



# VIEW FROM THE TOP INSURANCE ISSUES FOR THE BOARDROOM

C L I F F O R D  
C H A N C E

The global financial crisis has led to major changes in the way businesses think about risk. Our recent report “View from the Top – A Board-Level Perspective on Current Business Risks” highlights that the Boards of business are increasingly aware that the risk landscape has changed. However, many Boards are uncertain how best to address new and emerging risks, particularly in a globalised world where local issues in far corners of the world can have global consequences. In this supplement to our “View from the Top” report we highlight some of the current issues faced by our clients when seeking to rely on insurance to mitigate their key business risks.

## ***D&O Coverage for the Costs of Regulatory Investigations***

The importance of Directors & Officers (D&O) liability insurance to mitigating the risks faced by senior management is well understood. What is sometimes not so well recognised is the need for D&O policies to be regularly monitored and updated in order to ensure they continue to protect against a range of risks and liabilities that is constantly evolving.

Increasingly, regulatory risks are amongst the most serious faced by directors and officers. Cross-border co-operation between regulators has led to international regulatory investigations on a much larger scale than was previously the case. Regulators have also become increasingly active in pursuing domestic investigations. Many such investigations involve interviews with directors and officers and/or allegations of individual wrongdoing on their part. The costs of advising and protecting the interests of such individuals can be substantial. Increasingly D&O policies are being used to obtain cover for such costs rather than the costs of defending court proceedings, such as those that D&O policies were originally designed to protect against. So how well do D&O policies protect individuals against the cost of regulatory investigations?

Many D&O policies have evolved to cover legal expenses where an individual director or officer is either:

- required by the regulator to participate in a regulatory investigation in respect of the company;
- notified by a regulator carrying out an investigation that the regulator is considering whether the individual is culpable of misconduct; or
- identified as a defendant in a regulatory proceeding.

However, policies have not always kept pace with the risks posed by investigations, leading to potential gaps in the cover which may be unexpected. For example:

- A D&O policy will often only provide cover in respect of an investigation if the investigation meets criteria established by the policy. That may mean that there is no cover available unless the investigation is a formal one, which has been instituted by the regulator pursuant to some statutory power. However, some regulatory investigations may be informal, at least in their early stages. An investigation may not be specific as to its nature or status, meaning that the individual may be left without D&O cover because he or she is unable to demonstrate that the investigation satisfies the policy criteria. Others may never be covered by the policy criteria, for example, “investigations” by the Parliamentary Commission on Banking Standards, reports prepared by regulators (such as those into the recapitalisation of RBS or HBOS), or attendances before the Treasury Select Committee.
- In particular, regulators are increasingly choosing to require the company first to investigate its own conduct, before commencing any formal investigation of their own. Such self-investigations may have a statutory basis (such as investigations in the UK required by the regulator pursuant to s166 of Financial Services & Markets Act), or they may not. But in either case there is a risk that the D&O policy will not cover a directors’ or officers’ legal representation costs in connection with such investigations, if (as will often be the case) the policy only covers costs incurred in respect of investigations conducted by the regulator itself.
- Likewise many investigations may not identify their target or whether this includes an insured individual, at least in their early stages. This may also impact on the cover available under a D&O policy where the coverage depends on being able to establish that the regulator is looking specifically at potential misconduct on the part of the insured individual.
- In circumstances where the individual is not the target, the regulator may nevertheless request an interview with the individual, making it necessary for that individual to adequately prepare. However, unless the regulator formally requires the individual’s attendance, the D&O policy may not cover the costs of preparing for the interview.
- Moreover, issues such as those described above may apply to preclude cover under a D&O policy even if representation in respect of the investigation is necessary to protect the director’s or officer’s legal position in relation to an expected follow on investigation or claim, which would be covered by the policy.

D&O is undeniably a useful tool for mitigating regulatory risks, but the policy wordings need to be carefully reviewed. It will sometimes be possible to address potential gaps such as those identified above by negotiating changes to policy wordings, but only if the wordings are regularly monitored and updated with a view to maximising the protection they provide.

