Delaware Captive Insurance Association (DCIA) Annual Forum

Side A D&O Risks-Panel Discussion

DCIA
Delaware Captive Insurance Association

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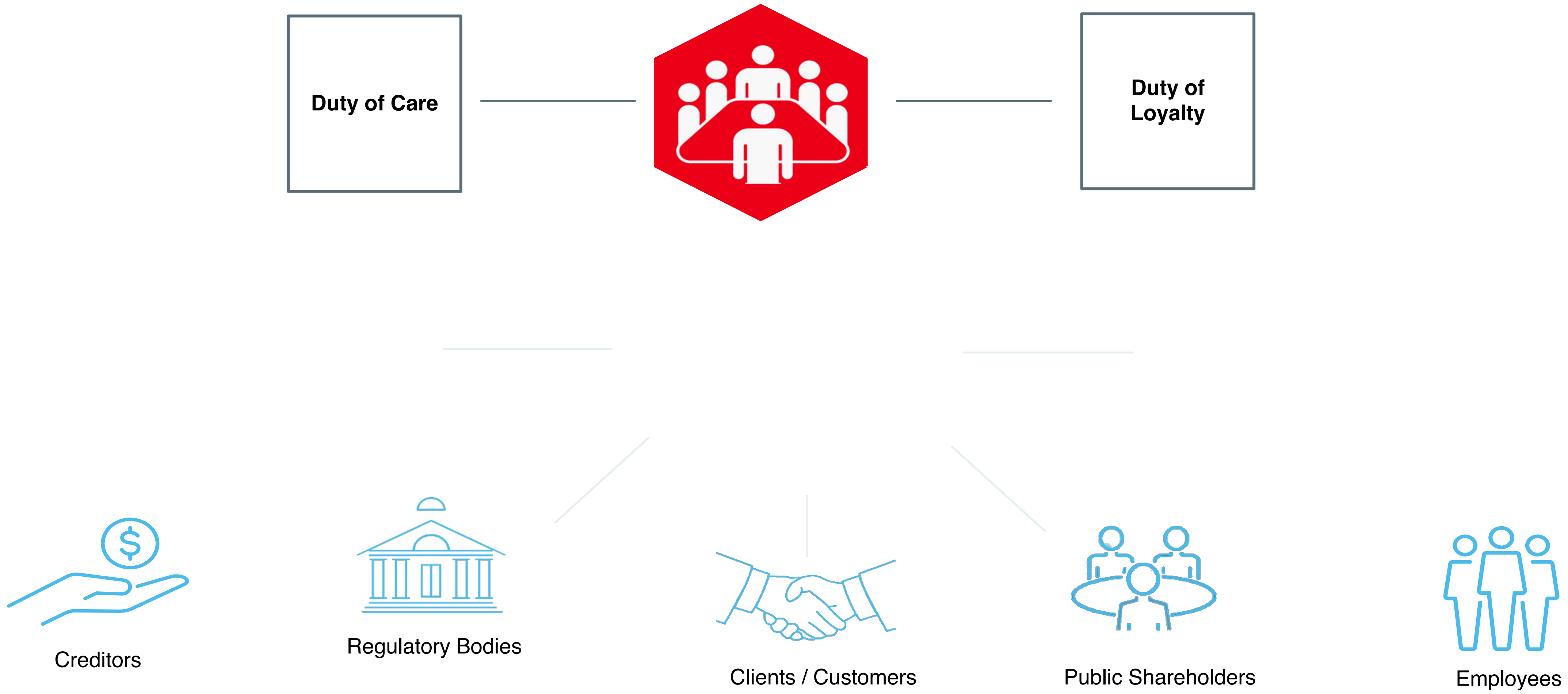
ANNUAL
FALL FORUM

Presenters

- Edward S. Little (Richards, Layton & Finger, P.A.)
- Kristin Kraeger (Aon)
- John Mark Zeberkiewicz (Richards, Layton & Finger, P.A.)
- Andy Rennick (Womble Bond Dickinson (US) LLP)

Fiduciary Duties of Directors and Officers

Overview



What is D&O Insurance?
Overview

- D&O insurance indemnifies directors & officers for their liability for damages to third party claimants as a consequence of the third party having suffered financial loss because of the alleged act, error or omission of the director or officer in his/her managerial capacity
- Covered financial loss includes defense costs, settlements and judgments
- Covers any claims made ("claims made policy") against the directors & officers during the policy period (vs. "occurrence based policy") for acts that occur during or before the policy period
- The contract works on an "all risk" basis vs. "named peril" basis; exclusions and policy definitions are key
- Every D&O insurer offers a different coverage contract, which must be heavily amended to provide the broadest terms and conditions

