D&O insurance – preparing for the tailwinds

Trends and insights, August 2024

Institute of DIRECTORS NEW ZEALAND

Marsh

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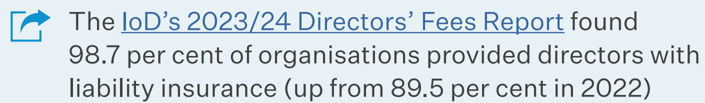
How many directors have D&O insurance?



The IoD’s 2023/24 Directors’ Fees Report found 98.7 per cent of organisations provided directors with liability insurance (up from 89.5 per cent in 2022)

98.7%

1. Introduction *by the Institute of Directors*

Insurance is increasingly top of mind for directors in light of the Supreme Court's decision relating to Mainzeal, a focus on due diligence obligations following the Whakaari/White Island case, and the potential unavailability of insurance due to climate change risks.

This is our fifth report on Director and Officer's insurance (D&O) trends and insights. The Institute of Directors (IoD) has partnered with Marsh and Dentons to provide an overview of market developments and regulatory updates, including looking at new and emerging risks and legal perspectives.

The pace of change, uncertainty and risk inherent in business today requires directors to be increasingly agile and curious. Good governance is not just the decisions that directors make, but the value they add to their boards and the organisations they govern. Understanding issues such as inflationary pressures, labour shortages, supply chain disruptions, generative AI, and climate-related risks requires greater awareness of the interconnectivity of global risks, economics, the environment and politics than ever before.

Directors are facing increasing complexity, risk and exposure to legal claims. Best practice governance is your best defence against a claim, as well as being an important aspect of indicating to your insurers how risk is being considered, managed, and mitigated within your company. As highlighted in *Richard Ciliang Yan v Mainzeal Property and Construction Limited (in Liquidation) And Ors*, one key but often overlooked element of this is board minutes. Minutes played a critical role in the evidentiary case against the Mainzeal directors, underscoring the importance of ensuring that decisions, and the principal considerations leading to them, are recorded.

The Supreme Court decision also highlighted the importance of having adequate insurance protection in place. D&O insurance is cover primarily for the benefit of directors, so the conversation needs to be led by the board. The board needs to engage early, separating out D&O renewal discussions from those of other organisational insurance policies, so there is a clear understanding of how the D&O policy is structured for both individuals and the company, limits of indemnity, exclusions (such as any insolvency exclusion/financial mismanagement clauses), trends in litigation and settlements in your industry, and confidentiality and non-disclosure requirements.

The real value of D&O insurance is its ability to provide cover for directors when the company is unable to indemnify the directors due to legal prohibition or financial constraints, or due to refusal by the company to indemnify.

The other publications in this series are available online at:

- D&O insurance – hitting the reset button (2023)
- D&O insurance – a rising sea of change (2022)
- D&O insurance in a hard market (2020)
- D&O insurance – trends and issues in turbulent times (2019)

2. Key market updates *by Marsh*

The headwinds that can hinder or challenge growth are increasing, including geopolitical tensions, extreme weather events, financial pressures and technological disruptions. Directors need to be able to navigate these turbulent times and, conversely, capitalise on the tailwinds that can support new opportunities and advancement. With stabilisation of the insurance industry, there are some potential tailwinds on the horizon.

Every day directors across New Zealand make decisions that influence thousands of lives and the futures of the companies with whom they work.

They are called on to make these decisions within a business backdrop of increasing complexity, impacted by fast-paced changes within industry, technology, legislation and regulations.

While we cannot reduce the complexity, we can support directors in understanding its implications for the work they do.

Along with the IoD, we work with directors to obtain a full picture of their unique risk exposures, and give them the advice needed to help them manage and transfer risk.

Marsh is delighted to contribute to IoD's publication this year and offer our perspective from working closely with the country's decision-makers across a breadth of sector environments.

Market changes

The D&O market has seen a steadying of market conditions over the past 12 months. This is being driven by increased levels of both domestic and international capacity but is threatened by numerous macro headwinds from regulatory pressures and environmental, social, and governance (ESG) developments, plus the evolving exposures from new technologies.

Following years of challenges and disruptions, the insurance capacity available is now higher than the demand in the D&O insurance market. This provides welcome relief for New Zealand boards and businesses as they continue to adapt and grapple with the economic challenges in a post Covid-19 environment headlined by inflation, high interest rates, the cost of living crisis and supply chain disruption.

We see the interrelated risk landscape as increasingly complex and fast evolving with cyber, geopolitics, and technology advancements such as in artificial intelligence (especially generative AI) playing important roles in the future economy. For both D&O insurers and insured organisations, this presents an opportunity and a challenge.

We expect further division in the market as D&O insurers compete for certain customers while other business remains outside of current insurer appetite. However, it remains to be seen if insurers will start to fall behind in their own growth targets for 2024 as a result of continued reduction in rates, leading to commercial pressure that will challenge both price and underwriting discipline.

Clients prioritising coverage over price during the past few years will be well placed to receive continued relief going forward, as insurers contemplate growth options in addition to maintaining their market positions. Clients who can both articulate and prove an alignment in their risk posture to that of insurers' risk appetites will be best able to leverage this competition among insurers.

