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Insuring Your Company's Future

A little-known insurance provision can help protect brokers in cases of indemnity claims

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Many people wonder why the nonprime-mortgage market collapsed, and many find it even more mysterious to comprehend where the money that the market thought once existed went.

Therein lies the rub.

In most instances, the value wasn't there in the first place. In other instances, the money went in the pockets of high-commission, fly-by-night mortgage brokers and lenders who also mysteriously evaporated into the mist of speculation.

As such, legitimate fund managers, lenders, brokers, bankers and others are left holding the bag. As indemnity demands pour in, fingers are immediately pointed at these third parties, and everyone is looking for a way to satisfy the outstretched hand.

As a broker, what can you do to protect yourself if you're involved in a third-party lawsuit? Insurance is a logical place to turn. It is therefore important to know which policies will provide the appropriate coverage for these indemnity claims.

Most people turn to their directors-and-officers (D&O) insurance to respond to these types of indemnity demands. There is a little-known coverage available in everyday comprehensive-general-liability (CGL) policies that can be more effective, however.

If triggered and pursued correctly, CGL policies can provide significant sums of money to help mortgage companies faced with lawsuits.

CGL's insured-contract coverage

For brokers and lenders faced with indemnity demands, a little-known provision in CGL policies can help. It is known as "insured contracts" on the broad-form endorsement and typically is a free or virtually free add-on that good business-insurance agents may include. Contract coverage does not offer coverage in a typical breach-of-contract situation. If you are sued for failing to deliver enough widgets on time to satisfy the contract, there's no coverage under this provision.

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Rather, the coverage is designed for third-party situations similar to what mortgage brokers may be facing. Consider this example: Company A sues Company B for something Company C did. Company B then tenders to Company C the defense and indemnity of the lawsuit from Company A. In this circumstance, Company C's insurance would pay to defend Company B in the litigation, but it would not pay for its own defense.

This coverage is rarely triggered because most company-to-company contract lawsuits don't invoke the insured-contracts provision. If there's a third party involved that might apply, most insureds don't think there's coverage for contracts in their policy, only accidents. Thus, the insurance policy never makes it to the lawyer's hands, and the claim is never submitted.

Indemnified contract coverage, however, appears tailor-made for the nonprime mortgage crisis because it's exactly the coverage anticipated by the language in the provision itself. Brokers, bankers and lenders who have received an indemnity demand then will want to ensure this claim is properly presented to their insurance carrier to trigger the coverage. The additional source of funds will go a long way to resolve the indemnity demand.

Further, CGL policies are ubiquitous, typically have little or no deductible, and have no time limitations. They also are occurrence policies, which means that the policy in effect when the occurrence happened pays the claim. Also, if the cause of the claim occurred over multiple years, then multiple policies may be available to pay it.

To cap it off, umbrella policies usually have "following form" coverage. This means that even though the umbrella policy itself may not offer the coverage, if the underlying CGL policy does, then the umbrella will "follow the form" of the underlying policy and pay the claim when the underlying policy is exhausted.

Directors-and-officers policies

Because many companies don't understand or know about the provision in CGL policies, they most often send such claims to their D&O insurance carriers. Although these sometimes bring positive results, many mortgage companies are seeing their claims denied.

Some D&O carriers have stepped up to the plate and honored those claims. But many have not, citing exclusions and other policy provisions to deny coverage. These insurers understand the scope and depth of the nonprime crisis all too well and may react in self-defense to avoid funding Wall Street's recovery.

The problem, in part, is because of the type of coverage these policies afford. Typically, they're claims-made policies. This means the policy in effect when the claim is made will be the policy that pays the loss. If a company does not have a current policy, there's no coverage. It's like renting an apartment: Once you move out, you have no equity.

Submitting a claim often is as much an art form as it is an exercise in persuasion. The insurance carrier must believe there is either a potential for coverage under the policy or an outright trigger. Rather than immediately tell the

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carrier that there's coverage either by a factual demonstration or citation to insuring language in the policy, it's frequently best to simply present the claim and allow the carrier to make up its mind initially.

If the carrier denies coverage, then the persuasion process begins in earnest with full citation of the facts, insuring language and applicable law. A well-written and researched letter from counsel frequently is worth its weight in gold — it can help to literally find money not previously available.

But D&O coverage sometimes is difficult to trigger. Coverage generally is only available to a company's directors and officers. Also, there frequently are large deductibles, self-insured retentions or copays with which to contend.

There also is the time factor. If you make the claim late, there's no coverage.

While D&O policies may be a valid option for some mortgage companies faced with third-party lawsuits, CGL policies and their insured-contract provision can present a more-readily accessible solution.

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