



# Financial Markets

Directors & Officers

Liability Insurance

Glenrand M·I·B is a Licensed Financial Services Provider





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## Introduction

Businesses operate today in an environment of ever increasing requirements for better **transparency, disclosure, accountability and governance**. Directors and Officers (D&O's) of companies are charged with the huge responsibility of maintaining compliance with many enactments, corporate codes and best practices, as well as having to illustrate to various stakeholders that they are running their organisations effectively and profitably.

When something goes wrong, the directors are the first port of call when other parties are looking for recourse against a company.

**Directors and Officers Liability insurance (D&O)** plays a pivotal role in **protecting financial risks** which directors and other senior managerial staff may become exposed to.

Here are some of the reasons businesses today are asking for D&O Liability insurance:

- Collapse of large corporate companies due to mismanagement by key executives
- Failure of accounting and auditing firms to unveil financial irregularities
- Increased awareness and practice of Corporate Governance
- Greater disclosures required of businesses in terms of reporting and listing requirements
- Extensive press coverage of directors' faults

As a director of a company, you can be held **personally liable** for your actions as they relate to the company. In extreme cases you may even be forced to **surrender personal assets** due to circumstances beyond your control. If your company purchases D&O Liability insurance, you and your senior colleagues can **put your minds at rest** in the knowledge that wrongful and negligent acts which you could be held liable for, will be covered.

With Glenrand M:I-B you can structure a D&O insurance policy to suit your needs, and **remove most of the financial risk** associated with the human element of managing a business.

## What Would Constitute a Claim?

A claim is usually initiated by a third party who has some relationship with or interest in the company and alleges that a director or officer has acted wrongfully. In most cases this results in financial loss to the third party, the company, or combination of the two. The third party will typically sue the company as well as the Directors and Officers, which involves legal costs and sometimes civil damages.

A wrongful act is defined as an actual or alleged breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, breach of warranty or authority or any other act.

## Common allegations against D&Os

- Manipulation of the share price
- Unfair dismissal / discrimination / harassment
- Breach of company articles or internal rules
- Unfair competition
- Unsafe work practices
- Delayed filing of insolvency and insolvent trading
- Breach of the Companies Act and other statutory enactments
- Incorrect statements in the Annual Report
- Breach of contractual duties

## Typical Plaintiffs

- Shareholders
- Creditors and liquidators
- Competitors
- Employees
- Customers and suppliers
- Government agencies
- Other third parties e.g. Environmental groups

## What does a D&O Policy Cover?

### Directors and Officers Liability

Covers actions brought against the directors and officers alleging a negligent or wrongful act. This can be on a named or blanket basis and applies to past, present and future directors and officers of the company and its subsidiaries.

### Company Reimbursement

Where the company indemnifies the directors and officers for a negligent or wrongful act first, the Company will be reimbursed. This section responds only once:

- a. the director successfully defends the action against him; or
- b. the director is able to prove that he acted honestly and reasonably,

In accordance with S247 of the Companies Act, 1973.

Cover automatically applies to all subsidiary companies

## What types of entities would D&O cover apply to?

- Public and private companies
- Listed and unlisted companies
- Mutual companies
- Co-operatives
- PFMA (Public Finance Management Act) and Government controlled companies
- Section 21 companies (Not for Profit companies)
- Associations including Homeowners Associations
- Shareblocks



## Noteworthy Extensions and Exclusions

Glenrand M·I·B has a wide base of strong relationships in the financial sector of the insurance market, and aim to provide what we believe is the widest cover possible at competitive prices on our **exclusive binder facility**. Here are the nuts and bolts of the cover:

### Extensions:

- Automatic new subsidiary cover - for new subsidiaries whose assets do not exceed more than 25% of your company's consolidated assets (automatically applied for 60 days until written into policy)
- Outside directorships on a blanket basis,
- Heirs, estate and legal representatives are also covered in the event of your death
- Joint property liability if the assets of your spouse are attached in a legal suit
- Optional 24 month discovery period at a discretionary premium
- Lifetime run off cover for retired uninsured persons
- Legal defence costs are advanced up front before civil damages are awarded
- Employment practice Liability for you and the other directors
- Investigation costs which are sub-limited to 100% of the policy limit

- Special Excess Protection sub limit for Non Executive Directors
- Tailor-made wording to include PFMA regulated entities and municipalities
- Kidnap and ransom extension
- Extradition costs included
- Assets and Liberty Costs included
- Public Relations Expenses
- Bodily injury and Property Damage Defence costs included

### Exclusions

- Fines, penalties and taxes, fraudulent or dishonest acts or other acts uninsured by law
- Prior claims
- General Professional Indemnity Exclusion with carve back for failure to supervise
- North American Exclusion – Option to remove
- Commissions and bribes for African countries excluding RSA

The above terms and conditions may vary for Financial Institutions

The above terms and conditions is a summary guide to the insurance portfolio and is in no way intended to override the actual policy wording and conditions.

