When a D&O policy could leave you bare

Don't presume that your 'mother company' policy offers any protection when you accept an outside board seat.

BY ANTHONY GALBAN

Even the largest and most sophisticated companies may not have consistent procedures that ensure their executives who sit on the boards of outside organizations have adequate directors and officers (D&O) liability insurance for this service. As a result, whether it's joining a new outside board or retaining a long-held seat, many outside directors may face a financial peril they do not realize exists. An outside director may unknowingly have assumed a personal financial risk should they be sitting on the board of a financially challenged company.

Anthony Galban is senior vice president, Chubb & Son, and underwriting manager, directors and officers liability insurance, for the Chubb Group of Insurance Companies (www.chubb.com).

The financial risk is personal because many outside directors are woefully underprotected — regardless of their outside organizations' or mother companies' indemnification provisions and D&O liability insurance limits. In many cases, an executive cannot count on his or her mother company's basic D&O liability coverage to respond at all if the outside company seeks bankruptcy protection and, therefore, cannot cover losses stemming from a D&O liability lawsuit. (Typically the outside company is not an insured under the mother company's policy.) As self-protection, the outside director should investigate whether his or her mother company has outside directors liability (ODL) coverage.

Typically, D&O policies that do provide an ODL extension provide blanket coverage only to executives who serve on limited types of not-for-profit entities. But D&O liability insurance for executives who serve on outside publicly traded or privately held for-profit companies is not an off-the-shelf policy provision. Each executive's outside board service on a public or for-profit private company must typically be scheduled into the D&O liability policy.

The situation is even more serious for an executive who accepted an outside board seat without the mother company's knowledge and consent. It is unsafe to presume that the mother company will offer insurance or indemnification protection for outside service of which they are unaware — regardless of how noble or altruistic the cause. Therefore, this person may not be able to count on any protection from the mother company.

Many outside directors unknowingly have strayed into this risky financial position because relatively few companies carefully manage this exposure. Directors should inquire into whether the mother company has a formal ODL protocol. The director will likely find that either there is no ODL protocol or that no one knows for sure. In either case, the board should request that the risk management or finance department get a firm grip on this exposure by developing a protocol that reflects the values of the company and its board.

Although local insurance mandates overseas might prevent a company from implementing a global D&O insurance program, a risk management or finance department can craft universal, multifaceted ODL procedures. The first step is to ensure that the company's D&O policies contain an ODL coverage extension that protects every executive who sits on an outside board. Such an extension should be specific, identifying both the covered executives and the outside companies they serve.

Part of the reason so many companies do not have a solid ODL program is the volume of information that a risk manager must gather to complete this step. At a multinational company, for example, completing this task involves determining every known and unknown outside board commitment for every executive of every unit in every country in which the company operates.

The most effective protocol, however, will be far more robust than simply adding ODL extensions to D&O policies. An ODL protocol also should:

- Clearly state the corporation's philosophy on outside board service.
- Identify the types of outside companies that executives are permitted to serve.
- Identify the executives who are permitted to take outside board seats.
- Detail how those executives would be indemnified or insured, or both, for a loss resulting from their service.
- Establish a process to track outside companies' financial condition.
- Explain how the mother company will track all of this information.
- Include a routine monitoring process to verify that the protocol is functioning properly.

Finally, for an ODL protocol to achieve full effectiveness, it must be communicated to all employees.

The outside director is not responsible for crafting an ODL protocol, but he or she has a duty to demand that it gets done — for one's own protection, as well as to safeguard fellow executives and the mother organization's treasury and reputation. ■

The author can be contacted at galbant@chubb.com.

Reprinted from Directors & Boards® First Quarter 2010
© MLR Holdings L.L.C. • 1845 Walnut Street, Suite 900 • Philadelphia, PA 19103
(215) 567-3200 • www.directorsandboards.com

Chubb Group of Insurance Companies
15 Mountain View Road, Warren, NJ 07059
www.chubb.com
Form 14-10-0695