Navigating the Pitfalls of Directors & Officers Liability Insurance

The U.S. economy has shed millions of jobs and stock indices have lost a large portion of their value over the last two years. These sobering statistics reflect a changed environment and profound challenges for all businesses, especially for those on Main Street. Tough times lead to increased scrutiny of the daily decisions made by business owners and managers. Directors & officers (D&O) liability insurance is a product that affords business owners and managers some level of protection from suits brought by employees, investors, suppliers and governmental agencies. Since most lawsuits filed against business owners and managers are brought by creditors and employees, a director or officer who is not covered by a D&O policy is playing a dangerous game risking his or her own personal assets. However, agents must be careful in procuring this type of insurance because not all D&O policies are equal.

The standard D&O policy offered by most insurance carriers has two separate coverage parts: an executive liability agreement, often entitled "Side A," and a corporate reimbursement part, often entitled "Side B." The Side A coverage agreement typically pays directors and officers directly for loss and defense costs when corporate indemnity is unavailable. The Side B coverage agreement reimburses the corporation for any money it has paid as indemnification to insured directors and officers. Typically, employment practices liability coverage is available by endorsement.

The first key to successfully procuring D&O coverage for your client is knowing the scope and nature of your client's business. Who owns the business? Are the officers and directors of the company also employees? How many people does your client employ? As all D&O policies have coverage gaps to a varying degree, knowledge of your client's business is essential because many insurance carriers will negotiate the terms of their D&O liability policy forms. Similarly, if your client has an outside sales staff and the D&O policy would afford employment practices coverage, it may be prudent to negotiate third-party liability coverage for customers' claims involving allegations of discrimination or harassment. Further, if you have a client who is very cost sensitive and would likely go without such coverage, it may be wise to request quotes with varying levels of coinsurance (i.e. a portion of the coverage would be self funded by your client) which can make this product more affordable and accessible for even your smallest commercial account.

The second key to successfully obtaining D&O coverage for a client is knowing the scope of coverage for the proposed D&O policies you present to clients for their consideration. How does the policy define a claim? Does the policy provide employment practices liability coverage? Does the policy provide coverage for investors' disputes involving a privately-owned company? Does the policy contain a professional services or paid services exclusion that would significantly limit coverage for future claims? Does the policy afford automatic tail coverage? These questions underscore the importance of reading the proposed D&O policy forms and exclusions carefully. This review should be fully documented in the agency file. Additionally, the agency file should contain all communication concerning all coverage and marketing representations made by the broker, the proposed carrier's underwriting and claims department. Remember, the successful defense of an errors & omissions claim starts with the documentation contained in the agency file.

Once the appropriate D&O coverage has been selected by your client, advise the client to report all claims and potential claims since this type of insurance coverage is often written on a claims-made and reported basis that has more restrictive claim reporting provisions.

Lastly, as coverage gaps are often created when the D&O policy is changed from a claims made to an occurrence basis, the prudent agent should always determine if the D&O carrier offers extended reporting coverage in the event that the policy is cancelled, non-renewed or procured from a different carrier. IA

Crystal Ivy is an assistant vice president, claims and liabilities, with Swiss Re.

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