Are Financial Institution Executives Becoming an Uninsurable Risk?

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You may have noticed that premiums for Directors and Officers Liability ("D&O") insurance are skyrocketing, largely as a result of the subprime lending crisis, stock market volatility, and the ensuing financial uncertainty. According to the *American Banker*, since 2008 D&O premiums, depending on the coverage type, have increased between 15% to 40% since last year. This trend shows no sign of abating. Other reports, including a recent analysis by Aon, confirm this trend. Similar increases are forecast for the next several years as claims stemming from the current financial crisis are litigated and resolved. In fact, directors and officers of certain troubled businesses, particularly of financial institutions, may soon find that they are uninsurable at any reasonable price.

Higher premiums, however, are only one of the insurance industry's reactions to the current financial conditions. Insurers also are instituting more restrictive terms and conditions, lower limits of liability, higher deductibles, and in some cases, specifically tailored exclusions that eliminate coverage for liability resulting from bankruptcy, bank failures, or claims brought by the Federal Deposit Insurance Corporation. In light of these developments, many financial institutions may find it difficult to retain and attract talented directors and officers at the very moment when such leadership is most needed. In fact, this current talent drain is a continuation of a trend that began in 2002 with the passage of the Sarbanes-Oxley Act.

One factor impacting rates and the availability of D&O insurance is the uncertainty surrounding AIG's financial condition and future viability. AIG has long been the dominant underwriter of D&O insurance. As banks turn away from AIG for their D&O coverage, they are not finding the competition for their business that one might expect when an industry leader appears vulnerable. On the contrary, banks are facing a shrinking D&O market as several smaller carriers have decided to stop underwriting such coverage, especially for banks and other financial institutions, because the premiums are no longer perceived as worth the potential risk. In turn, those smaller insurers' withdrawal from the market should only exacerbate the rate at which D&O insurance premiums increase in the ensuing months and years.

Faced with higher premiums for less D&O coverage, companies and their directors and officers should aggressively negotiate the most favorable coverage for their money. To that end, when negotiating new policies or renewals, they should carefully gauge their risk and exposure, and closely review proposed D&O policies, including exclusions, for provisions that could potentially eliminate coverage. If the proposed coverage is insufficient, or if sufficient coverage is only available at unreasonable rates, policyholders should consider alternative ways to maximize coverage and/or minimize risk going forward.