change and environmental claims

Environmental issues are behind a number of D&O claims, a trend that is likely to accelerate.

Interest in climate change risk is rising, from investors, regulators and various interested parties, and directors will be increasingly expected to have considered climate and other environment-related risks and taken steps to mitigate them. There have already been a number of cases in the US where claimants have sought damages from energy companies accused of contributing to global warming, while environmental disasters, including mining dam failures in Brazil and wildfires in California, have resulted in large D&O claims.

Investors may also seek compensation for a company's failure to adapt to climate change or to adequately disclose environmental risks. Activist groups in the UK and Australia have already filed complaints against financial services firms alleging they had failed to comply with climate change reporting requirements. In 2019, the UK's Prudential Regulation Authority applied new rules that require certain financial services firms to nominate a senior manager responsible for identifying and managing financial risks from climate change.

**“Ten years ago environmental claims were the exception but with growing environmental awareness, increased regulation and more active environmental groups, these claims are far more common.”**

Jose Martinez, vice president, financial lines major loss claims EMEA, AIG

## #MeToo and societal risks

With increased personal accountability, changing attitudes and the rise of social media, directors are increasingly exposed to claims related to employment related risks, ethics and culture.

Directors may face prosecution or civil litigation where they fail in their duty of care to employees or where they preside over a toxic corporate culture that permits abuses. Allegations of sexual misconduct, bullying and discrimination have led to a spike in the number of employment practices liability claims in the US, while a number of derivative class actions have been filed against boards of corporations that have allegedly turned a blind eye to misconduct or inappropriate workplace relationships.

The potential for employment liability-related D&O claims is not limited to the US. In France, for example, a group of former senior executives at a major telecommunications company went on trial in 2019 accused of "moral harassment", after a wave of suicides following company restructuring and job cuts in 2006. In the UK, the introduction of gender pay gap reporting creates a potential liability for directors that fail to take action to address any disparities.

**“We should expect to see more claims in the future resulting from societal change. People are now far less willing to put up with perceived injustices and failings in corporate conduct and culture. They are more willing to speak up and will find the lawyers waiting should they want to bring a complaint.”**

Geraud Verhille, head of financial lines UK, AIG

## Merger objection litigation

Mergers and acquisitions have become a notable source of D&O claims as plaintiff attorneys and investors use the courts to object to mergers and acquisitions or recoup associated losses.

Merger objection litigation has increased in recent years, to the point that the majority of M&A transactions involve a lawsuit, often filed within days of the deal being announced. According to Cornerstone, eight in ten mergers resulted in shareholder litigation in 2017 and 2018. Some 39% of all US federal court securities suit filings in 2019 were merger objection lawsuits, while 7% involved initial public offerings.

Plaintiff lawyers and investors are much more aggressive in pursuing claims against directors alleging they were misled by the prospectus or because they want changes in governance. Many M&A claims are “nuisance lawsuits” that are dismissed or do not result in large awards or settlements. However, they are relatively expensive to defend and D&O insurers often foot the bill for what has been described as this “tax” on M&A transactions.

**“In the US, D&O claims related to merger objection litigation are now standard and are becoming more common in Europe. We see claims following mergers and acquisitions where the transaction has failed or where there are issues with warranties and indemnities and where there is not an M&A insurance policy in place. We may also see a claim against directors and officers following M&A for latent issues, such as cybersecurity or crime within the acquired business, and where the company has failed to purchase appropriate insurance.”**

Nepo Loesti, head of financial lines Europe, AIG

# Regional D&O trends



## German firms hit by fraud and an increase in regulatory enforcement

D&O insurers have experienced an increase in claims related to "fake president" fraud. These scams typically involve an employee, often in the accounts department, being contacted either by telephone or email by someone impersonating a senior officer of the company, typically the COO, CFO or CEO. The fraudster then tricks the employee into making a payment to their account, often under the pretence of an urgent need, such as payment to a key customer or to fund an acquisition. Values can be in the millions of dollars and such incidents have resulted in claims against directors when they have failed in their supervisory duties.

Fake president fraud is just the latest trigger for D&O claims in Germany. Over the past 20 years, Germany has experienced a marked increase in D&O exposure from an increase in regulatory enforcement—in areas like bribery and corruption and competition law—as well as the rise in internal liability claims, a particular feature of the German D&O market. As a result, the German D&O market now experiences some of the largest D&O claims outside the US.

**“We see more and more insured vs insured claims as Germany has become more litigious. Any wrongful act by a director can lead to an internal liability claim.”**

Michael Unglaub, manager, financial lines claims, DACH Cluster, AIG

Large D&O claims in Germany often start with a regulatory investigation or criminal proceeding, which is then followed by a so-called company vs insured claim, whereby one or more directors are sued by the company. A 1997 legal precedent in Germany basically means the supervisory board is obliged to seek damages from directors for losses incurred by the company, for example, internal investigation costs, defence costs or other financial losses arising from their failure to supervise. Over 80% of German D&O claims involve company vs insured.

