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THE TOP 10 D&O INSURANCE POLICY EXCLUSIONS KEEPING BANK EXECUTIVES UP AT NIGHT

As litigation risks and regulatory scrutiny intensify for banks and other financial institutions, it is more important than ever for those financial-sector companies and their executives to assess the protection offered by their directors and officers liability insurance policies. Seemingly small variations in policy language, especially exclusions, can lead to significant gaps in coverage, potentially leaving executives exposed and personally liable. This article examines 10 common D&O policy exclusions that could materially affect banks' and executives' financial exposure and highlights the importance of understanding the finer details of placing and negotiating appropriate D&O insurance programs.

By Geoffrey B. Fehling and Alex D. Pappas *

In the past year, banks have faced adverse rulings in securities litigation challenging DEI initiatives, putative class action lawsuits alleging mismanagement of employee health insurance plans, and even eight-figure indemnification demands for legal costs incurred in the fallout from the 2008 global financial crisis. State and federal regulators have also been pursuing claims at a record clip, with the Consumer Financial Protection Bureau setting records for fair-lending enforcement actions and Department of Justice referrals.[1] Other regulators like the Office of the Comptroller of the Currency (OCC) and the Federal Reserve are also laser-focused on banks, with the OCC announcing four new enforcement actions in October 2024 alone. And while the reelection of President Trump may change regulatory enforcement priorities, banks and other financial institutions are still likely to face diverse and potentially significant claims going forward.

These and many other risks rise straight to the board room, making directors and officers ("D&O") liability insurance a crucial safeguard for banks and financial institutions of all sizes. But the fine print in these policies can sometimes lead to unexpected claim outcomes that materially limit, if not eliminate, insurance coverage. In this article, we explore 10 common D&O insurance policy exclusions and steps banks can take to try to minimize their impact.

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[1] Kate Berry, *CFPB sets record for fair lending enforcement actions and DOJ referrals*, American Banker (June 26, 2024), https://www.americanbanker.com/news/cfpb-sets-record-for-fair-lending-enforcement-actions-and-doj-referrals.

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1. LENDING SERVICES EXCLUSION

The Problem: D&O insurance policies, even those tailored for financial institutions like banks, often contain lending services exclusions. While the policy language can vary, lending services exclusions typically apply to acts performed by the bank while extending credit or restructuring, terminating, transferring, repossessing, or foreclosing on a loan.[2] These exclusions can be problematic because lending is a core function of banking. Compounding matters, lending services exclusions may also have expansive causation language that could not only exclude claims related tolending services as such, but also losses indirectly related to lending services.[3]

The Fix: To mitigate the risk posed by lending services exclusions, banks should consider buying a package insurance policy that includes both D&O and lender liability coverages from the same insurer.[4] By bundling D&O and lender liability coverages, banks can secure comprehensive protection against lending-related lawsuits. Purchasing these coverages from the same insurer can also help avoid the situation where one insurer tries to shift responsibility to another, leaving the bank caught in the middle of a dispute over which insurer's policy applies. Besides purchasing lending-specific coverages, banks may also negotiate carve-outs for certain claims — such as those related to the failure to monitor or supervise lending practices — that can further limit the effects of a lending services exclusion in D&O policies. For example, if a borrower sues over the bank's internal oversight rather than the lending decision itself, the D&O policy could still provide coverage if a carve-out like this is in place. At a minimum, banks should regularly review their insurance programs to ensure that different policies work together seamlessly to avoid surprise denials for claims implicating core banking activities.

2. FRAUD AND DISHONESTY EXCLUSION

The Problem: Virtually all D&O policies contain exclusionary language addressing fraud and dishonesty. Those exclusions apply to claims alleging deliberately dishonest, malicious, criminal, or fraudulent acts or willful violations of law.[5] Because allegations of fraud are common in lawsuits against financial industry defendants, placing reasonable limitations on fraud and dishonesty exclusions is especially important to maintaining coverage to defend and defeat claims of alleged fraud. This is all the more true given that

[2] *W. Heritage Bank v. Fed. Ins. Co.*, 938 F. Supp. 2d 1219, 1222 (D.N.M. 2013), *aff'd*, 557 F. App'x 807 (10th Cir. 2014) (defining "Lending Services" as "any act performed by an Insured for a Lending Customer of the Organization in the course of extending or refusal to extend credit or granting or refusal to grant a loan or any transaction in the nature of a loan, including any act of restructure, termination, transfer, repossession or foreclosure.").

