DIRECTORBANK.

DIRECTORBANK BRIEFING:

Insurance and the Board

Is your cover fit for purpose, and where does responsibility lie?



Introduction from Directorbank

In our work with private equity investors and company boards, risk oversight is a recurring theme in discussions about board effectiveness. Insurance is an area that is frequently delegated and seldom examined at board level until a significant claim brings it into focus. We invited Mactavish, an independent insurance advisor, to set out the key considerations for directors.

A matter of governance, not procurement

Under UK company law, directors have a legal and fiduciary responsibility to protect the interests of their organisation and ensure that appropriate systems of governance and risk management are in place.

Where insurance forms part of the risk management framework, the board should be satisfied that cover has been placed correctly and will respond as intended.

Understanding and overseeing insurance is therefore a critical aspect of both asset protection and effective corporate governance.

A business has four means of funding an unexpected loss: operating cash flow, new equity, new debt or insurance. Insurance is best suited to events of low frequency and high impact. Such losses are generally too large to be met from cash flow; holding surplus equity against them is inefficient; and the period immediately following a major loss is seldom a favourable time to raise debt.

Two points follow, both of which are critical for directors to understand:

1. Once a low-frequency / low-probability 'severe' event has occurred, its probability is no longer relevant. It has, in effect, become 100% likely, and the business is then reliant on the terms of its policies.

2. When a significant loss event happens, it tends to matter a great deal. The performance of the relevant insurance contract becomes critical to the business and, in some cases, to its survival.

It follows that insurance must deliver when called upon, and that the board should have exercised the necessary oversight to ensure that it will.

Where responsibility lies

Most mid-sized businesses in the UK do not have a dedicated insurance department or a staff member with specific insurance or risk management skills. Insurance is typically managed by the CFO or COO, alongside many other responsibilities, with considerable reliance on the company's broker.

Brokers play an important role in arranging cover, but it can be a significantly flawed assumption to regard the broker as the company's insurance advisor. It is not the broker's responsibility to classify and quantify the company's risks and to disclose them appropriately to underwriters. That responsibility rests with the company and, ultimately, with its board.

This delineation of responsibilities is often blurred, but it has a habit of becoming very clear in the event of a significant claim.

Nor is it sufficient for a company simply to answer the questions posed on an insurance proposal form. If those questions do not properly characterise the risk being insured, it is the company's responsibility, and ultimately that of its directors, to tell the underwriter the correct answers to questions they did not ask.

The Insurance Act 2015 sought to rebalance the relationship between the insured and underwriters. Whilst it included many provisions designed to prevent underwriters from unfairly denying claims, it also increased the insured company's responsibility to make a 'fair disclosure' of the risks to the underwriter.

In the event of a significant claim, the underwriter will immediately review - in considerable detail and with specialist lawyers - the disclosures made by the company when the insurance was placed. Any material variances can result in claims being significantly restricted or, in some cases, denied entirely.

An insurance contract is simply a specialist legal agreement, often with many pages of small print. Yet such contracts are seldom subject to the level of scrutiny and review that a board would expect of other agreements of comparable financial significance. How often does a company appoint an insurance lawyer to review the policy wording when cover is placed?

Five key questions for the board

1. Who has executive responsibility for insurance, and when did the board last review the programme as a whole?

2. Are we satisfied that the information given to insurers presents our risks fully and fairly, including any recent acquisitions, new products or new markets?

3. Has anyone independent of the placement reviewed the policy wordings, exclusions and limits against our most serious risk scenarios?

4. In the event of our largest plausible loss, such as a cyber-attack, a major fire or a significant liability claim, which policy would respond and to what extent?

5. Does our directors' and officers' (D&O) liability cover adequately protect the individuals on this board, including following a sale or change of ownership?

Commentary from Directorbank: George Heppenstall, Director

Insurance is not our specific area of expertise, but building effective boards is. This article raises questions that every board should be able to answer with confidence.

In our work with private equity investors and their portfolio companies, we see three points in the investment cycle at which boards and investors would benefit from looking closely at their insurance arrangements:

1. **On acquisition:** due diligence is naturally focused on the transaction, and the insurance on which the business depends day to day can receive less attention than it should.

2. **Following a change of control:** new ownership is a natural moment to confirm that existing cover, including D&O insurance, still fits the business and its directors.

3. **In preparation for exit:** a buyer and its advisors will want confidence in the company's insurance arrangements and claims history.

For any director considering a new board appointment, it is also sensible to review the company's D&O cover before accepting, as it is the policy that protects directors personally.

For finance leaders and COOs we recruit into growing mid-market businesses, an understanding of insurance as part of the wider risk agenda, rather than an annual review exercise, will add genuine value and credibility to the role. Where that specialist expertise is not available in-house, independent advice of the kind Mactavish provides can give boards valuable assurance.

What does Mactavish do?

Mactavish is an independent insurance advisor. They help the buyers of insurance understand the risks of their business and correctly characterise and disclose those risks during the insurance placement process. They also ensure that the policy wording is appropriate and that the insurance being placed is both fit for purpose and will perform (that is, pay out!) in the event of a relevant loss. Underwriters' policy wording can often be Delphic and honed over hundreds of policies and claim events to tilt the scales in the insurer's favour in a claims negotiation. Lastly, should a significant claims dispute arise, Mactavish can provide expert support in negotiating the best possible outcome for the insured company.

Whether the concern relates to property, employers' liability, public liability, cyber, professional indemnity or directors' and officers' (D&O) liability insurance, directors who are not fully confident that their company is appropriately protected may wish to seek an independent review. Mactavish works with boards and finance teams to provide exactly that assurance.

Mactavish
Expert insurance buyers

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