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5 major myths

Many directors and officers have misconceptions about their D&O insurance coverage. Here are the facts.

BY STEPHEN J. WEISS AND THOMAS H. BENTZ JR.

D&O insurance typically is a multimillion-dollar asset intended to protect the treasury of a company and the personal assets of its directors and officers. Despite its importance, many executives have fundamental misconceptions about this risk transfer product. To help dispel these misconceptions, we compiled a list of the more common myths and provide you with the facts.

D&O Myth No. 1 — All D&O policies are the same

Facts: D&O policies are not all the same. Unlike some other types of insurance, there is no standard D&O insurance form. More than 30 insurers offer D&O insurance, and each insurer's form is unique. Some even offer multiple forms, each with a different coverage focus. Even basic provisions, such as which individuals and what wrongful acts are covered, can vary among forms.

To be sure that you have the best policy for your needs, you need to know not only what your policy covers but also what protection is available from other insurers in the D&O marketplace.

D&O Myth No. 2 — D&O policies are non-negotiable

Facts: D&O policies are highly negotiable. If you are not aggressively negotiating coverage enhancements to your policies each year, you will not be maximizing the value of your insurance dollar.

D&O Myth No. 3 — It is better not to report some claims

Facts: Typically, insureds must report all claims to all policies in a D&O program. Notwithstanding this unambiguous requirement, some insureds believe it is better not to report certain claims, especially those they do not expect to exceed the applicable retention. Insureds often believe that reporting fewer claims will result in lower premiums.

Sooner or later, a claim you expect to be resolved for a nominal amount will blow up into a more serious situation. At that point, it may be too late to give timely notice to your insurers. Worse yet, the original claim may spawn a significant related lawsuit. If you did not give timely notice of the original claim, you could also lose coverage for the related claim as well.

Failure to report a claim also creates a potential rescission hazard. Underwriters use claim history to evaluate risk. If you omit your claim history from your application, your underwriter cannot underwrite properly. When the true claim history eventually comes to light, your insurer will likely argue that there was a material omission in the application and will try to make a case for rescission of the policy.

The bottom line: You should report all claims.

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D&O Myth No. 4 — Insurers rarely pay claims

Facts: While insurers don't always make it easy, the truth is that they generally pay covered claims ... eventually. That said, there are some real reasons this myth persists. First, some insureds don't consider what is and is not covered by their policies until after a claim is made. For example, many insureds are surprised to discover that their D&O insurance policies do not cover informal SEC investigations unless an individual insured is the subject of the investigation.

Similarly, many insureds run afoul of the requirements of their D&O insurance policy by failing to coordinate their defense strategy with their insurance requirements. Selection of defense counsel, public disclosures about the claim, and even efforts to resolve or settle the matter can all affect your potential for coverage. Insureds must work with their insurers from the beginning to ensure that they maximize their chance of insurance recovery.

D&O Myth No. 5 — Excess policies are all "follow form"

Facts: Although excess policies are often described as "follow form," meaning they track the terms of the primary policy, that description is dangerously misleading. Insureds may think that a careful review of the primary policy is all that is needed to negotiate a D&O program with top coverage. Not true. Many "follow form" excess policies dramatically depart from the coverage provided in the primary policy. For example, an excess policy may permit the insurer to cancel the policy for no reason while the primary policy permits cancellation only for non-payment of premium.

The crucial point is that the excess policies in your program require review and negotiation just like the primary policy. This is especially true when most of the aggregate policy limit is in the excess policies, not the primary. ■

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