Determining the Right D&O Insurance Limits for Your Private Business or Nonprofit

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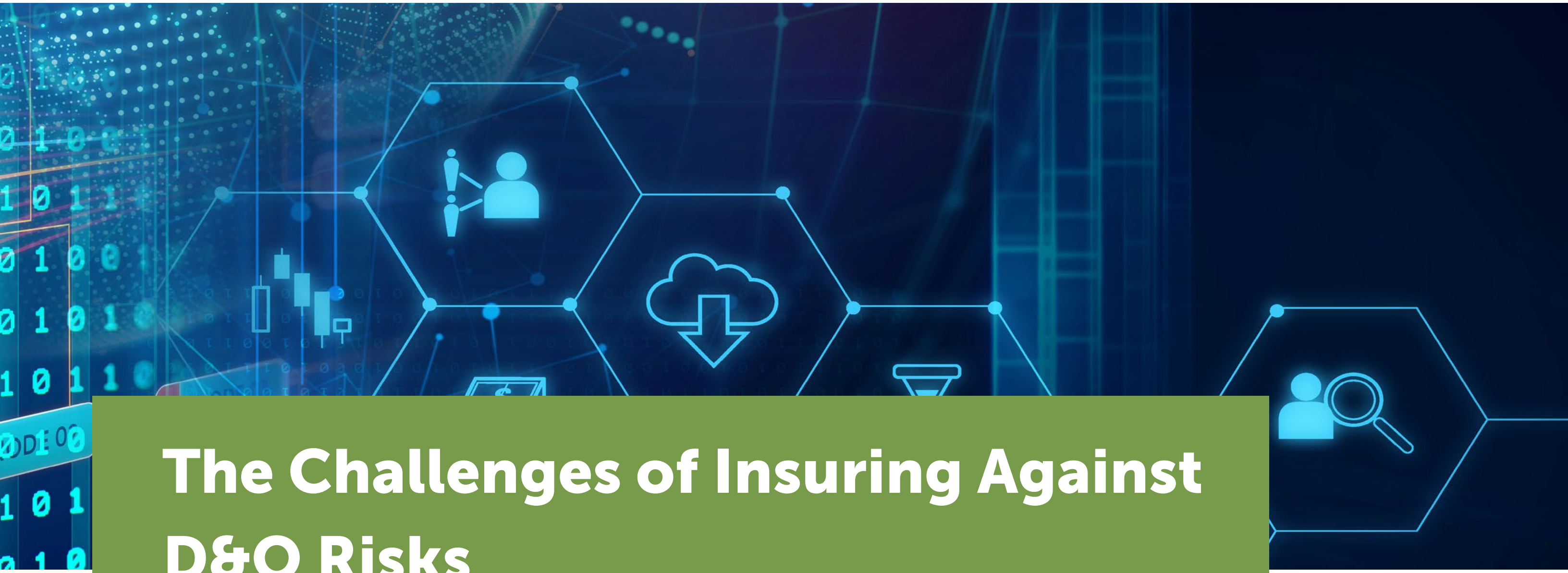
Directors and officers (D&O) insurance is critical for any private company or nonprofit organization that employs these professionals.

Most businesses recognize it's important to protect the organization as an entity and the directors and officers as individuals against claims of actual or alleged wrongdoing in managing the company, through an error, omission, neglect, or breach of duty.

What's not so clear-cut is the specific D&O policy limits your organization needs to address your exposure.

While there is no black-and-white calculation for determining the best D&O policy limit for your private or nonprofit organization, a strategic approach will help you navigate the complexities of obtaining the right policy for your needs. This guide reviews the key considerations to focus on when assessing your D&O insurance limits, along with strategies for structuring the policy to optimize the available limits. The guide also discusses the role of an independent insurance advisor in developing the optimal D&O solution.



The Challenges of Insuring Against D&O Risks

First, it's important to recognize that D&O exposures are continually evolving, and that makes it more complicated to determine your coverage needs.

For example, cybersecurity is an emerging D&O exposure that many companies overlook. A privately-held food distributor learned this lesson the difficult way when a cyberattack prevented them from shipping product, causing major logistics problems for their customers.

