

Understanding D&O Insurance & Key Coverage Concepts

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Disclaimer

- *Descriptions and summaries of insurance provided in the attached are intended as an outline of coverage only and are necessarily brief. For full information or understanding of specific provisions refer to the policy forms and endorsements. Where new or additional policies are discussed sample forms will be furnished on request. Also, any insurance proposed has not, and will not, be effected until you have instructed us to do so. Thereafter, any proposed insurance is in effect only after we have provided you specific binding confirmation.*

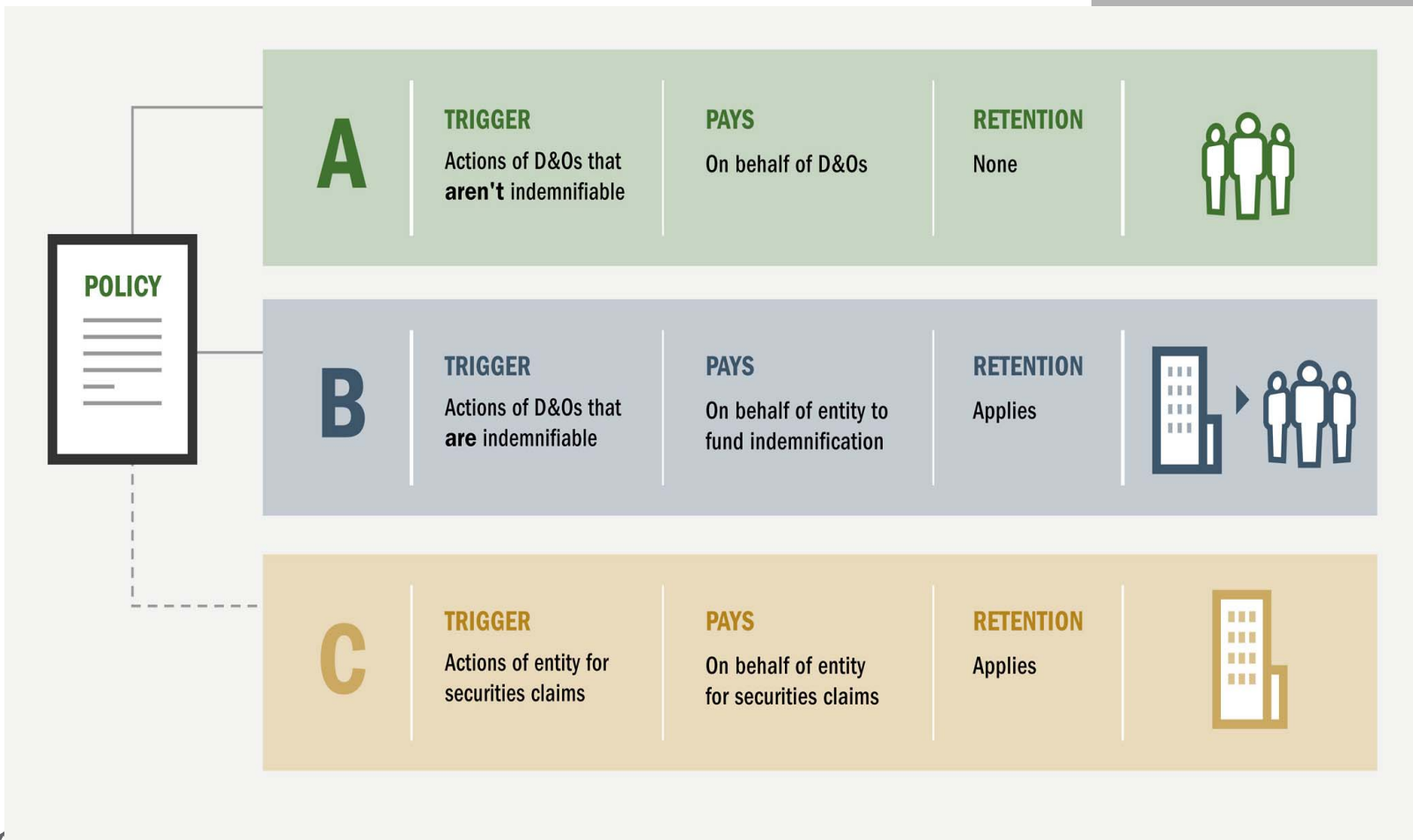


What is D&O Insurance?

