Why Every Financial Institution Should Have Bankers' Professional Liability Insurance, by Michael A. Rossi and Catherine L. Rivard, Copyright 2001 Insurance Law Group, Inc.

One very thorough treatise on risk management and insurance issues for financial institutions characterizes Bankers' Professional Liability ("BPL") insurance as the "cornerstone" of a financial institution's insurance program.

Ironically, a lot of financial institutions do not even know what BPL coverage is, let alone have the coverage in their program. Even more ironically, several insurance brokers who purport to be skilled at structuring insurance programs for financial institutions do not know what BPL coverage is, or why it is needed in a financial institution's insurance program. And even in those instances where the broker or financial institution knows what BPL coverage is and why it is needed, few know what issues should be considered when adding the coverage to an insurance program (whether when buying stand-alone BPL insurance or adding the coverage to a policy already in the insured's program).

The intent of this article is to present the perspective of policyholder counsel who regularly advise financial institutions and insurance brokers who service financial institutions on some of the issues that should be considered when adding BPL coverage to an insurance program (space limitations do not allow for a discussion of all of such issues).

Why Does Every Financial Institution Need BPL Coverage?

Simply put, the professional services provided by financial institutions can cause a variety of "pure financial loss" injuries which are not well suited to coverage under a financial institution's Commercial General Liability ("CGL") policy or a standard Directors' and Officers' Liability ("D&O") policy. To try to "bring home" the idea of why financial institutions need BPL coverage, the authors will relate some real-life claim experiences.

A financial institution came to one of the authors with a claim by one of its customers alleging that the financial institution mistakenly and unbeknown to the customer allocated one of the customer's deposits to the wrong account. The mistake led to a variety of financial problems for the customer. The customer sought damages for the financial injuries it suffered. The client thought the claim was covered by its Commercial General Liability ("CGL") policy. However, the claim did not involve any damage to or loss of use of tangible property, so the "property damage" coverage of the CGL policy did not apply (it should be noted that the definition of "property damage" in the policy also expressly said that "money" was not "tangible property" for the purposes of the "property damage" definition). The claim also did not allege "bodily injury" as defined by a CGL policy, or "personal injury" or "advertising injury," as those terms are defined by a CGL policy.

The client was asked if it had BPL coverage anywhere in its program. "What's that?", asked the client. After BPL coverage was explained to the client, the client said, "Well, that's what I have D&O insurance for." However, the claim was against only the financial institution, and not one of its directors or officers. And the "entity" coverage in the client's D&O policy only covered the financial institution for claims made against it (as opposed to claims made against directors and officers) for "securities claims" as defined by the policy, and the claim at issue was not a "securities claim." The response was, "So, what's this BPL coverage again?"

Another financial institution came to the authors with a class action where the claimants alleged that the financial institution improperly charged an item of interest on an entire loan portfolio for a certain segment of its business (e.g., auto loans). The claimants sought a return of the improperly charged interest. The client had BPL coverage in its program. The financial institution's BPL carrier is funding the defense of the claim.

Another financial institution came to the authors with a claim by one of its customers alleging that the financial institution wrongfully foreclosed on property that was securing a loan the financial institution had made to the customer. Because of the foreclosure, alleged the customer, it suffered a variety of financial losses. The financial institution's CGL policy had several exclusions endorsed to it that precluded the authors from making otherwise creative arguments for why the claim could be covered by the client's CGL policy. The financial institution did, however, have BPL coverage in its program. It also had been prudent enough to amend the "lender's liability" exclusion in the policy, so that the policy provided coverage for "back end" lender's liability. The financial institution's BPL carrier is funding the defense of the claim.

The foregoing examples highlight the need for BPL coverage. They also demonstrate that it is not enough simply to know that BPL coverage is needed in any financial institution's insurance program. Indeed, there are a variety of issues to consider. And, unfortunately, there are only a few knowledgeable insurance brokers that have a true command of these issues. Thus, even those financial institutions that buy BPL coverage often do so with very little understanding of the several different issues that should be considered when adding such coverage to an insurance program. The results can vary from the benign to the disastrous.