Evolving landscape

In the face of economic challenges and uncertainty, it is also crucial for both insurers and their boards to closely monitor the evolving regulatory landscape, especially in the first year under the new coalition Government. This includes staying informed about new, amended, or removed legislation and understanding the potential

adjustments to the roles of enforcement agencies. Areas such as health and safety, resource management and employment laws are particularly noteworthy and require careful attention.

Furthermore, the courts will continue to play a significant role. The high-profile climate change lawsuit of Smith v Fonterra (with the February 2024 decision by the Supreme Court overturning the Court of Appeal and granting iwi leader Michael Smith the right to sue seven of the country's biggest polluters for their role in causing climate change) will be keenly watched. The Mainzeal Supreme Court judgment in 2023 was timely amid an environment of increased credit risk in the economy. It is essential for insurers and boards to stay proactive and adapt to these evolving circumstances to effectively manage risks and ensure compliance with changing regulatory requirements.

Climate change and ESG

The interest in environmental, social and governance (ESG) issues in recent years may have taken a back seat to global economic challenges. However, over the long term, climate change, nature and ESG concerns are high on the risk exposure list for businesses. Insurers and organisations need to continually demonstrate a clear strategy in this space. In fact, environmental risks took the top four positions in the 2024 Global Risks Report over a 10-year period: extreme weather events, critical change to Earth systems, biodiversity loss and ecosystem collapse, and natural resource shortages.

New Zealand amended section 131 of the *Companies Act 1993* in August 2023 (the duty of directors to act in good faith and in the best interests of the company), by adding an additional subsection to clarify that directors may consider other factors outside of maximisation of profits, such as ESG matters.

While companies navigate increasing ESG scrutiny from consumers, government agencies and investors, the risk of litigation related to these efforts continues to grow.

Where companies articulate their position on ESG matters, they open themselves up to potential greenwashing and greenhushing allegations. However, silence is not a viable option due to new regulations and increased stakeholder expectations for transparency and accountability around ESG matters. Careful consideration is required of what companies are trying to accomplish and what is communicated. Silence may adversely affect access to D&O insurance.

New Zealand is yet to see significant levels of claims against boards for breaches of duty in relation to ESG issues that will challenge D&O insurers' approach to risk. However, there is keen interest in the direction the courts will take when addressing the broader issue of climate change, such as in Smith v Fonterra.

From a regulatory perspective we note the Australian Securities and Investments Commission's (ASIC) court win and the first greenwashing civil penalty action against Vanguard, one of the three biggest investment firms globally.

In New Zealand the climate-related disclosure regime has come into effect. Some large publicly-listed companies (insurers, banks, non-bank deposit takers and managers of registered schemes) are now required to publish disclosures. According to the

TOP FIVE GLOBAL RISKS OVER THE NEXT DECADE

1. Extreme weather events
2. Critical change to Earth systems
3. Biodiversity loss and ecosystem collapse
4. Natural resource shortages
5. Misinformation and disinformation

World Economic Forum, Global Risks Report 2024

Task Force on Climate-related Financial Disclosures, currently 60 per cent of world GDP is now subject to mandatory disclosures. An extension of the disclosure regime is likely, bringing in more New Zealand businesses.

This issue is further interconnected with the D&O insurer market where addressing the new disclosure requirements adds a level of complexity to capital raises and potential mergers and acquisitions. On the one hand, satisfying new disclosure requirements may hinder investor demand and scale and mean fewer deals are completed, thereby enhancing D&O insurer competition. On the other hand, the level of disclosure and resultant scrutiny may result in a sizeable gap in price expectations between similar companies that adopt different approaches.

> “Sophisticated analysis of larger data sets will enable the misuse of personal information through legitimate legal mechanisms, weakening individual digital sovereignty and the right to privacy, even in well-regulated, democratic regimes.”
>
> World Economic Forum, Global Risks Report 2023

The challenge posed by AI

Whether businesses are at the forefront of developing generative AI (Gen AI) or are operating its technology, careful consideration around the ethical, legal and societal implications will be essential. And critical to its successful use in business will be good governance.

Traditional AI has already influenced societal ethical issues and certain risks surrounding data privacy, security, policies and workforces. We have seen, through 2023 and into 2024, Gen AI challenging businesses in areas such as misinformation, plagiarism, copyright infringements and harmful content.

International litigation in the United States and United Kingdom has typically centred on companies that develop Gen AI, and involved allegations of infringement of intellectual property rights, violation of privacy or property rights or consumer protection laws. It is worth noting that the first securities class action has now been brought in the US on misrepresentations/misstatements of a company's use of Gen AI. With greenwashing a theme for climate change, AI-washing is expected to be another.

The insolvency risk

The wide support provided in many advanced economies such as New Zealand has meant that we haven't seen the global tsunami of insolvencies that were feared during the initial pandemic years. However, the number of corporate liquidations continues to grow amid tough economic conditions which is of heightened concern for D&O insurers due to the increased risk of claims from liquidators and/or creditors.

