



Guide to D&O Insurance for Private Companies

WHAT IS DIRECTORS & OFFICERS INSURANCE?

The executives and business leaders who serve as the directors and officers of your company can be (and are often) sued for breach of their corporate duties. If yours is a publicly traded corporation, the plaintiffs may be shareholders who decide to file a lawsuit alleging they have been harmed financially by negligent management of the corporation. Or they might be employees, customers or even clients of a private company. Indeed, more than half of all D&O claimants are not public-company stockholders, underscoring that smaller businesses

need D&O just as much as large, deep-pocketed corporations.

These lawsuits are expensive to defend and potentially expose the defendants to significant personal liability. That's where Directors and Officers Liability insurance steps in, indemnifying both the individual directors and officers and the corporation itself. D&O policies cover legal fees, settlements and other costs.

TABLE OF CONTENTS

What is Directors & Officers insurance?.....1

Reasons to buy D&O coverage 3

D&O for private companies.....4

Top private D&O exposures 4

The 'ABCs' of D&O..... 5

D&O exclusions 6

Deductibles 6

Limits 6

The cost of D&O..... 7



3 REASONS TO BUY D&O COVERAGE

A D&O policy can do more than help you cover the cost of claims against your company's leadership. Here are three additional reasons to carry D&O:

1. It can help you recruit the best leaders. Many potential directors and officers will be reluctant to join your business if they are exposed to personal liability. D&O liability insurance helps address this issue.

2. It can help you attract investment. Venture capital and private equity firms often require companies to have D&O coverage before they make an investment. Indeed, if a merger or acquisition is in your future, purchase D&O coverage as soon as possible. Your directors and officers will want to be indemnified should they be sued after the deal closes. The same goes for any company considering an initial public offering.

3. It can help you cover legal fees. Even if directors and officers are exonerated of wrongdoing, you may run into substantial legal fees in fighting a lawsuit against your leadership. With a D&O policy in place, your company's legal fees will likely be covered.

D&O FOR PRIVATE COMPANIES

Although developed to meet the needs of the largest corporations, the growth of claims against all corporations has created a need for D&O coverage for entities of all sizes. D&O coverage, of course, is without a doubt necessary for any company preparing to go public. But even smaller private companies with no IPO plans may find that outside directors will not serve on their boards unless a D&O policy is in place.

Larger private companies have certainly caught on.

In a recent survey, Advisen, a provider of information and analytics services to the commercial insurance industry, found strong demand for D&O insurance among the more than 250 private company risk management executives it canvassed.

Many of those risk managers already have D&O insurance, with 19 percent having bought up to \$5 million of coverage, 11 percent buying coverage of \$6 million to \$10 million, and 16 percent buying D&O limits in excess of \$96 million.

TOP PRIVATE D&O EXPOSURES

Shareholder Suits – Shareholder suits comprise the second-largest category of lawsuit brought against private company directors and officers. A common allegation is that majority shareholders took an action that benefited them, but at the expense of minority shareholders. Shareholders of private companies also may sue for inadequate or inaccurate disclosure in private placement materials.

Creditor and Bankruptcy Trustee Actions – Creditors also have successfully sued directors of failed companies for breach of fiduciary duty, alleging that directors allowed a company's assets to be squandered. Bankruptcy trustees also may sue to recoup losses from directors.

Competitors – Suits by competitors often include allegations of anti-trust or unfair competition. These allegations can include misrepresentation

of a competitor's products, inducing customers to breach contracts with a competitor, and enticing employees to leave a competitor.

Customers – The types of lawsuits brought by customers typically include those stemming from contractual disputes, debt collection, the costs or quality of products or services, refusal to extend credit, and discrimination.

Employment-Related Claims – Employment-related suits are by far the most common type of lawsuit faced by private company directors and officers. In recent years, the number of employment practices claims filed against directors and officers has skyrocketed.

Regulatory Enforcement – Includes claims for Wage & Hour, National Labor Relations Act, Foreign Corrupt Practices Act, False Claims Act, Consumer Protection and Competition Laws and the JOBS Act.



