

IT PAYS TO compare policies

Shane Crocker of Strategic Insurance & Risk Solutions Pty Ltd compares the relative advantages and disadvantages of two new personal D&O liability insurance products that have been recently released.

DIRECTORS AND OFFICERS rely solely upon their organisations' indemnities and corporate D&O insurance as the only means of protecting their personal assets from actions arising from their duties as directors and officers. While it is prudent to insist upon indemnity from the organisation and that the organisation affects corporate D&O Insurance, there are inadequacies with this as a sole strategy from an individual standpoint. They include:

Failure of the organisation indemnity: The organisation may not always be in a position to fulfill an obligation to provide indemnity because:

- it may not have sufficient funds; or
- it may not be permitted by law to provide indemnity; or
- it may refuse to provide indemnity.

Sharing and erosion of corporate D&O insurance policy limits: D&O insurance limits of indemnity apply to "any one claim and to all claims made under the policy during the period of cover". Therefore the limit could be eroded by claims:

- against other directors or officers; or
- involving reimbursement to the organisation following indemnity to a director or officer; or
- against the organisation (if entity cover is purchased for employment practices liability or securities claims).

Choice of legal representation: In the event that there are a number of directors and officers, and even the organisation itself, involved in a single claim, the organisation or its D&O insurer may insist on combining legal representation for all parties. This may not be in the interests of each individual.

Inadequate cover under corporate D&O insurance: The organisation's corporate D&O insurance may contain gaps in cover. For example; there may be no cover for claims brought by another director or officer or the organisation.

Advancement of defence costs: Under many corporate D&O insurance policies the insurer has sole discretion over whether or not it will advance defence costs if it has not accepted that it is liable. This could happen if it suspects that a policy exclusion may apply.

Varying policy conditions under corporate D&O insurance: A person who holds multiple directorships is likely to find it very difficult to ensure that the corporate D&O insurance policies purchased by each of the companies for whom they act provide consistent and acceptable cover. Indeed they may have little or no say as to the extent of cover purchased.

Retirement: Once a director or officer retires it may be difficult for them to keep track of the corporate D&O insurance purchased by their former organisation.

It has been some years since there has been a policy available for individual purchase by directors and officers. Recently two new personal directors and officers liability insurance (PDO) products have been released onto the insurance market. The following are some observations in relation to these products.

MARSH PTY LTD (Marsh)

The first product released onto the market was by Marsh, a subsidiary of Marsh Inc., the world's leading risk advisory and insurance broking firm.

"*Personal Directors and Officers Insurance Cover*" has been designed to provide 'sleep easy' protection as a last resort in the event that both the organisation's indemnity and corporate D&O insurance are unavailable.

The following are some key issues with respect to the Marsh product:

The pluses

- The limit of indemnity is available only to the insured person.
- Limits of indemnity of up to \$5 million are available.
- The insured person has the flexibility to choose their own legal representative subject to the insurer being kept informed. However, the insured person may not have total flexibility as the policy protection is available only in the event that corporate D&O insurance and indemnity from the organisation are not available. If there is corporate D&O insurance or an indemnity from the organisation, the insurer or the organisation may have the right to take over the conduct of any claim. It is therefore possible that in certain circumstances the insured person's defence could be influenced by the interests of others.
- Cover can be arranged in relation to positions held with any public or private company or any not-for-profit organisation.
- The policy states that cover is available only to any natural person who is a director. However, Marsh has confirmed that cover can be provided to certain officers upon request.

Where the policy may provide similar cover to that of an organisation's corporate D&O insurance this insurance is able to differentiate itself. Subject to the policy terms and conditions some of the areas where it is successful are:

- the policy includes cover for representation costs incurred by the insured person attending any hearing or investigation resulting from, or connected with, them serving the position. There is no requirement for allegations of a wrongful act.
- the policy definition of loss confirms that cover will apply to a court order by an Australian or New Zealand court to pay compensation arising from a contravention of a law in Australia or New Zealand.
- the insurer agrees to advance defence costs as they are incurred in circumstances where the organisation and/or the corporate D&O insurer fails to do so.

