



A committed relationship

How to get the best out of your D&O coverage

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A COUPLE OF YEARS AGO, it was difficult to pick up a business publication that did not contain some worthy treatise on the need for good corporate governance, accountability and ethical values. While these topics were certainly not new, the misbehavior of several large, high profile organizations brought them to the forefront of the business world. Along with this came the heightened awareness of the need for directors' and officers' insurance coverage. If these directors and officers (D&Os) were going to be held to a higher standard of accountability, then they were going to need a broader, stronger safety net.

D&O coverage has been around for decades in the US, which has led the rest of the world in insurance for directors and officers since the 1950s. What is newer is the dedicated A-side D&O product.

The term "A-side" refers to a fairly standard Insuring Agreement found in most D&O contracts. This agreement provides coverage to the insured persons (D&Os) where corporate indemnification is unavailable to them. Most stan-

dard D&O contracts also contain Insuring Agreements B and C, providing coverage to the Entity (or Corporation) for its indemnification obligation to the insured persons (Insuring Agreement B), and claims against the Entity itself (Insuring Agreement C), respectively.

A dedicated A-side product has many benefits, including:

- The contract is designed to protect the individual D&Os only. There is no coverage for the corporation embedded in the policy form. The benefits are: a) no sharing of limits with the company; b) in the event of bankruptcy, there is less risk of the court "freezing" the policy proceeds as an asset of the bankrupt estate.
- Difference-in-conditions coverage: Most A-side forms provide broader coverage to the insured persons than a standard ABC D&O form. For example, our main A-side form only contains four exclusions, whereas most standard ABC D&O forms contain at least double that number. Since A-side forms are often purchased to supplement a standard ABC D&O program, the

YOU SHOULD BE WORRYING ABOUT WHETHER YOUR CARRIER WILL STILL BE AROUND IN FIVE YEARS

potential exists for an A-side policy to provide coverage to the D&Os that simply does not exist within a standard ABC contract.

- Response feature: The A-side products are designed to take effect before an individual D&O has to dig into his/her own wallet. If a company refuses indemnification to an insured person, rightly or wrongly, and the traditional insurance program fails to pay for any reason (exclusions, rescission, bankruptcy of insurance carrier, poor claims response by primary carriers, etc.), our policy is designed to respond on behalf of the insured person who has been left uncovered. The XL Insurance companies would retain subrogation rights against those corporations or insurers who have wrongly denied indemnity or coverage. The point is: the insured person who buys our A-side contract knows they have a last line of defense in the event that “all else fails”.

This leads to the two main scenarios in which A-side policies are implicated.

1. **Corporate insolvency.** If a company can't pay (or more technically, indemnify its D&Os) because of its insolvent status, Insuring Agreement A is triggered. If the policy is tied up in bankruptcy court, it may not be working for the individual D&Os. In addition, most D&O claims take years to resolve, making it important that your carrier is still in business in five years' time when a claim is finalized. There is no security guarantee for any carrier, regardless of their rating, but statistics show that highly-rated companies are more likely to main-

tain claims-paying abilities over time when compared to lesser rated companies.


2. **Derivative shareholder suit.** Simply stated, this is a law suit initiated by a shareholder on behalf of the company, against the D&Os. These suits seek damages on behalf of the company, in contrast with direct securities class actions, in which plaintiff shareholders are suing for their own benefit. Derivatives have more meaning in an A-side world because of “circular indemnity”. Let me explain: in many states, it is against the law for the corporation to indemnify the D&Os for settlements and/or judgments arising from a derivative lawsuit. Why? Follow the money: the shareholder initiates the suit on behalf of the company, against the D&Os; if the shareholder wins the action, then the D&Os are required to pay money to the company; if the company indemnified those D&Os, the money would be taking a round trip, from D&Os to company back to D&Os. Note, however, that most states allow for D&Os' defense expenses to be indemnified by the company. For these reasons, an A-side insurance product is a valuable asset for D&Os entangled in derivative lawsuits.

It is essential to ensure you have the “right” A-side carrier — and in this respect there are some key characteristics to look for:

- Financial strength: Clearly you want a highly rated provider. Again, apply the stress test lens; choosing an A-minus carrier to provide your A-side

coverage doesn't make a lot of sense, nor would you want to buy it from an insurance company's managing general agent, whose stability is not assured.

- Commitment to the A-side product: Although the product has been around for some time, most carriers didn't embrace it until 2004 or later. The XL Insurance companies have been committed to the A-side product since its very early days, but many large carriers have been inconsistent with their A-side product offerings, moving in and out of the market depending on whether the product is a “hot” item or not.
- Claims handling staff who are familiar with and experienced in dealing with the product.
- Forms that are structured in a simple, “all-risk” nature, are superior to those written to address the 2005 issue, or the 2006 issue, for example. At XL, A-side forms are designed to be simple, all-risk policies designed to address whatever the issue of the year ends up being. In our view, an A-side policy should address future D&O risks, not just risks from the past.

In conclusion, it's important to remember that not all A-side is the same. Many companies have entered this business recently, making the market more competitive on a pricing basis. That can be good for customers, but it is important to remember the core benefit of the product: to be there consistently when all else fails. 

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