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Liberating Coverage for Libor-Related Lawsuits and Investigations

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On June 27, Barclays Plc agreed to pay $448 million in fines to U.K. regulators over allegations that it improperly manipulated Libor and Euribor, the London interbank offered interest rate and Euro interbank interest rate applicable to loans made between banks and large corporations. Recent reports indicate that Barclays and other Libor banks are the subject of government civil and criminal investigations in the U.S.

The costs stemming from U.K. and U.S. investigations are staggering with individual banks facing up to an estimated $1.06 billion each in legal expenses. But this is just the tip of the iceberg.

On top of government investigations and potential fines, the banks have been named by institutional investors in numerous class action suits for violations of antitrust and securities laws. In addition, Citigroup and Bank of America each face shareholder derivative actions, actions that will likely increase in number as government probes expose further wrongdoing. One analyst has estimated that the costs related to only pending class actions could be in the region of $6 billion, in addition to the costs of resolving any regulatory investigations.

The Libor Exposures

Due to the allegations of Libor rate manipulation, financial institutions have become the subject of a number of proceedings.

1. Civil and criminal investigations are being conducted by regulators in various countries, including the U.S., U.K., Japan, Switzerland and Canada
2. Class action suits are being brought by institutional investors who purchased Libor-linked derivatives asserting violations of antitrust, racketeering and securities laws based on the allegation that the manipulation of the Libor rate reduced returns on investments
3. Shareholder derivative actions have been instituted against former and current directors and officers of Bank of America and Citigroup alleging breaches of fiduciary duty
4. Banks have fired or suspended employees suspected of involvement in manipulating rates, which has led to at least one wrongful termination action by a trader at the Royal Bank of Scotland, who was fired after RBS conducted an internal probe of Libor-related wrongdoing. In the wrongful termination action, filed in the Singapore High Court,

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the trader claimed it was common practice for RBS traders to request a higher or lower rate from RBS' Libor rate-setters, and that senior management knew of this conduct.

As the various governmental investigations come to their conclusion, it is likely that similar Libor-related claims against banks and other financial institutions will continue to grow.

Potential Sources of Insurance Coverage

As reports of Libor-related lawsuits and regulatory investigations continue to amass, financial institutions should know what kinds of insurance may be implicated by the claims.

D&O policies typically cover directors and officers of corporations against litigation arising out of their status or conduct as directors or officers. Some D&O policies also provide coverage for the corporate entity itself with respect to claims alleging violations of securities law. D&O policies therefore will likely provide financial institutions and their individual directors and officers with coverage for any Libor securities-related claims and shareholder derivative suits.

E&O policies cover companies and individuals against loss resulting from acts, errors or omissions in their performance of professional duties. These policies may provide coverage for claims brought by customers of financial institutions who allege they were damaged by an institution's failure to deliver adequate professional services in connection with Libor.

Employment practices liability insurance policies insure companies and individuals against costs arising out of employment practice disputes, such as wrongful termination and wrongful discipline. These policies may provide coverage for the defense of whistleblower claims and claims brought by fired employees alleging wrongful termination in connection with Libor-related issues.

Fiduciary liability policies cover fiduciaries against costs arising from the administration and management of employee benefit and pension plans, including claims of negligent advice, careless plan management and errors and omissions. These policies may cover claims related to losses incurred by 401(k) funds and pension funds that were connected to Libor rates.

Finally, general liability policies normally cover "sums that the insured becomes legally obligated to pay as damages because of 'personal and advertising injury'. . ." (Commercial General Liability Insurance Form, § I, Coverage B, ¶ 1.a [ISO Properties, Inc. 2006]). These policies may provide coverage for antitrust claims and claims of unfair competition arising out of the Libor allegations.

Policyholders Should Not Accept Insurance Companies' Attempts To Limit or Deny Coverage for Libor-Related Claims

In the face of what may be very large potential exposure to Libor-related claims, insurance companies are likely to take coverage positions that attempt to limit or eliminate coverage for Libor-related

claims. Good arguments exist against many of those coverage defenses.

Coverage for Antitrust Claims: While insurance companies may assert that there is no coverage under a D&O policy for antitrust Libor suits, to the extent a complaint also alleges securities law violations, D&O policies should provide coverage for the defense of such actions. In addition, a number of courts have held that an insurance company has a duty to defend against antitrust claims under general liability policies' personal and advertising injury coverage.

Subpoena as "Claim": Insurance companies may also take the position that the costs of responding to government subpoenas or requests for information as part of a Libor-related investigation do not constitute a "claim" sufficient to trigger a D&O policy. A number of courts, however, have found that government investigatory requests or subpoenas may constitute a claim sufficient to trigger coverage. In addition, to the extent a policyholder is incurring costs in conjunction with a government investigation while at the same time defending a civil lawsuit, the costs of investigations may be reasonably related to the defense of those claims and should therefore be covered under a D&O policy.

Restitutionary Damages: To the extent that shareholder derivative claims seek damages for a dilution in share value, or antitrust claims seek restitution or disgorgement, insurance companies may assert that such damages are not insurable because they purportedly constitute "restitution." However, good arguments exist that these kinds of damages are not "restitution" or "disgorgement," and are insurable.

Bad Acts Exclusions: D&O policies typically contain a number of "bad acts" exclusions that purport to exclude coverage for claims where a policyholder has engaged in fraud, gained an illegal profit or has engaged in a criminal act. Depending on the wording of the bad acts exclusion contained in the D&O policy at issue, insurance companies may contend that a deferred or non-prosecution prosecution agreement with the government, or an agreement with a regulator to pay a fine for Libor-related acts, constitute an admission of wrongdoing that would bar coverage for costs arising out of Libor-related suits and investigations. Very good arguments exist, however, that only a formal judgment of a "bad act" by a court can trigger a bad acts exclusion.

Criminal Charges: If an individual director or officer is convicted of criminal charges, or they confess or plead guilty in that proceeding, the insurance company may argue that there should be no coverage for the financial institution itself based on that director or officer's criminal acts. Many policies, however, contain a "severability" clause which limits the extent to which one insured's act is imputed to another for the purposes of coverage and therefore may prohibit imputing the knowledge and misconduct of one insured to other insureds.

Pursue Coverage Early and Aggressively

The costs arising from Libor-related claims and investigations are likely to be substantial. But the purpose of insurance is to mitigate these damages. Financial institutions facing Libor-related claims should resist any attempts by insurance companies to limit or eliminate coverage and pursue their coverage early and aggressively.

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