



# A Look AHEAD

A Beecher Carlson Publication

Keeping Directors and Officers at the Forefront of What's Happening in Executive Liability Risk Management

## Is Your D&O Insurance Policy Attracting the Wrong Kind of Attention? Part II: Advice for Distressed Institutions

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In light of the steadfast initiative taken by the Federal Deposit Insurance Corporation (FDIC) in pursuing executives of failed institutions, it is important to take the time to review the scope of your D&O coverage and assess if you are adequately protected. As the cases continue to be filed, they shed greater light on the approach taken by the FDIC. Certain factors appear to be influencing the FDIC's direction including pressure on the FDIC's balance sheet leading it to pursue damages repatriation in the event of receivership. Having an awareness of the bigger picture in relation to the current environment in which financial institutions operate, makes it important for even sound institutions to understand the ramifications and possible remedies available in the marketplace.<sup>1</sup>

The current economic climate has spawned a dramatic number of banking institution failures, costing the FDIC billions.<sup>2</sup> Now intent on recovering some of those losses, the FDIC and other regulatory agencies are looking to find someone to be held accountable – most notably directors and officers of failed institutions – going after the D&O policies meant to protect them, and, if warranted, even their personal assets.

Of late, the FDIC continues to take a more pronounced role in this battle, seemingly focusing on those failed institutions with sizable D&O insurance coverage. In turn, this raises the spectra of how directors and officers can take steps to protect themselves without attracting too much attention.

### D&O Insurance: Are you a target?

Distressed banking institutions face many challenges in their seemingly uphill battle to stabilize capital and protect their directors and officers from the onslaught of litigation

likely to result in the event of failure. In attempting to mitigate risks these institutions are further challenged by significant limitations in their ability to procure adequate D&O insurance. There are a myriad of reasons for these limitations some of which include high premiums, limited market capacity and restrictive policy terms.

The concerns of healthy and distressed financial institutions may appear diametrically opposed, as there is little threat of FDIC lawsuits during stable financial periods. During financially stable times, in a competitive market environment, there are more options available to address the needs of particular entities and policy terms can be tailored to better meet a particular institution's needs. Comparatively, for distressed banks, the ground rules are different and, oftentimes, there are barriers that impede their ability to obtain even basic D&O coverage. For instance, even for healthy banks headquartered in Georgia, Illinois, Florida or California, where failures are a regular occurrence, the slightest sign of distress may catapult a company from the competitive market to a shallower market where there is significantly less capacity. One way to circumvent this situation is to purchase D&O insurance well before a bank enters the distressed zone. With the assistance of a knowledgeable broker who understands the challenges directors and officers face, companies are able to negotiate certain terms that better address unique company needs.

For those companies that find themselves on the cusp of insolvency and discover they have insufficient D&O coverage, the environment is not as bleak as it may seem. Since the collapse of the economy, which led to a resurgence in bank insolvencies, insurance brokers have witnessed increased interest in the market for liability insurance for directors and officers of distressed banks. Several years ago, when it appeared that D&O coverage was a second thought to these institutions, there were fewer markets interested in this risk. As such, institutions

<sup>1</sup>Blake Kirk and John Kerns, *The FDIC is Poised to Make Another Run on Failed Bank's D&O Policies*, 2010.

<sup>2</sup>*Id.*

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looking at this coverage were forced to deal with a small group of underwriters who were dictating exclusions and higher premiums that made the policies unattractive. Times are different in that there is a better understanding of the risks and value to the coverage from both the prospective buyer and the markets as well as more market capacity forcing more competition.

With more markets to choose from, the next hurdle for these institutions is determining the right amount and type of coverage that will best protect them. On the one hand, the concept “the more coverage the better” may be a consideration as the availability of greater limits to cover expenses and costs relating to a settlement or court award may give an insured more comfort knowing that their personal assets are secure. On the other, greater limits may make an individual a more attractive target, increasing the likelihood that they will be named in litigation pursued by shareholders or regulators. While the debate as to the adequacy of limits may continue, it is clear that the key for directors and officers of distressed banks is not the limit but the type of and the scope of the coverage they elect to purchase. With a team of seasoned brokers who recognize the salient risk factors these institutions face and understand how to navigate through the turbulence, distressed institutions can find and secure comprehensive coverage for its directors and officers.

