

Directors and officers liability insurance for bribery and corruption





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INTRODUCTION

Australia is taking steps to strengthen anti-bribery laws, which had previously been criticised as being ineffective, inadequate and under enforced¹.

Companies implicated in bribery and corruption here or abroad are at risk of prosecution. Reflecting the increasingly borderless world in which companies operate, regulators around the world are collaborating and sharing information as part of a global effort to apply greater scrutiny on the way companies and individuals behave².

The heightened focus makes it ever more critical that companies put in place procedures to identify bribery and corruption risks. They must also implement systems to address those risks and discourage illegal behaviour.

This paper examines the extent of cover available under a directors and officers (D&O) liability policy for a bribery and corruption event³.

¹ Uncovering cover ups: Australia strengthens its anti-bribery laws. Regulatory Update 07 March 2016 Ashurst James Clarke and Fiona Hudson

² Don't be fooled – Australian anti-bribery and corruption laws exist. Regulatory Update 2 September 2016 Jonathon Ellis, DLA Piper

³ The Foreign Corrupt Practices Act and UK Bribery Act & Australia's Cth Criminal Code Act 1995 for example prohibit companies from bribing foreign government officials to further their business interests. In 2010 penalties for bribery offences under Australian laws were increased. Australia's Cth Criminal Code is a law mainly enforced by the Australian Federal Police.

Individuals and corporations can be prosecuted whether the offence occurred here or abroad and many anti-bribery laws have extensive extraterritorial reach.

COVER FOR INVESTIGATIONS INTO CORRUPT CONDUCT

Corrupt conduct is a global issue. For organisations with international operations, a single bribery event can result in multiple offences under different countries' laws. As many anti-bribery and corruption laws apply in Australia and overseas, individuals and corporations can be prosecuted whether the offence occurred here or abroad⁴ and many anti-bribery laws have extensive extraterritorial reach. Consequently, a businesses should look for D&O policies with worldwide cover.

Most D&O policies offer some cover for legal costs incurred by directors and officers in preparing for, responding to, or attending a formal investigation. The better policies provide this cover to the full policy limit, even when a wrongful act has not yet been alleged, and contain an advance payment promise. This is important as many investigations are conducted more as an evidence-gathering exercise, particularly at the preliminary stage.

However, investigations can result in adverse findings and lead to civil or criminal proceedings against directors so it is important that provision for coverage of the costs of legal representation is included in a D&O policy.

PRE-INVESTIGATIONS

Some D&O policies now provide cover for costs incurred by directors in preparing formal notifications to regulators or official bodies of an actual or suspected material breach of a company's legal duty.

Similarly, directors might incur costs for conducting internal investigations, if requested by a regulator following a formal notification of bribery and corruption. D&O policies can also cover these costs.

Market-leading policies will include cover for internal inquiries conducted by a company, as well as raids or on-site visits by an official body.

This cover can be sub-limited and additional premium and conditions may apply.



⁴ Don't be fooled – Australian anti-bribery and corruption laws exist. Regulatory Update 2 September 2016 Jonathon Ellis, DLA Piper

ADVERSE INVESTIGATORY OUTCOMES

In a worst-case scenario, the consequences of any type of investigation into corrupt conduct can include:

- criminal prosecutions against the company and its directors and officers
- fines and penalties against the company⁵ and its directors and officers⁶
- directors' disqualification or imprisonment⁷
- follow on civil proceedings
- significant legal costs and expenses
- disgorgement of profits
- civil recovery orders (UK)
- damage to reputation and brand
- disruption to business

PROSECUTIONS

If a prosecution is commenced against directors and officers this should trigger the definition of a 'claim' in the better D&O policies as it typically includes criminal proceedings.

As a result, directors and officers should be afforded cover for amounts⁸ they become legally liable for in defending a prosecution. This should be subject to the application of the 'dishonesty' exclusion and the exclusion for 'matters uninsurable at law'.

Importantly, a D&O policy should allow for defence costs to be advanced prior to the final disposition of any prosecution.

However, it is important to note that once it is determined a director or officer is not entitled to cover (including through the application of any exclusion) any defence costs advanced must be repaid.

Cover for prosecutions against the company itself may not be covered as the definition of securities claim in some D&O policies does not include criminal proceedings against the company.



STRUCTURE OF A D&O POLICY

A typical D&O policy provides coverage under the following categories:

- Side A covers D&Os for personal liability and associated legal costs and expenses in circumstances where the company is prohibited or unable to pay these costs.
- Side B covers a company where it can and does indemnify or defend its D&O.
- Side C provides cover for companies in relation to claims made by shareholders in relation to its shares.

A D&O policy predominantly covers individuals rather than the company, with limited exceptions. For instance, D&O policies typically reimburse the company for amounts it pays on behalf of its directors and officers under indemnity arrangements.

