

Why business leaders need D&O insurance

by [Mark Rosanes](#) 10 Jun 2022

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A company's directors and officers often make critical decisions that strongly influence how a business operates. But this great deal of power and responsibility also exposes them to a higher level of risk.

A survey conducted by insurance giant [Chubb](#) revealed that more than a quarter of private companies have experienced a directors' and officers' (D&O) loss in a span of three years and that 96% of these businesses were impacted financially. During that period, average losses reached nearly \$400,000 – an amount that could have a potentially devastating effect on an organization's balance sheet.

Despite this, only 57% of responding companies said they have purchased D&O insurance to help manage their risks due to the mistaken belief that coverage is unnecessary because their businesses are either privately held or family-run.

Although Chubb performed the study in 2016, the findings still demonstrate the serious financial impact D&O lawsuits have on businesses and a glaring coverage gap among companies.

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How does directors' and officers' (D&O) insurance work?

D&O insurance, also referred to as D&O liability insurance, is designed to protect the directors and senior management of a corporate or non-profit organization against financial losses resulting from business-related lawsuits. This type of policy pays out for monetary losses from these legal actions, including defense costs, settlements, and fines.

D&O coverage comes in main three types, also referred to as insuring agreements or sides, each offering different levels of protection. These are:

Side A

This type of policy provides coverage for “non-indemnifiable loss” or those situations where the company or business cannot indemnify its directors or officers, either due to bankruptcy or because they are not legally allowed to do so.

“When this clause responds to a claim, the insurance policy indemnifies the directors and officers directly for the defense and settlement costs or judgments against them,” the Insurance Training Center (ITC), a global provider of online professional and management liability insurance courses, explained on its website. “These would be allegations, for example, for breach of duties, negligent acts, or business-related suits.”

Side A coverage, or insuring agreement A, does not have a policy deductible

Side B

The most commonly accessed insuring agreement, according to ITC, Side B coverage works by reimbursing a company after it has compensated a director or other senior management for a loss, including defense costs, settlements, or judgments.

“It is essential to note this coverage reimburses the corporation only to the extent of the indemnification provided to the directors as opposed to covering the liabilities of the corporation,” ITC noted. “This is why D&O insurance is often explained as balance sheet protection for the corporation.”

Unlike Side A cover, insuring agreement B is subject to a deductible.

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Side C

Also called entity coverage, Side C agreement provides direct coverage for a business when both the company and its directors and senior management are named in a lawsuit. However, the scope of coverage varies between policies for private and publicly traded companies, according to ITC.

“For publicly traded companies, this insuring agreement provides coverage for its own liability arising from securities claims,” the group explained. “For private companies, not-for-profits, or even homeowners’ associations (strata corporations), this is entity coverage and would cover lawsuits against the corporation itself.”

ITC added that coverage for private corporations can be extensive and may include claims beyond lawsuits such as government subpoena or investigation demands in a D&O policy.

What does D&O insurance cover?

D&O liability insurance covers a wide range of claims targeted at a company’s leadership.

“Business leaders can be held responsible for a company’s failure to comply with regulations and to provide a safe and secure workplace,” the Insurance

Information Institute (III) wrote in a guide on its website. “In addition, if a company is found liable for losses because of operational failures and mismanagement, directors and officers may be exposed to liability as well.”

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Here are some other claims that directors and officers may be liable for, according to the institute.

- Shareholder suits over company or stock performance
- Creditor or investor suits over mismanagement or dereliction of fiduciary duties
- Misrepresentation in a prospectus
- Decisions exceeding the authority granted to a company officer
- Failure to comply with regulations or laws
- Employment practices and HR issues
- Pollution and other regulatory claims
- Cyber liability

However, there are also exclusions. The III explained that D&O policies typically do not include:

- Fraud and criminal offences
- Personal profiting
- Accounting of profits and other illegal compensation
- Pending and prior litigation
- Prior (late) claim notice
- Bodily injury and property damage, which is covered by general liability policies
- Insured versus insured claims, where one director or officer sues another
- Employee Retirement Income Security Act (ERISA) claims, which may be covered by fiduciary liability insurance

How much does D&O insurance cost?

Premium prices of D&O insurance depend on a range of factors, including the company’s size, financial standing, and claims history, the industry it is in, years in business and management experience, and ownership structure.

A recent study by insurance marketplace Insureon has found that most small businesses paid an average of \$1,500 annually for D&O coverage.

Brokerage firm Embroker, meanwhile, pegged the cost of \$1 million worth of yearly coverage to be between \$5,000 and \$10,000 for companies that generate below \$50 million in annual revenue. Premiums decrease as businesses purchase higher coverage limits.

Read more: [D&O insurance can't stay this cheap as assumed risks outpace premiums - TransRe](#)

Why do business leaders need D&O insurance?

According to Embroker, the main function of D&O insurance is to allow business leaders to make decisions confidently and without fear of personal financial loss.

“D&O claims are not just costly, they can be complicated, stressful, and drag on for years,” the firm added. “This may distract the leadership of your company from running the business effectively if they aren’t covered properly. Given the complexity and costs associated with these claims, any company or organization that has a board of directors, has secured investments, or could be accused of financial mismanagement should strongly consider D&O insurance.”

ITC, meanwhile, explained that while D&O policies are designed to cover for the business-related mistakes of senior management, lawsuits can sometimes arise even if there were no negligent acts committed.

Read more: [Lack of diversity on boards impacting D&O](#)

“What’s important to remember is that mistakes happen, and mistakes have consequences,” the center noted. “And even when mistakes haven’t occurred, allegations of mistakes or misconduct have to be defended, which can be very costly. Without a D&O policy or another indemnity mechanism in place, directors and officers would have to pay to defend themselves, settlements, or even fines out of their own pocket.”

Apart from these, D&O insurance can help companies retain strong leaders, according to the III.

“Many potential directors and officers will be reluctant to join your business if they are exposed to personal liability,” the institute explained. “D&O liability insurance helps address this issue.”

It added having this type of coverage can help attract investors as venture capital and private equity firms often require companies to have D&O insurance before making an investment.