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D&O Liability Coverage for Private Firms: A Case of Nice, or Necessary?

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Once unknown or misunderstood by many privately owned businesses, directors & officers' (D&O) liability insurance has been pushed onto the radar by the recession and national headlines.

While the reasons for purchasing D&O liability coverage have become less of a mystery, the question remains: Is D&O liability insurance "nice" or "necessary"?

Too many private businesses still view it as a nicety, leaving them exposed to potentially serious risk. Yet what leaders of private companies might not realize is that nearly 74 percent of private D&O claims are tied to direct shareholder/investor suits or employment-related issues.

One significant exposure facing leaders in private companies is that their personal financial well-being could be on the line in the event of a lawsuit against the company, its leadership or its employees.

For example, a manufacturer relies on a raw-materials supplier. If the supplier files for bankruptcy and shuts down, the manufacturer will most likely be forced to find a new supplier—which could push back product-delivery schedules. If customers decide to take their business elsewhere and expenses for the new supplier increase internal expenses, shareholders may file suit against the board, asserting they should have known the supplier was on the verge of bankruptcy.

The suit can also assert that the board failed to find a replacement supplier, which costs the company a business loss as well as loss of dividends. Directors and officers may then need to retain counsel to defend these allegations. Without the proper insurance protection, their personal assets may be the only available source to cover potential costs.

Private companies neglecting to manage D&O risks can find themselves in other equally grim scenarios. In the event a director or officer is specifically targeted in a claim, the company is typically held accountable as well. In fact, 8 to 9 times out of 10, corporate entities are listed as the defendant in lawsuits brought against directors and officers, leaving the company's assets at risk.

As private companies overlook these potential exposures, new trends in D&O liability triggers are emerging. Actions or events that historically occurred infrequently have become more ordinary for companies of all types, but are particularly dangerous for private institutions because both personal and corporate finances are at stake.

Private companies need to understand the reality of their D&O liabilities—not only that litigation or claims are possible, but that the fallout of the economy may mean the threat is growing. Agents can play a pivotal role in educating clients about their risks and providing solutions to help manage them by taking the guesswork out of whether D&O liability coverage is truly necessary. When company and personal assets are on the line, the answer should be clear.

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