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D&O Insurance Coverage Tips For Financial Institutions

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Directors and officers insurance liability coverage terms continue to evolve in ways that can be important to directors and officers if and when lawsuits or investigations against them arise. These terms can be particularly important for directors and officers in the heavily regulated financial services industry.

Fortunately, in the midst of decreasing premiums and a very competitive insurance market, new and broader coverage features have appeared as carriers try to distinguish themselves. Corporations and financial institutions need to understand both the coverage options and the negotiable terms, particularly in this buyer's market. After all, no one wants to try and explain to senior management or a board of directors facing a claim why their D&O insurance policy does not cover the claim when available standard-in-the-industry policies typically would.

Regulatory Enforcement Action Coverage Terms

One of the major questions that has arisen regarding D&O insurance is the extent of coverage for regulatory enforcement actions. When entities like the U.S. Securities and Exchange Commission, Consumer Financial Protection Bureau, attorneys general, and/or federal and state banking agencies open inquiries, what kind of inquiry triggers coverage under a D&O insurance policy? Because responding to such inquiries can be disruptive and expensive for a company, this question can have significant implications.

One recurring issue related to regulatory enforcement actions is whether D&O policies cover costs incurred in responding to informal inquiries. For example, while some policies might cover an informal document request and employee interview by a government agency, other policies might not. Also, while many policies now offer some coverage of a formal

government agency subpoena to a company, the specific scenarios in which such a subpoena is covered can vary between policies, and there are often add-on coverage terms that a company can request upon renewal that will cover more scenarios in which such a subpoena might arise.

A related issue that has come up in recent case law is whether an ongoing government investigation is a "claim" that will trigger preclusion of D&O insurance coverage under an excess policy's "pending and prior claim" exclusion.[1] In a case out of the Southern District of New York, the policy language provided that the excess policy did not apply to "any amounts incurred by the Insureds on account of any claim or other matter based upon, arising out of or attributable to any demand, suit, or other proceeding pending or order, decree, judgment or adjudication entered against any Insured on or prior to July 31, 2011."[2] The court ruled that the parties had agreed to exclude from the excess policy coverage any claim as defined in the language of the primary policy.

Unfortunately for the insured company, the court also ruled that an ongoing SEC investigation, even though it was not being covered by any insurance policy, was a claim as defined under the primary policy, and thus was subject to the pending and prior claim exclusion of the excess policy.[3] This case emphasizes the importance of clarifying definitions of a claim within the relevant policies. It also highlights the importance of understanding and potentially negotiating the use of prior and pending litigation exclusions in excess policies, which are becoming a more common practice.

Professional Services Coverage Terms

D&O insurance policies commonly have exclusions for loss arising out of the performance of professional services. The exclusions are typically in place to keep claims covered by a company's errors and omissions insurance out of D&O coverage, but they can create issues when a director or officer, who also provides services, is sued in their capacity as a director or officer for consequences of their services. Recent court decisions raise some important considerations for these kinds of exclusions.

Earlier this year, the Eleventh Circuit held that a bank's D&O insurance policy's professional services exclusion precluded coverage for all insureds, not just those delivering the services.[4] The exclusion in the case provided that the insurer would not be liable for claims "made against any Insured alleging, arising out of, based upon, or attributable to the Organization's or any Insured's performance of or failure to perform professional services for others …."[5] The court held that the phrase "any Insured" made the insurer's obligations jointly held, which prohibited recovery from any insured.[6] However, the policy at issue in this case did not have a severability provision.[7] The court's opinion suggests that a professional services exclusion in a policy with a severability provision would preclude coverage only for those who actually performed the professional services, so this is something that companies should confirm is in their policies upon renewal. Another consideration is the broad language that was used in the clause in this case — it uses words like "arising out of," "based upon" or "attributable to" the professional services provided. These words could potentially threaten any and all coverage under the policy, depending on the nature of the business. Companies should consider narrowing the exclusion in the professional services context to ensure that the clause serves its purpose and does not preclude too much coverage.

Another issue involving professional services exclusions, particularly for banks, is overdraft fee cases. A recent case from the Seventh Circuit considered the question of insurance coverage for a bank's obligation to repay overdraft fees.[8] In this case, a bank customer

filed suit against the bank, seeking relief from "unfair and unconscionable assessment and collection of excessive overdraft fees."[9] The bank filed suit against its insurer for refusing to pay defense costs in the lawsuit.[10]

The policy at issue had a duty-to-defend clause under which the insurer agreed to pay for claims "for a Wrongful Act committed by an Insured or any person for whose acts the Insured is legally liable while performing Professional Services, including failure to perform Professional Services."[11] In an arguably contradictory clause, however, the policy also had an exclusion "for Loss on account of any Claim ... arising from ... any fees or charges."[12] The court affirmed the denial of the companies' entitlement to payment for defense costs, ruling that the fees exclusion absolved the carrier of an obligation to pay such costs.[13] Cases like these reinforce the importance of making sure the language in D&O insurance policies provides defense costs coverage for these kinds of overdraft fee cases.