## The New Companies Act 71 of 2008

Around the world, reporting standards of companies are evolving due to minimum levels of accounting reporting standards, triple bottom line reporting, environmental responsibility, corporate social responsibility with a concentrated focus on sustainability reporting and sensible corporate governance. This focus on greater accountability of companies and their stewards has raised a heightened awareness by the general public of their rights of recourse against companies and directors in their personal capacity where the business carried on has not been conducted or managed in a responsible manner.

South Africa is no exception to this, and has recently updated its Companies Act which will come into effect in 2011. This new enactment follows trends in other more modern acts. In addition to this change, we have just seen the King III revision finalised on 1 September 2009. The need for this revision is because of the extent of change in the New Companies Act.

### **What effects do these changes have on Directors and Officers Liability Insurance?**

We have already seen a sharp increase in the appetite of companies, first listed and now larger private companies as well, towards purchasing Directors and Officers Liability insurance. This is attributable to raised awareness of the subject of corporate governance and a rising concern that directors have, or being held personally liable for their actions.

Going forward, it is possible, even likely that this trend will continue at an even more rapid rate,

where Directors and Officers insurance will become an absolute necessity for the protection of personal interests of Directors, Officers and other employees who are charged with supervisory and managerial responsibilities and can be held liable for wrongful acts which may occur in their day-to-day management activities. Managers of mines are a prime example of this.

Policies available locally, are adapted from international forms to apply to local jurisdiction and are therefore relatively traditional in nature. It is unlikely that insurers will change the basis of cover as a result of the introduction of the Companies Act, and we confirm that this is the case following the amendments made to the King III Code of Corporate Governance, which is a recommended code of practice, and is only strictly implemented by companies which are listed on the local JSE bourse, as part of the JSE listing requirements on the main board.

### **How then would these developments be expected to affect Directors and Officers Liability Insurance?**

#### *Companies Act 71 of 2008*

Directors and Officers Liability insurance generally includes two main insuring clauses:

Side A – Personal Liability of Directors and Officers

Side B – Company Reimbursement where the Company has first indemnified the Director or Officer



The context in which the applicable sections (247 and 248) of the existing Companies Act No 61 of 1973 discuss indemnification of directors provides limited opportunity for the indemnification of directors under insuring clause Side B, Company Reimbursement.

Effectively, before a company is able to reimburse a director, the following requirements must be satisfied:

1. The director or officer must have acted reasonably and honestly
2. Having regard to the circumstances the director or officer ought fairly to be excused for negligence, default, breach of duty or breach of trust

The court will then have to excuse the director concerned or the director will have to successfully apply for relief in terms of section 248 in order for the Company to validly claim Company Reimbursement benefits under Side B of the Directors and Officers Liability Insurance Policy.

At all times, the indemnification of the director by the Company is only allowed as a result of a judgement in that director's favour or him/her having been acquitted of any proceedings in connection with a section 248 application as discussed above.

It follows that Side B, Company Reimbursement is seldom activated when claims are reported against policies.

One of the main developments under the new Act is that Indemnification of Directors and Prescribed Officers is allowed, which will enable the Company Reimbursement section of the policy to be activated without as many formalities to comply with.

Without there being any direct amendments to the policy coverage, we anticipate the following effects as a result of the introduction of the New Companies Act:

- Companies will more readily indemnify their directors and officers against certain actions allowed within the framework of the new Act
- The Side B – Company Reimbursement section will become active and start responding to insured events.
- Insurers will impose side B deductibles or raise their existing deductibles.
- Common Law responsibilities of Directors and Officers have been codified into the New Act to some extent, which will result in a greater means of available recourse against them for wrongful acts.
- Increased public awareness and a more educated public will lead to a culture of wishing to seek recourse against directors and officers.
- Litigation levels will increase
- The introduction of the new Business Rescue section may serve to reduce the number of 'reckless trading' actions against directors for companies which have traded under insolvent conditions.

