AKO FINANCIAL SERVICES ALERT

ANDERSON KILL & OLICK, P.C.
Attorneys and Counsellors at Law

Spring 2002 Issue

Securities Professional Liability Policy Coverage

By R. Mark Keenan and Mark Garbowski

Professional liability policies designed for securities professionals (sometimes known as "errors and omissions" or "E&O" policies) typically provide coverage for Wrongful Acts, which are commonly defined as "any negligent act, error or omission," in providing specified types of securities-related services.

A claim against the professional or the professional's firm will therefore have to fall within one of the specified types of services to trigger coverage. Some policies specify the activities by stating that the Wrongful Act must be performed in connection with certain roles, such as a Security Broker/Dealer, an Investment Advisor, and an Administrator. Other policies directly list the covered activities.

Coverage can be structured with separate policies for separate activities, such as Broker/Dealer and Investment Advisor activities, or with single policies that cover all, or at least several, securities-related activities.

Defense Coverage

Securities E&O policies typically place the obligation of defending the claim on the policyholder, who has to obtain the consent of the insurance company before incurring any defense costs, admitting liability or settling any claim. The insurance company is required to reimburse defense costs, but only within the limits of liability. In addition, Defense Costs are commonly defined to be incurred by the Insurance Company or by the Policyholder with the written consent of the [Insurance] Company. Accordingly, it is important to check your policy for such requirements and to obtain the necessary written approvals before incurring significant defense costs. Such consent should not be unreasonably withheld, even if the policy does not so state.

Trigger of Coverage

Securities E&O policies are generally claims-made policies. This means that they are triggered when someone makes a claim against the policyholder. Most policies define the making of a claim to be the service of a complaint or demand for arbitration, as well as any written demand for compensation based upon a Wrongful Act. Other policies expand the definition to include even oral demands. Policyholders cannot rely on this definition, however, to determine when it is necessary to provide notice to their insurance companies, as many policies contain provisions that require that the policyholder give notice not only of claims, but of circumstances and events that are likely to give rise to claims in the future.

ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, NY 10020-1182
(212) 278-1000
Fax: (212) 278-1733

ANDERSON KILL & OLICK, P.C.
1600 Market Street
Philadelphia, PA 19103
(215) 568-4202
Fax: (215) 568-4573

ANDERSON KILL & OLICK, P.C.
One Gateway Center
Suite 901
Newark, NJ 07102
(973) 642-5858
Fax: (973) 621-6361

ANDERSON KILL & OLICK, L.L.P.
1275 K Street, N.W.
Suite 1101
Washington, DC 20005
(202) 218-0040
Fax: (202) 218-0055

ANDERSON KILL & OLICK
190 South Lasalle Street
Suite 800
Chicago, IL 60603
(312) 857-2500
Fax: (312) 857-0122

www.andersonkill.com

R. Mark Keenan

who's who

R. Mark Keenan is a shareholder in the New York office of Anderson Kill & Olick, P.C., and Co-Chair of the Financial Services Insurance Coverage Group. Mr. Keenan is a leading lawyer in the fields of insurance coverage, securities law and litigation.

Mark Garbowski

Mark Garbowski is a member of the AKO Financial Services Insurance Coverage Group. Mr. Garbowski is a litigator who specializes in representing policyholders in insurance coverage disputes involving general liability, fidelity, professional liability, D&O, employment liability, political risk policies, and other forms of insurance.

Anderson Kill & Olick, P.C. created the Financial Services Insurance Coverage Group to serve its various clients in the financial industry and to focus its coverage expertise on the insurance issues common to broker/dealers, commercial banks, investment banks, investment advisors, hedge funds and financial institutions including mutual funds.

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Potentially Applicable Exclusions

The seeming breadth of the coverage grant is contrasted with the myriad exclusions that are tacked onto the policy, which have the potential to take away much of what appears to be given by the coverage grant. It is not uncommon for a securities E&O policy to have more than 20 standard exclusions, plus others added by endorsement.

Insurance policy exclusions should be construed narrowly in favor of coverage. *Jefferson Ins. Co. of N.Y. v. Travelers Indemnity Co.*, 92 N.Y.2d 363, 371, 681 N.Y.S.2d 208, 212 (1998); *Continental Cas. Co. v. Rapid-American Corp.*, 80 N.Y.2d 640, 652, 593 N.Y.S.2d 966, 972 (1993). Moreover, as the Second Circuit noted, the doctrine of *contra proferentum*—pursuant to which policy language is construed against the insurance company drafter and in favor of coverage—is afforded a "heightened application," where ambiguities exist in an exclusionary provision. *Sea Ins. Co. Ltd. v. Westchester Fire Ins. Co.*, 51 F.3d 22, 25 n.4 (2d Cir. 1995) (citing *Breed v. Ins. Co. of N. Am.*, 46 N.Y.2d 351, 353, 413 N.Y.S.2d 352, 357 (1978)).

Most Common Exclusions

Two common exclusions appear in most securities E&O policies and are the most likely to affect coverage for the bulk of claims brought against securities professionals—one exclusion bars coverage for claims for criminal, fraudulent or dishonest acts, the other bars coverage for claims in the nature of unjust enrichment.

Other Troublesome Exclusions

Other exclusions of potential concern include one relating to claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. While not in every policy, it has the potential to eviscerate coverage in any policy of which it is a part. Other exclusions reduce or eliminate coverage for specific types of activities, such as underwriting or private placements.

If your policy contains exclusions that preclude coverage for activities that you or your firm engage in, then you should either shop for a new policy, or attempt to negate the exclusion through an endorsement. ■

The information appearing in this newsletter does not constitute legal advice or opinion. Such advice and opinion are provided by the Firm only upon engagement with respect to specific factual situations. For more information contact one of the attorneys listed.

Eugene R. Anderson	(212) 278-1751	eanderson@andersonkill.com
Robert Chung	(212) 278-1039	rchung@andersonkill.com
Mark Garbowski	(212) 278-1169	mgarbowski@andersonkill.com
Robert M. Horkovich	(212) 278-1322	rhorkovich@andersonkill.com
Nicholas M. Insua	(215) 568-4711	ninsua@andersonkill.com
R. Mark Keenan *Co-Chair*	(212) 278-1888	mkeenan@andersonkill.com
Pablo Quiñones	(212) 278-1034	pquinones@andersonkill.com
David M. Schlecker *Co-Chair*	(212) 278-1730	dschlecker@andersonkill.com
Mark Silverschotz	(212) 278-1870	msilverschotz@andersonkill.com
Edward J. Stein	(212) 278-1745	estein@andersonkill.com