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2010 SPECIAL SUPPLEMENT

Boardroom Liabilities

Shining a Spotlight on Risk

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Jordan Hershman: The first subject I want to talk about is the director's duty of oversight. We'll begin by focusing on what should be a top-of-mind issue for directors in the wake of the recent economic crisis—the director's duty to oversee corporate risk. It is important to note that day-to-day risk management is still management's duty, while the board should set the tone at the top to shape the company's corporate culture. The board should always be aware of the company's risk philosophy and risk tolerance, understand how management has established the company's structure to deal with risk exposures, and stay informed and updated about the most significant risks facing the company. Steve, can you briefly discuss a director's legal duty to oversee risk for the company?

Steve Browne: The director's duty is just as you described it—not to manage risk, but to oversee how management manages risk. The board's duty has not really changed over the last few years, but there is heightened scrutiny on risk management given some of the risky behavior that led to the financial institutions crisis and severe downturn in the economy. The role of the board with respect to corporate risk is to make sure the proper mechanisms are in place to manage risk and to keep informed as to how management is managing the business in light of the risks the company faces. So again, it's not a new duty, but it is an area of extremely high focus and boards are well advised to make sure their company has a risk management function, a risk management policy, and that the board is receiving regular reports and is actively involved in understanding the risk-related decisions management is making.

Dennis Gustafson: I agree and to go a step further, I think a lot of times from a board perspective, directors should look at risk in two capacities. One is the day-to-day risk, and that's absolutely the responsibility of the CEO, the CFO, and the management team, though the board should have a comfort level with regard to the level of aggressiveness and conservativeness. But then there is risk beyond the norm, for lack of a better term, and that is when there should be some type of gate-keeping mechanism that allows for director oversight. Some boards are actually creating a risk oversight committee, which would then review those items it determines to be risk beyond the norm.

Steve Anderson: I'll add two comments to what's already been offered. The first is that a company needs to be really clear which executive is responsible for risk management. There's a recent study by Korn/Ferry in which a large minority of companies surveyed feel that the chief executive officer is ultimately responsible for risk management. But a healthy minority also felt it was the chief risk officer, and other companies offered that in their organizations it's the chief operating officer. So there needs to be clarity in terms of where the buck stops with respect to risk management. The other comment I would offer is that the SEC is clearly pushing companies for more specific information in their filings with regard to risk. In many situations, the SEC is not pleased with generic statements of risk. Regulators want to know how a risk factor impacts or may impact your specific company. They're not necessarily requiring companies to restate what they've already filed, but they have sent letters advising companies that they expect better disclosure in future financial reports.

Hershman: Picking up on a point Steve made earlier, the increasing complexity of business transactions, coupled with the advancement of technology, has

made enterprise risk management more difficult, especially after the economic crisis of 2008. Is it more difficult now for directors to address risk?

Browne: It's an interesting premise. I'm not really sure business transactions are necessarily more complex today than they were in the past. I am sure directors who were on boards 10 years ago had plenty of complex business issues to deal with. Indeed, given the heightened scrutiny on risk management over the last few years, there are actually more risk management tools and resources available to directors now than ever before. Their peers on other boards are all focused on risk issues, so it's possible for directors to talk to directors at other companies and learn about risk management. The Internet is loaded with materials about risk management. There are consultants who can be engaged. Again, what has changed is a heightened focus on risk management. The key point to me, as it relates to the complexity of the modern business world, is yes, directors have to understand risk management, but more important, they have to understand the risks that their particular business faces and know how those risks are being managed. What's inexcusable is a failure to have a good understanding of the company's business and the risks it faces. If you understand those things, then you are in a position to understand how management evaluates risk, what the risks are, and how they are being addressed by management. If you don't understand the company's business, then you can be a genius about risk management and it is going to be of little value because you won't be able to apply what you know about risk management to the actual business of the company.