## Cyber Insurance

In order to mitigate your cyber risk, it would be prudent to review the insurance cover that you have in place in order to determine whether you already have sufficient cover in the event of a cyber security incident or whether you should consider a standalone policy. Such policies are becoming more prevalent as the insurance market starts to understand the risk. In our experience, you may find some cover, particularly for third party risks, within your existing policies, but damage to your own business may be not be adequately addressed without putting in place a specific policy. Further, care needs to be taken when placing your policies to ensure that you make full disclosure of the risk to your insurers and that, in the event of a claim, you comply with often complex policy terms.

## Reform of Business Insurance Law

English insurance law and insurance policies have traditionally been seen, with some justification, as overly insurer-friendly, with draconian remedies available to insurers for even minor breaches by the insured. This has led to some businesses becoming cynical about the value that insurance policies provide.

Against that backdrop, the UK Parliament has recently passed legislation to reform business insurance law. The Insurance Act 2015, which will apply to policies entered into after August 2016, includes major changes to the law relating to the disclosure of risks during the insurance placement process, and the remedies available to insurers for breach of disclosure obligations and warranties.

The Act's reforms include:

- Clarifying the disclosure duty that applies during the placing of policies, by providing greater statutory guidance on what proposers are required to disclose, and, if the presentation of the risk suggests potential problems, shifting the onus to insurers to ask further questions.
- Modifying the remedies available to insurers in the event of a non-disclosure. The insurer's existing remedy of avoidance of the policy would remain in cases of dishonest non-disclosure. In other non-disclosure cases a proportional system of remedies would apply whereby the remedy available to the insurer will depend on the actions the insurer would have taken had it known the true position.
- Similarly the insurer's existing right to be discharged from liability under the policy wherever there is a breach of an insurance warranty would be replaced with a more proportionate system of remedies, whereby the breach of warranty may only suspend the insurance coverage for the period of time until the breach is remedied, or may only suspend the insurer's liability in relation to the particular type of risk to which the warranty relates.

With corporates heavily reliant on insurance as a means of managing risk, it is more important than ever that policies work as intended. The Act is a step in the right direction. But the Act only addresses part of the overall picture.

Apart from the legal issues, there is also a need to address the process by which corporates arrange their insurance policies, so as to ensure that policies are properly tailored to the risks that businesses face.

The Act's reforms do not avoid the need for corporates to engage more fully in the insurance placement process. This will continue to be vital in order to ensure that proper care is taken to make sure that the expectations of insured and insurer are matched from the outset.

## Global Insurance Programmes

For multi-national corporations a global insurance programme often recommends itself as a simple solution. However, putting together such programmes can be complex, there being a need to combine local knowledge with big picture know how.

The range of complications which can arise putting together a global programme can be as varied as the jurisdictions within the programme. To take just a single example, it is sometimes the case that local law prohibits foreign insurers covering local risks without a licence. This may mean that conventional umbrella policies, which provide coverage from international insurers according to global benchmark terms in scenarios where local policies do not respond, may not be enforceable. As a result, insurers, brokers and risk managers have sought to introduce more innovative multi-national insurance programmes to mitigate these risks. However, these programmes can be more complex as they insure the parent company (rather than the local subsidiaries) based on its financial interest in such subsidiaries. These structures raise a number of specific insurance law and regulatory issues which need to be addressed.

The unique combination of our firm's global reach and wealth of relevant experience in insurance and reinsurance matters makes us ideally suited to advise on all aspects of the structuring, negotiation and drafting of global insurance programmes.

Our specialist, market-leading, Insurance Group can assist with all aspects of your business's insurance requirements, including by advising in respect of the negotiation and drafting of, and the making of notifications and claims under, a wide range of policies, including:

- Directors & Officers liability;
- Cyber insurance;
- Political Risk;
- Transactional insurance (including Warranty & Indemnity and Contingent Tax);
- Public Liability;
- Professional Indemnity;
- Fidelity;
- Product Liability.

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### *Chambers UK 2015*

**Ranked Band 1 Insurance – Policyholders**

### *Legal 500 UK 2014*

**Ranked Tier 1 Insurance Litigation – Policyholders**



*The firm has extensive experience in the application of the principles of insurance law, as well as a good understanding of market practice within the insurance community, which gives their advice a genuine commercial value.”*

Chambers UK 2014, Insurance



*Offers policyholder clients the comprehensive resources of a magic circle firm for all their insurance needs. Counts some of the largest financial institutions and energy companies among its clients. Possesses particular strength in political risk, D&O claims and mis-selling of financial products.”*

Chambers UK 2015, Insurance – mainly policy holders

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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