Directors & Officers Liability Insurance Program

Contract Overview

Limited Insured Side-A Excess DIC

- A limited number of public companies purchase a layer of Side-A coverage for a small group of Insureds such as Independent Directors (4% of Aon's public clients)

Side-A Excess DIC

- Broad Side-A Excess Difference-in-Conditions ("DIC") policy pays on behalf of the directors and officers for non-indemnifiable Loss
- The DIC policy will drop-down and act as a primary policy if the underlying D&O program does not pay or is unable to pay on behalf of the directors and officers
- Broader terms and conditions than the traditional Sides A/B/C policy
- The DIC policy will also drop-down and pay the defense costs of the directors and officers covered under the policy if the primary policy cannot or is unwilling to pay

Side-A

- Non-indemnifiable loss coverage
- No retention

  Examples of potential coverage response:
  - Shareholder derivative action (except as per in statutes)
  - Entity's insolvency
  - Entity's failure or refusal to indemnify

Side-B

- Indemnifiable loss coverage
- Reimbursement coverage for the entity's indemnification of directors and officers
- Retention applies

Side-C

- Entity coverage
- Entity is generally only covered for securities claims
- Securities retention applies
- Derivative investigative costs coverage (sublimit applies)

Entity investigations Coverage

Foreign Policies

- Non admitted insurance is problematic in some countries

No Retention

Retention for Indemnifiable Loss & Securities Claims

Directors & Officers Liability Insurance

Contract Overview

The Policy

A	B	C
Trigger Actions of D&Os that aren't indemnifiable	**Trigger** Actions of D&Os that are indemnifiable	**Trigger** Actions of the entity for securities claims
Pays On behalf of D&Os	**Pays** On behalf of entity to fund indemnification	**Pays** On behalf of entity for securities claims
Retention Does not apply	**Retention** Applies	**Retention** Applies

Comments:

- Personal Asset Protection:
  - Side A
- Balance Sheet Protection:
  - Side B: Corporate Risk Transfer
  - Side C: Coverage for the Entity – provides the Entity with coverage for securities claims only
  - Loss on one Insuring Agreement erodes limits available under the other Insuring Agreements
- Shared Limit:
  - Loss on one Insuring Agreement erodes limits available under the other Insuring Agreements

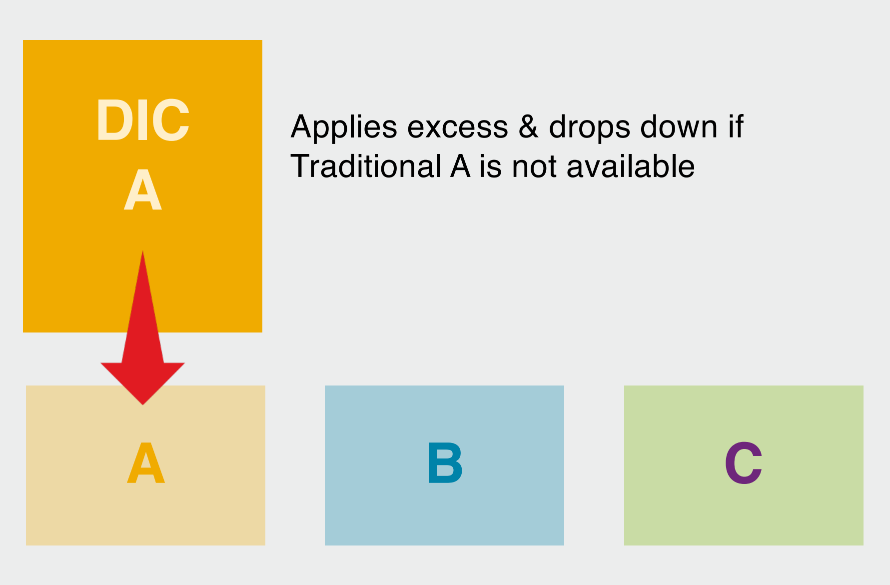
The following is a general summary, the actual policy terms and conditions will govern the adjustment of any Claim

Directors & Officers Liability Insurance

Side A DIC Coverage

- With a Side A DIC (“Difference in Conditions”) policy, individuals do not share the limits with the corporation as the “insureds” under the Side A policy are only the directors & officers
- Further, a Side A DIC policy does not include a presumptive indemnification requirement, generally has fewer exclusions than the underlying policies and includes a “drop down” feature for several situations, including the following:

  - ✓ Underlying insurance has more restrictive A Side coverage terms
  - ✓ Bankruptcy implications over who owns the policy and its proceeds (generally, the Side A policy is deemed to be an asset of the individual Directors’ and Officers’)
  - ✓ Insolvency of underlying carrier(s)
  - ✓ Policy will respond for *any failure to indemnify by the company or the underlying insurers*

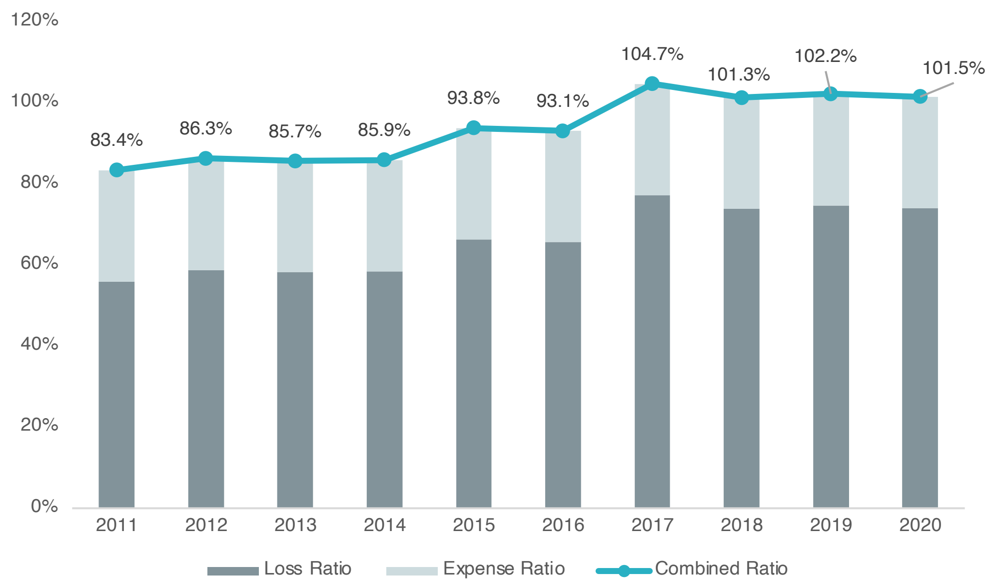


Directors & Officers Market Overview

Factors Driving D&O Pricing

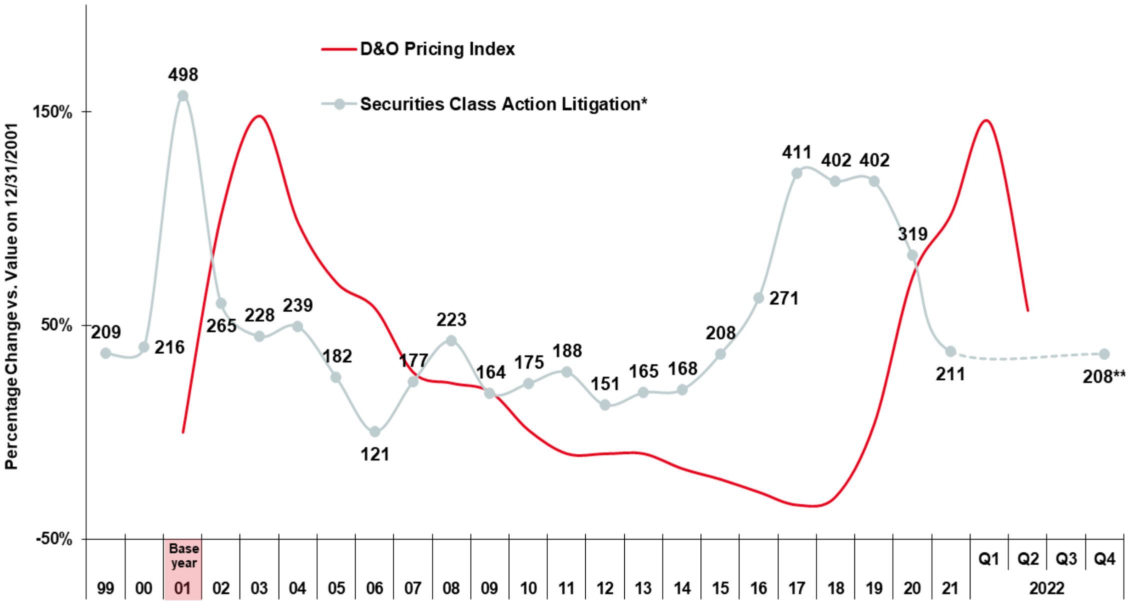
U.S. D&O Combined Ratios

Source: A.M. Best Company and TransReView
Note: Expense ratios vary per insurer; a 27.5% ratio is used below.