Anderson: I agree with what Steve just offered. We have come out of the worst of the economic crisis, yet we are now in a situation where risk has become a four-letter word. We need to remember that the value of business enterprise is fundamentally based upon taking reasonable risks. It's the no-risk, no-reward theory. But we're in an environment, at least for the time being, where cash is king, companies are hoarding cash, leverage is out, and the idea of taking on any meaningful risk is not a conversation companies necessarily want to have with investors. So we've got to get through this period where there seems to be a disproportionate amount of scrutiny on risk avoidance and realize that the foundation of our economy was built around companies and entrepreneurs who took a lot of calculated risk.

Browne: I agree. What is important is that the board of directors treats risk management as an important issue and aligns incentives so that management is incented to behave in line with the board's risk tolerance. That means thinking about compensation in the context of risk management and making sure compensation doesn't unnecessarily reward undue risk. It means treating risk management as an important issue and having regular presentations from management to the board about risk management. As the management team learns that it's going to be required to report regularly to the board on risk management, team members will make sure they do the work to manage risk so that their reports will be acceptable to the board. It's really about creating a culture where everyone in the organization understands that risk management is important and understands the board's view of what is an appropriate level of risk, and then management is compensated for managing risk in alignment with the board's view. If you set up that culture and people understand what is expected of them, they will behave accordingly.

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> **—Jordan D. Hershman,** Bingham McCutchen LLP

Hershman: To effectively perform its oversight duties, the board should foster a corporate culture that discourages undue risk taking. How can the board effectively create the right tone at the top vis-à-vis risk? What specifically can the board do with respect to corporate culture issues?

Gustafson: Some boards create a specific risk oversight committee dedicated to those risks they determine are not everyday risk, which again, as we all said, is really based upon their confidence in management with regard to those risks they feel are beyond the norm.

Anderson: I'm not a proponent of the risk oversight committee. To me, it's a similar reaction to what we saw after Enron and WorldCom and Sarbanes-Oxley, where a lot of companies ran out and formed governance committees. I've talked to a number of directors who have always felt that governance was the responsibility of the entire board. So delegating to a risk committee the board's function with respect to risk oversight may not necessarily be a good or viable long-term solution. What I think is really important is making sure that compensation within each business unit is aligned around the appropriate markers so that you are not exposing the company to undue risk taking. I think it's very important that compensation is appropriately aligned so that the risks/rewards fall on the key employees or officers responsible for the business units. This will discourage people from taking disproportionate risk because they will have a financial incentive not to overly expose the company to the risk of disaster.

Hershman: Since the role of the board in the company's risk oversight has become more demanding, what type of training, if any, should the board receive in order to ensure directors are familiar with their duties?

Browne: There are a lot of resources available to the board and, frankly, companies can spend a lot of money hiring consultants to come in and talk about risk management, and there are lots of risk assessment tools available. But to me the most important training is having management educate the board so that the board can understand the company's business and the risks it faces. The critical challenge for board members is to understand how the business operates, what its challenges are, what risks it faces, and to understand, from an oversight perspective, what decisions management is making in light of those risks. Some of the largest problems companies have faced in recent years can be traced to situations where board members who were very smart, well educated, and experienced people just didn't understand the nature of the company's business and the risks it was taking. An example of this is the complex hedging and derivatives activities at large financial institutions. There were very smart, experienced directors on those boards, but some of them simply did not understand the nature of those hedging activities and the risks that were being taken with respect to them.

Anderson: I agree. What we've seen with respect to major financial institutions is that some of them revamped their boards and, in fact, realized that they didn't have any former bank CEOs on their boards, which is the very risk you just described, Steve. They had really smart people from different industries, but they really weren't well versed or they lacked practical experience in the banking industry. When you look at the full scope of operational risk a company is exposed to, you want to make sure the backgrounds of the board members represent an amalgamation of practical experience across those risk areas. As was said earlier, they don't have to actually measure the risk—that's the responsibility of management—but they do have to be able to review what's presented to them and see how well that tracks or doesn't track with what their own actual working experience has been in the very same industry, or at least with the very same issues.

