CGF RESEARCH INSTITUTE (PTY) LTD
Corporate Governance Framework®

AON

ARTICLE

Johannesburg

08 October 2012

WHEN THE D&O COVER IS NOT ENOUGH

In the constantly changing area of director's and prescribed officer's (D&O) liability, it has become clear that significant D&O exposures are no longer limited; recent legislative and regulatory developments require prudent companies to take a fresh look at D&O exposures and related insurance coverage issues. In this regard, a company must now -- more than ever -- understand the multitude of laws, regulations and nuances in which it operates. These laws and regulations change regularly and if left unchecked, can leave an unprepared company exposed to *uncovered* and often *unexpected* risks. And as matters such as class actions continues to draw attention amongst informed activists, companies will need to seriously rethink the manner in which they provide their executives the type of protection required that limits their risk exposure, particularly when matters turn nasty. Considering the extent to which personal liability is now attached to directors as well as prescribed officers in their several and joint capacities, companies should reassess the cover they have in place. Of course the question arises as to how much cover is needed, and will this cover only protect the employee when they are affected in their immediate place of employ? Or might the cover also need to cover a full time director whilst they act as a non-executive director, at the behest of their full time employer, in another company?

In terms of risk, undoubtedly it would be risky occupying a directorship position, or any other business leadership position knowing full well that these posts attract intense scrutiny of the employee's actions, which are not necessarily restricted to an eight-to-five job. As business working conditions have evolved with the advent of ubiquitous computing and borderless office geographies, the reality is that these executives are 'at work' pretty much all the time, and exposed to many new forms of risk which didn't exist in times gone by. That said, has the *type of protection* currently being provided evolved sufficiently enough to cover these working conditions presented in today's complex business environment, where many new risks are posed -- for example -- by the business social media channels which may still not be fully understood?

As though this was not enough; what about the rising legal costs and the extended battles in the courtrooms? So we've been assured that there is cover for directors and prescribed officers on a blanket basis in place to ward off these increasing risks associated to the functions performed by our executives, but has the company considered the extent of the legal fees it may require as court cases continue to be dragged out for months, or even years? Before you know it, your D&O cover may have covered the legal defence costs, but will there be enough to pay the awarded damages?

It is imperative that directors and prescribed officers are assured by their employers that their D&O liability insurance supports them by funding the legal or defence costs which they incur in connection with regulatory or other enquiries or claims made against them. Interestingly, the more forward-looking D&O underwriters have developed policies that protect a number of *constituent interests*; these not only being the directors and prescribed officers, but also shareholders, investors, creditors and other vested parties. In order to provide a policy which offers a *combined insurance* approach, the insurer provides a 'combined limit' such where a single pool of funds is made available to meet both directors' and prescribed officers' legal costs as they are incurred (in respect of formal enquiries and claims made against them) and also awards for compensation or damages made against them. Until the issue is clarified, directors and prescribed officers would be well advised to ensure that their defence costs policy proceeds are 'ring fenced' from any claim that may be made against them by regulators, shareholders, creditors (including liquidators) or other third parties.

Expectedly investors, lenders and shareholders will continue to require companies and their directors to maintain liability insurance which should be available, if necessary, to compensate them for losses they may incur as a result of the director's and prescribed officer's conduct. To address this, company owners, insurance buyers, brokers and underwriters need to explore how to ring-fence defence costs from third party claims that would otherwise freeze the D&O policy proceeds.

In more recent times, the underwriting fraternity has canvassed a number of options to address the ring-fencing of defence costs. One such option; *insurance for directors' liabilities with defence costs being 'in addition' to policy limits*, is unlikely to appeal to insurers and, in any event, may not be appropriate for multi-layer insurance programmes. Another option; *for excess layer insurance to 'drop down' to cover defence costs*, may not always work smoothly either. It assumes the existence of an excess layer (which may not exist) and there are likely to be technical issues which give rise to further disputes.

A more user-friendly alternative to the above considerations, is for directors to *couple their existing combined limit D&O liability insurance with 'contingent defence costs cover'* which would be triggered only in the event of the notification of a charge on the combined limit policy to the extent of its policy limit. This may be illustrated as follows:

The 'contingent defence costs only' cover (CDC) could be written by the same 'combined limit' insurers or by different insurers or by a combination of the two. It could also be structured in such a way so as to allow the CDC insurers to recover defence costs they may have advanced from the traditional 'combined limit' policy in the event that the charge over the latter were released and to the extent that its policy limit has not been exhausted. There are further provisions which might be included to make it more affordable. In this way, directors and prescribed officers would be able to sleep more easily with the comfort of knowing that their protection for defence costs is not squeezed out by the operation of a statutory charge in favor of third party claims, the merits of which are uncertain. Clearly the risks attached to business leadership can be a mine field -- and there's a lot of liability attached to these positions -- but having the peace of mind of knowing *where* to tread and where not to tread, makes all the difference of succeeding or not.

* CGF would like to thank Aon South Africa, for its vast insight and contribution to this article.

About CGF Research Institute (Pty) Ltd

CGF is a Proudly South African company that specialises in conducting desktop research on Governance, Risk and Compliance (GRC) related topics. The company has developed numerous products that cover GRC reports designed to create a high-level awareness and understanding of issues impacting a CEO through to all employees of the organisation.

Through CGF's strategic partners -- supported by our Corporate Patrons *iS Partners, Rifle-shot Performance Holdings and DQS South Africa* -- our capabilities extend to GRC management consulting, executive placements, executive mentoring, company secretariat and the facilitation of Corporate Governance and Risk Awareness workshops. To find out more about CGF, our patrons and our associated services, please access *www.cgf.co.za* or *www.corporate-governance.co.za*

ARTICLE

About Aon South Africa

Aon South Africa provides its clients with seamless insurance and risk solutions backed by a world of resources. Their product solutions provide the full range of world class, cost effective personal and business insurance covers and related services. Decades of experience, local alliances, local and global links, expertise and buying power in the market are unmatched. Aon offers a broad range of products, services and solutions that meet the needs of its clients ranging from individuals to multinational corporations.

Aon South Africa acquired Pinion Insurance Brokers and Glenrand MIB in recent years. With these acquisitions, Aon South Africa is now one of the largest providers of risk management services, insurance and reinsurance brokerage, human capital and management consulting, and specialty insurance underwriting. For our clients, this means expanded and new offerings, greater efficiencies of economies of scale which means better rates and negotiating power with insurers, global network and depth of local talent and capabilities. To find out more about Aon South Africa, please access www.aon.co.za

Words: 1,374

Further Media Information:

Terry Booysen (CEO)
CGF Research Institute (Pty) Ltd
Office: (011) 476 82 64 / 1 / 0
Cell: 082-373 2249
Fax: 086 623 1269
Email: tbooysen@cgf.co.za

Further D&O Product Information:

Taariq Minnaar (Account Executive)
Aon South Africa (Pty) Ltd | Financial Institutions & Professional Risk Office: (011) 944 8169
Cell: 083 657 3715
Fax: 0863 555 9584
E-mail: taariq.minnaar@aon.co.za