One of the core purposes of a D&O policy is to provide indemnity and defence costs to insured persons, where the company is unable to indemnify (refer to Appendix 1). Not all bankruptcies result in litigation but, equally, directors and officers shouldn't ignore the exposures that can come from such a corporate catastrophe. Litigation can arise from a number of sources including trading while insolvent, actions for unpaid wages or taxes, breach of fiduciary duties and creditor or liquidator recourse.

The adage 'cash is king' is a major influence on the perception of risk for insurers. Insurance companies are strongly competing for economically resilient businesses as they strive for their own sustainable long-term portfolio growth.

While insurers focus on cost of interest rates and debt covenants, consideration is also extended to working capital management, containment of operational costs and efforts to reduce counterparty credit risk. These are areas that will require additional communication and effort through the insurance process, including pre- and post-renewal discussions.

While highly competitive in specific areas, the broader competitiveness of D&O insurers is yet to filter through to any material relaxation of renewal pricing or terms for those organisations that present increased solvency and credit risks. This position is unlikely to materially change in light of the high-profile Mainzeal decision that affirmed the duties of directors to creditors. Looking ahead, this is leading to an ever-larger gap in pricing as insurers compete for a narrowed pool of accounts.

For businesses reliant on consumer spending, and partly as a result of the double-dip recession, we see significant challenges across the asset classes and sectors of consumer goods, restaurants, healthcare and real estate.

Organisations that have had half a handbrake on business growth over the past few years may find the current D&O market provides an opportunity to finesse their programme and prepare for the next few years.

Heightened regulatory activity

The New Zealand regulatory environment matures year on year. In the World Bank's *Worldwide Governance Indicators*, of the aggregate data for the more than 200 countries and territories analysed, New Zealand consistently ranks highly in three of the six indicators: rule of law, control of corruption, and regulatory quality.

The regulatory environment will continue to change in response to the challenges posed within the current economic landscape, such as the cost of living, inflation and global influences that are felt locally on supply chains, social unrest and geopolitical uncertainties.

There remains potential for a reduction in red tape under New Zealand's new coalition Government while there will be ongoing financial pressure on regulators to do more with less. However, under pressure to encourage economic growth, the oversight and role of regulators will be of paramount focus and potentially intensify around the areas where domestic markets behave inefficiently.

High-profile investigations, such as those by the Financial Markets Authority, Commerce Commission or WorkSafe, have highlighted the increasingly aggressive and broad approach that regulators are taking in their initial investigations and prosecution strategies.

The courts will also be watched closely. In 2023, the Mainzeal case clarified some aspects of the roles and rights of creditors during corporate insolvency, although uncertainty remains. We are now watching the approach of the courts and their pivotal role in climate change and ESG, such as with the Smith v Fonterra case, as well as the interpretation of new health and safety laws introduced after the Pike River mine disaster.

Regulatory investigations have potentially severe outcomes for companies and their directors and officers. Putting in place a broad D&O policy that provides assurance for directors and officers and affirms coverage positions for legal representation, defence costs and the payment of fines and penalties where insurable, is critical (refer Appendix 1).

3. Mainzeal and Whakaari/White Island – a legal lens *by Dentons*

The legal risks to directors continue to evolve with decisions both nationally and globally highlighting exposure. Boards are increasingly focusing on understanding their D&O cover and ensuring that it meets their specific needs.

The more that is at stake in the law, the more we seek certainty. It is a discomforting reality, then, that in two aspects of director liability things remain less than perfectly clear. One regards the failure to protect human life; the other to prevent company failure.

Recent litigation regarding the Whakaari/White Island tragedy and the Mainzeal collapse has thrown this concern into sharper relief.

The essential facts of the two cases are likely well known:

- In 2013 Mainzeal went into receivership and liquidation owing around NZ$110 million to unsecured creditors. The liquidators of Mainzeal brought proceedings against the directors, alleging (among other things) that the directors had breached sections 135 (reckless trading) and 136 (duty in relation to obligations) of the *Companies Act 1993*.
- The Whakaari/White Island eruption of 2019 resulted in 22 deaths and numerous injuries. It subsequently led to charges against 13 parties under the *Health and Safety at Work Act 2015*.

Mainzeal

Ultimately, the case reached the Supreme Court where the key issues addressed were:

- Did the directors breach section 135?
- Did the directors breach section 136?
- If the directors did breach either of these sections, how should loss be calculated?
- What orders for compensation should be made?

The Supreme Court decided the following:

- The directors did breach section 135. Mainzeal was balance-sheet insolvent from 2005, its financial position was precarious, and the directors could not have reasonably relied on the assurances of support given. The directors should have stopped trading by 31 January 2011. In continuing to trade after this date, the directors adopted a policy that was likely to create a substantial risk of serious loss to creditors.
- Following a breach of section 135, in most cases, loss should be calculated on the basis of the extent (if any) that the financial position of the company worsened between when the directors should have stopped trading and liquidation. Because the liquidators did not prove that there had been such a net deterioration, they were not entitled to compensation for the directors' breach of section 135.
- The directors did breach section 136 in respect of four major projects. Following such a breach, loss should be calculated on a 'new debt' basis. In this case, the relevant loss was the gross amount of debt incurred after 31 January 2011 and unpaid at the time of liquidation.
- The directors should be liable for about a third (NZ$39.8 million) of the total amount owed to creditors (NZ$110 million).