Gustafson: I agree with a lot of what you said, but I would add that there is still some value to outside training to get a perspective from individuals or groups who work closely with these issues. I really like ideas distributed in smaller tidbits—an hour, a half a day—but more frequently, say, at least annually. The ones I see typically like to break up risk analysis into legal risk, financial risk, and insurance risk. So my thinking is you can also look for outside options to give the board members training, particularly with what's going on with the new regulations. Nobody can keep on top of all the new regulations, guidelines, and governances without some form of help.

Hershman: I'm going to shift gears and talk about some D&O liability issues. Though 268 banks have failed since Jan. 1, 2008, there has been relatively little litigation brought by the FDIC related to those failed banks. However, the FDIC's lack of litigation in this area could be changing. On July 2, 2010, the FDIC filed its first suit against the former directors and officers of the failed bank Indy Mac. This suit could mark the beginning of a new wave of litigation against former directors and officers of failed financial institutions, making it important to discuss D&O liability issues related to insurance. What key questions should directors and officers be asking about their D&O insurance to ensure they have coverage that will protect them?

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Gustafson: I think this is a great question and really a very timely question, not only with regard to all the failed banks and the FDIC actions, but also with regard to the new forms. I don't want to jump ahead, but it all pertains to the insured-versus-insured exclusion. These new languages that are available to the marketplace remove that exclusion altogether. In addition, they offer coverage grants for informal investigations, which could have a direct impact on the FDIC actions going on right now. I'm curious how this will work for folks in the pilot. I'm predicting a paradigm shift where we might see fewer shareholder actions and more coverages granted for regulatory investigations, informal investigations, and those type issues. I think these new languages are being created to address those situations.

Anderson: I agree with Dennis. In addition to the insured-versus-insured exclusion, I think there are three other things directors and officers really need to know about their D&O policy if they're involved with a troubled bank. The first is whether there's a regulatory exclusion on the policy that would purport to knock out coverage for future claims brought by the FDIC or some other regulatory body. The second thing they need to know is whether they have full coverage for past acts. We've been asked to review a number of policies for troubled banks where the coverage shifted from one D&O insurer to another, most often because the previous insurer didn't want to continue providing the insurance. Quite often, the new insurer added exclusions for any past acts or litigation prior to the date it became responsible for coverage, which is going to knock out coverage for most or all the management decisions that led the bank into trouble in the first place. The third thing they really need to look at is whether they have a traditional policy that provides coverage to the bank itself and whether, in the event of an insolvency of the institution, directors and officers may be competing for coverage with the defunct bank because they're all insured parties under the policy.

Hershman: Among other frequently recurring issues are questions regarding whether post-bankruptcy claims against the bankrupt company's directors and officers run afoul of the insured-versus-insured exclusion found in many D&O insurance policies. Dennis and Steve just mentioned the insured-versus-insured exclusion. Can one of you provide a brief explanation of what the insured-versus-insured exclusion is?

Gustafson: As I see it, pretty much every exclusion in a policy results from some act that occurred and wasn't excluded, so the insurers realize they need to fix the hole and put the exclusion in. The insured-versus-insured must have been a situation where an individual director sued another director or the company, and it was potentially covered. Now they're basically saying that they are not going to cover any claims where an individual director sues another director or the company. What has stemmed from that is a lot of carve-backs to that exclusion to soften it and grant coverage where deemed appropriate.

