

Directors and Officers Liability Insurance

We wanted to share with you a [short D&O policy document](#) that you may find valuable. Written by John Kerns, a 25 year veteran D&O broker, Mr. Kerns has found countless community and regional bank situations in which the existing coverages were found to be inadequate. In many cases, the coverage was brokered by a local insurance agent or friend of the board, who were not complete D&O specialists.

D & O Insurance: An interview with a D & O Liability Expert (Part 1)

We discussed Director and Officer Liability issues with Mark D. Belongia, managing partner for Belongia, Shapiro, and Franklin, a Chicago-based law firm. Recently, Mark has been involved in defending officers and directors of failed institutions in various types of claims. Any officer or director from a financial institution should be aware of issues surrounding the D & O policies.

Why should bank directors and officers be concerned about their D&O coverages?

Bank directors and officers have a fiduciary responsibility to customers, shareholders, and the general public in all dealings. There are also regulatory issues. The purpose of directors' and officers' insurance is to protect the personal assets of the directors, officers, and employees of a financial institution from losses arising from "wrongful acts." Each insurer has a unique definition for "wrongful act." The term generally means any actual or alleged act or omission, error, misstatement, misleading statement, neglect, or breach of duty by an "insured person" in the discharge of his/her duties with the financial institution. "Insured persons" are (generally) any past, present or future director, officer or employee, or honorary director or trustee of the financial institution. "Losses" include any amount that the insured persons are legally obligated to pay, including judgments, settlements, defense costs, pre- and post-judgment interest, and punitive damages (where insurable by law). As you can see, the definitions in any given policy are very important. There are no standard D&O insurance policies and coverage provided varies widely by insurer. Each policy and proposal of coverage must be reviewed and analyzed carefully to determine the best offering based upon the needs of that specific financial institution and its directors and officers.

What are typical coverage amounts?

As D&O policies are "claims-made contracts" the total amount of protection offered for the total of all claims during the covered time frame (also known as an aggregate limit) must be reviewed. Coverage applies to any claim brought during the policy period. Multiple claims can, in effect, use up the limit of coverage. Many factors must be considered when deciding what policy limits are appropriate like: price, terms of the policy, peer data, regulatory requirements, and capital levels.

Some D&O policies break up the coverage into three sections, A, B, and C. Some just use A and B. Side A is coverage for individual directors and officers. Side B pays for incidents where individual directors and officers are sued when indemnification of the individuals is allowed. Side C is coverage for the bank. Some policies use the term "entity" to describe who is insured by this section. Side A only comes into play when indemnification is not allowed. Side B claims are the most common in incidents involving individual directors and officers.

Following a bank failure, targeted officers and directors frequently discover that, prior to the failure, the failed institution had elected to be "penny wise" by purchasing a minimum amount of D&O Insurance coverage with the result that expected coverage—particularly coverage that might be used as a source to pay legal fees—is not available. While the cost for additional coverage must be considered, seeking additional coverage is possible and can result in coverage for claims filed by the FDIC. It is also critical to

note that most D&O Insurance policies impose strict, and oftentimes enforceable, notice provisions in order to obtain coverage that has already been purchased. A policy review by competent insurance coverage counsel and coordination with all involved to ensure complying with notice requirements cannot be overemphasized.

Failure to have to have the right D&O coverage can leave directors and officers with not enough coverage or no coverage at all.

Sometimes policies exclude coverage for regulatory actions and, if there is coverage, what happens if a bank fails?

The regulatory claim virtually always comes in the form of a proposed civil money penalty. This is where most bank board members need to carefully review their D&O policy. The board also needs to become familiar with Part 359 of the FDIC Act. Most D&O policies will exclude payment for civil money penalties. Some will allow payment for the attorney's fees associated with deciding whether a penalty ought to be assessed, but exclude the money penalty itself.

Some banks believe they are fortunate because they have a rider on their policy that actually covers the civil money penalty itself. However, that is where the provisions of FDIC Part 359 come in. And they come in whether you are a state-member bank governed primarily by the Federal Reserve as your federal regulator; a state nonmember bank regulated by FDIC; or a national bank regulated by the OCC. Part 359, in its simplest terms, provides that the directors cannot be indemnified by the bank for the payment of any civil money penalty. In other words, if the regulators assess a \$150,000 civil money penalty for violation of a legal lending limit or some other issue, it has to come out of the director's own pocket and he/she cannot be reimbursed by the bank - there can be no reimbursement for a penalty, even if there is a civil money penalty rider on the insurance policy, if the premium on the insurance policy was paid by the bank.

Also, after a bank fails most D&O policies do not cover claims if they have a "Gerrish Endorsement". This endorsement either prevents coverage for any claim after the bank closes, or disguises it in a rider and prevents coverage for any claim "by an insured against an insured" at any time after the bank closes. Since the FDIC, as receiver of the bank, steps into the shoes of the bank (the "insured"), the argument is that the FDIC as receiver, or even in its corporate capacity as an assignee of the claim, is making a claim against another insured, and, therefore, no coverage exists. So once again, the specific terms of the policy must be reviewed so that this issue can be addressed in advance of this event occurring. Failure to address this issue can cause individual directors and officers to be left exposed to huge legal bills in the future.

Banks and CRE: The Road Ahead

Join us in early June for a cocktail reception and a presentation on the current state of the banking and CRE markets. We will be presenting in the following cities on the following dates:

Tuesday, June 1 at 4:00 PM - Bloomington, MN
Wednesday, June 9 at 12:00 PM - St. Louis, MO
Thursday, June 10, 2010 at 4:00 PM - Indianapolis, IN
Tuesday, June 15, 2010 at 4:00 PM - Milwaukee, WI
TBD - Chicago, IL

We will be sending out invitations, but feel free to RSVP in the meantime.

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