

Understanding Directors & Officers Liability



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Directors, officers, and others in business leadership roles could be one decision away from losing their personal assets. When a company's financial results don't meet up to shareholders' expectations, lawsuits can target the firm and its executives.

With the right D&O Liability Insurance, companies can protect themselves and their management members from bankruptcy. This coverage serves as a defense tactic and empowers corporate leaders to take the strategic risks necessary to promote company growth.

Every organization with a board of directors, private, public, or nonprofit, can benefit from a D&O policy. This type of insurance covers the gaps left by most General Liability and Umbrella policies. Another aspect business owners should consider is that most top executives won't work with an employer that doesn't provide D&O coverage.

D&O Insurance Overview

Company leaders, officers, and directors are responsible for making decisions that impact a business long-term. However, the opportunity for greater rewards also carries significant liability exposure.

Even when executives have the best intentions, the potential for plans to go awry leaves managers susceptible to different risks. If adverse consequences occur due to poor decision-making, the director could be facing a "wrongful acts" lawsuit.

- Failing to comply with regulations or laws
- Decision-making that leads to company insolvency
- Breaching fiduciary duty
- Negligent maladministration
- Disclosing inaccurate account information
- Reporting errors
- Misusing business assets

Business leaders are often held accountable for organizational failures and losses like the ones above. However, D&O insurance can help cover the cost of legal fees related to such claims. Coverage can also protect executives from HR, employment practice, cybersecurity, and misrepresentation issues.

Why D&O Coverage is Critical

For companies and executive leaders, D&O coverage is an essential policy for several different reasons.

- Attract investors – Most venture capital firms will examine a company's D&O insurance before investing.

- Gain talented leaders – Strong leaders understand the importance of protecting themselves from liability risks and prefer employers with D&O coverage.
- Protect business assets – Lawsuits and legal disputes can be costly and can even force some companies into bankruptcy.

Different D&O policies will cover various exposures and include specific liability conditions. Because this type of insurance is so detailed, many companies seek guidance from an insurance professional. An agent can explain each coverage option’s technical intricacies and determine which policy is suitable for an organization’s particular circumstances.

What D&O Insurance Covers

D&O policies typically come in the structure of an ABC plan. These plans contain a Side A, Side B, and Side C with different protection layers. Depending on the coverage, D&O insurance can provide financial protection to an individual company, officer, and the organization.

D&O Coverage Side	What it covers	Who it covers
A	Individual asset protection for directors when the company cannot fund indemnification	Officer or Director
B	Public and private corporate asset protection for the company when the business pays for an officer’s indemnification	Company
C	Coverage for the organization, or public company security claims (Entity Coverage)	Company

Businesses of all sizes can face legal claims that target individual leadership roles and the firm itself. For example, workers could file a claim for unsafe working conditions, or investors could sue over stock performance. A D&O policy can help cover legal fees, litigation defense costs, and settlement expenses.

What’s Not Covered

Most D&O policies won’t cover intentional criminal acts or exceptions, such as the following.

- Property damage
- Bodily harm, except for corporate manslaughter
- Claims covered by other policies
- Claims from previous policies

- Fraud
- Illegal personal profit activities

Some coverages include an “insured vs. insured” clause. This clause excludes claims directors, or officers make against the insured company. Insurers typically add this statement to protect themselves from conspiracy and deceitful claims.

Duty to Defend or Duty to Indemnify

Business owners need to be aware that D&O coverage will either include a Duty to Defend or a Duty to Indemnify clause. Each option has benefits and downsides, depending on a company’s preferences.

A Duty to Indemnify, or Non-Duty to Defend policy, allows a company to select its own defense attorney. However, the insurer will only reimburse “reasonable” expenses, which may or may not be sufficient in a legal battle.

Small and mid-sized businesses usually benefit more from a Duty to Defend contract. With this type of coverage, the insurance carrier is obligated to pay legal defense costs. However, the insurer will have the power to select the company’s legal counsel. Despite this drawback, the Duty to Defend is typically the safer option considering lawsuit expenses can lead to business insolvency.

D&O Excess Layer Protection

Most D&O insurance policies have a protection limit that is capped at a certain dollar amount. For this example, we will use \$10 million. Companies that require higher limits can add on “Excess Layers.” These layers offer additional coverage from other insurers to protect large groups and international organizations.

Insurer	Policy Limit
Insurer A	\$10 million
Insurer B	\$10 million
Insurer C	\$10 million
Insurer D	\$5 million
Combined Coverage Limit	\$35 million

Typically, the primary insurer provides the largest portion of coverage, and each additional carrier covers a smaller amount of the risk. If an organization requires a \$20 million coverage limit, insurer A and insurer B could each cover a portion of the risks. For a \$35 million coverage limit, the policyholder would need four different insurers or excess protection layers (see able example).

Emerging D&O Claims Trends

New D&O liability trends are emerging every day that can pose financial threats to businesses and their corporate leaders. The following are some emerging claims trends that directors and officers may encounter.

Security Class Action Filings

Shareholders of public companies file securities Class Action claims when investors allege that the firm's director or officer is responsible for an unexpected market value decrease.

Company executives are typically responsible for completing SEC filings, earnings conference calls, and speculative financial statements. If a firm's stock prices drop suddenly, investors could, for example, hold an executive accountable for producing misleading revenue trend reports.

