D&O Glossary

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Directors and officers (D&O) insurance can be confusing. Policies often contain a variety of terms that can be difficult to understand, especially for someone without an insurance background. Understanding what's in your D&O policy is critical, particularly during the underwriting or renewal process. Prior to meeting with your broker, it's important for policyholders to review their coverage and exposures. That way, they can come to their broker with specific questions regarding their policy and coverage options.

The following is a list of common D&O terms to keep in mind the next time you meet with your insurance broker:

ALLOCATION—A determination of the portion of a loss that is considered to be covered by an insurance policy when less than 100 percent of the loss is covered. In some cases, a D&O insurance policy may not cover all of the defendants or entities named in a claim. In other cases, a D&O insurance policy may not cover all of the allegations made in a certain claim. In these instances, allocation would come into play.

CLAIM—In order for the protection of D&O insurance to become active, a claim that falls under the scope of a policy must occur. Most policies define a claim to include any written demand received by an insured, as well as any civil, regulatory or administrative proceeding arising in the line of corporate duties. The definition of claim may also include any criminal proceeding bought against an organization or its managers. Please note, policyholders should always review their policy to find out what qualifies as a claim and if they have any questions to check with their insurance broker.

CLAIMS MADE (AND NOTIFIED)—D&O policies operate on what is known as a claims-made and notified basis. This means that a policy provides coverage for claims made against an insured and notified to the insurer during the period of insurance. In order for a claim to be covered, it must meet the following requirements:

- Management must become aware of a claim during the policy period
- The insurer must be notified of a claim within the policy period

COINSURANCE—Coinsurance refers to the percentage of all loss that is the company's sole responsibility. Coinsurance can either apply only to defense cost or to settlements and judgments. However, it usually applies to all losses under a D&O policy.

CONDUCT EXCLUSIONS—Coverage for certain types of conduct is excluded from D&O policies. The conduct exclusions found in most policies preclude coverage for the following two categories of conduct:

- For claims related to fraudulent or criminal misconduct
- For claims related to illegal profits or wages the insured executive was not legally entitled

CONFIDENTIALITY—D&O policies typically prohibit organizations and their directors and officers from disclosing information about their D&O coverage, such as terms, conditions, policy limits and self-insured retentions (SIRs), to third parties. The purpose of this policy condition is to protect the organization and the insurer from malicious third parties. For example, if a third party gathered information about an organization's D&O policy, the information could then be used to make unreasonable demands during litigation.

COST ALLOCATION—D&O policies typically contain an allocation clause, which states that an insurer is liable for any losses sustained by the insured and its management to the extent the policy affords coverage. Essentially, insurers only pay for claims they are legally required to, based on the terms of the policy itself.

D&O PROGRAMS—Organizations that require a larger limit of liability must work with an experienced insurance broker to develop a D&O program. These programs allow organizations to acquire their total policy limit of liability from multiple insurers. This is particularly useful when a company's unique requirements are too much for one insurer.

DUTY OF DILIGENCE—Sometimes referred to as duty of care, this responsibility requires directors and officers to act in good faith. This means that directors and officers must consider all available information before making a decision and act in the same way a reasonable person faced with the same decision and responsibilities would act.

DUTY OF LOYALTY—Directors' and officers' duty of loyalty is meant to prevent them from engaging in conduct that would otherwise hurt or take advantage of the company they serve. Through this duty, directors and officers have an obligation to avoid any conflicts of interest.

DUTY OF OBEDIENCE—Per their duty of obedience, directors and officers are obligated to follow the statutes and terms of their organization's agreements. Directors and officers may be held liable if they authorize an act that is beyond the powers established by their company's charter.

ENDORSEMENT—An endorsement is a separately negotiated clause in the insurance contract that is not considered part of the standard insurance policy. Endorsements are added to modify or amend an insurance policy. Many insurers have standard required endorsements that must go on every account and are not considered negotiable.

HAMMER CLAUSE—If an insurer believes that a settlement is in the best interests of both parties, and the insured does not approve the recommended course of action, the insurer may invoke a protective clause referred to as a hammer clause. Insurers use a hammer clause to limit liability to the amount that the claim could have been settled for and any defense costs incurred. If a claim ends up costing more than the recommended settlement value, the insurer will not pay additional costs.

INSURED PERSON—For D&O and most forms of insurance, an insured person refers to the individuals or entities covered by a specific policy. To qualify as an insured person, directors, officers and organizations must fall under a broad, predefined description. These definitions often include all directors, officers and corporate entities of the named insured (the parent organization).

INSURED VS. INSURED EXCLUSION—D&O policies preclude coverage for claims brought by one insured director or officer against another director or officer also covered under the same policy. The purpose of this exclusion is to eliminate coverage for internal disputes among directors and officers and claims involving collusion.

INSURING AGREEMENTS—The insuring agreements, sometimes referred to as insuring clauses, of a D&O policy specify the scope of coverage afforded by a policy. Insuring agreements are presented in broad terms and subsequently modified by exclusions, definitions, conditions and endorsements noted in a policy. D&O policies will include separate insuring agreements for any Side A, Side B and Side C entity coverage the organization obtains. Each insuring agreement outlines the promise of the insurer to protect the policyholder (the insured) in accordance with the terms and conditions of the policy.

INSURING AGREEMENTS: SIDE A—Side A is the first insuring agreement of a D&O policy and it insures individual directors and officers against losses that the organization is not legally or financially able to indemnify.