Anderson: I agree, Dennis. I think there are two purposes to the insured-versus-insured exclusion. The first comes from real life experiences, as you described. In the mid-1980s there were situations involving major banks that had taken huge write-offs for bad loans in third-world countries. They looked at the D&O policy and said, "Gee, there's no exclusion, so maybe we can sue ourselves on a shareholder derivative basis and recoup through the D&O insurance policy some of the amount that we wound up writing off." The minute that happened, the D&O insurers reacted by slapping an insured-versus-insured exclusion on the policy to prevent those types of collusive claims. The other reason is basically because the D&O insurers did not want to get involved in infighting, whether it was a situation where you have a family-owned company and various members of the family were on the board, or a situation where board members were no longer getting along and they started suing each other. As you noted, we've reached a point where, at least for Side A coverage where there is no indemnification, you can either get a policy that doesn't have the insured-versus-insured exclusion at all or, if you have one, there is a provision allowing a majority of the disinterested directors in the event of a claim to vote to effectively void the exclusion for that particular claim. So the policies have been dramatically liberalized and the insured-versus-insured exclusion really has very limited application on the Side A policy.

Hershman: Let's switch to the topic of executive compensation. In 2009 a significant focus on executive pay led to nearly 10 different bills being proposed on executive compensation, but only one bill proposed by Congressman Barney Frank got the approval from both the House and the Senate. On July 21, 2010 President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. Companies now must have annual, nonbinding shareholder votes on executive compensation, a so-called say on pay. The act requires that each member of the company's compensation committee be independent, and independence must also be a consideration for the selection of compensation consultants, legal counsel, and other advisers. Under the act, companies are required to make additional compensation-related disclosures in their proxy statements. How will the new disclosure requirements affect how companies structure their executive compensation packages?

Anderson: I know that at the companies we work with, process is really important to them—going to outside executive compensation consultants, doing benchmarking in terms of what other executives are paid, taking a look at the talent pool they're attempting to draw from and the alternative positions that may be available to those same executives. There's still a competitive environment for qualified management talent. I don't know that the process has changed all that much other than that they're spending more time and money around that process to make sure that ultimately they're not second-guessed.

Gustafson: I completely agree and would add that increased levels of transparency behind the decision making is something I think can impact companies down the road.

Browne: I will just add a few points to what has already been said. One is that most companies are already very highly focused on the compensation structure and disclosure requirements. Some of these new requirements will drive further incremental changes. Companies are obviously focused on the new metrics and the disclosure requirements, so they'll probably spend more money around those issues, but I don't think it is fundamentally going to change pay practices in the way some of these disclosures requirements were intended. Frankly, I'm not sure the metrics are really all that useful to investors. At the end of the day, it is still a competitive marketplace for highly talented management and if the disclosure and other technical requirements lead to pay packages that shareholders are unwilling to accept, then companies will not be able to attract the right talent. So I don't expect a lot of change other than companies will spend a lot of time and money creating disclosures to satisfy the new disclosure requirements and will continue to have a high level of focus and thoughtfulness around their executive compensation packages.

Hershman: Let's talk a little bit about proxy disclosure. On Dec. 16, 2009 the SEC, by a vote of 4 to 1, approved amendments to increase disclosures in proxy statements. These rules went into affect on Feb. 28, 2010 and they enhance disclosure obligations relating to risk oversight, corporate governance, and executive compensation. Among other things, the new rules require the disclosure of compensation policies and practices that expose the company to material risk. They also require companies to disclose compensation policies and practices that are reasonably likely to have a material adverse affect on the company. The company is not required to make these disclosures if it determines in good faith that its incentive compensation program does not expose the company to material risk of loss. What factors should companies consider in deciding whether or not to make this disclosure, and what should be included in the disclosure if the company decides to do so?

> "The role of the board with respect to corporate risk is to make sure the proper mechanisms are in place to manage risk and to keep informed as to how management is managing the business in light of the risks the company faces." **—Steven C. Browne**, Bingham McCutchen

Browne: The strange thing about this disclosure requirement is that if any company is starting to come to the conclusion that its compensation policies may lead to a material adverse affect on the company, then it will change its compensation policy to avoid the disclosure—which I think is the real intent of requiring the disclosure. So I don't know that you're going to see any company, unless somebody really makes a mistake, having to disclose that its compensation policies are reasonably likely to have a material adverse affect on the company. What this really boils down to, again, is having a compensation philosophy, making sure the board understands the company's business and the risks it faces, and ensuring that the compensation practices and compensation packages align the philosophy with the appropriate level of risk taking.