THE 'ABCs' OF D&O

A typical D&O insurance policy will include three types of coverage:



A-SIDE COVERAGE. One of the most important functions of D&O insurance is to protect directors, officers and sometimes employees when the company has become insolvent and is unable to honor its indemnification obligations. This last line of defense is extended under Side A of a D&O policy. Because of the critical importance of this insurance protection, some companies choose to buy additional amounts of insurance providing

higher limits of liability just for this Side A coverage, in what's known as Excess Side A insurance.

B-SIDE COVERAGE. This reimburses the company for directors', officers', and employees' losses when the company does indemnify them. Side-B is only intended to cover the costs incurred on behalf of directors and officers, and will not protect an organization from claims made directly against it.

C-SIDE COVERAGE. Also called "entity coverage," Side C protects the corporation itself. Side-C coverage is typically reserved for publicly listed companies and protects the corporate entity from its own liability exposures. The coverage provided here is limited to claims made against a company as a result of the offer, sale or purchase of its securities.

D&O coverage is written on a claims-made basis, meaning coverage is provided for claims made during the policy period, regardless of when the underlying conduct may have occurred.

Structure of a Primary D&O Policy

Who is at risk?	Insured: Directors and Officers	Insured: The company	Insured: The company as a defendant in securities claims only
What is at risk?	Personal assets	Company assets	Company assets
Coverage description	Coverage: Non-indemnifiable liability of directors and officers	Coverage: Company reimbursement of directors' costs	Coverage: Company liability for securities claim
		Retention applies	Retention applies
	Side A	Side B	Side C



D&O EXCLUSIONS

Most D&O policies exclude bodily injury and damage to tangible property – items that would be covered under a General Liability policy. This exclusion is simply meant to ensure the D&O policy doesn't do the work of other policies in a policyholder's insurance program.

Most D&O policies also have exclusions for claims brought by one insured against another insured, in order to preclude coverage for collusive claims and for infighting among senior corporate officials.

D&O policies also typically exclude liability for pollution and nuclear hazards.

Other exclusions found in D&O policies include:

- libel or slander;
- gaining any personal profit to which they were not legally entitled;
- failure to maintain adequate insurance for the corporation;
- certain violations of the Securities Exchange Act;
- acts of deliberate dishonesty;
- liability under the Employee Retirement Income Security Act.

DEDUCTIBLES

Typically, a D&O policy requires the policyholder to pay a flat deductible and a percentage of any losses. For example, assume you have a \$1 million

D&O policy with a \$25,000 deductible and a 5 percent "participation" retention.

If your insurer settles a covered D&O claim for \$100,000, your company would pay the \$25,000, plus 5 percent of the \$75,000, or another \$3,750, while the insurer will pay the remaining \$71,250.

LIMITS

How much insurance is the right amount? It's a big question whether yours is a public or private company. Either way, it's important to consider defense costs (along with your tolerance for risk) in determining policy limits. That's because under most D&O insurance policies, defense costs erode the limits of liability. Every dollar of defense cost means one less dollar available for settlements or judgments.

For a company to ensure that it has adequate limits of liability both to defend and to settle serious claims, consider likely defense expenses as well as settlement amounts and keep in mind that both settlement costs and defense expenses have been rising fast in recent years.

One other important benchmark to consider is what your competitors are doing. How much D&O coverage are they buying? Examining that question can help you decide what might be right for your company.

FINDING A D&O BROKER

It's important to note that there is no standard D&O insurance policy. Each D&O insurance carrier has forms that differ from their competitors' and most policies are the subject of extensive negotiations.

In order for D&O insurance buyers to be assured that they have the best and broadest available terms and conditions and the appropriate insurance

structure in place, it is critically important that they retain a knowledgeable and experienced broker. A skilled specialist who places significant volumes of D&O coverage can connect you with the carriers that will pay attention to your account and can offer the best policies.



**Want to learn more?
Contact us via our website
or call 480-730-4920.**