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INSURANCE COVERAGE & REGULATION

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Risk Management in Troubled Times: Understanding D&O Insurance and E&O Insurance

The turmoil in the financial industry and the real estate market has resulted in increased claims against individuals and companies connected with those sectors, including lenders, mortgage brokers, real estate brokers and agents, appraisers, and financial advisers. Directors and officers of corporations can expect to face civil suits brought by investors, customers, and borrowers attempting to recover losses. Professionals holding licenses will also be targets. Whether companies developed and implemented necessary risk management practices, supervised employees, and made appropriate decisions will be significant issues in these claims.

In this environment, it is important to understand the coverage afforded in Directors and Officers insurance policies and Errors and Omissions insurance policies, as well as some of the basic concepts underlying these types of policies.

Directors and Officers Insurance Policies

Directors and Officers ("D&O") policies are "claims-made" policies. As such, coverage is provided for certain claims arising out of the wrongful acts of the company, its directors, and officers, that occur during the policy period, plus any extended "tail" period. Typically, D&O policies act as "litigation insurance," in that they pay for the legal fees and costs for defending claims, as opposed to indemnification for or paying any damages to which the claimant is adjudged to be entitled.

If a D&O policy contains a continuity date, coverage will not be provided for claims arising out of acts that occurred prior to the continuity date. As a result, if insurance companies are changed at renewal, the new policy will not respond to claims for acts that occurred before the policy's effective date, and the prior policy will not respond to claims asserted after the new policy is in place. In this situation, care must be taken to ensure that the replacement policy does not contain a continuity date, so that the replacement policy will provide coverage for wrongful acts that may occur before the replacement policy's effective date.

Many D&O policies exclude coverage for fraudulent, criminal or dishonest acts. In many instances, whether there has been a fraudulent, criminal or dishonest act is not determined until a judge or a jury reaches a decision. In such instances, the exclusion arises at the end of the legal proceeding. It is critical that the policyholder carefully present the facts at the outset of such claims to make sure that coverage is maximized.

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Finally, the majority of D&O policies require the insured to notify the insurance company of a claim as soon as practicable. The definition of a "claim" varies from policy to policy. As a general rule, a "claim" is a written demand for compensation or suit papers. In the event a claim is made, the insurance company must be promptly notified in writing and any claim documents received should be forwarded to the company. The failure to give prompt notice to the insurance company can have drastic consequences to the policyholder, specifically the loss of coverage. In some circumstances, it may also prove beneficial to give notice to the insurance company of any wrongful act an insured becomes aware of which may reasonably give rise to a future claim. Such notification will trigger coverage under the current policy rather than under a subsequent policy.

Errors and Omissions Policies

Errors and Omissions ("E&O") policies are written for professionals, including real estate brokers and agents, attorneys, and real estate appraisers. E&O polices are "claims-made" in which coverage is provided for the claims reported during the policy period that arise out of the professional duties in question. Claims asserted before the policy period are not covered. Unless a "tail" is purchased for the policy, claims asserted after the policy period are not covered. E&O policies provide defense costs and indemnification of the policyholder for covered claims (i.e., the insurance company will pay the claimant's damages up to the limits of coverage).

Traditionally, the legal theories of liability alleged against brokers, agents and other professionals were based on "breach of contract," "negligence," or "breach of fiduciary duty." However, in addition to the traditional theories of liability, claims can be based on theories of "negligent misrepresentation" and "fraud." The latter type of claim raises potential exclusions from coverage for intentional, criminal or fraudulent conduct.

E&O policies have claim reporting requirements that are similar to D&O policies, and which must be strictly adhered to.

Conclusion

In the current environment, it is important for the policyholder to understand the policy in order to maximize the insurance coverage available and to avoid situations where coverage can be lost or jeopardized. When presented with a claim or a potential claim, the policyholder must carefully navigate the process in order to protect its rights. ■

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