⁵ For example for a corporation an intentional breach of the new false accounting offences introduced into the Criminal Code (Cth) is punishable by a fine of up to \$18 million, up to three times the value of the benefit obtained from the conduct or up to 10% of the annual turnover of the corporation during the 12 months prior to the conduct.

⁶ For example for an individual an intentional breach of the new false accounting offences introduced into the Criminal Code (Cth) is punishable by a fine of up to \$1.8 million.

⁷ For example for an individual an intentional breach of the new false accounting offences is punishable by imprisonment for up to 10 years.

⁸ Refer to the definition of "Loss" in your policy wording. Note any exclusionary language.

D&O policies exclude matters uninsurable at law on the basis that people must not benefit from their own wrongful acts or be indemnified against the consequences of wrongdoing.

CIVIL PENALTY PROCEEDINGS

Cover should also be available for any civil penalty proceedings instigated by a regulator against a director or officer for statutory breaches following an investigation.

DISQUALIFICATIONS AND EXTRADITION PROCEEDINGS

Most D&O policies provide some cover for legal costs and expenses incurred in defending disqualification orders and extradition proceedings.

FINES AND PENALTIES

Although some D&O policies expressly exclude cover for fines or penalties, the better ones provide worldwide cover for civil fines and pecuniary penalties. The exception is if the insurer is legally prohibited from paying fines or penalties in the jurisdiction in which the claim is determined. Market-leading wordings cover fines or penalties including those resulting from strict liability offences⁹, provided the fine or penalty is not derived from a wilful, deliberate or intentional act.

Some D&O policies have been endorsed so the definition of loss includes cover for civil penalties assessed against an insured person, pursuant to the *US Foreign Corrupt Practices Act (FCPA)*.

But there is a question in the UK as to whether fines or penalties can be insured under the *UK Bribery Act* and cover may not be available under a D&O policy.

There is also a question mark over insurance cover for criminal fines and penalties in Australia¹⁰.

D&O policies exclude matters uninsurable at law¹¹. This is for reasons of public policy on the basis that people must not benefit from their own wrongful acts or be indemnified against the consequences of wrongdoing. Any insurance contract that insures against these risks would be void and unenforceable. This would include any policy that claims to indemnify a person against criminal liability if the crime is one that can only be committed with guilty intent.

⁹ The UK Bribery Act for example imposes strict liability regardless of intent.

¹⁰ In 2010 penalties for bribery offences under Australian laws were increased to \$1.7M or 10 years imprisonment for directors, and considerably more for companies.

¹¹ Typically by virtue of the definition of "Loss".

The position is less clear where the crime is one of strict liability and the offender is morally innocent, although the majority view seems to be that an indemnity can be given in this scenario. The outcome may depend on whether there is an element of fault or intent attributable to the person who has committed the strict liability offence.

Cover for fines and penalties under a D&O policy will also be limited by the application of the dishonesty exclusion, which excludes cover for any fine or penalty arising out of any 'deliberately fraudulent act or omission', 'wilful conduct' or 'wilful breach of duty'.

A D&O policy does not usually provide cover for fines and penalties assessed against a company itself.

DISGORGEMENT OF PROFITS

Disgorgement of profits as a remedy for corrupt conduct tends to be more applicable to companies than to directors and officers. Companies are, consequently, unlikely to be afforded cover under a D&O policy even in the context of a securities claim. This is owing to the dishonesty exclusion, which operates when a company gains any profit, remuneration or advantage to which it was not entitled.

It is also uncertain as to whether disgorgement is insurable at all, when considered against the previously mentioned public policy against a person benefiting from wrongful acts or indemnifications from the consequences of wrongdoing.





INSURED VS INSURED EXCLUSION

A number of D&O policies contain an insured versus insured (IVI) exclusion, which operates to exclude cover for claims against a director brought by his or her company, a subsidiary or by another director or officer.

The IVI exclusion came into widespread use in the mid 1980s in response to certain suits by corporations against their own directors and officers that were designed to trigger a D&O policy following disastrous losses. Since that time there have been a number of buybacks in coverage.

Some D&O policies provide IVI cover (except for those IVI claims made in the USA or Canada), while others contain an exclusion for consensual claims in lieu of the IVI exclusion. A policy that contains an IVI exclusion should be carefully reviewed to ensure that the maximum buybacks in cover are afforded, otherwise the personal assets of directors and officers may be exposed.

CIVIL RECOVERY ORDERS

Pursuant to the *UK Proceeds of Crime Act*, the Serious Fraud Office can seek a Civil Recovery Order¹², whose purpose is to recover property obtained through unlawful conduct. Like with disgorgement of profits, there are questions about both the insurability and the application of the dishonesty exclusion for civil recovery orders.

