

The best time to review D&O coverage? Now

In these especially challenging times, take these steps to ensure you have the protection you need and deserve.

BY EVAN ROSENBERG

TODAY'S credit crisis has boards on high alert.

What organization today is not feeling the pinch of tight credit and a dismal economy? The fact is that most economic signs point to continuing pressure on an organization's bottom line. Unfortunately, for some organizations, increasing financial pressure could devolve into distress and even insolvency. Could that happen to your organization? Will the signs be clear and easy to see, or could the board be missing them?

A slide toward bankruptcy often happens slowly and the signs can be seen from afar, as has been the case with the airline industry. But, as we have seen recently, bankruptcy can also happen quickly, with little warning, almost appearing out of nowhere. It is in these sudden-insolvency situations that investors are especially fond of reacting to with lawsuits. Fortunately, your organization's D&O liability insurance program was designed to reduce its financial exposure — and your personal exposure — to lawsuits brought against its leadership team in certain situations, including bankruptcy. Right?

Well, that can depend on whether the D&O policy responds the way the board intended. Sometimes good intentions can be derailed. For example:

- An organization in financial distress or bankruptcy may not be able or willing to provide indemnification for its leadership team.
- If the organization's D&O policy

names the organization as an insured (entity coverage), then the policy may be deemed an asset of the bankruptcy estate because it is owned by the organization. If this happens, directors run the risk of not having insurance coverage to help pay for defense and indemnity costs incurred as a result of a lawsuit.

- A financially weak D&O insurer may be unable or unwilling to pay the organization's claims.

Whereas the original purpose of D&O liability insurance was to offer protection for individual directors, over the years D&O policies have evolved to also include protection for employees, the corporate entity, outside directorship liability, employed lawyers liability, and other coverage extensions:

- D&O policies today typically include employment practices liability (EPL) coverage, so if a lawsuit included EPL-related allegations, overall coverage for directors may

be eroded by the covered expenses of an EPL defense, as well as settlement or award costs.

- Entity coverage (defense of the company) can dilute coverage for individual board members.
- Coverage can be triggered by a criminal indictment, and policies may pay for significant defense costs. In virtually all cases, only insiders are named — therefore all losses incurred in defending the alleged criminal behavior reduces the limit of liability available to the independent board members for the civil suit.

Defense costs alone can be substantial,

especially when multiple law firms are involved in the defense, and essentially “use up” the policy.

In these especially challenging and dangerous times, a board can't afford to take its D&O liability insurance coverage for granted. Fortunately, an active board can take important steps to ensure it has the protection it needs and deserves:

- *Make sure you understand how a strained economy may affect your organization.* What “red flags” could be indicative of financial distress? These red flags may include access to liquid assets, possible breach of debt covenants, counterparty risk, and supply-chain issues.

- *Get to know your D&O liability insurance coverage and take an active role in its purchase.* Boards are often more concerned about the cost of insurance than the quality of coverage — a trap that can come back to haunt the directors when they actually need the coverage. It's important to examine a D&O policy in depth. Is coverage broad enough to address the organization's risk profile? Are limits high enough to protect individual board members, given the breadth of coverage? Is the insurer financially strong and does it have a good reputation for paying its claims? And, importantly: In addition to a D&O policy for the organization, should the organization also purchase “Side A” D&O limits or coverage tailored solely for independent director's liability?

- *Ensure that coverage is structured to your needs.* Have an advocate (e.g., general counsel or outside counsel) examine the D&O policy. Determine the primary purpose of the policy. Should it protect the organization's or the individual board members' assets?

The impact of the credit crisis and weakened economy is widespread, and boards can't afford to miss the signs of potential insolvency. More importantly, from a personal standpoint, the right time to examine your D&O liability insurance coverage is not when financial difficulty looms. The right time is now. ■



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