This coverage protects the personal assets of directors and officers in the event a company does not pay defense costs or fund indemnification.

INSURING AGREEMENTS: SIDE A EXCESS DIFFERENCE-IN-CONDITIONS (DIC)—Unlike standard Side A agreements, Side A DIC sits on top of a traditional D&O policy, effectively providing a broader coverage with separate limits for directors and officers. This fills the following gaps:

- Side A DIC coverage provides excess insurance that kicks in once a company's traditional D&O policy is exhausted.
- Side A DIC coverage provides protection when an underlying insurer fails or refuses to pay, attempts to rescind coverage or becomes insolvent.
- Side A DIC coverage is not typically subject to the exclusions found in traditional D&O policies, specifically the "insured versus insured" and "pollution" exclusions. This can create policies that are more dynamic.

INSURING AGREEMENTS: SIDE B—Side B, also known as corporate reimbursement coverage, is the second insuring agreement of a D&O policy. Side B reimburses organizations for expenses they incur when defending directors and officers in accordance with their indemnification obligations.

INSURING AGREEMENTS: SIDE C—Often, organizations are named in lawsuits alongside their directors and officers, leaving the entity exposed to serious legal action. Side C coverage, sometimes referred to as entity coverage, is the third insuring agreement of a D&O policy. This side insures organizations for claims made directly against the organization by providing entity asset protections and coverage for defense costs.

LIMIT OF LIABILITY—Put simply, the limit of liability sets the maximum amount that an insurance company is prepared to spend defending and settling claims on behalf of a business and its management. A limit of liability is available for the payment of legal defense costs, settlements and court awarded judgments throughout a policy period.

LOSS—Loss specifies the claim costs covered by a policy. Specifically, loss in D&O policies refers to expenses—investigation costs, legal fees and settlements—faced by defendants involved in litigation. Losses can also include court awarded judgments, like damages, civil fines and penalties.

PARTICULAR CIRCUMSTANCES EXCLUSIONS—During the D&O underwriting process, an insurance company may identify specific circumstances or risks it is unwilling to insure. Accordingly, the insurance company may offer coverage to the organization on a restricted basis. These exclusions, which are sometimes referred to as laser exclusions, are often used when an organization has disclosed a serious claim or circumstance that occurred during a past policy period. Particular exclusions are relatively common, but, if possible, an organization should attempt to acquire D&O coverage without them.

POLICY INTERPRETATION—The policy interpretation clause outlines which jurisdiction's laws govern the policy. For the vast majority of policies, the laws of the country in which the policy was issued control the policy interpretation. The purpose of this clause is to ensure that all parties involved have a clear understanding of how the policy will be interpreted in the event of a dispute that leads to litigation.

RETROSPECTIVE COVERAGE—Retrospective coverage is usually unlimited, and, in most cases, insurance will kick in regardless of how long ago a wrongful act occurred. In some circumstances, however, a limitation may be placed on retrospective coverage. This is known as a retroactive date, which removes coverage for claims that arise as a result of actions committed before a specified time. Retroactive dates will be specific in a policy's schedule and are often applied by underwriters on a case-by-case basis.

RUN-OFF COVERAGE—Following a change in control, an organization's D&O policy will automatically convert into run-off. Run-off coverage is when a policy remains in force but only covers claims that materialize from actions that have occurred before the date of a transaction. Policies that automatically convert into run-off can be particularly beneficial, as any claims or circumstances that arise from past actions can be notified under the existing policy until the end of the insurance period.

SELF-INSURED RETENTION—Self-insured retention (SIR), sometimes simply referred to as retention, is an important component of D&O policies. SIR is a dollar amount specified in a liability insurance policy that must be paid by the insured before the policy will respond to a loss. In essence, SIR provisions represent the amount of risk an organization is willing to absorb before a policy kicks in and provides protection. SIR provisions can be complex, and there are a number of considerations organizations and their directors and officers should keep in mind.

SEVERABILITY—Most D&O policies contain an exclusion severability provision. This provision dictates that an exclusion applying to one executive's behavior won't affect the coverage afforded to another. In simple terms, this means that innocent executives will be protected regardless of whether or not other leaders act outside the boundaries of a policy. For example, if a claim is brought against a board of directors for the deliberate and illegal actions of one executive, such as fraud, a policy exclusion may be triggered. With exclusion severability in place, instead of coverage being excluded for the entire board, the exclusion will only apply to the offending executive.

SUBROGATION—In the event that a D&O insurer protects a policyholder from a covered claim, it inherits the right to subrogate against others. This means that an insurer can assume the rights of the insured and recover damages from any parties found responsible for causing the loss. This is done as a means of recovering the amount of the claim paid by the insurance carrier to the insured for the loss.

TERRITORIAL AND JURISDICTIONAL LIMITS—Territorial and jurisdictional limits of a D&O policy are of particular importance for organizations with international operations. Specifically, these limits refer to the jurisdictional region in which the insurer will respond with coverage, should a legal action arise. Similarly, territorial limits refer to the geographical area from which a claim can originate. While many policies provide worldwide territorial coverage, they can also limit the jurisdictional coverage available for regions that are considered highly litigious.

WRONGFUL ACT—This term specifies what types of actions are covered by a policy. D&O policies often define this term broadly to ensure directors and officers are protected from a variety of claims. In most instances, a wrongful act is considered to be any actual or alleged act, error, omission, misstatement, misleading statement, breach of duty, breach of trust, neglect and breach of warranty of authority.