What's Independent Director Insurance?

There are now liability policies solely for independent directors. This insurance product is referred to as independent director liability (IDL) insurance. It can be purchased by corporations or individual directors themselves. IDL is a type of Directors & Officers (D&O) Liability Insurance policy but, unlike traditional forms, IDL coverage is limited to independent directors.

Although IDL insurance offers some benefits to independent directors not afforded by traditional D&O Insurance, IDL has not sold well since it was introduced several years ago. Recently, a top D&O insurer introduced an improved version of its IDL policy and is marketing it heavily.

Should you consider an IDL policy?

Some background on D&O Insurance is needed. In the mid-1990s, most D&O insurance policies were re-vamped to provide *companies* with direct protection for securities claims (referred to as "entity coverage") in addition to the traditional protection for directors and officers themselves. While entity coverage eliminated the problems that arose from allocating loss between insured individuals and an uninsured entity, it had the adverse effect of potentially eroding the limits provided to individual directors and officers.

Furthermore under some policy forms, entity coverage increased the likelihood that the policy proceeds would be unavailable to the directors and officers if their company filed for bankruptcy.

Many insurers responded to these two issues by offering a "Side A policy", another type of D&O insurance that covers only directors and officers. (It is typically is in excess over traditional D&O insurance.) This policy eliminates the bankruptcy concern as well as the limit dilution that are undesirable side effects of entity coverage.

However Side A insurance does not completely eliminate the limit dilution problem. Remember, Side A covers *all* directors and officers, and officers are more likely to incur multimillion-dollar defense tabs and settlements, eroding and possibly exhausting policy limits. If policy limits are exhausted, the personal assets of the insured individuals will be at risk.

IDL insurance can reduce that risk for independent directors by providing dedicated policy limits that cannot be exhausted by claims made against the company, *or* its officers *or* inside directors. The degree to which IDL insurance reduces the risk of exhausting policy limits depends on the number of independent directors insured under the IDL policy - the more directors, the greater the dilution risk.

Coverage can be provided for: (i) all independent directors on a board, (ii) one or more committees of a board, (iii) one independent director on a board or (iv) one independent director on all of the boards on which they serve (sometimes referred to as a "portable" policy).

Choosing among these different options generally comes down to cost, personal exposure considerations and the independent directors' tolerance for the dilutive effects of covering all independent directors by a single pool of insurance dollars.

A word of caution – IDL Insurance is NOT inexpensive; hence, it's lack of popularity thus far.

It should be no surprise that there is no standard IDL policy form. As with any D&O policy, it is imperative that the definitions, exclusions, conditions, and other terms of an IDL policy are carefully negotiated - if you want to achieve your objectives and obtain the most for your insurance dollar.

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