

Hoping D&O Will CYA

Directors and officers are seeking greater personal protection against lawsuits, even as securities fraud claims against their companies decline.

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Companies are taking more active measures to protect executives from potential lawsuits by shareholders, as the number of inquiries and purchases of directors and officers (D&O) insurance is on the rise, according to a new report by the Towers Perrin consultancy.

Fallout from scandals during the last several years and the accompanying stricter corporate governance has driven purchases of insurance to reimburse directors and officers for third-party claims, known as Side-A coverage. Of the 2,875 U.S. companies surveyed, two-thirds reported having a record number of inquiries for increased coverage, while 14 percent purchased Side-A coverage in the last year. More specifically, 38 percent of public companies reported purchases of Side-A policies in the last year.

"For the first time, a study is confirming a significant change in how companies are protecting directors and officers from personal liability," said Michael Turk, a senior consultant with Towers Perrin.

Among those who have participated in the survey before, there was a 53 percent increase in Side-A purchases, with a high concentration of the increases occurring in private and non-profit organizations.

The study predicts further changes in demand for D&O insurance, as independent board members look for more specialized policies to protect their own interests. Most companies use Side-B insurance, which reimburses a corporation for the actions of its directors and officers, but not the individuals. Although scandals related to backdating stock options and executive pay draw much attention, shareholder derivative claims have the most impact on a company, according to Turk.

Such claims, however, have been on the decline. The latest study by Stanford University and Cornerstone Research finds that 2006 recorded the fewest securities fraud claims since the Public Securities Litigation Reform Act of 1995. Fraud class actions dropped by 38 percent in 2006, according to the study, and were 43 percent below the 10-year historical average.

"Is this a trend or not?" asks Turk, who suggests that a stable stock market and the watchful eyes of regulators are reasons for the improvement. While the D&O market seems to be softening overall – the liability insurance average premium index dropped by 18 percent in 2006 – directors and officers are looking for better protection for themselves.