

Smaller firms face D&O risks

Thursday, April 07, 2011

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Small and midsize firms, their executives and boards are vulnerable to costly lawsuits that could be covered by directors and officers liability insurance, experts say.

But D&O insurance seldom is purchased by smaller companies, and firms that buy the coverage often do not fully understand the value of the coverage or what risks are covered by the policies, they said last month at the Professional Liability Underwriting Society's 2011 Professional Risk Symposium in Chicago.

The insurance industry has seen continuous expansion and growth in D&O coverage for publicly held companies during the past 15 years. As the market for larger companies has expanded, small and midsize companies also have been offered broad and aggressively priced D&O coverage.

But while risk managers at publicly held companies often negotiate vigorously and knowledgeably for their D&O coverage, executives at smaller firms often do not fully understand how D&O coverage works, said Elizabeth A. Roussel, partner in the litigation practice of Adams and Reese L.L.P. in New Orleans, during a panel discussion.

D&O exposures for private companies are a low-frequency, high-severity risk and many policyholders who do not experience claims do not review the coverage at renewal time, said Lisa M. Jones, vp at Chubb & Son Inc. in Warren, N.J.

When claims hit, private firms are "surprised by the breadth of coverage" that exists, said Ms. Roussel, who advises her clients to submit potential D&O claims even if they are unclear if they are covered under a D&O policy. "Nine out of 10 times, it's covered," she said.

D&O claims for private companies can arise from various situations, said panelist Thomas Herendeen, vp of management and professional liability for Philadelphia Insurance Cos., a Bala Cynwyd, Pa.-based unit of Tokio Marine Group.

Frequently, claims stem from breach of contract suits where an employee leaves a firm and goes to another, or starts his or her own business, Ms. Jones said.

For example, Ms. Jones said, a plumbing company might sue a competitor if an employee left and misappropriated trade secrets to the competitor.

One in four small to midsize executives said they bought D&O coverage, according to a 2010 survey of 450 U.S. executives and 250 Canadian executives conducted by Chubb, Ms. Jones said.

Survey participants who did not buy D&O insurance said they thought they were covered for D&O risks under their umbrella policies.

Nearly half of the survey participants who bought D&O cover did so as a result of a recommendation from a colleague, and 26% bought the coverage for fear of financial failure.

Twelve percent of the surveyed executives experienced a D&O lawsuit -- the average cost of which was \$225,000 -- and losses of \$5 million and \$1 million were cited.

"There is a lot of work for all of us to do," Ms. Jones said.

The lack of takeup by smaller firms may be because D&O coverage is presented to buyers as a "cross-sell," said Dennis Donovan, executive vp of S.H. Smith & Co. Inc. in Hartford, Conn., and moderator of the panel. When D&O coverage is almost a "throw-in" to help place other risks, it can undermine the perceived value of the policy for the buyer, he said.

Also, for smaller firms, cost can be an issue. Even if buyers understand their exposures and the cost of D&O coverage, they may have pressing cost issues in areas they see has a higher priority than D&O insurance.

"Agents can actually take out the mystery for the insured," Mr. Herendeen said.

When claims hit, though, the "agent is rarely involved," said Ms. Jones, who agreed that agents can help facilitate a D&O claim. "We would love to see the agents more involved," she said.

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