

Basics of Outside Directorship Liability (ODL) Coverage



Senior leaders increasingly take opportunities to sit on boards or serve as executives of outside entities. But while serving in that capacity, is an individual director or officer covered under his/her organization's directors and officers (D&O) liability insurance policy?

Although such opportunities may benefit all companies involved, it also raises significant liability issues. As a result, it is critical to understand how D&O insurance protects executives that serve on other companies' boards. As directors and officers face increasing regulatory scrutiny, and in an effort to address outside directorship risk, organizations are more closely focusing on outside directorship liability (ODL) coverage.

ESSENTIALS OF ODL COVERAGE

Companies typically indemnify directors and officers for acts in their capacity as such, including as directors or executives of an outside entity for which they serve at the request of the company. This means that a company pays for the expenses and liability that a director or officer may personally incur as a result of their service to an outside entity. Indemnification is often included in the company's by-laws, articles of association, employment agreements, or deeds of indemnity. Before agreeing to sit on an outside board, the individual should understand the extent of its company indemnification.

A company's D&O insurance program will also typically cover these outside board activities for directors and officers as defined in the policy; however, ODL coverage generally does not extend to all employees. D&O policies often contain an ODL extension that most commonly works on a "double excess basis," where a company's ODL coverage applies excess of the outside entity's indemnification to the director or officer and the outside entity's own D&O program. In some cases, the ODL extension works on a "triple excess basis." This means that the company's ODL coverage applies excess of the outside entity's indemnification to the director or officer, the outside entity's own D&O program, and the company's own indemnification to the director or officer (see Figure 1).

FIGURE 1: ODL Scope of Coverage



FEATURES OF ODL COVERAGE

The ODL extension generally has three limitations:

1. To be covered, the director or officer's role with the outside entity must be at the specific direction or request of their company. Therefore, the company's D&O policy does not extend to protect the director and officer when, for instance, they serve on the board of a local golf club or homeowner's association because these are not company-requested roles. Such positions are typically self-elected roles; directors and officers should confirm directly with these organizations that they will receive indemnification and that they also have adequate D&O protection in place.
2. Blanket coverage typically is provided for nonprofit entities; this means that these entities do not need to be specifically scheduled on the policy. If there is a need to extend coverage to a for-profit entity (private or public or even to a minority-owned entity that is not deemed a subsidiary), the insurer may ask for additional information and a specific endorsement may be needed. It is important to note that insurers may be reluctant to extend coverage to outside public companies. If they do agree, it is likely on a triple excess basis and could be subject to a sublimit. As such, it is critical to understand the indemnification available and the direct coverage maintained by the outside entity, particularly if it is a public company.
3. ODL coverage does not cover the entity itself; it only covers individual directors and officers of the company. In the case of a minority-owned entity, it will not cover individuals that represent the other owners.

BEST PRACTICES

Because ODL coverage typically shares the limit of the overall D&O program, it is critical that a company understands the full extent of its ODL exposures. This can be difficult due to the cascading nature of the D&O policy in that it not only extends coverage to the parent company, but also to subsidiary companies that may appoint directors and officers to sit on outside boards. And since most D&O policies are global, ODL coverage and exposures extend worldwide.

Companies should have a tracking methodology in place to help quantify and assess their indemnification obligations as well as the potential impact on their D&O program. Such a system should include how companies:

- Facilitate and document decisions to approve or not approve indemnification for a particular outside position and how this is communicated to the individual at both the parent company and subsidiary.
- Track the start and cessation date of the outside position.
- Require individuals to report any claims against them regarding their outside position to the company on a timely basis.

A firm grasp on the basics of ODL coverage can help ensure that your directors and officers are protected in the event of any D&O litigation. Understanding the overall corporate and subsidiary exposures can help ensure that your D&O program limits are not inadvertently exposed to a claim that was not anticipated to be covered under your program.



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