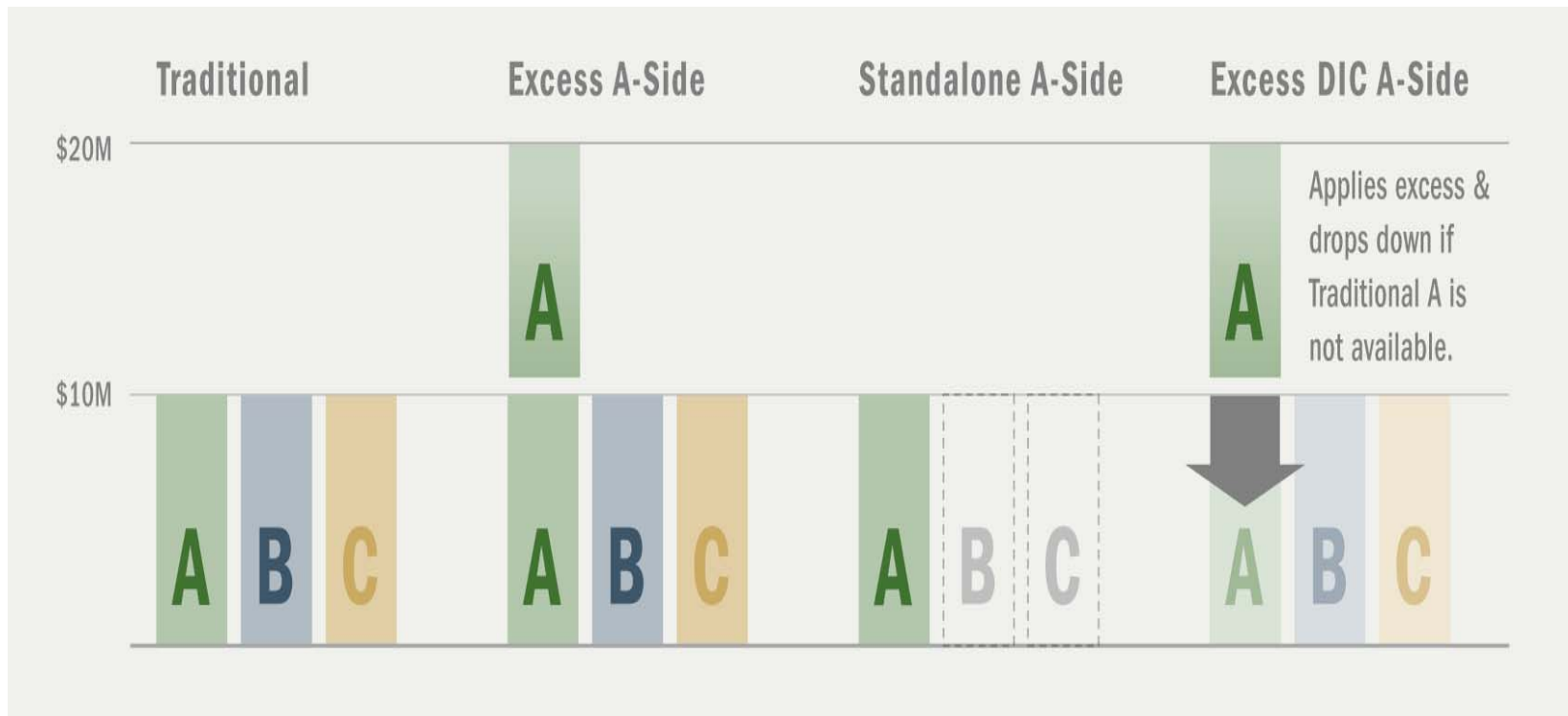
- Covers “Professional” liability arising from management activities
 - Errors, misstatements, misleading statements, neglect, breach of duty
 - Does not cover professional activities that may be provided by the company to others
- Typically part of a “Management Liability” package policy including
 - Employment Practices Liability
 - Fiduciary Liability
 - Kidnap and Ransom
 - Crime
 - Coverage Limits – Shared or Separate – Multiple Options
- No Standard Policy Form – Great variations in coverage, even between “name brands”. Watch policy version dates.



3 Parts to D&O:

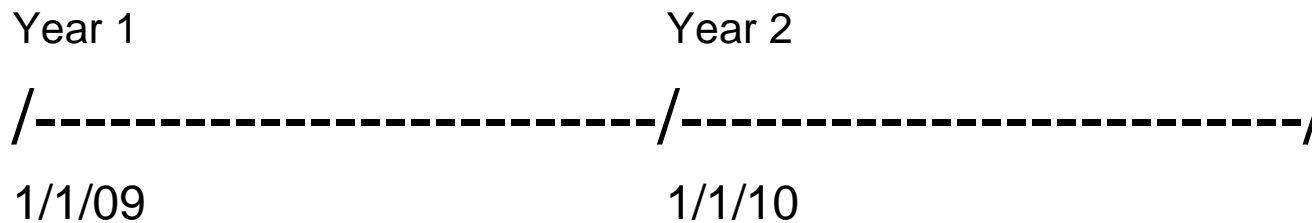


D&O Program Design:



Key Coverage Concepts:

- Coverage "Trigger" = Claims Made



- Retro-Active Dates – Typically don't apply
- Pending and Prior Litigation – Year 1
- Knowledge Warranty – Year 1