Anderson: I agree. I think if a company reaches the conclusion that it needs to make disclosure around these issues, it should change its compensation practices. However, I suppose there are some situations where a company may be very transparent around the fact that as an investment, it's not for the faint of heart; it takes huge risks in its business and compensates key employees accordingly. So if a company has always had a very volatile stock performance, then I suppose you could stretch to say that you would have something to disclose that's consistent with the company's overall risk-taking philosophy. But I think the vast majority of companies that come to this conclusion will change their compensation practices.

Browne: That's a great point because, for instance, a company that might have as part of its business significant hedging activity or collateralized mortgage obligation risk, I don't think its executives will state that they think this activity is reasonably likely to have a material adverse effect on the company, but they might well put a fair amount of disclosures about the risks resulting from those activities so that if those risks come to fruition, they'll at least have disclosed the possibility.

Hershman: Our last subject is one that officers and directors don't like to think

Reviewing Your D&O Liability Coverage

By Bryan Kocon, *Vice President, Business Unit Leader, Public Company Liability*, Travelers Bond & Financial Products

What questions should corporate directors and officers ask about their D&O policy to ensure they have adequate coverage and protection?

First and foremost, who are the insurance carriers that comprise the program? It's important when seeking out carriers that will play an important role in your program to determine whether the carrier has long-term financial wherewithal, extensive experience in handling complex D&O claims, and a reputation for being fair in handling claims. These key attributes have proven to be very important in the ultimate outcome of claims.

Second, it's important to ask and understand how the program is structured. It's valuable to gain the advice of industry professionals in determining adequate limits and, in doing so, to ensure the limits can protect the exposure of the company and the individual. Also, it is highly advisable to incorporate Side A DIC (difference in conditions) protection into the program. The coverage most often is placed on top of a typical D&O policy and has very few exclusions. This coverage is designed for individual directors and officers for claims in which their company is not able to indemnify. Side A DIC policies also fill coverage gaps created by exclusions in the standard D&O policy (DIC feature).

The corporation itself is not an insured under these policies, so the limits are dedicated to the individual directors and officers. To the extent possible, programs using excess layers of coverage should offer uniform coverage relative to the primary contract. This will lead to more predictable outcomes regarding claims. Contrast this to a program that has exclusionary wording found in some, but not all, layers of coverage. This type of program structure could lead to frustration and even conflict in discourse with regard to handling a D&O claim.

Third, corporate directors and officers should ask how broad the contract is. It's important to ensure the wording of the D&O contract reflects the realities of today's legal climate. Close examination of the entire contract by industry professionals is important. Here are just a few examples of what a contract should include:

- The definition of "claim" should encompass coverage for Wells notices, subpoenas, and investigations against insured persons, including coverage for interviews by regulatory authorities.
- So-called "conduct exclusions" with narrow application should be included. Conduct exclusions are those exclusions related to the personal conduct of insureds, which includes fraud and personal profit exclusion. In most D&O cases, there are allegations of fraud in one form or another, so it's advisable to have conduct exclusions that: 1) do not apply to all insuring agreements, and 2) are triggered only after there has been final adjudication (which doesn't happen very often in D&O matters, as most suits reach a settlement).

The conditions in the D&O policy that reference how representations and severability of those representations will be treated are very important. During the application process, insureds are asked to provide documents and make statements about their business. How knowledge of one person will or will not be imputed to another can have a dramatic impact on the outcome of a claim. Also, many markets today provide non-rescindable coverage, meaning the contract will not be rescinded even if there were misrepresentations made during the application process.

Can you briefly discuss conflicts that can arise under a D&O policy between the interests of the non-officer directors and other persons insured under the policy? What other types of conflicts most commonly occur?