These internal liability claims can be triggered by almost any event where directors might be liable. Over the past decade, bribery and corruption and cartel claims have all been common causes of company vs insured losses. The so-called CumEx tax fraud scheme in Germany has led to high-profile regulatory investigations and prosecutions, and could result in company vs insured claims in the future, as could a major cyber incident like a large data breach.

## France sees elevated regulatory and legal actions drive claims

The frequency and severity of D&O insurance claims has increased in France, reflecting increasingly aggressive enforcement by regulators at home and overseas.

Regulators in France are more active and communicate more with regulators abroad but they also have more tools at their disposal. With rising disclosure requirements it is easier to hold the country's companies and their directors to account. There has been a notable uptick in the frequency and severity of claims arising from bribery and corruption, as well as for price fixing and harassment.

**“We have seen a lot of regulatory activity in France for anti-trust law and price fixing allegations. AFA, the competition authority in France, is now much more active and has launched probes into a number of sectors, including telecoms. And once the competition regulator in France raises questions, other regulators, such as the DOJ in the US, are quick to jump in.”**

Paul Sterckx, head of financial lines,  
France, AIG

There has also been a focus in France on the role of directors in corporate culture and conduct. In December 2019, a former chief executive and two former executives of a French telecoms company received custodial sentences at the court of first instance (CFI) over an ‘institutional’ moral harassment policy related to a restructuring strategy in 2007-2008 that was followed by a number of suicides among employees.

Overall, directors and officers in France are now much more likely to be sued or investigated today than they were in the past. Mirroring international trends, the burden of regulation has increased and self-reporting and internal enquiries are becoming commonplace, as is international

cooperation between regulators. Regulators are also more aggressive and new public authorities have been established, such as the anti-corruption French agency AFA following the French anti-corruption law Sapin II of 9 December 2016, while new criminal policies and anti-corruption policies are supported by strong political will.

Other stakeholders, including trade unions and non-profit organisations, are also more active in holding corporations and their directors to account and defending the public interest. Insured vs insured claims are a growing feature of D&O liability in France as companies do not hesitate to sue previous D&Os while liquidators are now quick to pursue directors.

The most common causes of D&O claim in France were criminal liability (77% of claims notified in 2018), followed by health and labour regulation (51%), civil liability (18%) and administrative/disciplinary proceedings (5%). On a severity basis bankruptcy is the top cause, followed by insured v insured, US securities class actions and criminal liability for corruption or misuse of company assets.



## UK sees rise in bribery and corruption claims

Bribery and corruption claims against UK directors and officers have risen sharply since the passing of anti-corruption laws in 2010 and with more aggressive enforcement by regulators at home and abroad.

Under the Bribery Act 2010, directors are liable for their failure to prevent bribery, such as inadequate processes and procedures, or if they are found to have consented or connived in the offence. The Act has a broad definition of bribery that goes well beyond paying bribes, and includes awarding contracts, offering gifts, charitable donations and employing public officials and their families. The law is also far-reaching in its territorial scope, making companies and their directors liable for bribery and corruption offences committed overseas as well as in the UK.

Significantly, the legislation makes directors liable for the corrupt actions of third parties, including agents, suppliers and subcontractors. As a result, UK directors are vulnerable to prosecution for gifts, bribes or facilitation payments paid by an agent if they are deemed to be made on behalf of the company. The extension of liability to include third parties has been particularly problematic and a source of D&O claims, especially for companies with operations in parts of the world where facilitation payments are common practice.

Claims often arise from the overseas businesses of UK companies, in particular Africa, Middle East and Latin America, but also from unexpected jurisdictions, such as South Korea. Regulators in many jurisdictions are clamping down on bribery and corruption and are actively cooperating with their international peers. The cost of defending overseas bribery and corruption claims is high.

**“Bribery and corruption is one of the biggest drivers for D&O claims in the UK. Directors really need to get into the weeds of their operations, particularly in overseas operations. The vast majority of claims are down to third parties such as agents. This is where gaps in controls tend to exist and is an area that boards should focus on.”**

Chris Magee, head of management liability, financial lines UK, AIG

### How to stay out of trouble: a director’s risk management checklist

- Educate yourself on the risks that drive litigation and regulatory actions
- Invite subject experts to board meetings to discuss emerging risks
- Draw on the expertise of insurers and learn from D&O claims trends
- Reduce risk by developing robust governance and strong culture
- Encourage diversity of knowledge and experience at board level
- Carry out due diligence on business partners for corruption, ethics and cyber risks
- Don’t be afraid to question and challenge the conduct of others
- Take red flags seriously and act on them

# Section two

## A user guide to D&O insurance

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### The basics

Directors can face ruinous costs from a regulatory action or litigation. Even when they have done nothing wrong, refuting accusations or responding to regulatory inquiries can result in large unexpected legal bills.