[3] *Id.* at 1223-24 (upholding an insurer's denial of a bank's insurance claim, reasoning that claims arising or flowing from the bank's lending activities were excluded).

[4] Broad form company liability coverage may include lending services coverage — *i.e.*, "coverage for services involving or relating to an extension of credit, an agreement or refusal to extend credit, Loan Servicing, or the collection, restructuring, repossession, or foreclosure of any extension of credit by the

footnote continued from previous column…

Company." ABA Insurance Services Inc., *Broad Form Company Liability*, https://www.abais.com/docs/default-source/banks/coverage-summaries/broad-form-company-liability-112017.pdf.

[5] *USA Gymnastics v. Liberty Ins. Underwriters, Inc.*, 27 F.4th 499, 518 (7th Cir. 2022) (discussing a fraud and dishonesty exclusion that applied to "any Claim made against any Insured . . . based upon, arising from, or in any way related to . . . any deliberately dishonest, malicious, or fraudulent act or omission, or any willful violation of law by any Insured provided, however, this exclusion shall only apply if it is finally adjudicated that such conduct in fact occurred.").

defending fraud claims can be extremely costly, even if the allegations are ultimately proven false. Compounding the problem is that fraud and dishonesty exclusions are often written broadly, meaning that insurers may try to deny coverage even before any adverse findings establishing fraud occurred, leaving directors and officers to foot the bill for their own defense.

The Fix: The most effective way to limit the reach of fraud and dishonesty exclusions is to ensure that they apply only after a final, non-appealable adjudication of guilt.[6] This way, fraud allegations alone would not fall within the exclusion because they have not been finally adjudicated. Negotiating strong "final adjudication" triggers ensures that directors and officers are protected while defending themselves, rather than being forced to cover legal costs out of pocket before any wrongdoing is established. Apart from negotiating appropriate limitations to fraud exclusions, banks should also evaluate and, if necessary, negotiate improved language in recoupment provisions that may come into play in the event of an adverse adjudication of fraud.

3. CYBER EXCLUSION

The Problem: With the rise of digital banking and financial technology, cyber-related risks have become an ever-increasing concern for banks and other financial institutions. The average cost of a data breach in the US is estimated to be more than $9.3 million, but that number skyrockets to more than $6 million for companies in the financial sector.[7] Not only are cyber incidents growing in frequency and severity, but enforcement is also ramping up. Executives are right to worry about these risks, particularly because agencies and shareholders have shown a willingness to pursue individual directors and officers following an incident.[8] On top of coverage that may be available under cyber insurance policies, D&O policies can also reduce corporate and individual exposure in the event of a cyber incident. Other sources of recovery, like D&O, become essential if cyber limits are quickly eroded or exhausted by the immediate aftermath of a breach or similar incident. However, some D&O policies now include cyber exclusions, which can limit or eliminate coverage for claims related to certain "privacy incidents." The rationale for cyber exclusions is that these claims should be covered by separate cyber insurance policies. But the broad wording of these exclusions often captures a wide range of claims with only an incidental connection to cyberattacks. This can lead to a coverage gap for directors and officers, particularly in an era where cyber incidents often lead to follow-on regulatory investigations, shareholder lawsuits, or class actions.

The Fix: To mitigate the risks posed by cyber exclusions, banks should work with their insurers to narrow or remove these exclusions. If the exclusions remain, policyholders can negotiate carve-backs for specific claims, such as securities lawsuits stemming from a cyber incident. Negotiating away from broad "arising out of" causation language can also help minimize risks that an insurer denies coverage for losses indirectly related to cyber incidents. Companies must also review cyber and D&O policies together to ensure coordinated coverage for cyber exposures that may implicate both policies.

