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Lead Article:

DIRECTORS' & OFFICERS' LIABILITY INSURANCE - A PERSPECTIVE FROM INDIA

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"Uneasy lies the head that wears a crown"- William Shakespeare

With ever-increasing complexities of business and changing economic and legal landscape, demands are mounting on directors in relation to discharge of their duties. Directors are expected to be professional and result orientated and they have to work towards fulfilling the expectations of all the stakeholders. If organizations have to perform and achieve, management has to be ready to take risks – well considered and without any malicious or ulterior motives. When can one take a risk? When one feels that he/ she has done his/ her duties with all the care and caution and when the consequences of actions do not cripple him/her. But, we are in an unforgiving world. People may be allowed to make mistakes. But, they are expected to pay for it, should things go wrong.

A director's personal liability is unlimited placing all his personal assets at risk. Unlike the Company, he cannot take shelter under limited liability. Directors are jointly and severally liable. It is the directors who manage the assets and control the company's day to day affairs. Directors are liable *personally* to pay losses suffered by the Company following an act which is wrong, negligent, outside the Company's authority, beyond their power, or which evidences insufficient skill and care in managing the Company's affairs.

Directors and officers are bound by duty towards various stakeholders --- shareholders, employees, creditors, customers, competitors, members of the public, government and other regulatory bodies. Any breach or non-performance in the duties can result in claims against them by reason of any wrongful act, **actual or alleged**, in their respective capacities.

Then, how to avoid trouble?

First and foremost, there should be a realization that the fundamental responsibility of directors and officers is to represent prudently the interests of the shareholders as a group and other corporate constituencies in managing the business of the company within the law. Adherence to strict corporate governance standards and tighter disclosure standards would certainly make the corporate sector more transparent and consequently less prone to faults. However, it will not necessarily guarantee protection against litigation by any stakeholder in view of the increasingly complex set of laws that govern the business environment. While a company is legally permitted to cover the personal liability costs resulting from activities performed on behalf of the

company, this ability, called indemnification, may not apply to every situation. In some cases, the financial burden of the liability is the sole responsibility of the director or officer particularly in view of provisions like Section 201 of The Indian Companies Act 1956.

The primary purpose of Directors & Officers Liability insurance is to fill in these gaps, protecting the personal assets of the individual director or officer.

This insurance policy protects the Directors and Officers against:-

- a) Legal costs in defending allegations or suits brought against them *alleging wrongful acts*.
- b) Any damage awarded to the claimants against the directors and officers, including out of court settlements.

While the policy has different coverages and is subject to various exclusions, it is pertinent to note that unscrupulous behaviour is outside the scope of the policy. However, this exclusion is subject to final adjudication in the matter.

In order to appreciate the relevance and importance of this policy, it is necessary to recognize the emerging exposures, some of which are listed below.

Emerging Exposures – Global:

- Global Village & Multinational Environment: Today's world is a global village. Both demand and supply factors entail global vision for any business. Corporates have to factor diverse cultures, laws and regulations in different parts of the world. Predictability of operations would not be the same as it is when conducted in a single country
- Evolving Corporate Governance: The frontiers of corporate governance are ever-expanding. Interestingly, the citadel of capitalism has seen many governance break downs and scams. This has resulted in passage of Public Company Accounting Reform and Investor Protection Act laws in USA also known as Sarbanes Oxley (SOX) laws,
- Greater Public Disclosures: The need for disclosure is much more and truth and complete truth need to be revealed in all corporate disclosures.
- Sharper Scrutiny by Regulators: Regulators are continuously on watch to prevent errors of omission and commission and bring the wrongdoers to book.
- Rising Defense Costs: The enormous increase in the defence costs particularly in the corporate litigation space is too well known for repetition. This problem is compounded when the trial goes on for years
- Mergers & Acquisitions: M&A is the name of the game for business growth and consolidations. This presents challenges to managements with change in expectations from one another.
- Class Action: This is a form of lawsuit in which a large group of people collectively bring a claim to court. The judgment from the suit would be applicable to all the members of the group (class). Be it employment practice related or securities litigation related, class action is something managements need to continually watch out for.