The remainder of this article is intended to provide a quick overview of some of the fundamental issues to consider whenever adding BPL coverage to an insurance program. It is hoped that underwriters and brokers alike can use this article as an information tool for financial institutions large and small when explaining BPL coverage, what it is, why it is needed, and what issues should be considered whenever one buys it.

How Should BPL Coverage Be Added To An Insurance Program?

There are several different ways to add BPL coverage to an insurance program. The most common approaches witnessed by the authors are: (a) buying a stand-alone BPL policy, and (b) adding BPL coverage to a D&O policy, and extending the coverage to all "entity" insureds and all employees of such "entity" insureds, in addition to the directors and officers that typically are covered by D&O insurance. Each alternative carries with it certain "pros" and "cons." The authors do not purport to recommend one option over the other, but rather offer the following observations as a guide to just some of the issues that should be considered when considering and/or pursuing either option.

Adding BPL Coverage To A D&O Insurance Policy

One common way to add BPL coverage to an insurance program is to add the coverage to the D&O insurance carried by the financial institution. Such an addition typically extends coverage to "entity" insureds and all employees of such "entity" insureds, in addition to the directors and officers. The authors are wary of this approach if done without proper safeguards to eliminate the risk of exhaustion of the limits of the D&O program by an "entity" BPL claim, which could leave the directors and officers of the financial institution with no protection for "true" D&O claims against them (that's a risk that must be avoided).

The D&O program is intended first and foremost to protect the personal assets of the directors and officers of the financial institution. It is very popular nowadays to add a variety of extensions to such policies, a trend that began back in 1995 when "entity" coverage for securities claims started to be added to D&O policies. The "pros" perceived by many include cost savings for premium and administration because the insured has to buy and administer only one insurance program rather than several.

However, what only a few brokers appear to grasp is the real risk of exposing the personal assets of directors and officers to uninsured losses by adding a variety of "entity" and "employee" coverages to a D&O program. If a very nasty "entity" BPL claim comes in, it could wipe out the limits of the program, leaving nothing left to protect the directors and officers against a true D&O claim made just before, at the same time, or shortly after the nasty "entity" BPL claim is made.

At a minimum, when adding BPL coverage to a D&O program, it is strongly recommended that the insured structure the coverage to avoid such a result. There are several ways to do that. For example, the insurer could sell the coverage with separate aggregate limits (e.g., $3 million aggregate for BPL claims, and a separate $3 million aggregate for all other claims).

Alternatively, the insurer could sell the coverage with what many call "additional side-A coverage" limits. The separate side-A coverage limits can be used to pay only those claims that are made against directors and officers (as defined by the policy) that are not indemnifiable by the "entity" insureds.

Another alternative is to have the BPL and D&O coverage share limits, but to place a sub-limit on the BPL coverage (e.g., buying a policy with a $5 million aggregate limit, and a sub-limit of $3 million for BPL claims). This means that a full-limits D&O loss would eliminate BPL coverage under the program, but a BPL claim, no matter how bad, could never fully exhaust the limits available under the program for D&O claims.

In addition to addressing the fundamental issues discussed above, one must also review the coverage wording to make sure that the coverage being provided is as broad as one would get when buying a stand-alone BPL policy. Accordingly, the BPL-coverage issues discussed below must also be addressed with any BPL coverage endorsement added to a D&O policy. Where deficiencies are identified, they should be addressed.

Buying A Stand-Alone BPL Insurance Policy

There are many issues to consider whenever buying a stand-alone BPL insurance policy. The following lists what appear to be some of the more fundamental issues (space limitations preclude discussing more of such issues).

