From: Chris Hodge
Sent: 11 June 2009 09:33
To: Chris Hodge
Subject: Combined Code of Corporate Governance
Chris

My concerns revolve around the potential application of:
"A.1.5 The company should arrange appropriate insurance cover in respect of legal action against its directors."
by firms and its impacts upon the activities of directors.
I think I understand what A.1.5 is intending to do, but I believe that it can be misinterpreted and hence misapplied and without further guidance could be entirely counterproductive. The thrust of the matter is the interpretation of the word "appropriate".
Directors generally get very well paid for what they do and I think A.1.5 is meant to ensure that if a director acts outside of their remit or duty of care that the firm (and therefore the shareholders) do not suffer as a consequence. And indeed so that it is possible for the public or shareholders to pursue a case against a single director for misconduct without there being a risk that their claim cannot be met by the director in full (due to the lack of assets at their disposal) and thereby would leave either the claimant or the company at a loss to fill the shortfall.
However A.1.5 would be counter productive if it were used by a firm to pay for insurance that protected the director's assets or reputation in instances of misconduct (and I would guess that most contracts of insurance established for these purposes would, aside from a relatively small excess, protect all these real and intangible assets just for simplicity). Were a director appointed and on appointment provided with an insurance cover that made it clear to them that if they miss-managed the firm to the disadvantage of the public, but potentially to their substantial advantage that were anyone to take legal action against them that they would be covered and suffer only a minor loss (the excess - probably far less than a year's salary), then that director frankly carries little or no personal risk and is being encouraged by the contact of insurance to take risks in the firm's management that would profit that director and not necessarily profit the shareholders or the public and with little risk of personal reprisal.
In essence I think that A.1.5 should include a statement that specifies that directors should be disbarred from having insurance that covers their personal assets or their reputation in circumstances of misconduct as a director. Certainly that such cover should not be paid for by the firm. That whilst firms should establish insurance for their directors this should not provide legal costs protection (though a director may hold their own insurance in this respect) and damages cover should only come into effect where a director's estate is unable to meet the claim and in those circumstances should only cover the part of any damages awarded that cannot be covered by the director's estate. That firms should monitor that their directors are not arranging their estate (either before or after appointment) in such a way as to safeguard their estate and thereby increase the protection of the insurance the firm provides (as this increases the risk of misconduct and might invalidate the insurance) and directors should be removed or not appaointed if this sort of conduct is identified. That this duty to audit estate management should be the joint and several responsibility of the board so that a claim against a director if the insurance is invalidated by their miss-management of the estate can be transferred under this responsibility to the other directors as necessary.
That under no circumstances should insurance, paid for by the firm, be capable of making a payment of damages to a director for losses they suffer as a result of his own proven or potential misconduct.
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