There is little comfort for directors in the judgment: the main theme is creditor protection. The case once again highlights the need for law reform regarding directors' duties.

In the absence of such certainty, what might be a prudent course of action for a director of a distressed company?

- Carefully monitor the performance and prospects of your company.
- Seek professional advice about your options.
- Make a plan that addresses the issues causing concern and restores the company's solvency.
- Monitor the progress of the plan.
- If you are in charge of a company that is insolvent and can't be salvaged, don't trade on, even if doing so would reduce the debt owed to creditors. Take advice and consider the appointment of administrators or liquidators. Courts will allow a reasonable time for directors to take stock and decide what course of action they should take, and directors will not normally be liable for trading during this period (but that may not always be the case).

Whakaari/White Island

During the relevant time, Whakaari Island was owned by Whakaari Trustees Limited and leased to Whakaari Management Limited (WML). The three directors faced charges from WorkSafe under section 44 of the *Health and Safety at Work Act 2015* (HSW Act) for lacking the requisite care, diligence and skill, primarily due to not obtaining expert advice. However, the court found the evidence insufficient to prove individual negligence, attributing it instead to collective failure as directors. The absence of detailed evidence about their individual contributions made it difficult to determine if they met the expected standards of diligence. The court noted the outcome might have differed with a single director or if WML's constitution required unanimous decisions by directors.

Consequently, the charges against the directors were dismissed, underscoring the focus on individual accountability evidence in directorial liability cases.

Considerations for directors

- Directors should each ensure there is evidence of their individual adherence to the officer duties imposed by the HSW Act, taking into account their particular position and responsibilities.
- Where there is evidence that the directors of a PCBU (persons conducting a business or undertaking) are required to make unanimous and informed decisions, a court may attribute board-level failures to individual directors.
- Evidence of what goes on 'behind the boardroom door' is key to questions of liability.
- Careful record keeping of due diligence is paramount.

It may be tempting to observe that it can be easier to find fault in hindsight. That may be so, but the director who remains vitally alert to the gravest of risks may find their days in court go better than those who do not.

4. Emerging risk – generative AI *by Marsh*

With generative AI's rise comes a number of considerations for boards and their organisations. Generative AI presents a growing set of risks and opportunities that they will need to consider as they interact with, and try to harness, this fast-evolving technology.

Artificial intelligence (AI) has emerged as a transformative force, revolutionising various aspects of our lives. Some markets go as far as describing the advent of generative AI (Gen AI) as being the fourth revolution.

Gen AI refers to systems that possess specifically-defined advanced capabilities, such as deep learning, natural language processing and neural networks. It is characterised by the ability to learn, adapt and make decisions autonomously, enabling it to tackle complex problems and generate innovative solutions.

In establishing the right balance for the use of Gen AI, stakeholders need to check their AI outputs and adapt. Boards will have to maintain their intellectual curiosity, developing an understanding of Gen AI components and any model's potential risk of use/misuse in their businesses. Risk mapping and understanding a company's risk position around Gen AI technology will help provide a framework for decision making.

Existing and emerging risks

The approach to integrating Gen AI into a business will involve decisions on capex and investments, which may pivot on a board's understanding of broader risks and opportunities. This may include assessing the balance between a strategic step-by-step process or a complete overhaul and replacement of existing technology. Both during and upon integration, subsequent considerations will need to include the human oversight and input necessary to minimise errors and misinterpretations in operational use. Nonetheless, many of the risks currently associated with Gen AI, such as copyright infringement, data privacy and technology misuse and errors, are extensions of existing risks that companies should have existing systems to manage. However, data breaches and privacy concerns specific to AI are a new risk.

Due to the societal and ethical challenges presented, governments will need to work closely with key stakeholders and the wider community. Currently there are no Gen AI-specific laws in New Zealand with it being broadly covered under laws including the *Privacy Act 2020*, the *Human Rights Act 1993*, the *Fair Trading Act 1986, Patents Acts 2013*, and the *Harmful Digital Communications Act 2015*. The evolving regulatory landscape internationally enables New Zealand to assess approaches taken elsewhere and consider implementing or adapting them to suit our specific context, in conjunction with assessing the ongoing effectiveness of existing legislation.

> "So long as humans can be emotionally involved with AI, there can never be completely trustworthy AI systems."
>
> **Jaymin Kim**, Senior VP Emerging Technologies, Marsh

The European Union's *AI Act 2024* is the world's first comprehensive AI law, supported by policy measures such as the AI Innovation Package and a Coordinated Plan on AI. These are all aimed at addressing the pros and cons of the powerful risks and impacts of AI models. The EUs new rules establish obligations for both providers and users, depending on the level of risk.

D&O claims overseas are already trending on privacy, unfair competition, copyright, trademark, libel and facial recognition cases, with plaintiffs mainly focusing on the developers of AI technology. As litigation in this area continues to develop, the insurance industry has a huge opportunity to adapt. Insurer products specifically geared for AI developers and users of the technology are already on the market and we will see further evolution in this space.