## King III Code of Corporate Governance

Since its inception, the King Code has played an instrumental role in providing guidelines to companies of corporate and commercial categories on the manner in which their boards should be structured, and on setting up solid governance practices. Good corporate governance is a key factor which underwriters would consider in their assessment of the potential exposure of an entity, its directors, officers or employees to the risk of personal liability actions as a result of their negligent wrongful actions.

Whilst the King III Code is not required to be implemented in law, it raises appropriate standards of conduct, which could result in a court being able to find a director or officer personally liable if they do not meet what has become a generally accepted or reasonably acceptable standard of conduct, through principles of Corporate Governance.

The philosophy of the new King III report is based on three key aspects being:

- Effective Leadership
- Sustainability
- Corporate Citizenship

### **Comments on specific themes in the King III Code in relation to Directors and Officers Liability Cover**

#### ***Integration of Social, Environmental and Economic Issues***

This concept is alternatively referred to as triple bottom line reporting. Increased pressure which will continue to be placed on companies to report on their social, environmental and economic activities will force them to display a greater degree of transparency. The consequence for directors, officers and other employees could be a higher risk

of exposure to personal liability actions due to the sensitive nature of these disclosures and the extent to which they should be reported on in the annual financial statements, thereby increasing the risk of public misstatements.

#### ***Inclusive Stakeholder Approach***

The King III Code makes provision for a 'stakeholder inclusive' model of corporate governance. Here, the board of directors considers the legitimate interests and expectations of stakeholders in relation to the company as well as to the shareholders.

Since Directors and Officers Liability can arise from sources other than shareholders, such as creditors, suppliers, customers, government, environmental groups to name a few, this stakeholder inclusive model would only serve to reduce the risk of potential actions from stakeholders and shareholders alike, and would be considered a positive guideline for companies to follow.

#### ***Integrated Reporting***

King III has recommended integrated sustainability performance reporting, which will record how a company has both positively and negatively impacted on the life of the community in which it operated during the period under review, often categorised as environmental, social and governance issues (ESG).

Again, an additional requirement such as this would have advantages and disadvantages from a Directors and Officers Liability perspective. Advantages would be better transparency, increased focus on the impact of the company's operations upon its local environment. Disadvantages could be a greater exposure (public or private) to potential actions due to increased reporting and disclosure visibility.



## Summary

The New Companies Act and the King III Report together will bring about some significant changes to the way companies are structured and run. The basic Directors and Officers Liability product is standard across most countries and will not be likely to change as a result of these recent developments in SA.

Financial Markets will ensure that any developments or enhancements are applied to our Clients policies, either at renewal or mid-term as necessary so that our Clients continue to enjoy world class cover, which is up to date with current legislation.

## Why Glenrand M·I·B?

Financial Markets is a specialist division of Glenrand M·I·B. We have dedicated staff who are leaders in their areas of responsibility. The knowledge and expertise we possess only comes with experience and exposure to a battery of variables which present themselves on a daily basis given the expansive client base we already manage.

This specialist class of business should be handled by a suitably qualified specialist insurance broker who is up to date with all the developments in the market as a result of the introduction of the new Companies Act.

A specialist insurance broker will be aware of any material changes which insurers and underwriting agencies will make to their policies when the new Companies Act is implemented, and will be in a position to make necessary amendments to a client's policy to cater for any pitfalls in cover.

## Supplementary Directors & Officers Covers

The following types of transactional covers are available in addition to underlying D&O Liability insurance if there is a change in risk during the currency of your policy:

- **Run-off Covers**

Provide ongoing D&O cover for subsidiaries which are disposed of or sold.

- **Mergers and Acquisitions**

Insurance for warranties and indemnities in the event of a merger or acquisition.

- **Prospectus Offering Securities Insurance (POSI)**

D&O Insurance for public or private offerings which ring-fences the transaction from D&O cover required after the transaction.

- **Removal of Secondary Offering Exclusion**

Extends the underlying D&O policy to cover secondary offerings and additional share subscriptions



## Contact Details

Should you have any queries relating to your cover, please contact anyone in our team for assistance:

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