

Directors' indemnities and insurance: How covered are you, really?



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Imagine the following scenario.

A director is prosecuted for allegedly being in criminal breach of his duties. The case goes through the courts and the director is found innocent. He is landed with a huge legal bill for which he tries to seek an indemnity from the company or the insurers under the directors' and officers' (D&O) liability insurance policy that the company had purchased. Lo and behold, he finds the company is not legally obliged to indemnify him under either the terms of his appointment or its constitution. Nor does the policy cover legal expenses for criminal prosecution or regulatory actions. The director, though blameless, is out of pocket for tens, if not hundreds, of thousands of dollars in legal fees.

Most directors will have some inkling of the directors' liability insurance coverage the company has taken out, but probe further and chances are they will be unaware of the extent and details of that coverage. Given the scenario above, it is crucial that they step up their understanding of the legal exposure they face when serving on corporate boards and, more importantly, what protection they have.

What Does the Law Permit?

The recent changes to the Companies Act have clarified the extent to which a company can provide legal protection for its officers (including directors) against liability.

For starters, section 172 voids any arrangement whereby a company purports to exempt or indemnify its directors from liability in connection with any negligence or breach of duty in relation to the company.

Companies are, however, allowed to indemnify their directors in respect of liabilities incurred to third parties. The only exceptions to this are arrangements of indemnity for the payment of fines or liabilities incurred in defending civil suits, criminal prosecutions or regulatory actions taken against the director where he is convicted or judgment is given against him. Such arrangements are void. This is fair as directors should not be reimbursed by the company where he has breached his duties to it.

In other words, indemnities may be given for legal costs and other expenses incurred in successfully defending against any action. They can extend to costs associated with mediation or arbitration proceedings as well as expenses incurred in trying to reach an amicable settlement. They can also cover liability in respect of third party suits against directors in performing their duties properly for the company and associated legal costs. The indemnity can be provided for in the company's constitution or the director's contract. It can even be agreed upon after the expenses or liabilities have been incurred (provided the director is found not guilty).

Instead of, or in addition to providing an indemnity, companies may arrange for appropriate D&O insurance coverage. The law explicitly allows companies to purchase and maintain insurance, for the benefit of its officers, against liability incurred for negligence or breach of other duties. The extent of the coverage depends very much on its terms and the premium the company is willing to pay. Coverage can extend to matters for which an indemnity is not permitted by law.

Time for a Review

The implementation of the new provisions of the Companies Act dealing with indemnities and insurance against liability for officers presents an opportunity for directors to review their indemnity and insurance coverage vis-à-vis their respective companies.

The first thing directors should do is to review the scope and monetary limits of the company's existing D&O liability insurance policy to see if the coverage provided is adequate. Consideration should be given to whether their coverage extends to matters for which an indemnity by the company is void under the law. If it does not, directors should seriously look into arranging for such coverage personally. In this regard, the SID has an arrangement whereby its members can have personal D&O insurance coverage for up to \$1m for up to three separate directorships at a reasonable cost.

There should also be a discussion about whether the company should provide any indemnity to its directors against liability to third parties, and if so, the extent of such indemnity. This indemnity could be expressly incorporated into the directors' terms of appointment.

In recent years, the potential for directors to face legal suits or prosecution as a result of performing their duties has increased significantly. This may be attributed to various factors including the higher standards of care and diligence that the



modern corporate community expects of directors, the increasing complexity and sophistication of businesses and regulations, and the increasingly litigious society in which we live.

An adequate insurance framework for directors would very much help give directors some peace of mind. What is often not realised is that companies also stand to benefit from these arrangements as they can help ensure the company does not lose out in cases where the directors who are found liable to the company are unable to fully compensate the company from their personal assets. ■

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