Executive Risk Newsletter

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Third-party Litigation Funding and Its Impact on D&O Insurance

Third-party litigation funding (TPLF) is a significant trend in the legal landscape where external investors finance legal cases in exchange for a portion of any settlements or awards. These investors, often hedge funds or private equity firms, provide nonrecourse loans, meaning they are repaid only if the case succeeds. TPLF covers legal fees and other expenses, enabling plaintiffs to pursue otherwise unaffordable cases.

While TPLF offers financial resources for plaintiffs, it introduces important considerations for the insurance sector, particularly directors and officers liability (D&O) insurance. This coverage protects executives and board members from personal liability for business decisions and is crucial for attracting and retaining top leadership. It also covers the legal fees and other costs the organization may incur as a result of such suits.

Litigation funders often target large, complex corporate cases, such as shareholder derivative actions and breach of fiduciary duty claims, which typically fall under D&O coverage. TPLF can extend case durations and incentivize plaintiffs to seek larger settlements, raising costs for D&O insurers, who may respond by adjusting premiums or modifying coverage.

Additionally, TPLF contributes to social inflation, which describes the rising costs of insurance claims beyond general economic inflation and is driven by larger jury awards and evolving legal standards. Plaintiffs with funded legal expenses are often encouraged to hold out for higher payouts, further impacting litigation costs and premiums.

A key challenge for D&O insurers lies in the lack of transparency around TPLF arrangements. In many jurisdictions, there is no requirement to disclose third-party funding, leaving insurers and defendants unaware of external financial backing. This opacity complicates risk assessment and policy pricing, making it harder to gauge legal risks.

Overall, TPLF significantly impacts the D&O insurance market. While it provides critical support to plaintiffs lacking resources, it also drives up litigation costs for insurers. To address these challenges, D&O insurers may increase premiums, refine coverage terms or raise deductibles to manage their exposures. Emphasizing risk management and encouraging policyholders to reduce claim likelihood are also key strategies. Insurers may advocate for regulatory reforms to enhance transparency while actively addressing emerging risks. These measures reflect the industry's commitment to adapting in a complex legal environment shaped by TPLF.

Contact our team to learn how we can help you navigate these challenges.

The ABCs of D&O Insuring Agreements

D&O insurance policies typically include three standard insuring agreements—Sides A, B and C—detailing the scope of coverage and the insurer's promise to indemnify policyholders against covered losses:

1. Side A (D&O liability coverage)—Side A protects individual directors and officers against losses when the organization cannot indemnify them. This coverage safeguards personal assets and is crucial for attracting qualified board members.
2. Side B (corporate reimbursement coverage)— Also known as corporate reimbursement coverage, Side B reimburses the organization for defense expenses or indemnification costs incurred on behalf of its directors and officers. This provides balance sheet protection by covering legal costs the company advances.

3. Side C (entity coverage)—Side C offers protection for the organization itself. For public companies, this coverage is typically limited to securities claims, reflecting the higher risk of shareholder lawsuits. For privately held companies, it generally extends to a broader range of claims stemming from wrongful acts by the organization or its directors and officers.

The Importance of Corporate Recordkeeping in Boards of Directors

Corporate recordkeeping is crucial for preserving a company's history, especially concerning financial and business decisions. Despite its significance, many companies fail to create and maintain accurate records. Effective recordkeeping is not just a formality but essential for managing D&O risks. For corporate executives on boards of directors, precise documentation of key decisions and their contexts aids future decision-making and provides a strong defense in litigation.

Meeting minutes are a key element of D&O liability protection. Decisions made during board of directors meetings should be thoroughly documented, including details such as attendees, voting outcomes and supporting materials. These minutes serve as vital evidence if decisions are later contested by shareholders, regulators or auditors. Directors and officers should assume that meeting minutes could be subpoenaed in legal actions, emphasizing the importance of accuracy and detail. If a director is absent, they should review the minutes and formally document any disagreements in writing to ensure their concerns are recorded.

In addition to board meeting minutes, corporate recordkeeping encompasses various documents, including articles of incorporation, bylaws, resolutions and shareholder communications. These records are important not only for legal defense but also for facilitating smoother future business decisions.

Efficient organization is key to maintaining accessibility and complying with federal and state laws. Digitizing documents can save physical storage space and enable controlled access to sensitive materials, such as employee records. Public companies must adhere to the Sarbanes-Oxley Act (SOX) of 2002, which mandates specific record retention periods and prohibits the destruction of documents relevant to legal proceedings. While SOX primarily applies to publicly traded companies, its principles can guide private and nonprofit organizations in adopting strong recordkeeping practices.

By implementing comprehensive recordkeeping policies and ensuring compliance with retention regulations, companies can mitigate D&O liabilities and reduce the risk of costly lawsuits.

Contact us today for more risk management guidance.

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