Potential scenarios

Continuous disclosure: For publicly-listed companies, those making statements or representations on the use of AI and its potential benefits are subject to continuous disclosure requirements. Where there remains a degree of uncertainty about the technology and its use and benefits, this may heighten the risk of class action litigation from investors who believe they have been misled, or not fully informed, of the risk associated.

Fiduciary duties: For both private and publicly-listed companies, there is potential for allegations of inadequate oversight by the board of the company's use of AI. Scenarios could involve over-reliance and a lack of human oversight, or allegations of over-reliance in a business transaction such as a merger or acquisition.

Regulatory: Gen AI will pose significant regulatory concerns, particularly when it comes to workplace issues (including resource hiring and supervision).

Management liability/employment practices liability: As a potential disruptor to the labour force, the use of Gen AI heightens the potential for breaches of employment law. A further scenario could include allegations of bias.

Considerations for directors

- Many of the current risks are extensions of existing and known risks but new risks may arise.
- For businesses in New Zealand, there is no substitute for good governance.
- The interconnectivity of current and future risk will present both problems and solutions.
- Data protection and intellectual property are current areas of concern.
- AI laws and regulation are nascent and evolving.
- AI risks can come through third parties.
- Cybersecurity attacks are leveraging Gen AI tools.
- Generative AI is technology built by humans and prone to human error.
- Review the classes of insurance you purchase to ensure you have the coverage you need.

5. Not-for-profit sector update *by Marsh*

The legislation applicable to the not-for-profit sector has been significantly reformed over the past few years. Not-for-profit organisations need to be aware of the changes and what these mean for their governance and operations, and attuned to any changes in their risk exposure.

There are many legal structures and laws involved in the regulation of not-for-profits (NFPs) and charities in New Zealand. Each regime has different legal requirements relating to the governance of organisations. Nonetheless, NFP organisations are subject to the same financial pressures, health and safety obligations, operating environment and stakeholder expectations as for-profit organisations.

Incorporated Societies Act 2022 and Trusts Act 2019

The *Incorporated Societies Act 2022* (the Act) came fully into force on 5 October 2023, and applies to all societies incorporated after that date. The Act has a transition period requiring all existing incorporated societies that choose to re-register to do so by 5 April 2026. This represents a line in the sand for NFPs and the liabilities of their officers. The Act includes new requirements for committees as well as duties for officers of those committees that are similar to a director's duties under the *Companies Act 1993*.

The *Trusts Act 2019* was passed in July 2019 but came into effect on 28 October 2021, superseding the *Trustee Act 1956*. The new Act includes mandatory and default duties for trustees.

Officers of trusts or new/newly (re)registered incorporated societies have much clearer obligations and duties than they had under the previous legislation. While these are personal obligations for officers, there is a significant focus on good faith and performing duties with appropriate diligence, care and skill. Liability will only arise, in most cases, where adequate attention has not been paid to core duties, including following the law, making decisions consistent with the purpose or best interests of the entity, and appropriately following the provisions of the constitution (for an incorporated society) or the trust deed (for a trust).

WorkSafe New Zealand v RH & Jury Trust

This case of *WorkSafe New Zealand v RH & Jury Trust* resulted from a WorkSafe prosecution of a fatal workplace accident. The court's judgment addressed potential ambiguity between trust law and the *Health and Safety at Work Act 2015* (HSW Act). His Honour Harvey J found that a trust was not a "person" for the purposes of the HSW Act. His Honour concluded that the trustees, collectively, were a "body of persons… unincorporate" on the basis that they were

> "Insurers are now underwriting the trustee liability risks of not-for-profits through a similar lens to that of a traditional D&O risk, with increased scrutiny around governance and management."
>
> **Carien Ahdar**, Client Executive, FINPRO, Marsh

an unincorporated group that had “some form of internal structure which enables it to take and implement decisions as a collective”. As such, trustees may be collectively prosecuted under the HSW Act.

These findings are significant as they impact who could be charged as a Person Conducting a Business or Undertaking (PCBU) under the HSW Act. We note the wide interpretation given by the court to the definition of a PCBU for the purposes of the HSW Act, but the broader implications of this decision will be subject to the specific facts in question.

The court found that although the HSW Act prohibits indemnification of trustees as persons, a trust is not a “person” as defined in the Act. Therefore, the trust may indemnify its trustees and obtain insurance cover for fines and penalties.

While specific to the facts of this case, this decision has implications for the adequacy of insurance coverage, as trustees may face significant increases in their risk exposure under the HSW Act. The narrow decision of the court means the extent of that increase in exposure remains uncertain.

Taken as a whole, the High Court decision in *WorkSafe New Zealand v RH & Jury Trust* has clarified the potential liability of trustees under the HSW Act. As with other PCBUs and their officers, minimising potential liability remains dependent on having a focus on worker welfare in all its forms, strong and capable leadership of health and safety, and attention to good-practice governance in all organisations.

