

# Looking beyond your garden variety D&O risk

*Potential trouble lies in 'areas of tension' that are not so obvious or frequently discussed.*

BY ANTHONY GALBAN

WHenever there are economic problems, it becomes fashionable to find parties to blame and hold responsible. In the aftermath of such situations, we often see legal action and then some measure of reform to help prevent these problems from happening again.

It's in this context that I find myself fielding questions about loss prevention and precautionary measures that can be adopted to help mitigate a possible directors and officers liability lawsuit. These questions come from risk managers, senior management, and independent directors, who want to know what can be learned from this experience.

I don't pretend to have all the answers, but I see enough accounts and claims to make some observations. My observations do not necessarily reside in SEC or stock exchange requirements; rather, they're in places where consensus is *not* easy or readily available. They are also in places that can matter a lot in terms of risk mitigation, and that can make a difference in claim dynamics:

**Enterprise Risk Management:** Much of today's recession and financial crisis boils down to a collapse of enterprise risk management. This might be a result of a lack of education on effective risk analysis — which, done properly, involves specific methodologies to identify exposures, quantify their probabil-

ity, and measure their impact. Good risk management requires expansive, creative thinking to push an enterprise through hypothetical scenarios — even absurd ones. The exercise especially requires time, which may have been another problem in the past.

Boards simply must demand that the risk analysis exercise be performed at least annually, and they must be comfortable with the process that senior

management has established, as well as be able to make ongoing adjustments. The analysis should examine potential crisis scenarios involving financial, reputation, product, technology, and other areas. If such a vigorous process is unfamiliar to the board and management, then they should consult an outside adviser.

**Board Minutes:** I have had the opportunity to participate on some panels with attorneys to discuss best practices for taking minutes at board meetings. What I found rather intriguing about these experiences was the lack

of consensus on minute taking.

To determine the best approach, I highly recommend talking to outside counsel. In addition, because you might not get clear consensus on one or more protocols for taking minutes, the board may need to make some of its own firm decisions.

**The Early Response to Inquiries:** Many boards underestimate the importance

of the initial response of company personnel to inquiries from regulators and other investigating bodies. In some cases, benign-looking situations have virtually exploded into full-scale, expensive investigations, both of individuals and companies — largely because the tenor of the early exchanges between the investigators and the company were so poor.

Many companies do a fairly good job of managing inquiries from the media and equity analysts. Yet they often do not understand how best to respond to regulatory or other investigatory bodies. In some cases, employees might become intimidated and volunteer information without vetting questions with the proper internal company authorities. In the worst cases, regulators have been treated with rude condescension. Either way, a surprising number of companies have failed to train employees for these interactions.

Companies often presume that important inquiries automatically will be directed to senior management. In fact, this is not always the case.

An investigatory body may start its search at the lower levels of the company, where any damning information may be far less likely to enjoy the protections of a trained member of senior management and where the employees might feel more obligated to be responsive.

Hence, it's critical that employees at all levels be trained in properly responding to inquiries by regulatory or other investigatory bodies. Employees should be informed on where to forward inquiries and how to respond with a cooperative, professional tone.

None of these issues constitute a "garden variety" source of D&O liability exposure, but each represents an area of tension that is neither obvious nor frequently discussed. Nevertheless, I believe the problems that can emerge are quite real and deserve the investment of time. ■

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