A starting point is to understand why the D&O contract is being purchased. Is it to protect the corporation's assets, the individual insured's assets, or both? It's clear that most public companies require D&O insurance to attract and retain

much about: securities litigation. In addition to its provisions relating to executive compensation, the Dodd-Frank Act brings other sweeping reform to the financial industry, including adding new liabilities for swaps, dealers, strengthening protection for whistleblowers, creating new aiding and abetting liabilities, enabling the SEC to limit mandatory arbitration clauses, and strengthening the overall powers of the SEC. There are new private rights of action for whistleblowers as well as against credit rating agencies. Do you anticipate a large increase in securities litigation as a result of these new private rights of action as part of Dodd-Frank?

Anderson: The whistleblower provisions are a concern. I do believe you're going to see more whistleblowers going directly to the regulators to assert claims and seeking a personal financial gain in the outcomes of those claims. I'm not sure that's a good thing. Also, what we are witnessing is that the real adversary for directors and officers, at least for the time being, is the government with its numerous and serious claims—whether they emanate from the credit crisis, the FCPA, consumer-protection laws, or environmental-related matters—so D&O policies really have to adapt to pick up a lot of the costs and expenses incurred early on, before a formal claim is actually brought.

Gustafson: I see a paradigm shift as well. It's going to be coverage either for defense or for the actual potential fines and penalties for regulatory investigations, formal investigations, subpoenas, whatever stage it's at. And this is a more general response to the question, but as we look into our crystal ball a bit, we've seen definite softening of the D&O marketplace. Rates are going down, some carriers are trying to offer coverages for these types of informal investigations, taking away the insured-versus-insured

talented professionals on their boards, so it makes sense that individual asset protection is a key part of the equation. Program structure, as mentioned earlier, can play an important role in reducing or eliminating potential conflicts that can arise in terms of adequacy of limit for individuals. For example, having designated limits by way of a Side A DIC tower, building a program with additional limits set aside solely for independent directors (independent directorship liability known as IDL) or by eliminating coverage for the entity can go a long way with regard to keeping limits available for individuals and thereby reducing conflict during a claim.

No one likes to think about situations where there has been corporate malfeasance, but it does happen. In such situations, independent directors are often removed from day-to-day operations and are at odds with officers of the company. The alleged wrongdoers could consume huge amounts of the policy limits set aside for all insureds, leaving the non-officer directors with little to no protection. In such cases, it's not uncommon for there to be adversarial situations regarding who should have access to the policy limits and when. In other situations, perhaps the board decides not to indemnify (correctly or incorrectly) for whatever reason and the matter turns contentious. Both of the challenges illustrated by these scenarios can be solved or minimized by proper policy structure with dedicated and adequate DIC or IDL limits built into the program.

Finally, it's possible to endorse D&O contracts to make it clear who gets paid first in the event of a claim. These so-called "priority of payments" endorsements were created to address concerns insureds had when their companies entered bankruptcy. The individuals wanted to make sure their interests were looked after before that of the corporation. These endorsements are available today, even if a company isn't in or near bankruptcy. The wording will delineate by insuring agreement (individual coverage, corporate indemnification, or entity securities coverage) or by type of insured (independent directors, officers, or the corporation) who gets priority in terms of available policy proceeds.

As we enter the last few months of 2010, what are the top three D&O issues on corporate boards' radar?

The SEC's expanded powers and resources available to prosecute claims should be on a corporate board's short list. For example, the SEC has expanded subpoena authority to lower level staff, made investments in new employees (they will increase staff by more than 350 personnel in 2011), and reorganized into five specialized units. Companies should ensure that they have a sound methodology in place to respond to SEC inquiries or investigations. Organizations will need to respond appropriately and continue building relationships with the SEC.

The Financial Reform Act may have very broad implications, and not just to those in the finance industry. For example, the act includes incentives for whistleblowers (up to 30% of the penalties/recoveries) to tip off authorities. Understanding the breadth of the implication of this new law should be high on the priority list as well.