Considerations for Directors

- Office bearers and trustees now face higher levels of scrutiny following legislative changes.
- Directors need to be cognisant of their risks and have a robust risk management process in place.
- Directors need to be aware of legislative changes and what these mean for them as individuals and their organisations.
- Entities can encourage and attract talented office bearers and trustees with a regularly reviewed and robust governance framework.
- Ensure you are supported by a liability insurance programme designed and placed by an experienced liability broker.

6. Understanding your cover – an insurer's perspective *by BHSI*

Understanding your policy, what it covers, and ensuring that it is tailored to meet your specific needs is vital for boards.

There has been focus over the past few years on the increasing legal exposure of directors and officers, as well as their organisations. There are several class actions underway involving New Zealand companies, and the foreign-exempt listing status of dual-listed companies hasn't prevented these class actions.

Internationally and in New Zealand, climate-related reporting is now required for, or being undertaken by many companies either because they have to report, or they want to report. This has led to both greenwashing and greenhushing allegations. Many companies have made representations (or omissions) regarding climate-related matters. Potential claim notifications have been received for incorrect emissions reporting. Activist-type claims are likely to keep increasing, both against the entity and its directors and officers. A number of companies are having to transition to renewable energy, materially changing their business operations and funding.

Post Covid-19, almost all companies are impacted by higher interest rates and inflation. Health and safety proceedings are being brought against individuals, as well as their organisation (PCBUs). The potential for cybersecurity and privacy breaches remains a threat for most companies and something that directors are being expected to pay increasing attention to.

Some of these matters may result directly in claims against directors or officers. However, all of these have a potential flow-on effect to the financial position of a company and/or its share price. Increasing pressure on covenant compliance, debt repayments and insolvencies will lead to more insolvency related D&O claims. Profit warnings are having some dramatic impacts on share prices, off the back of (in many cases) already reducing share prices.

Understanding your cover

While D&O policies are generally written to apply across most types of claims and on a worldwide basis, some of the older clauses and exclusions, such as pollution and health and safety, do need to be reconsidered in light of evolving exposure and, potentially, unintended coverage issues.

The policies, and the structuring of the policy limits, should ensure alignment between the interests of the directors and/or the company and the insurer at claim time, including the advancement of defence costs. The focus

> "D&O insurance plays an increasingly important role, regardless of whether or not the company can separately indemnify the individual."
>
> **Karen Poching**, Senior Underwriter, Berkshire Hathaway Specialty Insurance.

should be on defending the claim, not figuring out how the D&O policy will respond. Also important is what the insurer can bring to the table in the event of a claim – including communication, a collaborative approach and experience.

Many New Zealand companies have material overseas exposure, either because of an overseas listing (including a secondary listing) or by having overseas operations, and therefore the international claims capabilities and resources that an insurer can offer can be of significant value. Alongside the main D&O policy, an increasing number of companies with overseas subsidiaries are looking at multi-national programmes – where the insurer can place local D&O policies in certain territories determined by the broker to assist with regulatory requirements and claims in those territories.

Meetings between organisations, their broker and their insurer are as important as ever. While the traditional D&O submission remains an important part of renewal, a meeting to discuss the exposures more specific to a company and its board is incredibly useful. Many organisations welcome the opportunity to meet with someone from the insurer's claims team – a great thing to do prior to any notification or claim necessitating a claims meeting.

7. Market trends 2024 and beyond *by Marsh*

Directors have some opportunities to take advantage of tailwinds in the D&O market, but the need to stay alert to changing risk exposure remains. Detail matters when it comes to all D&O insurance with directors needing to engage directly with the renewal process.

Insurers in the local D&O market remained highly competitive throughout 2023 and into 2024, generally leading to premium reductions and broader risk appetite.

In general terms, the market will continue to transition through its hard and soft insurance cycles. For those looking to improve their D&O programme, timing is favourable in the immediate future.

With legal costs rising and high-profile claims costing into the tens of millions of dollars, the risks facing directors remain very real. Further upward trajectory in these costs will factor into the pricing of risk by D&O insurers.

The current market competitiveness is a good sign but the size of the overall New Zealand market, from a global perspective, means we are vulnerable to outside shocks and potential withdrawal of insurer capacity. For individual companies and other organisations, the current market conditions also disguise potential uncertainties and exposure for D&Os brought on by the tough economic conditions and a fast-evolving risk landscape. We expect this current paradox to favour those insurers who can maintain underwriting autonomy, defend and compete where the opportunity presents, and take a long-term view that values insurer insured relationships.

Further differences in rates between those organisations that are making good progress in addressing matters such as ESG, climate change and good health and safety performance (and those who aren't) may continue as insurers look to strike that balance between underwriting discipline in their portfolios and maintaining market share. We are yet to see a material change in insurer risk appetite for businesses seen as hard to insure. This contrasts with insured companies and other organisations that have already achieved rate reductions over the past couple of years and where the trend is likely to continue as insurers look to defend their incumbent positions.