- the policy extends to include cover for pecuniary penalties awarded in Australia or New Zealand. A sub-limit of liability of \$1 million applies to any one or all such penalties in the policy period.
- the policy extends to include cover for defence costs incurred by the insured person in defending a claim for pollution. A sub-limit of liability of \$250,000 applies to any one or all such costs in the policy period.

Security is provided by Lloyds Syndicate 1007 which is managed by SVB Syndicates Limited (SVB). As a Lloyds syndicate SVB currently enjoys the Lloyds Standard & Poor's insurer financial strength rating of 'A' (excellent).

The minuses

The policy will respond only:

1. in excess of the limit of indemnity provided by any corporate D&O insurance; or
2. in lieu of corporate D&O insurance where the corporate D&O insurer has refused or is unable to provide protection; or
3. where there is no corporate D&O insurance.

In all cases cover applies only after indemnity by the organisation has been exhausted or the organisation refuses to provide indemnity or is unable to provide indemnity, including for financial reasons.

- The policy retention (excess) could be difficult to bear for an individual director. The retention is 10 per cent of any claim subject to a maximum of \$25,000. In other words the insured person will bear the first \$20,000 of a claim for \$200,000.
- The policy provides limited cover in respect of claims brought by another director or officer of the same organisation or the organisation itself. The cover is similar to that found in many standard corporate D&O policies.
- Cover is locally underwritten by Marsh under an authority given to it by SVB. This means that Marsh acts as the agent of the insurer and not that of the insured person.
- There is no claims settling authority in Australia therefore there is no local access to decision makers on claims. Payments will be directed from SPB in the UK.
- Proposal forms are available electronically, however quotations, placement and payment will be handled manually.

RISK PARTNERS

The second product released onto the market is known as "*Directors' Personal Liability Risk Protector*" and is available exclusively through Risk Partners, an insurance broking firm specialising in professional and financial risks insurances.

The insurance is a stand alone policy which is there for the director or officer to call upon at any time regardless of whether there is an indemnity from the organisation or a corporate D&O insurance arranged by the organisation.

The following are some key issues with respect to the Risk Partners product:

The pluses

- Cover is provided on a 'stand alone' basis. Therefore the insured has the option to choose between this policy and any corporate D&O insurance available to them.
Note: Dual insurance may occur. However, under the Insurance Contracts Act, the insured person can elect to claim on any contract covering the situation without prejudicing their right to indemnity purely due to the dual insurance.
- The limit of indemnity is available only to the insured person.
Note: In situations of dual insurance the PDO may be called into contribution and therefore the limit may be eroded even if a claim is not made directly under the policy.
- Limits of indemnity of up to \$5 million are available.
- The insured person has the flexibility to choose their own legal representative subject to the insurer being kept informed.
- The insured person's defence will not be influenced by the interests of other defendants.
- Cover can be arranged in relation to positions held with any public or private company, not-for-profit organisation or partnership.

- Cover is available to any natural person who is a director or officer or a partner in a firm.
- Where the policy may provide similar cover to that of an organisation's corporate D&O insurance, this insurance is able to differentiate itself. Subject to the policy terms and conditions some of the areas where it is successful are:
 - defence costs are defined to include all "reasonable" costs not "reasonable and necessary". This means that the insurer is not able to dictate what costs may not have been necessary.
 - other than where the insurer has denied indemnity, the insurer is obliged to advance defence costs as they are incurred.
 - the policy definition of loss confirms that cover will apply to any court order to pay compensation arising from a contravention of a law.
 - the policy extends to include cover for pecuniary penalties awarded in Australia or New Zealand. A sub-limit of liability of \$500,000 applies to any one or all such penalties in the policy period.
 - the policy extends to include cover for defence costs incurred by the insured person in defending a claim for pollution.
 - the policy extends to include cover for representation costs incurred by the insured person attending any hearing or investigation resulting from, or connected with, them serving the position. There is no requirement for allegations of a wrongful act but written notice requiring attendance must be received by the insured person.
 - the policy confirms that it will cover costs incurred by the insured person in relation to extradition. A sub-limit of liability of \$50,000 applies to any one or all such costs in the policy period.
 - the professional services exclusion does not apply to any claims alleging that the insured person failed to supervise an employee.
 - the securities offering exclusion does not apply to private placements.
 - the policy does not exclude cover for claims brought by any other director or officer of the same organisation or the organisation itself.