Historical Claims Frequency

Aon Quarterly Pricing Index: 1999 – Q2 2022 Base Year: 2001 = 1.00



*Stanford Law School's Securities Class Action Clearinghouse as of April 29, 2022. These totals include IPO Allocation, Analyst, and Mutual Fund filings.
**Projected annual filings based on trailing twelve-month totals.

Indemnification under Delaware Law

- Section 145 of the Delaware General Corporation Law governs indemnification of directors, officers, employees and agents.

- *"Third-Party" Actions:* Section 145(a) of the DGCL empowers a corporation to indemnify its directors against ***expenses, judgments, fines and amounts paid in settlement*** incurred in connection with ***actions other than those brought by or in the right of the corporation***, subject to a determination that the indemnitee has met the requisite standard of conduct.

- *Actions by or in the Right of the Corporation:* Section 145(b) empowers a corporation to indemnify its directors against ***expenses*** incurred in connection with the defense or settlement of ***an action brought by or in the right of the corporation***, subject to the standard of conduct determination and except that no indemnification may be made as to any claim to which the person has been adjudged liable unless the court determines such person is fairly entitled to indemnification.

Indemnification under Delaware Law

- The DGCL's limitation on indemnification of judgments and amounts paid in settlement in connection with actions brought by or in the right of the corporation is designed to prevent "circularity in payment" (i.e., the situation that would arise if the corporation were to receive a judgment or settlement payment from an indemnitee and then be required to indemnify the indemnitee for that payment).

- Nevertheless, Section 145(g) permits corporations to obtain insurance for losses incurred by directors, officers and others, including losses that would not be indemnifiable.

- Due to the statutory limitations on circularity in payment and other statutory restrictions, before the recent amendments to Section 145(g), it was unclear whether captive insurance could be used to cover losses that were not indemnifiable.

Requirements

- Section 145(g) authorizes a corporation to purchase and maintain insurance on behalf of covered persons by or through a "captive insurance company" licensed in Delaware or another jurisdiction, including through any "fronting" or other reinsurance arrangement.

- Under subsection 145(g)(1), a captive insurance policy must exclude from coverage, and must provide that the insurer may not make payment in respect of any loss arising out of, based upon or attributable to:

    - any personal profit or financial advantage to which the covered person was not legally entitled,

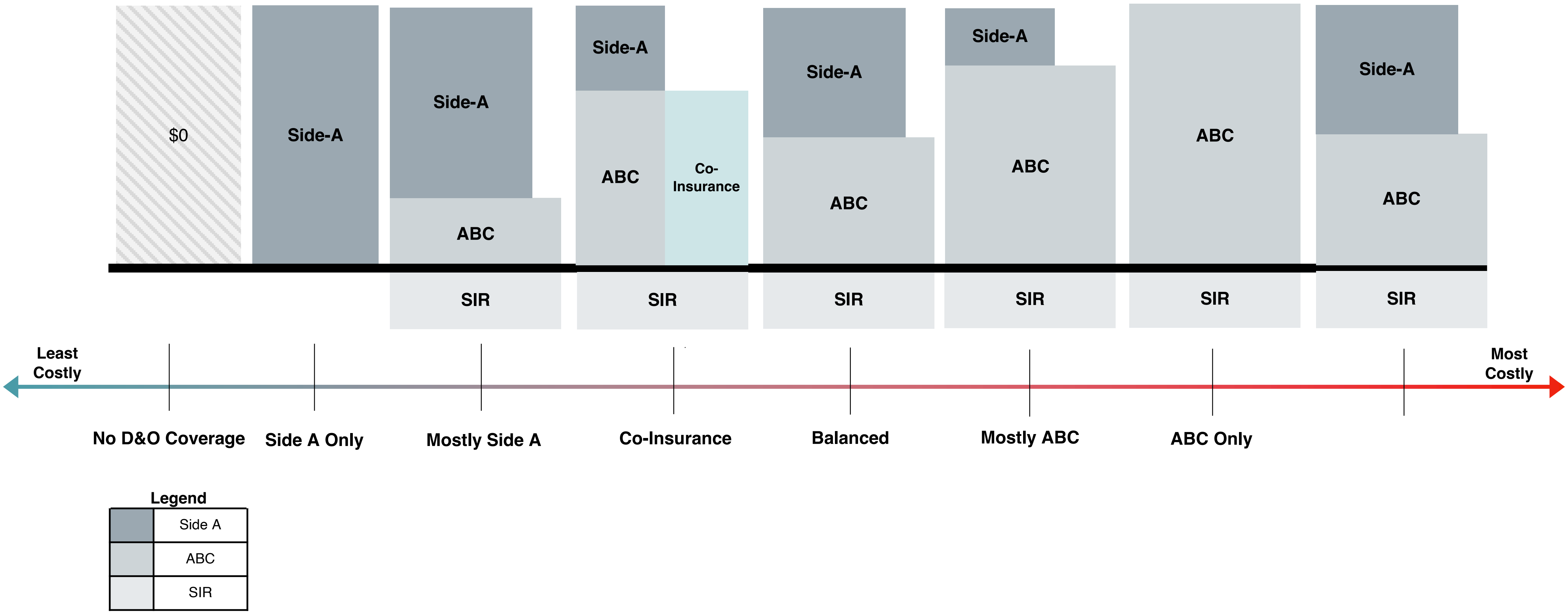
    - any deliberate criminal or deliberate fraudulent acts, or

