

ENTITY COVERAGE VERSUS PRE- DETERMINED ALLOCATION

ISSUE

Prior to the mid 1990s, public D&O policies provided two insuring clauses.

1. A-Side insured individual directors and officers against personal liability in the event that their employer organization (the entity) was unable to indemnify them for such loss.
2. B-Side provided insurance to the entity in circumstances where it was indemnifying its directors and officers.

One significant issue that arose constantly was that the claims against directors and officers would usually also name the entity as a defendant. However, since the D&O policy did not provide coverage for the entity, the full amount of the claim settlement and defense costs was not covered under the policy, which often led to lengthy allocation disputes between insurers and insureds over how much the policy should pay.

IMPACT

Insurers developed two options to resolve this gap in coverage.

1. **Entity coverage** includes a third insuring clause that adds the entity as an insured under the policy for claims

that allege breaches of the securities laws. In the context of securities claims, this eliminates the problem, since the most likely parties to the settlements (directors, officers and entity) are insureds under the same policy.

2. **Pre-determined allocation** limits the insureds under the policy to individuals (directors and officers) but adds a provision stating that, in any claim for breaches of securities laws that names as defendants directors, officers and the entity, the policy will treat the entire loss as being incurred by directors and officers even if the entity was a party to the action.

Both approaches address the problem but each has consequences that any D&O buyer should consider fully before they choose which is right for them.

ACTION

Understand the significant differences between the two approaches and consider which option fits your buying philosophy better.

- Entity coverage permits the coverage to continue even if no individual directors and officers are named in the action. Pre-determined allocation requires at least one director and officer to be named in, and to remain in, the claim for coverage to apply.
- Pre-determined allocation may prevent disputes over the allocation of proceeds in the event of a bankruptcy. Since the entity is not insured as a defendant, there is less chance that the policy will be deemed an asset of the corporate estate.





If entity coverage is purchased, the D&O limit could be used (in whole or in part) to pay claims that do not even name a director or officer. This is good for corporate asset protection but may not be why a company and its directors and officers buy the coverage.

CONTACTS

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