"All risk" vs. "specified perils" coverage

When buying a BPL policy, a financial institution should decide whether it wants a "specified perils" policy or an "all risk" policy. While these terms are more commonly used when discussing Commercial Property insurance, they also are used when discussing BPL insurance. Many years ago, BPL forms used to be written on an "all risk" basis. That is, all services provided by a financial institution were covered, unless otherwise expressly excluded by the policy. However, the early BPL insurance market experienced big losses on such forms. So, several years ago, BPL carriers switched to a "specified perils" policy form. Under such forms, only the particular professional services listed as covered services were insured. The coverage was narrow. In the past three or four years, however, several BPL carriers began selling "all risk" policies again.

Set forth below is the insuring agreement from a typical "specified perils" policy form. It will give readers an idea of the types of risks covered by such BPL policies.

> The Insurer will reimburse the Insured for all sums which the Insured shall have paid as Damages (as herein defined) resulting from any Claim or Claims . . . for any Wrongful Act of the Insured or of any other person for whose actions the Insured is legally responsible in rendering or failing to render Professional Services as defined . . . .

> [T]he term "Professional Services" shall mean services rendered or required to be rendered, for compensation, by the Company for any customer or client of the Company in the following designated areas or capacities:
>
> (1) The administration of trusts, estates or guardianships, including the rendering of investment advice and valuation services in connection therewith;
> (2) The administration of Individual Retirement Accounts or Keogh Retirement accounts;
> (3) Acting as a fiduciary as defined by the Employees' Retirement Income Security Act (ERISA) of 1974;
> (4) Acting as a receiver, trustee in bankruptcy or assignee for the benefit of creditors;
> (5) The administration of a program for the lending of securities administered for trust and custodial customers where there is a specific written instrument authorizing the Insured to so act on behalf of such customer;
> (6) Acting as a trustee under bond indenture;
> (7) Acting as a dividend disbursing agent, exchange agent, redemption or subscription agent, or warrant or scrip agent;
> (8) Acting as a fiscal or pay agent, or tax withholding agent;
> (9) Acting as a custodian or depository, or a managing agent for securities or money;
> (10) Acting as an escrow agent; or
> (11) Acting as a registrar, transfer agent or clearing agent.

Set forth below is the insuring agreement from a newer "all risk" BPL policy form. Readers should compare the language to the insuring agreement quoted above, to get a sense of the different approach to coverage (i.e., "specified perils" vs. "all risk").

> This policy shall pay the Loss of the Insured arising from a Claim first made against the Insured during the Policy Period . . . for any actual or alleged Wrongful Act of any Insured in the rendering or failure to render Professional Services.
>
> "Professional Services" means those services of the Company permitted by law or regulation rendered by an Insured . . . pursuant to an agreement with the customer or client as long as such service is rendered for or on behalf of a customer or client of the Company: (i) in return for a fee, commission or other compensation ("Compensation"), or (ii) without Compensation as long as such non-

compensated services are rendered in conjunction with services rendered for Compensation.

In addition to the issue of buying "all risk" or "specified perils" BPL coverage, there are a number of additional issues to consider when buying a BPL policy, some of which are discussed below.

Lender's liability coverage

When buying BPL coverage, a financial institution should decide whether it wants "lender's liability" coverage, and if so, whether it wants coverage for both "front end" and "back end" lender's liability.

"Front end" lender's liability involves, among other things, liability for wrongful acts committed in connection with the origination of a loan, the extension of credit, etc. For example, the financial institution or its agent might improperly characterize the interest to be charged, or omit an item of interest to be charged, and could face liability under the Truth In Lending Act ("TILA") or similar federal, state or local statutory or common laws.

"Back end" lender's liability involves, among other things, liability for wrongful acts committed in connection with the restructure of or foreclosure on a loan, extension of credit, etc. For example, in undertaking such activity, the financial institution or its agent might unknowingly violate some statutory or common law, or otherwise inflict injury upon its customer, client or another party, thereby subjecting itself to liability for taking such an action.

In the authors' experience, lender's liability is one of the most commonly overlooked items when adding BPL coverage to a program. Simply put, financial institutions should procure coverage for such liability; any BPL insurance program that does not provide coverage for lender's liability has a huge hole in it.