### Advice for Distressed Banks

For distressed banks, the key to getting the best D&O insurance is anticipating needs and planning in advance of major complications. In order to beat the challenges and stay ahead of your competitors, it requires maintaining a board and executive staff of the best in the industry supported with the most comprehensive protection available in the market. Distressed banks need to find and structure their coverage in a way that protects directors and officers in case of a crisis without letting the cost of coverage alone dictate the decision. Insurers are continuously rolling out new enhancements to meet evolving needs, particularly in a competitive market environment. Now is the time to take a second look at some of the offerings available:

**Regulatory Coverage** - When evaluating the benefits of regulatory coverage, distressed banks may consider coverage that allocates a specific amount of the limit exclusively for defense costs, in the event that an enforcement action were filed against them by regulators. The price break between defense only and full regulatory coverage is insignificant and banks would be remiss not to at least explore this option. Full regulatory coverage can be found with the right plan and focus on scouring the global insurance market for the right insurer. The size of this regulatory coverage can range depending on the banks’ needs, but should not be

so large that it attracts the FDIC and shareholders attention.

**Side A Coverage** - Banks that are teetering on the brink of insolvency need to be mindful of likelihood of facing protracted litigation. Regulatory coverage may not be enough to protect directors in the “end of days” scenario, where the insurance policy itself may, in some extreme cases, be deemed an asset of the failed institution, no longer for the benefit of the former directors and officers, leaving them without a safety net. In such calamitous situations, Side A coverage can be a lifesaver where there is no other source of indemnification, as it can provide unconditional advancement of legal fees from the first dollar to the directors without naming the bank as a beneficiary.

**IDL Coverage** - IDL policies that limit coverage only for the personal assets of independent directors are also integral to limiting personal liability for litigation expenses that can quickly become very costly. It may be advisable for independent directors to conduct a cost/benefit analysis to determine their comfort level as to limits gauged against their own personal appetite for risk and challenges facing the institution in the event they are named in a lawsuit and traditional insurance is insufficient.

### Where do we go from here?

Even in the midst of an improving economy, regulators are poised to demonstrate that they are holding bank executives accountable for actions that led to failure in efforts to counter strong criticism aimed at them at the inception of the financial crisis. With the emergence of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), other regulatory agencies are following suit. The FDIC has proposed “clawback” provisions similar to those found in Dodd-Frank, which would allow the agency to requisition up to two years of pay from an executive found responsible for the collapse of a major financial institution.<sup>3</sup> Such provisions signal more risk for directors and officers, who may demand more protection before committing to continue operating in such a risky business environment.

It may be too early to tell just how much of an impact FDIC litigation will have on the insurance industry, as the only a handful of cases have been filed so far. In spite of the uncertain regulatory and economic climate, banks can take steps to protect their executives by acquiring the right type and amount of coverage. With the help of seasoned insurance brokers, experienced in assisting distressed financial institutions through many difficult times going back to the S&L crisis, the right policy is not out of reach.

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<sup>3</sup>F.D.I.C. Rule Puts at Risk 2 Years of Executives’ Pay, The New York Times, July 6, 2011

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Continuously ranked by Business Insurance as one of the fastest growing insurance brokers in the US, Beecher Carlson has been a privately held company since 1981, with over 550 employees and 26 offices across the United States and Bermuda. An insurance brokerage and risk management-consulting firm dedicated to delivering analytic driven solutions and services to the Financial Services Industry. Through a combination of resources that include- analytics, technology and in-house actuarial services, Beecher Carlson assesses and models risk in a way that supports each client's unique operational culture and key risk differentiators.

For more information on Beecher Carlson and our Financial Institutions practice, please visit our website at [www.beechercarlson.com](http://www.beechercarlson.com).

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At Beecher Carlson, we've found success in our ability to be inventive. We see things upside down and inside out – from different angles. We're a team of seasoned and spirited professionals who take personal interest in our client's goals and never waiver in our commitment to put them first.

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