    - any knowing violation of law.

Considerations for Delaware Side A D&O Captives

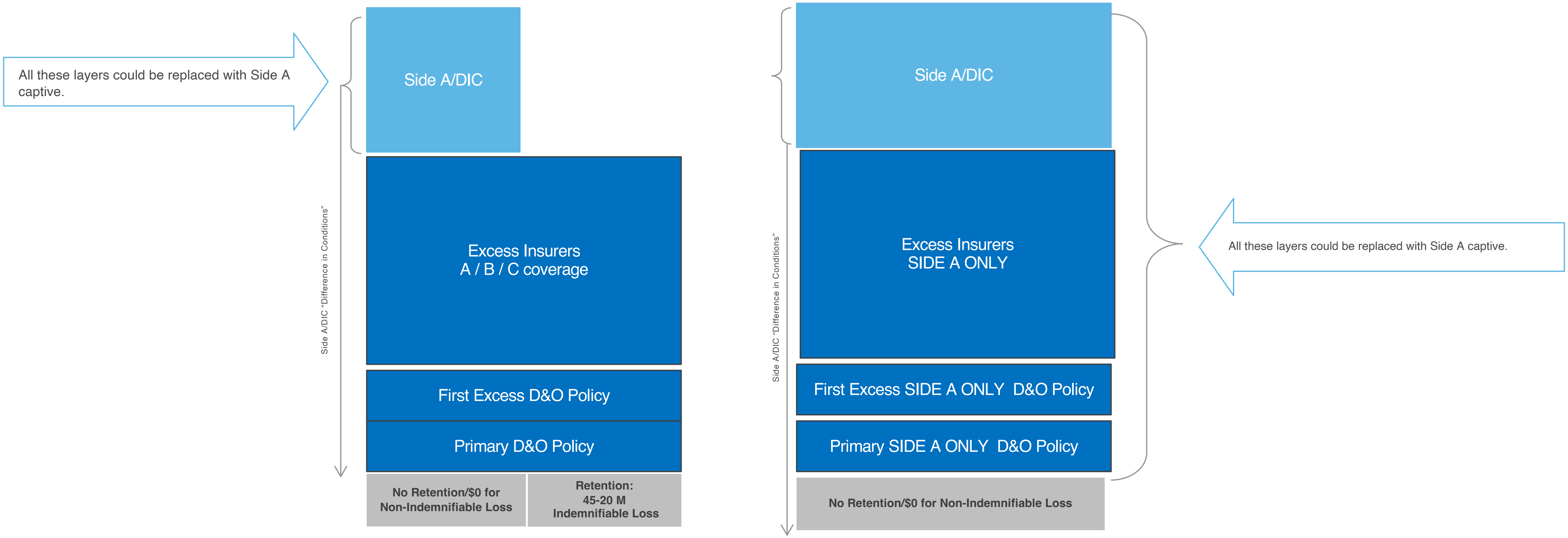
Directors & Officers Price vs. Structure Continuum

Structure Options



Classic Public Directors and Officers Program Considerations

“Full Sided Program” vs. Side A Only “Ground Up Program” – Where can a SIDE A Captive Function



Whose Laws/Regulations Apply?

Side A D&O Matrix

		Captive: Delaware	Captive: Non-Delaware
Corporation	Delaware	Indemnification governed by DGCL Delaware captive statute and regulations apply	Indemnification governed by DGCL Subject to the laws/regulations of the captive's domicile
	Non-Delaware	Indemnification governed by corporate code of the corporation's jurisdiction Delaware captive statute and regulations apply	Indemnification governed by corporate code of the corporation's jurisdiction Subject to the laws/regulations of the captive's domicile