FOLLOW-ON CIVIL LAWSUITS

Follow-on civil lawsuits generally take two forms. They are either securities class action lawsuits filed by company shareholders (alleging, for example, FCPA investigations into corrupt conduct caused the company's share price to fall) or in the form of a shareholder derivative lawsuit, filed on behalf of the company itself. Some insurers now offer cover for shareholder derivative suits.

The definitions of 'claim' and 'loss' in a typical D&O policy *may* be broad enough to trigger cover for a company under Side C coverage and for directors and officers of a company under Side A coverage. But cover for the resulting losses may be compromised by the application of the dishonesty exclusion and the exclusion for matters uninsurable. The USA Insured versus Insured exclusion may also impact a shareholder derivative lawsuit, unless one of the exceptions apply.

PUBLIC RELATIONS EXPENSES

The better D&O policies will also cover reasonable costs and charges of hiring a public relations firm to mitigate the effects of any reputational damage from investigation or litigation into corrupt practices.

¹² In Australia under the Proceedings of Crimes Act benefits obtained can be forfeited to the Australian Government.

IMPACT OF THE DISHONESTY EXCLUSION

No D&O policy will provide cover for claims arising from dishonest or fraudulent acts or wilful or intentional breaches of law.

Accordingly, if a director or officer has wilfully engaged in bribery, any resulting loss, for instance a fine or penalty, is unlikely to be covered.

Exclusions in the better D&O policies will not apply to defence costs advanced under the D&O policy until a final, non-appealable adjudication. Costs advanced may need to be repaid if the director or officer is found to have engaged in dishonest or fraudulent conduct.

Some policies to expressly exclude claims arising under the *UK Bribery Act* and *US Foreign Corrupt Practices Act*.

COVER FOR RETIRED DIRECTORS AND OFFICERS

Most D&O policies provide cover for former directors and officers, typically under the Insured Person definition, with two important caveats.

First, cover for former directors and officers is only for claims that concern events occurring before the director or officer left the company and that relate to the individual's capacity as a director or officer of the company.

Second, cover for former directors and officers typically continues only to the extent the company continues to purchase D&O insurance in the future, with limited exceptions.

The better D&O policies offer a Retired Directors and Officers Extension¹³.

The extension typically provides that if the D&O policy is not renewed or replaced when the policy expires, any retired insured person may be granted a further period in which to notify claims. This is typically 84 months. This extension is not available in certain circumstances, notably in the event of a transaction or insolvency.

¹³ The definitions of Retired Insured Person vary from wording to wording.

ASIC and APRA have made clear their intentions to pursue companies and their officers for corporate culture breaches.

CULTURE OF CORRUPTION

As countless media reports suggest, the investigations into certain international organisations show that, at least in some pockets, the rule of law has been replaced with an entrenched culture of corruption. Deeper assessments of the practices in these businesses reveal them to be organisations operating without governance structures or supporting frameworks. Both the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have made clear their intentions to pursue companies and their officers for corporate culture breaches¹⁴. To minimise this exposure, directors must develop appropriate controls and implement robust compliance systems to deal with corrupt conduct.



¹⁴ Directors Duties. Show me the money. And ethics, culture and reputation. Keely Graham, Principal McInnes Wilson Lawyers

CONCLUSION

While a D&O policy is designed to protect the personal assets of directors and officers it may not always respond to a bribery and corruption event in the manner expected. This is due to the serious nature of the conduct in question, given unlawful and dishonest conduct cannot usually be covered by an insurance policy.

The better D&O policies provide coverage to directors and officers for 'reasonable' costs and expenses incurred as a result of formal investigations in any jurisdiction.

Importantly, in today's climate a D&O policy should provide cover for:

- legal expenses incurred in relation to investigations related to anti bribery laws
- legal expenses in relation to prosecutions or follow-on civil suits after bribery and corruption allegations
- civil fines and pecuniary penalties awarded pursuant to anti-bribery legislation to the extent insurable at law

A company has more limited cover in relation to anti-bribery and corruption allegations compared to the protection offered to its directors and officers. But coverage may be available if the allegations relate to the company's securities.

In any case, it is safe to conclude that coverage is unlikely if the claim related to criminal fines and penalties, disgorgement orders and civil recovery orders. Such restrictions on coverage are common practice in D&O insurance based on the principle that such losses are uninsurable on public policy grounds.

With regulators increasing their focus on corruption allegations and determined to take a tough approach, a thorough understanding of the risks involved and how they can be managed is paramount. For companies looking to protect their business and reputation from this harm, the priority must lie in ensuring appropriate risk management frameworks are in place to prevent, detect and respond to corruption, while also encouraging a culture of compliance.

Please note that whether or not and to what extent a particular allegation of bribery and corruption and the related losses are covered depends on the specific facts and circumstances of the loss and the terms and conditions of the policy as issued. It is impossible to state in the abstract whether the policy will provide coverage in any given situation.

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