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Startup Funding and D&O Risk: Getting it Right

For startups, each round of funding is more than a milestone — it is a structural shift in governance, accountability and risk. As companies move from seed funding to later-stage growth, their Directors & Officers (D&O) risk profile evolves quickly, often outpacing the structure of their insurance programs.

In the wholesale market, the pattern is consistent: increased capital brings intensified scrutiny, more stakeholders and a higher likelihood of complex claims tied to disclosure, fiduciary duty and governance decisions. Understanding this progression and structuring coverage accordingly is critical to building a sustainable risk foundation.

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Getting started

In the earliest funding phases, startups are typically lean, founder-led and operate with limited internal controls. At this stage, the company is making formal representations through pitch decks, private placement memoranda (PPMs) and investor communications.

These materials carry significant liability risk. Even unintentional misrepresentations can trigger claims, particularly in private placements where strict liability standards may apply. If investors later argue they would have valued shares differently had full information been disclosed, the absence of intent may not eliminate exposure.

Governance structures may still be informal, but fiduciary obligations already exist. Founders and executives often underestimate how quickly their personal decision-making becomes subject to legal scrutiny once outside capital is introduced.

As companies enter Series A and B rounds, the D&O risk profile shifts materially. New investors frequently take board seats or observer roles, introducing independent oversight and, with it, potential governance tension. Founder dilution disputes, strategic disagreements between investors and management and capital allocation challenges also commonly emerge during this phase.

The addition of fresh eyes on the board can surface prior decisions, related-party transactions or perceived self-dealing that were not previously questioned. These dynamics increase the likelihood of internal disputes, making the structure of the Insured vs. Insured exclusion and its carve-backs especially important.

Scaling risk complexity

Each funding round typically attracts a more diverse and sophisticated shareholder base. As ownership expands, so does the potential for derivative actions in which shareholders allege mismanagement or failure to act in the company's best interests.

Derivative claims (brought by shareholders on behalf of the corporate entity) are particularly significant for startups because they often stem from strategic decisions, including entering new markets prematurely, pursuing aggressive growth initiatives or executing acquisitions that fail to deliver expected results. In certain jurisdictions and fact patterns, indemnification for derivative claim amounts — and, in some cases, related settlements — may be restricted or unavailable as a matter of law or public policy. When indemnification is limited or prohibited, the importance of adequate D&O insurance, particularly Side A protection, becomes even more pronounced.

Growth-stage companies frequently expand through M&A, and each transaction introduces integration risk, inherited liabilities, stakeholder disputes and allegations of inadequate due diligence. From an underwriting perspective, acquisitive companies are often viewed as higher risk because strategic missteps can quickly translate into shareholder litigation, particularly if valuation or financial performance suffers.

In addition to shareholder litigation, regulatory investigations represent a meaningful and sometimes underestimated exposure for private companies. As startups scale — particularly in highly regulated or high-visibility sectors — scrutiny increases. Policy wording around the definition of "claim," especially whether it includes investigations against the corporate entity, can materially affect how coverage responds.

Many D&O policies include sublimits for derivative investigation costs, and those limits can be modest relative to the potential severity of such matters. As ownership structures grow more complex, insufficient sublimits and narrow investigative coverage can create unintended protection gaps.

Side A Difference-in-Conditions (DIC) coverage becomes increasingly relevant as well. This Side A-only policy form is designed to protect individual directors and officers — not the corporate entity — when corporate indemnification is unavailable, such as in insolvency scenarios or where indemnification is legally prohibited. In addition, a Side A DIC policy is structured to drop down in certain circumstances where the underlying D&O program fails to respond, including exhaustion, rescission or specific coverage gaps. For capital-intensive startups or companies dependent on continuous fundraising or acquisition activity, Side A DIC can serve as a critical last line of defense for personal assets.

It's all in the wording

As exposures become more complex, policy language becomes increasingly important. Key provisions that can materially impact coverage include:

- Broad definitions of "claim," including regulatory investigations against the entity
- Conduct exclusions with final adjudication triggers
- Robust carve-backs to the Insured vs. Insured exclusion, including whistleblower, derivative and former director claims
- Allocation provisions addressing mixed covered and uncovered allegations

Another structural consideration is the choice between duty-to-defend and reimbursement policies. Duty-to-defend forms often provide broader defense cost allocation and lower up-front premiums. Reimbursement policies allow the insured to select counsel and control the defense strategy, a feature that may appeal to more sophisticated boards and investors. The decision ultimately depends on the company's governance profile, risk appetite and financial resources.

Limit adequacy should evolve alongside growth. As capital raises increase valuation, assets and shareholder complexity, benchmarking limits against similarly situated companies can help ensure programs keep pace with exposure. Defense costs alone can erode towers quickly, particularly in regulatory or governance-driven disputes.

Transitioning to public markets

The transition from private to public ownership represents one of the most significant inflection points in a company's D&O risk profile. Public company D&O forms typically limit entity coverage primarily to securities claims, whereas private company policies often provide broader entity protection for a wider range of claim types.

This creates a strategic decision point for the insured. Should the company purchase a runoff (tail) policy on the private company form to preserve broader historical coverage, or transition fully to a public company program with prior acts coverage? Many companies elect a go-forward structure, but that decision should be evaluated carefully in light of historical disclosures, prior fundraising activity and evolving investor expectations.

Amwins can help

Startup funding accelerates growth, but it also reshapes governance and liability exposure at every stage. As shareholder bases expand and oversight intensifies, D&O coverage must evolve in parallel. In this environment, coverage structure, wording precision and thoughtful limit deployment often matter more than premium alone — particularly when the personal assets of directors and officers are at stake.

Set your startup on the best course. Amwins' professional lines specialists will work with you to ensure coverage is properly aligned, minimizing your clients' exposure and safeguarding their projects from financial and legal setbacks.

No matter what stage your clients are in, we've got your back.

Insights provided by:

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CONTACT

To learn more about how Amwins can help you place coverage for your clients, reach out to your local Amwins broker.

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