Insurance Coverage Arising Out of the Financial Crisis

Bill Barbagallo
Managing Director
Navigant Consulting
May 18, 2009

NAVIGANT CONSULTING

Coverage Types

- E&O Coverage-professional liability
- D&O Coverage-management liability
- Fiduciary or ERISA liability
- Crime/dishonesty policies
- Fidelity Bond Coverage
- Credit Risk Insurance (including mortgage insurance and pool insurance

Claims Made Policies

- Claims made and reported during the policy period
- Notice conditions vary but usually require notice shortly after expiration (extended reporting provisions). Some jurisdictions only allow a carrier to prevail on this issue if they can show prejudice by the delayed notice
- Common discrepancy arises out of Employment Retirement Income Security Act (ERISA) claims which are usually covered under fiduciary liability insurance policies. This litigation may be filed at or close to the same time the securities action is filed

D & O Coverage

- Covers allegations for corporate wrongdoing, though if there is a final adjudication that there was in fact a deliberate crime or fraud, there is no coverage
- Corporate criminal investigations involve individual director and officer allegations and each are entitled to their own defense (costs average $1.7M per employee)
- Policyholder must obtain the insurers consent before the retention of counsel AND before agreeing to a settlement
- Entity Coverage, corporations are not covered unless specifically stated
- Ultimate net loss wording (expenses erode the limit)
- Separate limits by individual director or officer

D&O Coverage Nuances

- Manuscript Policies (ISO did not offer standardized D&O forms until May 2003)
- Insurer's duty is not to defend the policyholder but reimburse the policyholder for their expenses
- Coverage pays for any claim for a wrongful act (actual or alleged misconduct)
- Many policies require there be a binding adjudication of liability for damages however often the exclusions do not apply for fraud or criminal wrongdoing until the case is decided
- SEC investigations can last 2 years before the formal legal discovery process incepts
- Priority of Payments provision (commonly seen when former directors and officers are involved and want to preserve limits for future defense costs for other litigation)

Definition of a Claim - Part 1

- An investigation that cannot result in binding relief against the insured is not a “claim,” but a lawsuit against the insured is a “claim.”
- Claim has been more defined in recent years to include corporate criminal investigations
- A criminal investigation includes a demand for monetary damages, service of a complaint, proceeding followed by an indictment, formal investigative order. (SEC’s request for information is not a claim until a formal order is issued requesting formal production and noticing of depositions)
- Department of Justice (DOJ) subpoena’s are claims as they are considered sufficiently serious to constitute a claim

Definition of a Claim - Part 2

- Definition of a claim varies by facts and jurisdiction (investigations, subpoena's, pre-indictment expenses, grand jury proceedings are not necessarily claims). The distinction here is that the request for information and/or investigation must involve the policyholder and not simply a request by a third party for information
- The 2008 Excess Policy and 2008 Endorsement broaden the definition of a claim including SEC, DOJ, state attorney general, and other investigations with the current crisis may well qualify as "claims."
- Common allegations triggering coverage are shareholder class actions alleging violations of federal securities laws

NAVIGANT CONSULTING

An Investigation is Not a Claim

- An administrative proposal to enter into a consent decree
- A letter from the EEOC notifying the insured that a charge has been made against it and they are under review
- A letter from the US Attorney's office advising that the bank's individual officers were targets of a grand jury investigation
- Letter from a Federal Agency detailing a bank's deficiencies and requesting immediate corrective action
- A cease and desist order issued by a state agency barring the bank from making questionable loans
- A letter of agreement between a Federal agency and a bank to adopt policies and procedures to prevent future violations of law and regulations
- An RTC notice of intent to hold directors liable

Defense Obligations

- What begins as a subpoena for information from a governmental agency can turn into civil litigation and criminal indictment. Thus, the policyholders have an interest in aggressively defending the case from the outset
- Individual directors and officers may have conflicts of interest among themselves as well as the corporate entity. Different insureds may be accused of different misconduct. These conflicts require the separate retention of counsel for each individual.
- Governmental agencies oftentimes subpoena voluminous information taking months to produce
- Some policies contain a "consent" provision which states the insurer is only responsible for payment of those expenses to which it has consented. However, most times the form is not stated and it can be construed as written or implied.

Carrier Coverage Defenses - Part 1

- Late notice
- Prior notice
- Prior Litigation
- Consent to defense counsel and defense costs
- Duty to cooperate
- Consent to settlement
- Reasonableness of Settlement

Carrier Coverage Defenses – Part 2

- Deliberate crime of fraud (applies separately to each individual). Corporation can lose entity coverage if an officer commits the wrongdoing
- Exclusion for wrongdoing, fraud or crime does not apply if there is a voluntary settlement
- Wrongful profit
- Rescission for misrepresentation of financial statements is asserted but rarely if ever successful
- A Bank's payment of restitution to settle (so as to avoid criminal charges against D&O's is not a loss)

Other Potential Policies affording Coverage

- Fiduciary Liability Policies Respond to ERISA claims
- Prior notice exclusions exist: Coverage is often times disclaimed if it relates to securities litigation that was notified to D&O insurers during an earlier policy period
- E&O policies may afford coverage for governmental investigations
- CGL and Excess policies generally are unlikely to afford coverage as they require a "suit" and "damages"