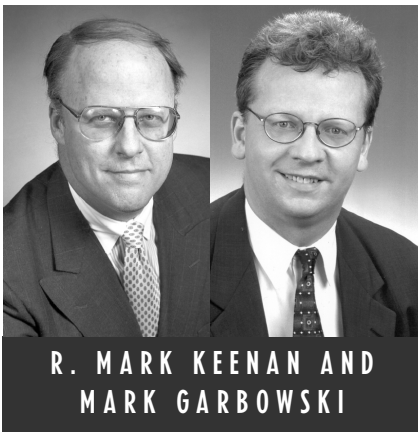


## Liability Insurance for the Securities Professional



Liability policies designed for securities professionals typically provide coverage for "any negligent act, error or omission," but limit that coverage to specific types of services to trigger coverage. Some policies specify by listing certain roles, such as a Security Broker/Dealer, an Investment Advisor, or an Administrator. Other policies directly list the covered activities, such as securities trading, investment management services, the giving of financial advice, and the purchase and/or sale of securities. Other policies often fail to define such key terms.

In such instances, the policy terms should be read as broadly as reasonably possible, because the insurance company, not the policyholder drafted the terms and had the only opportunity to define the key

terms. Usually, it would be reasonable to refer to definitions included in federal securities laws, especially if the effect of applying such definitions would be to create coverage.

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

Professional liability 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. 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

Professional liability policies are gener-

ally 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.

### The "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 to have more than 20 exclusions.

However, 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)).

#### A. 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.

First, one exclusion bars coverage for claims for criminal, fraudulent or dishonest acts:

based upon or arising out of any deliberate, dishonest, fraudulent or criminal act or omission by such **Insured(s)**, provided, however, that such **Insured(s)** shall be protected under the terms of this Policy with respect to any [such] **Claim(s)** made against them . . . unless judgment or other final adjudication thereof adverse to such **Insured(s)** shall establish that such **Insured(s)** were guilty of any deliberate, dishonest, fraudulent, or criminal act or omission;

However, claims of criminal or fraudulent acts which are not proved but are resolved through settlement (without a finding of "guilt") would require the insurance company to indemnify. Atlantic Permanent Federal Savings & Loan Assoc. v. American Casualty Co. of Reading, Pa., 670 F. Supp. 168, 171-72 (E.D. Va. 1986) (holding that where underlying claim was settled, insurance company was not permitted to rely upon fraud and dishonest exclusion requiring judgment or final adjudication).

Second, another exclusion bars coverage for claims in the nature of unjust enrichment:

based upon or arising out of the **Insured** gaining in fact any personal profit or advantage to which the **Insured** was not legally entitled, including but not limited to any actual or alleged commingling of funds or accounts;

Although this exclusion is not structured in the same fashion as the "dishonest acts" exclusion, a properly fashioned settlement agreement that does not admit unjust enrichment could sidestep this exclusion.

#### B. Other Troublesome Exclusions

Other exclusions of potential concern include exclusions relating to claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5; the exclusion precluding coverage for "any underwriting, syndicating, or investment

banking work," including "primary or secondary offerings of securities (regardless of whether the offering is a public offering or a private placement)" and an exclusion for claims involving the formation, syndication, operation or administration of any limited partnerships, including acting as a General Partner of any limited partnership and/or partnership Manager of any general partnership."

These "exclusions" like all "exclusions" in professional liability must be reviewed in the context of relevant case law limiting their scope in order to fulfill the reasonable expectations of the insurance-buying public.

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