We see balance sheet resilience as a key area of focus for D&O insurers, along with the continued impacts of the interest rate environment and supply chain disruptions. As the higher cost of debt starts to make its mark on the economy, further economic

MARSH'S TOP TIPS

1. A good quality D&O insurance policy should form part of a comprehensive risk-management programme.
2. Understand your coverage and address gaps, and any restrictions, in policy terms and conditions.
3. Consider the adequacy of limits and sub-limits for extensions of cover.
4. Monitor legislation and regulatory changes and adapt to changes as needed.
5. Foster strong relationships with insurers through engagement and detailed communication.

volatility will likely lead to an increase in corporate insolvencies, which in turn may increase levels of litigation activity and D&O insurance claims.

Climate change and ESG factors are expected to remain of interest to insurers over the long-term, so organisations should be prepared to show that they have a clear strategy in this space. This is now embedded in underwriting strategies as it is in legislation. In August 2023, the *Companies (Directors' Duties) Amendment Act 2023* came into effect to amend section 131 of the *Companies Act 1993*. The updated legislation clarifies that directors may consider matters outside of the maximisation of profits (including ESG factors) when determining whether a decision is in the best interests of the company.

Looking beyond 2024

Strong insurer competition is expected to persist in the D&O market and likely lead to premium stability.

Looking further ahead, the traditional sluggishness of the local D&O market to adapt to changes in global conditions makes a precautionary outlook in terms of both rates and cover essential.

Traditional D&O exposures plus the relatively new but embedded areas of risk such as ESG, remain of central importance for insurers and directors alike. However, the future risk landscape will require consideration of cyber risks, geopolitical volatility, and technological advancements in terms of opportunities and challenges.

The current market presents a window of opportunity to position insured companies' and other organisations' D&O policies for the future. Taking a good look at your D&O insurance needs now, and discussing options with your insurer, may set you up well for when the headwinds turn to tailwinds and the market shifts again.

Appendix 1: *by Marsh*

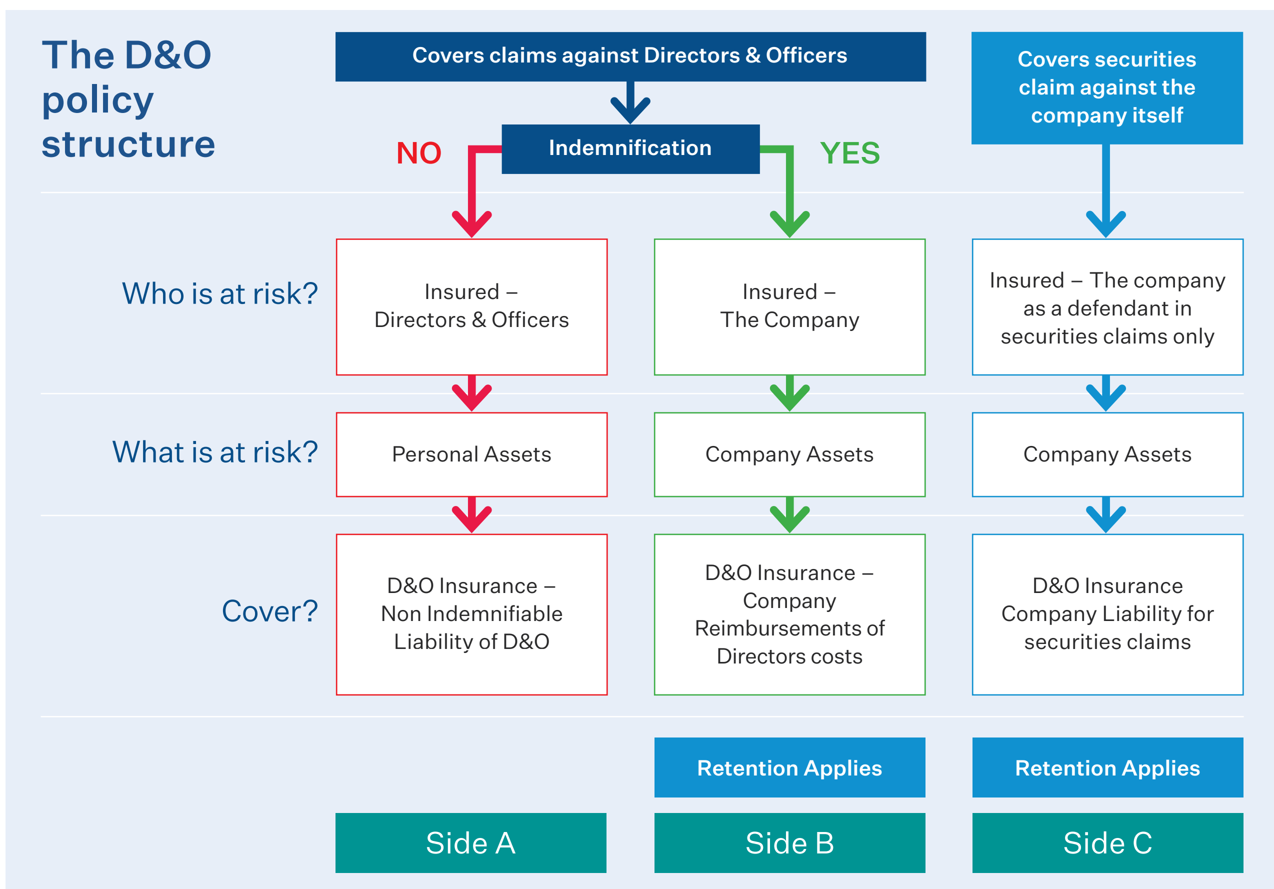
What does D&O insurance cover?