Because the company had inadequate cybersecurity controls and insufficient insurance to cover payments to the cybercriminals, the attack brought the business to a halt—resulting in financial losses for the company, its customers, and its stakeholders. In turn, the company's officers faced a D&O claim alleging they failed to make cybersecurity a priority.

For reasons like these, it's essential to stay on top of your D&O exposures in a fast-changing world, especially as you contemplate what policy limits to take.

KEY CONSIDERATIONS

That Influence Your Policy Limit Needs

Determining the most appropriate D&O policy limits for your organization starts with assessing your risk profile. The following considerations all weigh into your D&O risk profile and will impact the policy limits you should consider and may be able to obtain.

Board Size and Composition

Other factors being equal, the more directors on your board, the greater your D&O coverage needs. But the actual makeup of your board is an even more important factor in choosing your policy limits.

Many companies intentionally invite well-known, high-profile professionals to sit on their board, whether to leverage their background and expertise or to attract large donors. But along with notoriety comes a higher expectation of performance and greater scrutiny by external stakeholders like customers and vendors, increasing the odds of a D&O claim.

A business with a top-name director on the board should also consider obtaining additional Side A coverage, which is designed to cover directors and officers individually for non-indemnified losses. For example, Difference in Conditions Side A coverage comes into play when one board member sues another—which is excluded under traditional D&O policies—or when your primary D&O limits have been exhausted by other claims. Some businesses find it very affordable to buy relatively significant Side A limits, especially since it is first-dollar coverage (which means no deductible).

Industry and Nature of Your Work

Certain industries and types of work naturally create greater D&O exposure. For example, higher education institutions typically attract significant grants and donor funding, which opens the organization and its directors and officers to scrutiny over how those dollars are spent. Life sciences and biotech companies that are developing novel therapies tend to have a higher risk profile. Nonprofit organizations that engage in environmental or social impact work can find themselves the target of D&O claims by others who oppose their actions. Any private company's environmental, social, and governance (ESG) policies could be called into question, even though they aren't bound to the same ESG reporting requirements as public companies. And generally speaking, public companies have greater exposure to D&O claims than privately-held businesses.

Along with impacting the D&O limits you should consider carrying, your industry and the nature of your work will affect the ease or difficulty of obtaining adequate coverage, your premiums, and the retentions the insurance company requires.

Company Size

A larger company is likely to serve more clients or customers, work with more vendors and other third parties, and have more investors—all of which increase the organization's D&O exposure.

A company with higher revenue might also become the target of a D&O lawsuit seeking larger damages. While it's not the only factor, your total revenue is a consideration when determining how much coverage to purchase.

Lifecycle Stage

Startup companies often find it more difficult to obtain D&O coverage than later-stage businesses because there is little or no record of performance for the insurer to evaluate. The underwriting process is likely to be more rigorous as the insurance company scrutinizes your board members' resumes, along with your bylaws, pro rata financials, and shareholder materials.

In addition, an early-stage business typically doesn't have the same rigorous risk management processes or internal checks and balances that a mature organization has—and which a D&O insurer will expect to see. As a result, a relatively young private business or nonprofit might only be able to secure lower D&O policy limits at first.

Financial Health of the Company

D&O claims often arise because the business fails financially. If your organization is currently struggling, you likely need higher policy limits to protect against a claim brought by an investor or creditor, alleging that your board or officers were negligent in managing the business responsibly. Yet, you might have trouble obtaining higher limits due to the business's poor financial health, or an insurer might offer the limits you want but at an exorbitant premium.

Organizations that are facing financial difficulties should work closely with an independent insurance advisor to determine the best approach to obtaining adequate coverage at a reasonable price.

Company Ownership Structure

It's not unusual for a privately-held company to have a single owner, especially in the early stages. When one person makes all key decisions unilaterally, it opens the organization to more risk and necessitates more D&O coverage. On the other hand, a single-owner company might find it difficult to get sufficient policy limits for the very reason that their D&O risk is higher.

The profile of your organization's owners also impacts your D&O exposure and, in turn, the policy limits you should consider. If any owners are high-profile or controversial, that could place a target on the business's back, inviting more D&O claims.

