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Navigate Carefully to Preserve D&O Coverage

By John Eichman
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Faced with the prospect of post-failure suits by shareholders, the FDIC and other claimants, the directors and officers of troubled banks should ask this question: Are there any steps that we should take now to preserve coverage under our directors and officers liability insurance in the event our institution fails?

Here are some pertinent considerations:

• Insureds might lose D&O coverage if, during the policy period, they fail to submit notice to the carrier of either an actual claim by a third party or of circumstances that might give rise to such a claim. Most D&O policies now define "claim," but the definitions vary and should be carefully considered before notice is submitted.

"Circumstances which could give rise to a claim" is not a defined concept. Assessing whether circumstances exist that can furnish a basis for notice can be challenging in the troubled-bank context.

• Before submitting notice of circumstances that could give rise to a claim, insureds should consider the disclosures made in the bank's last application for the policy. If the insureds submit notice to the carrier and cannot point to a post-application event as giving rise to a possible claim, the carrier might contend the bank made misrepresentations in applying for the policy.

• Deciding whether to give notice of circumstances out of which a claim might arise is particularly important when the bank's D&O policy contains a provision attempting to terminate coverage upon appointment of a receiver. One court recently rejected a carrier's effort to rely on such a provision to deny coverage. Nevertheless, if such a provision is applied it can deprive the insureds of coverage unless proper notice has been given during the policy period or any extended reporting period and before the institution fails. This will require the insureds to assess, before failure of the bank, whether they have knowledge of circumstances that could give rise to a claim.

• Nearly all policies provide that in the event of a nonrenewal or termination of the policy, insureds have the right to buy an extended reporting period, usually of at least 12 months. Under some policies, or by virtue of some states' laws, insureds can buy the extended reporting period no matter who nonrenews. And, depending on the policy terms, a carrier's offer to renew with significantly

reduced coverage might constitute nonrenewal and trigger the right to purchase the extended period.

But the coverage provided during an extended reporting period differs materially among policies. Nearly all D&O policies cover third-party claims actually asserted during the extended period, but only for wrongful acts committed before the end of the policy period. Some extended reporting periods provide that coverage only, and notice must be given during the extended period to preserve coverage. Other policies are more generous, giving coverage when, during the extended reporting period, the insureds become aware of circumstances out of which a claim might arise and give notice to the carrier, even if the claim is not asserted until after the extended period ends.

So what does all this mean for the troubled bank and its directors and officers?

First, the insureds should examine their policy to assess whether notice of claim or notice of circumstances which might give rise to a claim should be submitted. Whether they should submit notice depends on the specific situation and the particular policy terms, including whether the policy purports to terminate when a receiver is appointed. Before submitting notice of circumstances, insureds should always consider what was disclosed in the last policy application.

Second, if the policy period is ending, the insureds should be careful about the accuracy of any renewal application in order to avoid post-failure coverage fights.

Third, when the carrier has refused to renew a policy, the bank should almost always buy the extended reporting period. And when the carrier has offered to "renew" the policy with significant coverage limits, the bank should consider whether it has the right to purchase the extended discovery period.

Finally, if the bank intends to buy the extended reporting period, the insureds should determine whether coverage can be triggered during the extended period by submitting notice of circumstances which might give rise to a claim or just notice of a claim. If the policy has the latter, less generous coverage, the insureds should consider whether to give notice of circumstances before the policy period ends, in case a "claim" is not actually made until after the extended reporting period ends.

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