The SEC has announced enhanced disclosure requirements for this year's proxy season, for which the potential ramifications have yet to be determined. A sampling of new disclosure items include:

- situations where compensation policies may lead to material financial loss" for the company,
- the structure of the board, including why it's structured the way it is, and
- the board's role in "risk" oversight.

With additional disclosure requirements comes additional risk of failure to make proper and timely disclosures. Although most boards have addressed these new requirements in one form or another, the proof of their effectiveness will come when these disclosures or alleged omissions get challenged in years to come.

exclusion, but offering that at a cost, saying there's a value to this. If there are more regulatory actions, as Steven said, and there is coverage and we see paid claims associated with these actions, I think the end result is going to be, again just a prognostication, increased pricing on primary D&O insurance and then further decreases in the excess limits and in the rates. Obviously there will be exceptional, very large claims, but a lot of these claims for community or regional banks are going to be below a million dollars. It could potentially be within the primary limit and that's where the carriers are paying out, but excess limits may not get touched on those type of claims, whereas in the old days with the class action, it could go through an entire D&O tower.

> "If there are more regulatory actions…I think the end result is going to be…increased pricing on primary D&O insurance and then further decreases in the excess limits and in the rates."
> —**Dennis Gustafson**, Armfield, Harrison & Thomas

Hershman: The Dodd-Frank Act both strengthens the SEC's enforcement powers and places new deadlines for the completion of investigations. How will these changes affect the way the SEC conducts its investigations?

Anderson: I've been involved in a number of client situations where the SEC has chosen to be very aggressive, and in those instances, the legal and related expenses that a company incurs in responding to the SEC are significantly greater than the costs ultimately incurred in defending securities class-action litigation. So when the government wants reams of information in a very short period of time, you need to have all hands on deck and that involves your inside counsel, your outside lawyers, and whatever other experts you need to respond. So my short answer is that there is increased aggressiveness, and because of the time limitations it's going to drive up a company's expense of cooperating with the SEC.

Gustafson: As Steve was talking, it made me think, again going back to D&O language, about the definition of claim. We know the coverage doesn't pick up until a claim is triggered. But where in the stream of events is a claim triggered? Where exactly during the SEC investigation? You want that, obviously, to be as early as possible. That goes along with what we've been talking about with regard to the recent coverage enhancements.

Hershman: Right. With an increasingly aggressive SEC and the high costs that accumulate relatively quickly with an SEC investigation, especially with a regulator who is reluctant to end any investigation without carefully reviewing the files in a post-Madoff environment, it's important for companies to get D&O coverage that starts from the very beginning of their first contact with the SEC, whether that be an informal inquiry letter or subpoena, or just a request.

Anderson: I think that when a director or officer receives a letter or a call from someone at the SEC looking for information or to have an interview, the first piece of advice is that you need to have your lawyer with you from the beginning. It's serious enough that a director or officer needs to incur some expense to make sure they're represented, and the D&O carriers should acknowledge that the clock needs to start to tick from that point in terms of coverage.

Gustafson: Just to add to that, please note that this is an area where the D&O policies vary widely. The definition of claim and when a claim is triggered is definitely something directors should be looking at, and when you're talking about the renewal process and getting enhancements, this is something, particularly for a bank or financial institution, they should put a keen eye on because it is not at all standard.

Hershman: I would add in closing that the language of D&O policies is hardly self-explanatory. There are a lot of terms that are built into the way the policies are written, and it would be advisable for boards, especially in this environment with heightened risk and heightened regulatory aggressiveness and scrutiny, to involve good insurance brokers as well as good counsel to help them in the renewal process. Directors need to make sure they've got the right terms in their policies to protect them against these heightened risks.

Anderson: I agree, Jordan, especially given the fact there are still somewhere around 250 regulations to be promulgated in order to give Dodd-Frank full effect. This will be a complex exposure area and it is going to evolve, so I recommend that every company consider having independent counsel review its D&O policy over the next 12 months.

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