4. PROFESSIONAL SERVICES EXCLUSION

The Problem: Professional services exclusions apply to claims made against a bank based on the bank's performance of or failure to perform professional services.[9] Practically, professional services exclusions might apply to claims arising from the performance of specific services like investment advice, trust management, or financial consulting. Professional services exclusions aim to shift liability to professional liability or errors and omissions ("E&O") policies. But in the banking industry, where directors and officers often handle diverse financial products and services, often subject to contracts outlining services and fees, distinguishing between management decisions and professional services can be difficult and leave directors and officers exposed. These risks are not hypothetical. For example, a California appellate court recently affirmed a trial court's decision holding that a

[6] *RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 906-07 (Del. 2021) (discussing the final and non-appealable adjudication trigger).

[7] IBM, Cost of a Data Breach Report, at 9-10, https://www.ibm.com/reports/data-breach.

[8] *SEC v. SolarWinds Corp.*, 2024 WL 3461952 (S.D.N.Y. July 18, 2024). In *SolarWinds*, US District Judge Paul A. Engelmayer dismissed a substantial portion of the US Securities and Exchange Commission's case against SolarWinds Corporation and its chief information security officer. Even though the court partially granted a motion to dismiss, SolarWinds' CISO still faces litigation costs and personal exposure.

[9] *Stettin v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 861 F.3d 1335, 1337 (11th Cir. 2017) (enforcing a professional services exclusion providing that "the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against any Insured alleging, arising out of, based upon, or attributable to the Organization's, or any Insured's performance of, or failure to perform professional services for others, or any act(s), error(s) or omission(s) relating thereto.").

professional services exclusion in a software provider's D&O insurance policy precluded coverage for the company's nine-figure settlement with the DOJ of kickback payment allegations.[10] Compounding matters, insurers may argue that the exclusion applies to all insureds — not just those insureds providing professional services.[11]

The Fix: To mitigate the effect of professional services exclusions, banks must understand their exposure to professional liability claims and, if needed, procure express E&O insurance to cover claims arising from professional services. Some insurers offer package D&O/E&O policies that cover both management and professional liability. These policies can help bridge the coverage gap, ensuring that directors and officers are protected against a wider range of claims. Banks should also work with insurers to redefine and narrow the scope of "professional services" in their D&O policies to avoid excluding broader management issues that may be indirectly connected to a bank's provision of professional services.

5. INSURED VERSUS INSURED EXCLUSION

The Problem: Insured versus insured exclusions are also common. These exclusions preclude coverage for claims brought by one insured party against another. As an example, this means that there may not be coverage for lawsuits initiated by one director or officer against another, or by the bank itself against its executives. As another example, if a bankruptcy trustee sues the bank's former directors for alleged mismanagement just before the bankruptcy, an insured versus insured exclusion may obviate coverage.[12] Similarly, if a shareholder derivative suit is filed against the bank's directors, the exclusion could prevent coverage for the directors' defense costs, despite the claim being brought on behalf of the bank itself.

The Fix: Banks can address insured versus insured exclusions by negotiating carve-outs for specific types of claims. Necessary carve-outs include claims by bankruptcy trustees and receivers, and shareholder derivative actions, among others. Banks may also want to consider purchasing Side A Difference in Conditions ("DIC") coverage, which offers broader protection and can cover claims otherwise excluded under a primary D&O policy.

6. CONTRACTUAL LIABILITY EXCLUSION

The Problem: Contractual liability exclusions preclude D&O coverage for claims arising from breaches of contract. Contractual liability exclusions can be particularly problematic for banks, which routinely enter into contracts with customers, vendors, and other third parties. In a contract dispute, if a bank's directors and officers are sued for failing to meet contractual obligations, a D&O insurer might deny coverage under this exclusion. This potentially leaves directors and officers exposed to significant financial liability, especially in cases involving high-value transactions or long-term commitments.[13]

The Fix: To address the contractual liability exclusion, banks should negotiate with their insurers to secure carve-outs for claims involving breaches of duty rather than direct breaches of contract.[14] Narrowing broad "arising out of" causation language can also prevent insurers from barring coverage for claims with only an incidental connection to an underlying contract.