Exclusion for fraud, dishonesty and conflict of interest

Most, if not all, BPL policy forms have an exclusion for fraud, dishonesty and conflict of interest. The authors cannot over-emphasize the importance of making sure this exclusion, if it has to be in the policy, is written favorably for the insureds.

One unfavorable version of the exclusion provides that the insurer has no duty to defend, or pay defense costs for, a claim that merely ***alleges*** fraud, dishonesty, or a conflict of interest by ***any*** insured. To put it bluntly, this type of an exclusion is terrible and makes the coverage not worth much at all, because the exclusion can be applied to most BPL claims, and gives the insurer an easy way to deny coverage. First, the "alleges" wording is problematic. Many BPL claims allege fraud, dishonesty or conflict of interest by at least one of the insureds under the program. Second, the "any insured" language is problematic. An innocent insured (one who did not commit fraud or dishonesty or have a conflict of interest) might not be entitled to coverage if another insured under the program was alleged to, or found to, have committed fraud, dishonesty or have a conflict of interest.

Accordingly, if the BPL policy has to have an exclusion for fraud, dishonesty or conflict of interest, it must be written favorably for the insureds. The exclusion should expressly provide that (a) the insurer has to defend claims that contain allegations of such activity, and (b) the exclusion applies only to the particular insured(s) who is(are) found by a judgment or other final adjudication in the claim to have committed fraud or dishonesty or to have a conflict of interest.

Insured vs. Insured Exclusion

Another frequently overlooked item in BPL policies is the scope of the so-called "insured vs. insured" exclusion. Most insurers do not want to cover intra-company management disputes that turn ugly and sometimes result in litigation. However, bank officers or employees who have deposit or loan accounts with the financial institution may unwittingly become claimants against the institution when some other customer brings a class action lawsuit and defines the plaintiff class broadly enough to include those bank officers or employees. All the insureds could be left without any insurance coverage because one employee unknowingly and involuntarily becomes a claimant against the financial institution. To minimize this risk, whenever an "insured vs. insured exclusion" is included in a BPL policy, it should exempt those claims in which (a) the insured is a claimant only because he or she is the institution's customer, and (b) the insured is not an active participant in bringing of the lawsuit.

Concluding Remarks

Some may regard this article as a ploy by the authors to create unwarranted angst for the persons within financial institutions who have responsibility for the institution's insurance program—perhaps so that such persons will hire the authors to help them structure the BPL coverage in their insurance programs? That is not the purpose of this article. Rather, the purpose of this article is along the same lines of another article by one of the authors, entitled *Why Every Privately Held Company Needs D&O Insurance.*

In brief, the authors perceive a lack of understanding of BPL coverage among too many insurance professionals and financial institutions. The consequences of that lack of understanding range from the benign to the potentially disastrous. Time and again the authors are brought into claim or insurance program review situations where the financial institution either has no BPL coverage in its program, or the BPL coverage was structured in one or more flawed, or even dangerous, ways. The addition of "entity" BPL coverage to a D&O policy without the safeguards discussed in this article is perhaps the most troubling aspect of this subject, and one which the authors see with alarming regularity.

Thus, the authors have written this article with the purpose, intent and hope that it will be read by insurance professionals who service financial institutions, and persons at financial institutions who have insurance responsibility, whether they are risk managers or other professionals, so that the issues discussed in the article are addressed.

Insurance Law Group, Inc. is a law firm that is dedicated to servicing the legal needs of policyholders in insurance coverage matters. Michael A. Rossi is President of and Catherine L. Rivard is Senior Risk Management Counsel at the firm. Each has spent more than a decade representing policyholders in various aspects of giving insurance coverage advice, from helping to structure insurance programs and policies to pursuing claims against insurance companies. Copies of this and other articles written by the authors can be found at the firm's website, www.inslawgroup.com. Mr. Rossi can be contacted on phone 1-818-649-7654 and Ms. Rivard can be contacted on phone 1-818-649-7659.