- Employment Practice Violations: These relate to actual or alleged wrongful or unfair dismissal; defamation in relation to wrongful or unfair dismissal; sexual harassment; discrimination; denial of natural justice; adverse change in the terms and conditions of a person's employment in retaliation for that person's exercise of his or her rights under law.
- Foreign Corrupt Practices Act 1977: FCPA: This is a good example of the long arm of the US law. The Act is not merely restricted to the United States, although their signatory clearly adds weight. USA is a joint signatory along with many other OECD member governments in the application of FCPA. Substantial fines for the lack of effective controls to prevent the bribing of overseas officials have been levied in several signatory countries including the UK.
- The Corporate Manslaughter and Corporate Homicide Act 2007 of UK is a landmark in law. Companies and organizations found guilty of corporate manslaughter as a result of serious management failures resulting in a gross breach of a duty of care will be penalized.

Emerging Exposures - Indian:

- Companies Bill: Apart from imposing higher standards of professional conduct and governance, provision is made for class action suits. These increase the exposures for directors and officers significantly.
- Serious Fraud Investigations Office: A multi-disciplinary organization with experts from several sectors, including finance, law, accountancy, customs and tax. Investigations can be detailed and lengthy (Satyam report – About 14000 pages). These investigations have resulted in many prosecutions against various companies, directors and officers, which evidence the SFIO's extensive range of investigation and enforcement powers.
- SEBI: Clause 49 of the listing agreement. This increases exposure for directors and officers in listed companies.
- Competition Commission of India: This is a body of the Government of India created to enforce The Competition Act, 2002 throughout India and to prevent activities that have an adverse effect on competition in India.
- The Protection of Women against Sexual Harassment at Workplace Bill, 2010: It is necessary for managements to be sensitive to protection required for women workforce. Actions both proactive and remedial are called for protection of women at workplace.

How does a good D&O liability insurance help?

Introduction of corporate governance regulations and heightened monitoring does not guarantee that we see the last of corporate governance breakdowns. Should that breakdown happen, there should be protection and relief for the affected parties. D&O insurance does not dilute the need for corporate governance. It offers help as given below:

1. Improve the company's ability to recruit qualified directors and officers. Directors designated are beginning to insist on a good D&O policy before assuming duties. With the sweeping changes in the profile and the responsibilities of the directors, it is becoming increasingly necessary for the persons intending to become directors to seek protection in some form or the other.

2. Enhance the defense of claims and reduce the potential recovery by a claimant.
3. The increase in public interest litigations, environmental petitions and customer grievances, which would result in the risk of civil liability claims and litigation against directors and officers increasing considerably. This makes it very important for the directors to protect themselves against such risks.
4. Globalization has also resulted in Indian companies, particularly from the knowledge-based sectors, increasingly accessing the global markets for capital as well as acquiring and setting up companies in other countries. This opens up a lot of new challenges and risk exposures facing which will be difficult for the directors without a proper D&O policy. Globalization inevitably will expose Indian corporate management to a variety of different legal cultures, be it in the US, Europe or other Asian countries.

Directors and Officers who run public sector organizations broadly run the same risks as their counter parts in the private sector. The concept of sovereign immunity is not applicable for commercial transactions and it is primarily applicable and relevant only with reference to sovereign functions.

A D&O liability insurance policy is not a replacement for sound management & corporate governance. But, a good policy helps in as much as it reduces the apprehensions and addresses the concerns of the Directors & Officers so that they can concentrate on their work to take the company on growth path in a sustained manner. It is stakeholder's interest and not only shareholders interest that would dictate future direction of the corporate governance and directors need to ring-fence their liabilities with an appropriate D&O policy.

D&O liability insurance policy is an important and integral part of Corporate Governance, as it protects the directors and officers against personal liabilities and also may ensure relief to the victims of corporate governance failures.

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At the request of the core members of the erstwhile Commonwealth Association for Corporate Governance, a proposal has been conceptualized for convening a meeting to examine recent developments, regulatory aspects and future course of action. This proposal submitted by Y.R.K. Reddy, in his capacity as the member of the Commonwealth Expert Review Group (2007) on behalf of all members. Plans are afoot to organize this international meet during the third quarter of 2013.

A further proposal was given to the Commonwealth Secretariat, at their informal request, relating to Centers of Government with special focus on small states and corporate governance policy.