These lawsuits pose one of the most severe risks to directors and officers. The settlement process tends to be lengthy, complicated, and expensive, which is why smart executives choose their D&O insurer carefully. By having the right insurance company, directors and officers have a better chance of negotiating a favorable outcome.

Regulatory Compliance Issues

Regulatory compliance is another issue challenging executive leaders. Frequent legislative updates and strict enforcement protocols can result in complications. When directors and officers fail to keep up with the changes, government agencies may begin to take legal action. Even when corporate

leaders aren't at fault, they can still be held liable.

Directors may also be responsible for the non-compliance of employees. For example, if an employee accepts a bribe, the executive officer could be found guilty of improperly supervising its workforce. Corruption is a leading cause of a regulatory investigation, but social, ethical, and environmental concerns also create tremendous potential for allegations.

Mergers and Acquisitions (M&A) Activity

Mergers and acquisitions are to blame for many D&O claims. M&A activity can present new growth opportunities. At the same time, M&A deals nearly always come with potential risks. High acquisition costs can cause liquidity issues and result in litigation during a critical transitional period.

Sometimes, sellers fail to disclose relevant details about their operations, which leads to disputes after the sale. One way to minimize exposure is through a Transactional Liability Insurance policy. This type of coverage protects shareholders and companies from misleading statements or inaccurate information presented by the M&A target.



COVID-19 and D&O Risk Exposure

The onset of the pandemic created new D&O risk exposures and potentially severe implications. An increase in cybersecurity breaches and new challenges meeting Fair Labor Standards in work-from-home environments are some of the rising concerns business owners face.

Remote Workplaces and Cybersecurity

More employees are working from home since the pandemic began, creating more opportunities for cybersecurity risk. Cyberattacks, cloud service failures, and issues with internet providers can all contribute to devastating operational interruptions. In some cases, these problems can result in D&O liability.



While a cybersecurity policy covers some of the risks involved with new technology, many companies overlook the D&O implications. Such issues can cause massive financial losses and damage a company's reputation. Corporate governance could potentially blame a director or officer for failing to perform due diligence in preventing cyber-related threats.

The challenges of mitigating these exposures increases in a remote work

environment. When remote network security falls short, shareholders may sue directors and officers for mismanagement or wrongful acts. D&O coverage can add an extra layer of protection that enables executives to carry out these emergency decisions confidently.

Supply Chain Location and Class Action Securities

Businesses across the country experienced supply chain disruptions with the onset of the pandemic. In response, many company decision-makers opted to move their manufacturing facilities or work with suppliers in different locations.

The exceptional economic circumstances leave companies with few other choices than to relocate distribution centers or find alternative suppliers. However, legal problems can arise when new logistics plans don't meet up to their promises.

Directors and officers can be sued if stock prices dropped substantially as a result. Even if the decrease is only temporary, it could be enough to send investors into panic mode. Stakeholders could claim that a manager's public statements were misleading, triggering an expensive and time-consuming fraud lawsuit.

Failure to Manage the Impacts of COVID-19

Securities lawsuits can also arise when a company's leaders ineffectively manage the impacts of emergencies. During unprecedented times, recognizing, addressing, and disclosing business concerns can be incredibly challenging.

At the same time, shareholders tend to be unforgiving when substantial financial

losses are at stake. When business executives' efforts to navigate COVID-19 challenges fail, a lawsuit could target directors and officers. A D&O Liability policy could help pay for legal defense costs resulting from such securities litigations in many instances.

Unfortunately, the economic uncertainty following COVID-19 has increased the number of D&O liabilities. These risks are still changing, and new ones are emerging, which puts companies and their executives in even more danger. In this type of environment, the importance of D&O coverage can't be overemphasized.

Who Needs D&O Liability Insurance?

D&O coverage isn't only for large, multinational corporations. Private companies, nonprofits, and startups are also vulnerable to legal issues. Almost every business with shareholders, investors, or a board of directors needs D&O Liability Insurance.

- **Private company** – In many instances, private company executives have more of their personal assets on the line than large company executives. Additionally, directors and officers of private firms tend to partake in a wide variety of risky business decisions.
- **Startup** – Company leaders with limited business experience are particularly susceptible to litigation action from investors. These business owners are most likely to overlook regulatory details, underdeliver on promises to investors, and make other critical mistakes.
- **Nonprofit** – A nonprofit organization and its board members could face allegations from government regulators. Discrimination, misleading financial reports, wrongful employee termination, and other lawsuits could put a nonprofit out of business.

Many small business owners save on their D&O Liability Insurance by bundling it with other Management Liability policies. For example, Employment Practices Liability Insurance (EPLI) is one type of coverage that pairs well with a D&O plan.

How the WA Group Can Help

D&O Liability Insurance policies typically require heavy negotiation and careful examination of coverage details. Every business and its directors face unique risk exposures that are often only fulfilled through specific contract considerations.

Small and mid-sized business owners benefit the most from working with an agent who understands executive coverage lines' risks. The WA Group is a 100% employee-owned and Employee Stock Ownership Plan (ESOP) company, with the only executive risk expert in Minnesota.

Find out more about **Directors and Officers (D&O) Liability Insurance** from our executive risk expert at the **WA Group** at **(507) 452-3366**. We look forward to answering your inquiries.