

NEW LEGISLATION CREATES OPTIONS FOR D&O COVERAGE



Written By Caroline McDonald

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irectors & Officers (D&O) insurance is designed to protect the personal assets of company executives and board members from lawsuits for mismanagement and other breaches of responsibility. But it can be very difficult to obtain sufficient coverage in the commercial market and, until recently, very expensive.

If a publicly traded firm needed financial protection for its directors and officers, options were limited to a moderate number of commercial insurance carriers.

More carriers entering the D&O market has caused rates to begin dropping, falling by as much as 14 percent for publicly traded companies in 2022, according to Marsh in its recent Global Insurance Market Index report. This while insurance pricing overall went up 3 percent in the fourth quarter of 2022 and 4 percent in the first quarter of 2023, Marsh said.

Even with lower D&O insurance costs, “We’re still seeing those companies that struggle,” said Donna Weber, senior vice president, Marsh Captive Solutions. “They are having trouble with the cost, getting the limits they want, or even getting coverage at all. Some industries find it prohibitively expensive.” In addition, rates are determined by the insurer – and the market can harden at any time.

Sectors that are struggling include pharmaceutical, cannabis, crypto, aviation and renewable energy. “Industries that are more challenged in the D&O world,” she said.

THREE CATEGORIES OF D&O INSURANCE

Side A, the most expensive and hard-to-place coverage, insures a company’s directors and officers when the company cannot reimburse them.

Side B reimburses the company after it has compensated a director or officer.

Side C supplies coverage for the business when it and its directors and officers are named in a securities lawsuit.

Most challenging is coverage for Side A. “It’s an issue of wanting to be able to attract qualified directors,” explained Steve Kinion, captive director at the Oklahoma Insurance Department’s Captive Insurance Division and previously director at the Bureau of Captive and Financial Insurance Products with the Delaware Insurance Department.

While Sides B and C have been insured in the captive market for years, he said, Side A has been more difficult. “Side A is primarily when the shareholders sue, and the corporation is bankrupt,” Kinion said.

LEGISLATION FOR SIDE A

All that changed on Feb. 7, 2022, when Delaware amended its corporate law, to allow a company to form a captive insurance company for Side A insurance purposes.

Stephen Taylor, director of the Delaware Captive Insurance Bureau, noted that the Delaware Captive Department is currently “developing guidelines to assist captive managers and applicants with the licensing of captive insurers issuing Side A D&O policies to Delaware corporations.” He added, “We are collaborating with the Delaware Captive Insurance Association in the development of the guidelines.”

Similar legislation will be introduced in the domicile of Oklahoma in 2024, Kinion said. The new law clarifies how companies can use captives for Side A D&O coverage.

Like Delaware’s law, Kinion said, Oklahoma will also prohibit the corporation from indemnifying the officers and directors in the context of shareholder suits, or when the corporation is bankrupt and doesn’t have the funds to indemnify.

“That’s where a third-party insurance company becomes valuable for the officers and directors,” he said. “Because then they can look to that company to pay, for instance, their legal fees in a lawsuit where they are being sued.”

If they are in a state that doesn’t allow that, they must purchase insurance. “In Delaware, the law changed in 2022, stating that the insurance can be purchased from a captive insurance company. That is the difference,” he said.

Weber noted that Delaware’s legislation removed some jurisdictional concerns for writing Side A D&O cover that had previously existed. She said that while captives may not be able to provide the exact coverage as the commercial market, “captives or cells provide another option for companies struggling to purchase coverage.”



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As a result, “We are seeing those companies looking into using a captive or a cell facility,” Weber said.

Michael Serricchio, managing director at Marsh Captive Solutions noted, “Captives are obviously a great option.”

Because of this option, “If your D&O is unavailable, you can now do it in a better, more refined, legally governed way in a cell captive,” he said. “By virtue of the fact that we have a decent number of these captives, it has been attractive to companies.”

Since the Delaware corporate law change, with the captive or cell option becoming more feasible, “We currently have 10 cells writing Side A coverage,” Weber said.

There is also added flexibility, as organizations have the option to use their captive for D&O, or “They might buy their primary limit in the commercial market and put some excess either in a captive or a cell captive,” Weber said.

LOOKING AHEAD

Speaking about the D&O insurance market, Taylor said, “While there is still a soft market, there could be some hardening of the market in the near future, with possible increasing risks to the D&O market in a number of areas.” These include, “rising volume and severity of claims; proposed Securities and Exchange Commission rules on Environmental, Social and Governance (ESG) disclosures; and the challenging economic environment.”

Kinion noted that captives that are being used for Side A are primarily cell captives, “and the cell structure is a good one to use for that purpose. I believe there will be a trend for this coverage, but how much will be up for debate.”

The reason, he said, is that the trend will be dictated by the direction the market takes. “If the D&O market is receptive to offering Side A at competitive prices, companies may feel they don’t need a captive for that.”

If the market hardens again, however, “and it becomes a question of being able to find reasonably priced coverage, and there are exclusions in the coverage, captives will be strongly considered,” he added.

While the insurer trend for D&O pricing appears to be going in a positive direction, “remember where we’re coming from,” Kinion cautioned. “Prices became high and now they’re coming down. So, while they are moderating, look at where they are moderating from.”

Marsh summed it up in its article: “The approved Delaware law is a significant step forward as it allows more companies to consider a wholly owned captive or a “cell” as a partial or complete solution for covering Side A D&O claims. Companies with very high insurance premiums or that are struggling to obtain sufficient capacity in the commercial market may be particularly interested.”



REASONS FOR D&O PRICE HIKES

There have been several events that were instrumental in driving up D&O prices, said Steve Kinion, captive director at the Oklahoma Insurance Department's Captive Insurance Division and previously director at the Bureau of Captive and Financial Insurance Products with the Delaware Insurance Department.

Among them, in 2019 "there was Wells Fargo, that was a \$240 million settlement." This was a fraud scandal when bank employees opened millions of bogus accounts in customers' names to meet sales goals.

In May of 2023, Wells Fargo agreed to a class-action settlement of \$1 billion for misleading investors on the progress of its internal cleanup of the 2019 fraud.

Another was Equifax, which agreed to a global settlement of up to \$425 million for a data breach in 2017.

Yet another was Wynn Resorts in 2019, when Steve Wynn was accused of sexual harassment. Wynn Resorts was fined \$20 million for failing to investigate sexual conduct claims.

And then there was Bluebell Creameries, which was linked to a number of people being sickened by listeria and three deaths in 2019. The company was ordered by a federal court to pay \$17.25 million in criminal penalties.

"Those were all shareholder suits brought against the board, saying they should have been doing their job and overseeing operations," Kinion explained.

He added, "As the court said to Bluebell, 'All you do is make ice cream.' Board members don't have to be making the ice cream, but they should be aware of the procedures involved." ■

Caroline McDonald is an award-winning journalist who has reported on a wide variety of insurance topics. Her beat has included in-depth coverage of risk management and captives.