However, directors cannot rely on their company to indemnify such expenses, including defence costs or fines. In many countries a company will be prohibited from indemnifying a director for certain costs, while insolvency or a conflict of interest, such as a dispute between the company and the director, could leave them out of pocket.

D&O insurance will indemnify directors and senior management against the considerable liabilities that arise from their roles as directors, up to the policy limit. There are different forms of D&O insurance (see over page), but the core cover is a "sleep-easy" insurance that will protect a director's personal assets. Essentially, D&O insurance will pay the costs of civil litigation, regulatory investigations and criminal proceedings, which can run into six figure values.

**“Directors are often seen as an easy target and will face claims that are not always valid. We have seen regulatory investigations that go on for many years before the directors are finally exonerated. That’s the real value of D&O cover.”**

Chris Magee, head of management liability, financial lines UK, AIG

D&O insurance is broad and is designed to respond, irrespective of the cause of claim (there are some exclusions, such as fraud). The policy is typically purchased and paid for by the company, but individual directors are the main beneficiary of the policy. However, companies may also buy additional cover to protect their own balance sheets from associated liabilities.

D&O insurance is not just about financial protection. The value of insurance is in the claim, and a knowledgeable insurer can provide a director with essential independent advice and support. A good D&O insurer will guide individual directors through the claim process, ensuring they receive specialist advice and representation.

### Insurance market trends

The D&O liability insurance market is currently in a state of transformation. In response to substantial increases in exposure for directors, and an increase in losses for insurers, terms and conditions for D&O insurance are being revised and prices are rising.

D&O premium rates declined in almost every year since 2003 but have steadily increased since the third quarter of 2018, initially in the US and Australia, but more recently in the UK and Europe. Rate varies by region and sector, but there is a general trend for increasing premiums for D&O insurance, especially for companies with US securities class action exposure.

Price is not the only lever available to insurers. D&O underwriters will now typically request higher deductibles—the first part of the claim paid by the policyholder. In some cases insurers have reduced the limits of cover and capacity they are willing to offer, especially for higher-risk sectors or particular exposures, such as US listings. However, D&O cover remains extremely broad and most companies will be able to buy the cover they require in the open market.

## Forms of D&O cover

- Side A** This is the essential form of D&O insurance for directors. Side A is exclusively for directors and officers and will cover their personal liability. It can be seen as financial protection for directors.
- Side B** This cover reimburses the company for the costs of indemnifying directors, such as legal defence costs, settlements or judgments. It is a balance sheet protection for the company's obligation to indemnify its directors and officers.
- Side C** This protects the company from securities claims. It operates as balance sheet protection for the company's own securities exposure.

In today's market, insurers may ask for more disclosure in topical areas, like cyber; for senior interaction with the market; for evidence of controls and procedure, such as to prevent bribery and corruption; whether controls and procedures are reviewed by external counsel.

## Common features of D&O insurance

D&O insurance for large companies is typically a bespoke product, structured according to the needs of the insured company and its directors. However there are some common features that directors should be aware of.

- **Coverage** D&O covers the cost of defending legal and regulatory actions, a director's single biggest exposure and the main driver for D&O claims. However, D&O insurance can (where allowed by law) pay fines and penalties as well as other costs, such as crisis management fees.
- **Exclusions** Generally speaking, D&O cover is broad and designed to pay defence costs and damages, irrespective of cause. However, certain types of risk are typically excluded; such as deliberate fraud, criminal acts, willful misconduct or damages for bodily injury and property damage.
- **Extensions** Standard D&O policies may exclude or restrict certain exposures, such as internal investigations or insured vs insured claims. However, it is often possible to purchase additional cover through extensions, such as employment practices liability insurance, public relations fees or extradition costs.
- **Retentions** Insurance policies typically include a retention level, also known as a deductible or excess. The insured is required to pay the first part of the claim up to the retention level, after which the insurance kicks in. However, individual directors typically have a zero-deductible, although minimum deductibles are required by law in some countries, such as Germany.
- **Limits** D&O policies will pay claims up to a total policy limit. In some circumstances insurers may apply a sub-limit, restricting cover for certain risks, such as certain types of investigation. Once the limit is exhausted the insurer is under no obligation to continuing paying the claim. It may be possible to negotiate higher limits or top-up cover for certain risks or individual directors.
- **Difference-in-conditions (DIC) cover** D&O coverage can be exhausted by company entity losses and/or indemnifiable losses, such as securities claims against the company and the directors. As a result, some 90% of UK publicly traded companies purchase Side A DIC coverage. The DIC cover sits on top of the traditional policy and provides additional limits dedicated to individual directors. It can also fill coverage gaps and will cover losses the company refuses, or is financially unable, to indemnify.

