
“Protecting the Chain of Command”

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Boards, directors, officers and trustees should become more involved in assessing the insurance policies designed to protect them.

At first glance, the Canadian DO&T (Directors, Officers and Trustees) market appears saturated, and so it might appear that newcomers to the market would have little chance to succeed. But despite a variety of offerings in the current DO&T market, opportunities remain available for exploitation. Companies can expect success if they are prepared to identify and meet existing needs within the market.

Such needs include a proven methodology for underwriters to assess corporate governance, further development of innovative and comprehensive coverage and better service resulting in contract certainty.

These needs are born out of the frustration expressed by consumers of DO&T insurance products and services.

As a member of a variety of executive boards, I witnessed frustration with the poor quality of coverage, confusing policies, long wait times for policies to be issued, and U.S. matrix-based underwriting. Board members were told their coverage was restrictive and capacity limited because insurers were concerned about board governance. These explanations were troubling, frankly, because some of the insurers with whom the boards dealt did not have a comprehensive approach to assessing governance.

Let's take a look at some of the market needs and existing opportunities that companies might exploit within a supposedly saturated market.

UNDERWRITING

Underwriters typically refer to the inherent risk of assessing corporate governance when asked to explain why DO&T coverage terms are restrictive, policies seem convoluted and capacity is often limited. And yet, when pressed to describe their methodology for underwriting corporate governance, underwriters and their reinsurers admit they have no meaningful capacity to quantify or qualify corporate governance. This astonishing deficiency is telling: underwriters are not in a position to offer broad coverage with confidence, because they have no ability to assess a key element of risk. To date, underwriters rarely make use of sophisticated means to assess corporate governance. Furthermore, given the softening market, carriers are not prepared to ask the difficult questions; instead, they negotiate terms of coverage in an effort to mitigate risk.

Future success in the DO&T market will therefore depend on companies that can fashion a proprietary methodology for assessing corporate governance and board effectiveness. Based on a capacity to assess underwritten risks, companies will be able to offer extensive coverage in its base form.

PRODUCT

Two years ago, the DO&T product offered - and still offers today - an old policy form frozen in time, lacking in current, comprehensive coverage. Generally speaking, the old policy forms demonstrated minimal innovation and a lack of capability to assess corporate governance and board effectiveness risk. Even today, many policies offered in Canada are reminiscent of the old D&O policy forms that use antiquated terms of coverage, obfuscated by endorsement upon endorsement, thereby making the policy incomprehensible. Examples of key terms of coverage missing in the base form include (but are not limited to):

- * Non-rescindable Side A coverage.
- * Non-cancellable policies.
- * Affirmative coverage of statutory tax and wage liabilities.
- * Full severability.

By restoring faith in the underwriting process and demonstrating the capability to assess governance risk, a product can modernize and internationalize the coverage terms offered in Canada. Base policy coverage terms such as those listed above should become industry benchmarks for comprehensive coverage.

SERVICE

As someone working outside the insurance industry, I was shocked to discover that acquiring a copy of a bound policy could take from nine to 12 months. Consequently, clients have no contract certainty. I don't know of any other industries that would accept contract uncertainty, for even small amounts of risk, for such long periods.

The reason for this lack of service is easy to understand. Although carriers have numerous underwriters to capture business, the industry as a whole has not sufficiently invested in the support staff necessary to amend and deliver the policies to the clients. This cannot be accomplished with technology alone: each policy is complex and has its own wrinkle.

Companies can capitalize on the need for contract certainty by delivering the final policy to the broker within days of being bound. How? They need to make investments in people and technology, knowing that brokers and clients will find this to be a positive, distinguishing factor.

Policies should and can be delivered within days of binding.

THE PURCHASE DECISION: COVERAGE V. PRICE

Until recently, most directors were not involved in the purchase decision, which was left mainly in the hands of management. But neither management nor directors were focused on coverage issues. DO&T was being purchased for limits, brand and price - not coverage and ratings. One possible reason for the historical lack of director involvement and the focus on price is that both directors and management did not consider the risk of corporate and economic loss as being substantial. Consequently, given the absence of screaming consumers and limited new competition, coverage and service were lacking. Recently, however, the winds of change are blowing.

In Canada, the past few years have seen an increase in claims against directors, as well as the beginning of meaningful DO&T settlements. Examples are numerous: Nortel, Westar Energy, Canadian Superior Energy, Bennett Environmental, CP Ships, etc. Directors, officers and trustees in Canada have suddenly become concerned. Conferences and organizations such as the Institute of Corporate Directors began to educate directors about the complex nature of DO&T coverage and the risks inherent in poor coverage terms. Outside counsel, recognizing their responsibility to advise directors about coverage and related business opportunities, began reviewing coverage terms and advising directors about the issues. The New York state attorney general, Eliot Spitzer, challenged the insurance fraternity to refocus on meeting the needs of the insured.

As a result, directors, officers and trustees are taking responsibility for the DO&T purchase decision. Based on the advice of counsel and broker support, they are focusing on DO&T insurance coverage and security first, moving away from a fixation on price and brand. Knowledgeable, client-focused brokers began demanding contract certainty and the best coverage for their clients, playing a critical role in raising the standards demanded by DO&T.

ROAD AHEAD

It is likely the large, U.S.-based DO&T markets will continue to improve their underwriting techniques, clarify and enhance the product, and provide appropriate service only if directors become more educated and involved in understanding the terms of coverage and the purchase decision and therefore demand change.

In the meantime, specialist players will continue to be the innovators, driving change and educating directors, and thereby gaining market share.