

PICKING THE RIGHT LEAD A-SIDE D&O CARRIER

Selecting the lead carrier for your A-Side D&O coverage is an important strategic decision. Before making the choice, risk managers should consider several factors: the financial strength, experience and commitment of the potential carriers, plus the long-range value of matching the right primary and A-Side D&O insurers.

FINANCIAL STRENGTH

A-Side Liability coverage is the only thing standing between a director or officer and personal liability when there is a non-indemnifiable claim, so while financial strength is always important when choosing an insurance carrier, here it is absolutely critical.

The best excess A-Side forms, those that complement a traditional underlying A+B or A+B+C tower of coverage, potentially drop down and in-fill on A-Side claims if an underlying carrier is financially unable to pay. For this advantage to be meaningful, the A-Side carriers have to be financially *as strong, if not stronger*, than the carriers below them.

EXPERIENCE

A-Side policies and claims can raise complex legal and contractual questions for insureds and insurers. The more experienced the carrier, the easier it will likely be to sort out the issues. When A-Side cover was introduced in the U.S. insurance market after decades of development in Bermuda, we tested the new domestic markets by asking how their coverage would work under two standard claim scenarios. Few passed. Now, though virtually every D&O policy



includes an element of A-Side coverage (whether they are A+B or the more common A+B+C), we still ask probing questions. You should, too.

COMMITMENT

Over the past two years, stand-alone A-Side policies as well as the A-Side of the broader, more traditional D&O insurance contracts have been tested by roughly 100 derivative claims filed in the wake of improper stock option dating allegations. (Settlements or court awards resulting from D&O derivative claims are generally considered to be non-indemnifiable, triggering A-Side D&O coverage.) We saw carriers repeatedly address both novel and routine A-Side claim and coverage questions. In most cases, buyers were ultimately satisfied with how their insuring agreements responded.

Some carriers, however, were repeatedly tripped up by the routine issues in derivative claim settlements. Claims were ultimately properly handled, but client satisfaction was far from optimal. For new market entrants, where experience may be lacking, the insurer's commitment to D&O and A-Side D&O may make the difference. Find out what the carrier's strategic plans are.

TO LEAD, OR NOT TO LEAD

It is generally true that the best domestic carriers for A-Side coverage are also the best domestic lead or primary D&O carriers. However, most buyers avoid choosing the same carrier for both lead positions because the A-Side cover is designed, in part, to drop down and fill in when the primary D&O carriers can't – or won't – pay. If you have the same carrier in the lead position on *both* the underlying program and the excess A-Side layers, then you are relying on the carrier to drop down and fill in on *its own* primary layer. The possibility of having the A-Side excess policy drop down due to the financial inability of the underlying carrier to pay a claim is completely negated where the carriers are one and the same.

The same potential problem also exists when the lead A-Side carrier is on *any* of the underlying layers, and not just the primary layer. Avoiding the primary carrier on any of the excess A-Side layers – not just in the lead positions – is the only logical means of avoiding both of these potential pitfalls.

But perhaps the most common reason for not using the same carrier to lead on the underlying primary and A-Side excess layers relates to a third situation: where the excess carrier is asked to drop down and in-fill because the underlying carrier could and *should* pay an A-Side claim but has (wrongfully) refused to do so. The problem here is that if the two key lead positions are held by the same carrier, that insurer could easily be *more likely* to deny coverage under either or both layers than if it took the lead position on only one of the two. The standard solution, again, is to use different carriers for the lead A-Side layer and the underlying primary.

If an insurance buyer suspects that a D&O market might actually be more inclined to deny coverage for a claim because of its double position on the primary and A-Side placements, wouldn't that buyer simply walk away from the market altogether, or at least from the lead position on the primary layer? The exigencies of the D&O marketplace are such that many buyers decide in the end that it is in their best interests to work with these markets in the lead primary role and simply deny them the lead on the A-Side placement.

BOTTOMS UP

In determining which carriers to pick for primary and which for A-Side lead positions, it is useful to note that, in general, carriers would rather pay a claim under a lower layer than an excess layer. Why?

- They get more premium for lower layers, so if they have to pay a claim, they would prefer to pay out on layers where they get the greatest return for their risk.
- Many excess A-Side carriers have little or no reinsurance of these layers, in contrast to their lower, traditional D&O coverage, where they more commonly cede the risks to reinsurance partners. Bottom line: A-Side losses would come directly from the carrier's bottom line.
- Lower layers usually pay out first, so pushing up a claim that should have paid out of a lower layer to a higher layer, where it will drop down, increases the risk that the carrier will ultimately pay out of *both* layers and remove the benefits to the carrier of having ventilated its risk or separated its participation in the program by intervening layers of coverage from other carriers.

Some might argue that the greater carrier risk associated with A-Side layers would underscore the importance of choosing the strongest partner for this piece of the overall D&O protection. However, primary layers are still primary, and the strongest players might well be preferred there. While splitting the lead roles between two separate carriers usually makes sense, the underlying assumptions behind this strategy should be reviewed carefully. The best strategy for your overall D&O coverage will depend on your circumstances and the strengths and weaknesses of the active insurers in the marketplace.

For further information, please read these Executive Risks publications:

Quick Take – Put A-Side Coverage on Your List (July 2009)

Quick Take – Choosing a D&O Carrier (June 2009)

Alert – A-Side D&O FAQ (June 2009)

Alert – Details in Delaware (When is a Derivative Case No Longer a Derivative Case?) (May 2009)

Alert – D&O A-Side Report (August 2007)

Alert – Anatomy of a D&O Derivative Claim (March 2005)

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