Key Coverage Concepts:

- Severability & Imputation – How one insured is affected by the acts of another insured.
 - Concept applies to the insurance application & exclusions
 - Full Severability – Best
 - Partial Severability – (Officers actions or knowledge attach to the corporation.)
 - No Severability – Not good!
- Policy Rescission
 - Material misstatements in the application & supporting information including financials
 - This may even occur if misrepresentation is unintentional
 - “State of the Art” non-rescission language



Exclusions to watch for:

- Fraud & Intentional Act Exclusions
 - Fraud “In fact” vs. “Final Adjudication”
- Products Liability, Bodily Injury, Pollution Liability Exclusions
 - Exclusions “For” vs. “Arising from or attributable to”
- Intellectual Property
 - “For” vs. “Arising from”
 - Does it apply to part A, B or C?
 - Does it provide a “Carve-Back” for claims brought by security holders?



Exclusions to watch for:

- Insured vs. Insured
 - Insured Persons may include any past, present or future duly appointed executive or employee and the CORPORATION
 - Key “Carve backs” may include
 - Security Holder Derivative Demands
 - Claims brought by prior officers after they have been gone for a period of time (HOW MUCH TIME?)
 - Claims by Founders
 - Claims by Bankruptcy Trustees
- Anti-Trust / Unfair Trade Practices
 - For or Arising out of?
 - Applies to coverage side A, B or C?
 - Sub-Limit for Defense?



Other Notable Provisions

- “Hammer Clause” – None is better!
- Notice of Circumstance – Permitted or not?
- Change in Control & Run-Off Provisions
- Newly created or acquired subsidiary coverage
- Order of Payments
- “Tail” coverage
- Duty to Defend vs. Indemnity – Pros & Cons



Reporting Claims or Potential Claims

If you buy it, make sure you can use it! If you want to use it, report it!

- Obligation may be to **report claims** "as soon as practicable" but in no event more than **XX** number of days after **XX** becomes aware
- Defense Expense and "Claim" **Notice Date**



Changing D&O Insurers

- If changing insurers, watch for the following
 - Any change in the **pending and prior litigation** exclusion? Consider potential for claims arising from ANY and ALL prior litigation, not just D&O related litigation.
 - More current **knowledge warranty** (Closely review the application requirement) If required, make sure your prior insurer allows for “notice of circumstance” allowing you to tag the prior policy with a notice.
 - Consider any **prior circumstances or claims** reported and the potential for any follow-on litigation
 - Any new exclusions for **prior acts**?
 - The value of continuity increases as the “noise” level increases.



Limit Benchmarking Considerations- Planned financings, sector & other

<i>Asset Size - D&O</i>	1st Quartile	Median	3rd Quartile	Average
\$0 - \$6M	1,000,000	1,000,000	2,000,000	1,837,500
\$6M - \$10M	1,000,000	2,000,000	5,000,000	2,736,842
\$10M - \$50M	1,000,000	3,000,000	5,000,000	3,180,000
Over \$50M	2,000,000	5,000,000	5,000,000	4,111,111
<i>EE Count - D&O</i>	1st Quartile	Median	3rd Quartile	Average
0-25	1,000,000	1,000,000	2,000,000	1,991,935
26-50	1,000,000	1,000,000	3,000,000	2,216,418
51-100	1,000,000	2,500,000	4,750,000	2,837,838
101+	1,000,000	3,000,000	5,000,000	3,333,333
<i>Revenue - D&O</i>	1st Quartile	Median	3rd Quartile	Average
\$0 - \$6M	1,000,000	1,000,000	2,000,000	1,866,162
\$6M - \$10M	1,000,000	2,000,000	3,250,000	2,531,250
\$10M - \$50M	1,000,000	3,000,000	5,000,000	3,430,108
Over \$50M	2,000,000	3,000,000	5,000,000	3,857,143

Source: Carpenter Moore Insurance Services, Inc., a NASDAQ Company



Underwriting

- Underwriting Requirements – Application, Financials, List of Directors & Officers, Capitalization/Ownership table
- D&O Underwriting risk factors:
 - Cash on hand, burn rate & financing plans – R&D
 - Ownership – Concentration of inside vs. outside investors
 - Industry segment and stage of development
 - Management experience and turnover
 - Asset size, Revenue, Profitability, Debt Levels
- Willingness to negotiate increases with premium size



Current Market

- Broadly - P&C Premiums down due to reduced exposure basis and underwriters looking to off-set gross premium reductions with growth in profitable lines
- Private company D&O premiums for most sectors continue to hold flat but greater underwriting scrutiny
- Increase in employment practices claims not yet having an impact on coverage and premiums except some upward pressure on EPL deductibles especially in California
- Coverage continues to be highly negotiable and highly variable between insurers and individual underwriters
- Premiums for a \$1M limit start around \$3,500



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