Cover is locally underwritten and administered by Dexta Corporation Pty Ltd (a member of the Stardex Insurance Group) (Dexta). Dexta also has claims handling and settling authority in Australia. Therefore insured persons have access to decision makers on claims. Quotations, placement and payment are able to be handled electronically. Risk Partners acts as the agent of the insured person and not that of the insurer.

The minuses

- The policy retention (excess) must be borne by the insured person. The retention is \$5,000 for each and every claim. All claims arising from the same wrongful

act or causally related wrongful acts are subject to only one retention.

- Security is provided by Axis Specialty Europe Ltd, which is a direct foreign offshore insurer not an authorised insurer in Australia and therefore not subject to supervision by APRA. However, comfort can be gained from the following:
 - Axis Specialty Europe Ltd is a wholly owned subsidiary of Axis Capital Holdings Ltd, headquartered in Bermuda, with operations in the US, the UK, Ireland and Switzerland and a representative office in Singapore.
 - Axis Capital Holdings Ltd currently has an 'A' (excellent) rating from A M Best and an 'A' (strong) rating from Standard & Poor's for claims paying ability.
 - Axis Capital Holdings Ltd's financial year 2004 shows gross written premium of more than US\$3 billion, total assets of more than US\$9 billion and net assets of more than US\$3.2 billion.
 - AXIS Specialty Europe Ltd is regulated and authorised by IFSRA to conduct business in the UK.

Conclusion

As the policies vary, the value or benefit of each in isolation or in addition to D&O insurance should be analysed on a case by case basis. Advice should be obtained from specialist advisers such as insurance brokers, independent consultants or lawyers.

Based purely upon the analysis of policy terms and conditions, the "Directors' Personal Liability Risk Protector" product offered by Risk Partners has generally wider application than the "Personal Directors and Officers Insurance Cover" product offered by Marsh.

This view is based upon the facts that the "Personal Directors and Officers Insurance Cover" responds only if:

- a) D&O insurance arranged by the organisation fails to respond to a claim, either through refusal by the insurer or the financial failure of the insurer; and
- b) the organisation fails to fulfil any obligation to provide indemnity either by refusal, financial failure or inability at law.

The insured person will not have the same level of flexibility to choose their own legal representation under the "Personal Directors and Officers Insurance Cover" product offered by Marsh.

The policy features of the "Directors' Personal Liability Risk Protector" product offered by Risk Partners offer wider benefit to insured persons. For example, the level of the insured person's retention and the cover provided for actions by other directors and officers or the organisation.

Local claims handling and settling authority is also a valuable feature of the "Directors' Personal Liability Risk Protector" product. ①

THE VERDICT

	"PERSONAL DIRECTORS AND OFFICERS INSURANCE COVER" MARSH	"DIRECTORS' PERSONAL LIABILITY RISK PROTECTOR" RISK PARTNERS
HOW THEY RATE OVERALL (HIGHEST RATING IS 5★)		
Basis of cover	★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity or corporate D&O insurance.	★★★★
Available limits	★★★★	★★★★
Retention	★★	★★★
Ease of application and payment process	★★★	★★★★★
Claims handling	★★★	★★★★
HOW THEY RATE ON KEY LIMITATIONS OF ORGANISATION INDEMNITIES AND/OR CORPORATE D&O INSURANCE		
Failure of the organisation indemnity	★★★★★	★★★★★
Sharing and erosion of corporate D&O insurance policy limits	★★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity.	★★★★
Choice of legal representation	★★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity or corporate D&O insurance.	★★★★
Inadequate cover under corporate D&O insurance	★★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity or corporate D&O insurance.	★★★★
Advancement of defence costs	★★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity or corporate D&O insurance.	★★★★★
Varying policy conditions under corporate D&O insurance	★★★ The benefit is limited by the fact that the cover applies only where there is no organisation indemnity or corporate D&O insurance.	★★★★
Retirement	★★★★★	★★★★★