

# Home Counties Insurance Services Ltd



## A Guide to Directors' and Officers' Insurance Requirements



Home Counties Insurance Services Ltd  
Highway House  
4 Doolittle Yard  
Ampthill  
Bedfordshire  
MK45 2NW

T: +44 (0)1525 719955  
E: [info@homecountiesinsurance.com](mailto:info@homecountiesinsurance.com)

[www.homecountiesinsurance.com](http://www.homecountiesinsurance.com)

# HCI Guide to Directors' and Officers' (D&O) Insurance

## What is it, and why do you need it?

Directors are legally required to act:

- with care
- in good faith
- within the law
- in the best interests of your company.

Individual directors are also required to ensure that their fellow directors do likewise. Failure to comply can lead to a fine, imprisonment, and having to pay compensation for damages, which could involve seizing your personal assets.

Company officers and senior managers also have a personal liability for their actions within the company. This liability is **UNLIMITED**, and if a post-holder is personally sued, the company doesn't have to provide them with financial assistance.

The limited liability protection of a company only applies to shareholders. A D&O insurance policy protects company directors and officers from having to pay legal costs, and from civil damages awarded against them as a result of a wrongful act.

## Examples of claims

There are plenty of examples of claims published online. However, here are a few that could happen to almost any company. They illustrate how complicated D&O claims can be, and the impact a comprehensive insurance policy can have.

**Dismissal reveals Data Protection Act (1998) breach:** A trailer rental and leasing company needed help with a claim against the business and its directors. The claim was brought by the former company solicitor and company secretary, for discrimination and constructive dismissal. Some of the directors were involved in purchasing phone records to help substantiate their case against the claimant, and had inadvertently breached the Data Protection Act. Settlement and legal costs amounted to **£75,000**.

**Directors questioned about a fatal accident in a company vehicle:** A road sweeping company's vehicle was in a fatal accident, which triggered a police investigation. A company director was accused of contributing to the accident by dangerous driving. The insurer's claims team provided support and legal services. Although the director was never tried, due to ill health, the insurers incurred defence costs of over **£118,000** and legal costs of over £3,000.

**Health and safety breach:** A construction company suffered a near miss when a pane of glass fell from a tower block. Miraculously, no one was injured, but a HSE visit revealed a number of legislative breaches. Various actions were brought against the directors, resulting in costs of **£45,000**.

## Who can insure?

In addition to directors and officers of limited companies, most insurers will provide cover for those running a PLC or LLP. Specialist policies are available for the trustees of pension funds and the trustees/committee members of charities and other not-for-profit organisations.

### **Who is a Director or Officer?**

Although directors are logged by name at Companies House, the Companies Act provides a non-exhaustive definition of 'director' – anyone in the position of a director, regardless of job title. This can leave individuals open to legal challenge.

The legal definition of an officer is unclear, and could include most managerial or supervisory roles. Case law has held that an officer is someone 'managing a company's affairs'.

### **Who can bring an action against a director or officer?**

- Government bodies alleging breach of regulations, e.g. health and safety, data protection, bribery, competition, export, corporate manslaughter, wrongful trading, failure to disclose information
- Employees (past or present) alleging breach of employment conditions or legislation, e.g. sexual harassment, wrongful termination, age, sex or race discrimination, non-payment of wages, breach of minimum wage law
- Shareholders, bondholders or holders of other securities can take action regarding a fall in share price (possibly due to mergers and acquisitions), misleading statements, poor business decisions, mismanagement, etc.
- If your company goes out of business, actions can be brought against you by the company's creditors, the receivers, administrators and liquidators in respect of wrongful trading in the run-up to the closure of the business
- Potential purchasers, for the provision of incorrect information and failure to disclose information
- Customers involving contractual disputes and misrepresentation
- Suppliers alleging misrepresentation
- Competitors alleging unfair practices, libel and slander, and the infringement of intellectual property
- The company itself.

### **How does the cover work?**

Insurance is provided on a claims made basis – cover for claims made (and reported to the insurer) during the period of insurance only. A claim is generally notifiable under a D&O policy when the insured first becomes aware of circumstances that may lead to a claim.

### **How much cover should I buy?**

The limit of indemnity is the maximum amount of money that the policy will pay out.

D&O policies are usually issued with aggregate limits of indemnity – that is, the limit is the total amount that can be paid out for all claims made during the policy period, and the limit usually includes defence costs. It is generally felt that the limit of indemnity should be at least equal to the gross assets of the company.

### **What are the key benefits of a D&O policy?**

Insurance for directors and officers covers their personal legal liability, which might arise from a wrongful act while in post. It would also cover costs incurred from:

- investigations
- defending legal action which seeks disqualification as a director
- extradition proceedings (including appeals).

A company can indemnify a director against costs incurred in the defence of a civil or criminal proceeding brought against him/her, providing the defence is successful. The policy reimburses the company for lawful payments.

Most policies include extensions for:

- Entity cover (defence costs only) for when the company is sued at the same time as the director or officer. This avoids disagreements between parties over the allocation of defence costs
- Outside board coverage if your company asks you to join another board
- Retired directors
- Acquisitions (usually subject to the acquired company meeting certain criteria)
- Extended discovery period – when a policy is cancelled, generally a period of 30 days is allowed for claims to be made. Longer periods may be available for an additional premium
- A spouse extension protects the spouse/heirs if a director/officer dies or if, by law, the claim liability is passed on to the spouse (i.e. jointly owned assets)
- Non-executive directors
- Employment practices liability.

Some of these extensions incur an additional premium.

### **Main coverage exclusions**

- Dishonest, fraudulent, criminal or malicious acts
- Claims by major shareholders (generally classed as over a 15–20% share) because this is viewed as too much control/suing yourself
- Criminal fines and penalties
- Civil fines and penalties (these are usually excluded)
- Prior or pending litigation at the time of taking out the policy
- Acting pension scheme trustees require specialist cover
- North American claims (unless the policy has been extended)
- Personal injury, property damage and professional duties to third parties unless the claim is from a shareholder relating to the value of the company's share capital (should be included in employers and public liability cover, or material damage or professional indemnity policies)
- Pollution cover can either be limited or excluded
- Assured v Assured – this exclusion is sometimes included in old-fashioned policies. However, most modern insurers will now provide cover (excluding USA claims)

### **Who can buy a D&O Policy?**

The company can purchase a D&O policy to protect itself and its directors, provided its Articles of Association permit it to do so, and the existence of the policy is declared in the annual report.

### **Subsidiary Companies**

Policies should be issued in the name of the ultimate holding company. They will then cover the directors and officers of all wholly owned subsidiaries.

**If you sell your Company**

D&O policies automatically go into 'run-off' once a company is sold or its assets cease to exist. The acquirer will arrange cover for acts occurring after the change of control. Either the seller or acquirer can arrange run-off cover to protect the directors and officers against pre-sale acts. It is important to establish who will take responsibility for run-off cover before the sale completes.

**Retroactive date**

Most policies automatically provide cover for wrongful acts that occurred prior to inception of the policy, subject to the prior and pending claim exclusion. The general exception is where a company is under new ownership.

**Multiple companies**

This guide refers to policies in relation to a company. However, personal cover can be arranged for individuals who hold directorship or officer roles in more than one organisation.

**Help is at hand**

If you're unsure about D&O insurance, please contact us for one-to-one assistance.

T: +44 (0)1525 719955

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