Strategic Plans

The greater the degree of change your organization expects, the greater your potential D&O exposure. For example, if your strategic plan calls for branching out into entirely new lines of service, or expanding into emerging markets, those activities could increase the odds of a claim of negligence or errors against your board or officers.

Be sure to consider your strategic plans, both short- and long-term, when evaluating your D&O policy needs.

M&A Activity

Mergers, acquisitions, and divestitures are major drivers of D&O claims. For instance, when you purchase another company you take on their exposures—some of which might not come to light even during rigorous due diligence. If you and several competitors engage in a bidding war for the same acquisition target, you could face an unfair trade allegation. And a merger that moves your business into new and unfamiliar geographic markets could result in operational errors or omissions that trigger a D&O claim.

When you anticipate expanding or changing the scope of your operations through M&A, recognize that your D&O exposure is likely to evolve and you might need to adjust your policy limits. Be sure to evaluate your policy limits before you begin any M&A negotiations, so you're adequately covered for anything that arises during the process.

D&O Claims History

Having a D&O claim on your record isn't a problem in and of itself. But failing to take remedial action after a claim *is* problematic, since underwriters will ask for evidence that you have corrected the issues that led to the claim. For example, did you develop, implement, and monitor a plan designed to prevent the same issue from happening again?

If you can demonstrate that you've taken appropriate actions to reduce your D&O exposure, the insurer might be willing to offer higher policy limits at a more favorable premium, even though you have a claim on your record. On the other hand, you might decide you're comfortable taking lower limits because you now have stronger risk management practices in place.

Keep in mind that if you increase your limits at renewal, the insurer is likely to add a warranty statement indicating that the higher limits only apply to claims arising during the new policy period.

Director or Officer Expectations

It's common for a prospective board member or a candidate for a senior executive role to ask about the company's D&O coverage before agreeing to join the company. They might even ask the organization to increase its policy limits. That's especially true of high-profile and high-net-worth individuals, but anyone considering a top position or board seat might make this request. As you add or replace board members or recruit C-suite talent, be prepared to revisit your D&O coverage to meet their expectations.

Risk Exposure

As with any type of insurance, buying D&O coverage is all about addressing what keeps you up at night. And that can vary based on your risk tolerance. However, risk tolerance isn't uniform across an organization; it's likely that different individuals or board committees will feel different about certain types of risks and the company's ability to withstand them.

An independent insurance advisor can help you assess the risk tolerance of your business as a whole and your individual directors and officers, how it's evolving over time, and the impact on the policy limits you ultimately decide to take.

Optimizing Your D&O Limits

Once you've evaluated these considerations, consulted with your insurance advisor, and decided how much coverage you want to obtain, it's equally important to think about how to structure your commercial insurance to optimize the available D&O limits. One of the most important factors is whether to buy a separate D&O policy or bundle it with other coverages.

Some private businesses and nonprofits bundle D&O insurance with other management lines of coverage, such as employment practices liability. This approach can prove less expensive than buying separate policies, but it usually means the policy limits are shared among the various coverage types. For example, if the insurer pays out an employment practices liability claim that uses up most of the total policy limit, there will be little left for a D&O claim in the same policy period.

On the other hand, employment practices and D&O claims don't happen frequently, at least for most businesses. So bundling the coverages often makes sense, as long as you structure the policy limits effectively. An insurance advisor with deep experience in management lines of coverage can guide you through the complexities of structuring a policy with the best total limits.

Turn to B. F. Saul Insurance for D&O Guidance

Determining the optimal D&O coverage and policy limits for your needs is a complicated undertaking that demands a thoughtful, strategic approach. The commercial insurance specialists at B. F. Saul Insurance have the experience and expertise to guide you through this process and help you make the most informed decision.

We walk you through all the considerations that impact your D&O coverage needs and policy limit preferences. We also analyze peer benchmarking data to determine how companies with similar revenue, number of employees, and other factors are approaching their D&O coverage. While benchmarking data should never dictate your decisions, it can prove helpful in many ways—even giving you insight into the types of claims similar companies are experiencing and what you should guard against.

In a dynamic and volatile world, you need a trusted advisor helping you to navigate the complexities that can place your business at risk. Contact B. F. Saul Insurance to learn how we can help protect your business from the most likely exposures, including D&O claims.

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