

NO TIME FOR GUESSING AT D&O COVERAGE

Directors and officers need to know where they're uncovered—and where there are remedies

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Lately, as I tour the country, as you can certainly appreciate, I have received many questions on directors' and officers' liability insurance. These questions are coming from healthy banks, unhealthy banks, and banks in the queue for failure. Obviously, their perspectives, particularly on immediacy, are different, but their concerns are the same:

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- What's the basic coverage?
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- "Wrongful acts" coverage: the easy one
 - Most directors' and officers' insurance policies cover what are deemed to be "wrongful acts." These are negligent acts by directors and officers. This is your garden-variety negligence claim that the board did something it should not have done, or should not have done something it did, and, nevertheless, is liable to a shareholder or some other party because they acted negligently. This would involve a typical claim by a shareholder of your bank or holding company. The D&O policy does a nice job of covering these claims, so I view that as the least concern of most bank directors and officers.
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 - Civil money penalties: Not so easy
 - The second category of claims occurs while the bank is open, yet is not a claim by a shareholder, but a claim by a regulator. The regulatory claim virtually always comes in the form of a proposed civil money penalty. This is where most banks need to carefully review their policy. The board also needs to become familiar with Part 359 of the FDIC Act. Most D&O policies will exclude payment for civil money penalties. Most will allow payment for the fees associated with deciding whether a penalty ought to be assessed, but exclude the penalty itself.
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 - Some banks believe they are fortunate because they have a rider on their policy that actually covers the civil money penalty itself. Now, that is where the provisions of FDIC Part 359 come in. And they come in whether you are a state-member bank governed primarily by the Federal Reserve as your federal regulator; a state nonmember bank regulated by FDIC; or a national bank regulated by the OCC. Part 359, in its simplest terms, provides that the directors cannot be indemnified by the bank for the payment of any penalty.
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 - In other words, if regulators assess a \$150,000 civil money penalty for violation of a legal lending limit or some other issue, it has to come out of your own pocket and you cannot be reimbursed. You also cannot be reimbursed for a penalty, even if you have a civil money penalty rider on your insurance policy, if the premium on the insurance policy has been paid by the bank.
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 - The solution to this (we hope, since it has not been tested) is that the bank obtains a rider on the policy that covers civil money penalties, both the legal fees and the penalty itself, and that the directors and officers individually pay their portion of the premium for that rider so the bank is not indemnifying them. If they are not being indemnified directly or indirectly by the bank for the payment of that penalty, the coverage should be deemed to be personal to the directors and officers, and, therefore, coverage provided.

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- "The Gerrish endorsement"
- The third situation is even tougher, and that is where the bank is in imminent danger of failure and ultimately does fail.
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- Most D&O policies after the late seventies-when I was suing directors for FDIC and collecting a fair amount of money-added to the policy what I call the "Gerrish endorsement." This is the one that either prevents coverage for any claim after the bank closes, or disguises it in a rider and prevents coverage for any claim "by an insured against an insured" at any time after the bank closes.
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- Since FDIC, as Receiver of the bank, steps into the shoes of the bank (the "insured"), the argument is that FDIC as Receiver, or even in its corporate capacity as an assignee of the claim, would be claiming against another insured, and, therefore, no coverage.
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- If you are in imminent danger of failure, review that policy closely and see if you can do something to get coverage.
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- Cover your tail with a "tail"
- The whole issue of D&O coverage not only is getting more complicated, it is also becoming more real and more expensive.
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- If you think your bank is going to fail or the carrier decides to terminate or "non-renew" coverage, make sure you purchase tail coverage, which will at least cover you for any claim made during the tail period. Typically, the tail lasts a year or so.
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Editor's Note: Tell us about your own recent D&O experiences in the comments section below.

If necessary, you may put yourself down as "Anonymous," but we require a valid e-mail address, which will not be published, to verify that your comments are legitimate.

About the Author

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