**“The D&O insurance market is in the midst of a perfect storm. Years of premium reductions have eroded the premium pool for the D&O insurance market, yet claims and losses have been increasing. This is why we now see the market adjusting to a new reality.”**

Geraud Verhille, head of financial lines UK, AIG

## Key considerations when buying D&O insurance

As the stakes for directors and officers continue to rise, the effectiveness of D&O insurance becomes increasingly important. This requires directors to develop a deep understanding of their liabilities and emerging risks, and to engage with the insurance buying process.

**“Make sure you select an insurer that is experienced in handling claims, including large complex claims. You will need advice and an insurer that can find the right legal representation, especially in overseas jurisdictions and for claims that require specialist legal expertise.”**

Nima Rafiee, underwriting manager,  
financial lines Europe, AIG

It is essential that directors, in partnership with their risk managers and legal counsel, perform regular reviews of their D&O liability insurance. Too often, directors do not read their D&O insurance policy and are not up to speed. A 2019 survey by AIG of UK companies found that board awareness of risk governance to be lacking. Risk managers perceived that as many as 50% of boards did not know what a D&O policy typically pays out for, while only 38% were completely aware of their firm’s D&O policy.

Typically, boards will approve the annual D&O insurance renewal but will have very little information on claims trends and potential executive liability risks. Directors need to keep abreast of D&O risk trends and draw on the

expertise of risk managers and the insurance industry, which can provide insights on emerging claims trends; in AIG’s survey, only a small proportion of boards were thought to be aware of the scope of cover for cyber, social media and #MeToo issues.

Boards should also take the time to consider and discuss D&O risks, claims and their insurance arrangements. Directors that are likely to be the subject of claims under the policy should be involved in the risk strategy and risk mapping process. This will ensure that all stakeholders relevant to the policy will have an early insight into the types of coverage available, and what may be excluded.

### Advice on buying D&O insurance

- Ensure you have adequate limits and broad coverage
- Be aware of exclusions in policies
- Make sure you have D&O insurance with an experienced carrier
- Focus on the expertise and capabilities of your carrier, not price alone
- Consider workshops with your broker and/or carrier

### Choosing an insurer

- You need a carrier with experience of large complex claims
- A quality insurer will have contacts with specialist law firms
- A good underwriter will understand your exposures and work with you
- Overseas claims need an insurer with local knowledge and claims handling capabilities

## Common misconceptions about D&O insurance

A lack of awareness and understanding of the workings of D&O insurance may result in directors not getting the best from their policy. Common issues to consider include:

- **Timely notification** Prompt notification is essential to a successful insurance claim. If reporting the claim is delayed, then legal costs incurred before the claim was reported to the insurer will generally not be covered under the policy. The insurer can also provide critical guidance about steps to take in dealing with a claim at an early stage.
- **Appropriate representation** Typically, the insurer's consent is required before lawyers are retained. If this process is not followed, the insurer is not obliged to cover these defence costs. In addition, hiring an inappropriate advisor can increase the overall cost and prejudice possible defences.
- **Adequacy of limits** A common myth is that a policy will contain sufficient limits for all defence costs. The costs associated with an investigation are hard to predict and are often underestimated. For example, 89% of UK risk managers believe that defence costs per director are £1m or less, when in fact they can be as much as £4m.
- **Prioritise cost** The costs associated with an investigation can quickly escalate but there may be confusion about how director defence costs are prioritised. A survey of UK risk managers found only 18% are confident there is a clear process in place for who gets paid first under their D&O policy. Policies do not stipulate which directors claims are paid first and if the policy limit is exhausted (by losses under Side A, B or C cover), the insurer is under no obligation to continue paying defence costs.

**“The value proposition of each insurer is fundamentally different. Directors buy a D&O policy to pay claims and that should be at the forefront of the purchasing decision. The value of D&O insurance is in the claims payment.”**

Nepo Loesti, head of financial lines Europe, AIG

### Key questions to ask your risk manager and broker

1. Is our limit adequate for a large claim?
2. What exclusions do we have?
3. Do we have cover for regulatory investigations?
4. Is there cover for potential event litigation, such as cyber?
5. Who is insured and are we covered worldwide?
6. What is the experience and footprint of our insurer?
7. Should we buy top-up or Side A cover?

### What to do in the event of a claim

- Call your broker immediately
- Report the claim to the insurer
- Collaborate with your insurance carrier

# Board Directors' Guide to D&O Liability Insurance

## Contacts

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