7. ERISA EXCLUSION

The Problem: ERISA exclusions operate the way the name would suggest — they exclude claims related to employee benefit plans governed by the Employee Retirement Income Security Act ("ERISA").[15] Banks often manage complex employee benefit plans, such as pension funds, 401(k) plans, and health insurance plans,

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[10] *Prac. Fusion, Inc. v. Freedom Specialty Ins. Co.*, 2024 WL 3078283, at *1 (Cal. Ct. App. June 21, 2024).

[11] *Stettin*, 861 F.3d at 1337.

[12] *BancInsure, Inc. v. FDIC*, 796 F.3d 1226 (10th Cir. 2015) (holding that an insured versus insured exclusion unambiguously barred claims by the FDIC when it was acting as a receiver).

[13] *See, e.g.*, *Paraco Gas Corp. v. Ironshore Indem., Inc.*, 2024 WL 3024658, at *3 (2d Cir. June 17, 2024) (finding that various claims in an underlying lawsuit arose out of contractual obligations and were, thus, excluded); *Russell v. Liberty Ins. Underwriters, Inc.*, 950 F.3d 997 (8th Cir. 2020) (similar).

[14] Since insurance is a creature of state law, choice of law, and governing law, it can have a material impact on the resolution of D&O coverage issues. For example, the Fifth Circuit held in one case that a claim for breach of fiduciary duty is not a claim for a breach of contract and was therefore not subject to the breach of contract exclusion. *See, e.g.*, *Windermere Oaks Water Supply Corp. v. Allied World Specialty Ins. Co.*, 67 F.4th 672, 673 (5th Cir. 2023).

[15] *See, e.g.*, *Lifeline Health Grp., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 665 F. Supp. 2d 770 (W.D. Ky. 2009) (employees' claims which alleged violation of ERISA arising from failure of healthcare plan were excluded by an ERISA exclusion).

which can expose directors and officers to significant ERISA liabilities. ERISA exclusions, therefore, can create significant coverage gaps for banks, especially as employee benefit-related lawsuits are becoming increasingly prevalent. Without D&O coverage for ERISA-related issues, directors, and officers may face substantial personal liability for defending against these costly and time-consuming lawsuits.

The Fix: To address the ERISA exclusion, banks should consider purchasing fiduciary liability coverage, either as a standalone policy or as part of a package management liability policy, to cover claims related to the management of employee benefit plans. Fiduciary liability insurance specifically protects against breaches of fiduciary duty under ERISA, including mismanagement of retirement plans and failure to properly administer health benefits. Banks may also want to work with insurers to clarify the scope of the ERISA exclusion in their D&O policies. Some insurers may agree to provide limited coverage for ERISA-related claims, particularly if the claims challenge management decisions rather than specific breaches of fiduciary duty imposed by ERISA. By negotiating carve-outs or endorsements for ERISA-related risks, banks can effectively minimize the effect of ERISA exclusions.

8. PRIOR ACTS EXCLUSION

The Problem: Prior acts exclusions bar coverage for claims arising from actions that occurred before a specified date. Prior acts exclusions create potentially significant coverage gaps, especially for directors and officers who have been with a bank for a long time. For example, a director might face a lawsuit over a decision made years earlier, only to find that the D&O policy excludes coverage for actions before the policy's so-called "retroactive date." This exclusion arises when banks undergo major organizational changes, such as mergers, acquisitions, or leadership transitions, where legacy issues from previous management might surface. In such cases, directors and officers could be left without insurance protection for decisions made before their current D&O policy took effect.[16]

The Fix: To mitigate the effect of the prior acts exclusion, banks should consider negotiating for retroactive coverage that extends to the earliest possible date, including full "prior acts" coverage with no retroactive date, if available. This ensures protection against claims arising from past decisions, even if those decisions occurred before the current policy was in place. Maintaining continuous D&O coverage is also crucial to avoid gaps in protection. If a bank allows its D&O policy to lapse or switches insurers without securing continuous coverage, it risks losing the ability to make claims for actions that occurred before the new policy took effect.