Many carriers will, upon request, significantly narrow or even remove some exclusions, like the professional services exclusion. Therefore, it is important to be aware of the potential consequences of the language surrounding the exclusion, and be prepared to negotiate with the insurer as needed.

Cyber Liability and Privacy Coverage Terms

D&O insurance policies often have clauses that exclude claims based on invasion of privacy. Recent case developments suggest that, based on these kinds of clauses, coverage may not be available in claims against directors and officers in cyberbreaches.

The Ninth Circuit recently affirmed a holding that the Los Angeles Lakers were not entitled to D&O insurance coverage for allegations that the team violated the Telephone Consumer Protection Act.[14] The court held that "because a [TCPA] claim is inherently an invasion of privacy claim, [the insurer] correctly concluded that the underlying [TCPA] claims fell under the Policy's broad exclusionary clause."[15]

This decision could affect coverage of cyber liability claims involving cybersecurity and data privacy, which are becoming increasingly common and which often touch on invasion of privacy issues. Companies may want to consider negotiating with insurers to obtain an exception in their existing exclusionary clauses, an add-on to the traditional policy, or a separate, cyber-specific product that would cover those privacy claims.

Final Adjudication Coverage Terms

Many D&O insurance policies have fraud exclusions, which often provide that the exclusion is only triggered after a "final" judicial determination that the excluded conduct has occurred. However, the issue of what a "final" determination is can affect the extent to which the insurer is willing to continue to offer coverage for a claim.

Companies should look for fraud exclusions in their D&O insurance policies that refer to a "final, nonappealable adjudication," not simply a "final judgment."[16] In a New York state case, after a former CEO was sentenced for the commission of various fraud crimes, he filed an appeal of his convictions.[17] While the appeal was still pending, however, his D&O insurer asked to be relieved of its obligation to defend the plaintiff because the fraud exclusion in its policy was triggered upon a "final judgment against its insured."[18]

The former CEO filed suit against his insurer, but the New York Supreme Court, Appellate Division, First Department affirmed the trial court's ruling that the insurer was no longer obligated to pay his defense.[19] The court held that the imposition of the criminal sentence was a "final judgment," which appropriately triggered the fraud exclusion in the policy.[20] The court explained that even if an appeal is successful, "the finality of [the sentence] is not changed."[21] Needless to say, without insurance paying for the defense, a director/officer is dramatically constrained in the ability to mount an effective defense on appeal.

This case shows how important it is that a D&O insurance policy's fraud exclusion uses the language "final, nonappealable adjudication" instead of language like "final judgment," or even "final adjudication." Insured entities should seek fraud exclusion language that ensures they are defended until all appeals have been exhausted.

As D&O insurance liability coverage terms change and adapt to industry trends, they become an increasingly important consideration when directors and officers find themselves facing lawsuits or investigations. While complex, many of the terms and features of coverage can be negotiated with D&O insurance providers. Companies should consider reaching out to insurance brokers and attorneys who specialize in D&O insurance in the financial services industry to assist them in this process.

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[1] Patriarch Partners LLC v. Axis Ins. Co., No. 16-CV-2277 (VEC), 2017 WL 4233078 (S.D.N.Y. Sept. 22, 2017).

[2] Id. at *2.

[3] Id. at *4, 7.

[4] Stettin v. National Union Fire Ins. Co. of Pittsburgh, PA, 861 F.3d 1335 (11th Cir. 2017).

[5] Id. at 1337.

[6] Id.

[7] Id. at 1338.

[8] BancorpSouth v. Fed. Ins. Co., 873 F.3d 582 (7th Cir. 2017).

[9] Id. at 585.

[10] Id.

[11] Id. at 584.

[12] Id. at 584-85.

[13] Id. at 589.

[14] Los Angeles Lakers Inc. v. Fed. Ins. Co., No. 15-55777, 2017 WL 3613340 (9th Cir. Aug. 23, 2017).

[15] Id. at 806-07.

[16] Dupree v. Scottsdale Ins. Co.,129 A.D.3d 586 (2015).

[17] Id. at 587.

[18] Id.

[19] Id.

[20] Id.

[21] Id.