

ALERT

When the FDIC Comes Calling: Protecting D&O Coverage for a Failed Bank's Directors and Officers

By William G. Passannante and Raymond A. Mascia Jr.*

The Federal Deposit Insurance Corporation has begun the process of pursuing the directors and officers of failed FDIC-insured financial institutions by sending "claim letters" to former officials informing them of the FDIC's intent to sue. As of December 1, 2009, 124 FDIC-insured banks have failed this year—over four times the number in 2008—and the FDIC most likely will allege that some former directors and officers are responsible for the failures, as it has done after roughly a quarter of all seizures since 1985. In addition to FDIC-related claims, ousted directors and officers may in the coming months face shareholder claims, securities and ERISA class action suits, and even criminal investigations and prosecutions.

Each area of potential liability implicates the insurance policies that financial institutions maintain as protection for such claims. In light of the upcoming wave of litigation, Directors and Officers (D&O) coverage, which often is described as "litigation insurance," will be a significant asset to the failed financial institution's officials.

This is not the first time we have witnessed claims and attendant insurance disputes arising from bank failures. The FDIC pursued similar lawsuits against banks and former officials during the savings and loan (S&L) crisis of the late 1980s and 1990s, and many of the same issues presented then are likely to arise now. Undoubtedly, insurance companies will attempt to deny D&O coverage arguing, for example, that the so-called "insured v. insured" and "regulatory" exclusions preclude claims and suits brought by regulatory agencies, such as the FDIC. In our experience, such assertions often have little basis in fact and are recited in an improper attempt to protect the financial self-interest of the insurance company. Policyholders should be prepared to resist such defenses.

The So-Called "Insured v. Insured" Exclusion

The so-called "insured v. insured" exclusion, which is commonly found in D&O insurance policies, purports to preclude D&O coverage for claims by an insured corporation against its directors and officers. The exclusion originated in the early 1980s in response to attempts by several corporations to obtain D&O coverage for losses resulting from the acts of directors and officers. Thus, the exclusion is widely thought to prevent only collusive lawsuits by a corporation against its officials.

Many insurance companies improperly argue that the exclusion precludes coverage when a statutory receiver, such as the FDIC, sues a former director or officer. However, most courts have held that the exclusion does not apply in these situations because the exclusion is designed and intended to prevent collusive lawsuits between "insureds." The FDIC, as a statutory receiver, is a sufficiently adverse party to the failed financial institution, not an "insured," and thus, lawsuits

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.
Two Sound View Drive, Suite 100
Greenwich, CT 06830
(203) 622-7668 Fax: (203) 622-0321

ANDERSON KILL & OLICK, P.C.
One Gateway Center, Suite 1510
Newark, NJ 07102
(973) 642-5858 Fax: (973) 621-6361

ANDERSON KILL & OLICK, P.C.
1600 Market Street, Suite 2500
Philadelphia, PA 19103
(267) 216-2700 Fax: (215) 568-4573

ANDERSON KILL WOOD & BENDER, P.C.
864 East Santa Clara Street
Ventura, CA 93001
(805) 288-1300 Fax: (805) 288-1301

ANDERSON KILL & OLICK, L.L.P.
2100 M Street, N.W., Suite 650
Washington, DC 20037
(202) 416-6500 Fax: (202) 416-6555

www.andersonkill.com



who's who

William G. Passannante is a shareholder and co-chair of Anderson

Kill's Insurance Recovery Group. Mr. Passannante is a leading lawyer for policyholders in the area of insurance coverage. He has appeared in cases throughout the country and has represented policyholders in litigation and trial in major precedent-setting cases.

(212) 278-1328

wpassannante@andersonkill.com

***Raymond A. Mascia Jr.** is a law clerk (admission to the New York State Bar pending) in the firm's New York office.

The article appearing in this alert does not constitute legal advice or opinion. If you require more information, legal advice or an opinion with respect to a specific situation, please contact the authors.

© Copyright 2009 Anderson Kill & Olick, P.C.

To subscribe to this or any of the Anderson Kill & Olick Newsletters and Alerts, visit:
[www.andersonkill.com/
publication_subscribe.asp](http://www.andersonkill.com/publication_subscribe.asp)

To unsubscribe, please email:
unsubscribe@andersonkill.com

brought by the FDIC against directors and officers of a failed financial institution cannot be collusive in nature.

Regulatory Exclusions

The "regulatory" exclusion, although very uncommon in current policies, purports to deny coverage for suits brought by any governmental, quasi-governmental, or self-regulatory agency. These exclusions proliferated in the wake of the S&L crisis. According to a 1995 estimate, fifty to seventy-five percent of D&O policies sold to banks contained regulatory exclusions. In recent years they have become much rarer as the D&O market softened and memory of the prior crisis faded. However, with the number of failed financial institutions rising daily, policyholders should expect a reemergence of the regulatory exclusion and be prepared to defend against it.

If your policy does contain this exclusion, closely examine its wording. In some cases, the FDIC is named explicitly; in others, not. While some courts have upheld the applicability of regulatory exclusions, others have determined the language to be ambiguous and refused to preclude coverage. Moreover, in cases in the wake of the S&L crisis, government regulators themselves successfully defended against the regulatory exclusion using a public policy argument to the effect that regulatory exclusions significantly constrain the ability of federal regulators to sue directors and officers of failed banks.

Protect Your D&O Insurance

The collapse of the U.S. credit market will increase litigation in the coming months and years. The current list of FDIC failed institutions since the start of 2008 now stands at 149 institutions. Moreover, the FDIC's list of troubled banks is well over 500 institutions long. Commentators expect that bank failures will continue to grow. Future claims activity against financial institutions and directors and officers will be copious.

The "insured v. insured" and "regulatory" exclusions are only two examples of the roadblocks to insurance recovery that a failed financial institution and its directors and officers will face in the coming months. Thus, when faced with liabilities arising out of the current financial crisis, continuing efforts to protect the availability of liability insurance are crucial. In-house counsel and risk management personnel can provide valuable counsel in interpreting existing insurance policy exclusions and resolving insurance disputes. Take steps today to protect your D&O Insurance. Those insurance policies can often be one of the most important assets between a failed bank's officials and financial ruin. ▲

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.