Subject to the particular policy's terms, conditions and exclusions, cover is commonly provided for:

- Legal costs incurred by or on behalf of the insured director or person investigating, defending or settling claims, or investigations/prosecutions brought against them.
- Awards/settlements of insured damages (most commonly limited to compensatory damages).

In the absence of D&O Insurance, individuals must rely on receiving indemnity from the company to pay their defence costs and any eventual settlement. Where such indemnity is not forthcoming for whatever reason, the individual will have to fund the cost of the defence themselves (which can be protracted and expensive) and if their defence is unsuccessful, they face the loss of their personal assets to pay penalties, or bankruptcy, or prison for criminal activities.

- Traditionally, a D&O policy provided coverage under two categories (insuring clauses) – Side A and Side B.
- Side A pays on behalf of individuals any loss that is not indemnified by the company.
- Side B reimburses the company for amounts it pays under indemnity arrangements.
- Both Sides A and B apply only to loss incurred by the directors and officers in claims made against the directors and officers, but not against the company.
- Side C, if purchased, insures loss incurred by the company, resulting from certain types of claims (e.g. Securities Claims), for the company's own wrongful acts, even if directors and officers are not named as defendants.



Appendix 2: *by Marsh*

D&O cover extension

Extensions of coverage can significantly enhance the value of the D&O product with better ones often providing for the advancement of defence costs along with affirmative extensions, for extradition proceedings, manager fines and penalties (where insurable), investigations and regulatory costs/expenses.

The changing landscape and heightened focus of both domestic and international regulators makes it even more critical today that companies put in place procedures to identify risks and implement systems to address them. It is also important to safeguard individuals who are exposed to such risks on a company's behalf and ensure they receive adequate protection.

As the breadth of D&O coverage available can vary significantly through the use of policy extensions, it is important to clarify what is provided and what's not. In particular, most policies should provide affirmative positions on regulatory cover, extending to associated legal costs of an investigation even when a wrongful act has yet to be alleged or if the investigation is simply at an evidence-gathering stage. Most insurers are able to go further and provide public relations costs, reputational protection expenses and pre-investigation costs, all with due provisions to enable advancement of such costs.

Where a prosecution is commenced against directors and officers, this should satisfy the definition of a 'claim' or 'defence costs' in the better D&O policies. However, in defending a prosecution, coverage may then vary dependent on policy language, such as the "fraud" exclusion and the definition of "loss" for matters uninsurable in law. Nonetheless, most policies will have provisions for the repayment of defence costs advanced back to the insurer if the individual is not entitled to cover.

Other considerations:

- Cover does not extend to costs the company incurs (as under a statutory liability policy)
- Requires insurer's consent to directors' nominated defence lawyers
- Market-wide investigations are not typically in scope (for the full policy limit)
- Sub-limits may be applicable and vary between the various extensions

Companies, directors and officers can be the subject of protracted and costly follow-on litigation after a breach has been established by a regulator. Regulatory investigations are becoming more aggressively pursued so it is important for directors and officers to be confident that their D&O policy is structured to provide them with the broadest cover where possible.

Directors and officers under Side A or B of a D&O policy (or the company in the event of a securities claim under Side C of a policy) should be covered for any 'loss' they become legally liable for in defending, investigating, settling or appealing claims that often arise subsequently/following an investigation. To allow for this, loss is typically defined to include damages (including punitive damages or compensation orders), judgments (including pre and post interest), settlements (entered into with the insurer's consent), and defence costs and other associated expenses such as claimant's costs, fines, penalties, if insurable at law, and crisis costs.

About us

Marsh is a global leader in insurance broking and risk management solutions. With a legacy spanning more than 150 years, we are an established and trusted advisor, dedicated to protecting and promoting possibility for our clients. Our mission is to empower our clients to dream bigger, reach further, and strategically plan for the opportunities that lie ahead. Operating in more than 130 countries and with a global network of 45,000 experts, Marsh serves our clients' needs on a global scale. In New Zealand, we have been supporting local businesses since 1958, establishing a robust network. Our team comprises more than 450 experienced local colleagues who leverage the collective expertise of our global network to deliver tailored solutions to our clients.

Dentons is part of the world's largest global law firm, and a leading law firm in New Zealand. A firm that embraces change and has unparalleled access to legal expertise in more than 160 locations across over 80 countries. Dentons helps you grow, protect, operate and finance your organisation by providing uniquely global and deeply local legal solutions. The challenges that our clients are navigating and the opportunities they are advancing are changing at an accelerated pace. This is why we offer more than legal insight; we help you find business solutions to achieve your goals.

The IoD is New Zealand's leading organisation for directors and at the heart of the governance community. We believe in the power of good governance to create a strong, fair and sustainable future powered by best practice governance. Our role is to drive excellence and high standards in governance. We support and equip our 10,500+ members and the broader governance community who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

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