9. BANKRUPTCY AND INSOLVENCY EXCLUSIONS

The Problem: Bankruptcy and insolvency exclusions can bar coverage for claims arising during or after a bankruptcy filing or when a business is found to be insolvent. This often-overlooked risk can exacerbate risks in bankruptcy when a company cannot indemnify or advance costs on behalf of individuals, making D&O insurance the sole source of protection should a claim arise. Financial distress often leads to increased scrutiny of directors and officers, and in a bankruptcy or insolvency scenario, creditors, regulators, and shareholders may file lawsuits against the bank's leadership, alleging mismanagement or breaches of fiduciary duties. If a D&O policy excludes bankruptcy- or insolvency-related claims, directors and officers could be left without protection precisely when they need it most.[17]

The Fix: If bankruptcy and insolvency exclusions cannot be eliminated, banks should try to narrow the exclusion's reach through carve-outs or otherwise. Non-rescindable coverage can also guarantee that protection remains in place even if the bank files for bankruptcy or becomes insolvent. Banks can also consider purchasing Side A DIC coverage, which specifically protects individual directors and officers when the company is insolvent and cannot indemnify them.

10. MAJOR SHAREHOLDER EXCLUSION

The Problem: Major shareholder exclusions in D&O policies bar coverage for claims brought by shareholders who own a significant percentage of the company's stock. Major shareholder exclusions can lead to D&O coverage disputes and risk creating significant coverage gaps for banks with institutional or majority shareholders, who may file substantial claims against the

[16] *See, e.g., Zucker for BankUnited Fin. Corp. v. U.S. Specialty Ins. Co.*, 856 F.3d 1343, 1349 (11th Cir. 2017) (prior acts exclusion barred coverage).

[17] *See, e.g., Fla. Dep't of Fin. Servs. for Am. Superior Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2012 WL 13026760, at *3 (N.D. Fla. May 10, 2012) (enforcing bankruptcy and insolvency exclusions).

bank's leadership.[18] For instance, if a hedge fund or private equity firm with a large stake in the bank sues the bank's directors for mismanagement, the D&O insurer might deny coverage based on a major shareholder exclusion. This can leave directors and officers vulnerable to substantial financial liability, particularly if the shareholder has the means to pursue lengthy and costly litigation.

The Fix: Banks can negotiate with their insurers to either limit or remove the exclusion. Insurers might also agree to carve out exceptions for claims from shareholders owning less than a specified percentage, such as 10% or 20%. As with the other exclusions, this is yet another reason why dedicated Side A DIC coverage — which offers greater protection for directors and officers without some of the more common exclusions in traditional D&O policies — can be invaluable.

* * *

These are just some of the more significant exclusions that can rear their head in D&O claims. As these 10 exclusions show, when it comes to D&O coverage, the devil is in the details. Not all policies are created equal, and many provisions can be negotiated to improve coverage, many times without an extra premium. Exclusions are important to constructing a comprehensive insurance program but are only one small part of the risk mitigation puzzle. By understanding these pitfalls and taking proactive steps, financial lines policyholders can ensure the company and its key decision-makers are not left counting the costs of uncovered claims. Retaining experienced brokers, outside counsel, and other risk professionals throughout the insurance life cycle, from placement and renewal to claims and litigation, can help avoid common missteps. ■

[18] *EMSI Acquisition, Inc. v. RSUI Indem. Co.*, 306 F. Supp. 3d 647 (D. Del. 2018), *aff'd*, 787 F. App'x 97 (3d Cir. 2019) (holding that a major shareholder exclusion did not bar coverage).