SECURITIES LITIGATORS WHO DO NOT UNDERSTAND INSURANCE COVERAGE COULD PAY DEARLY

By Jeffrey S. Grubman, Esq.

There was a time not that long ago when lawyers representing parties in securities litigation and arbitration did not have to concern themselves too much with insurance coverage issues. Federal and state statutory securities and common law claims were routinely filed against large investment banks, trust companies, commercial banks, savings and loans, insurance companies, broker-dealers and public companies. Collectability was not a concern with these large companies. It was also much easier than it has become to bring securities class actions, and plaintiffs' lawyers understandably focused on deep pockets.

The world of securities and financial markets litigation has changed dramatically since the financial market meltdown of 2008-2009. Nobody would have imagined in the 1990s or early 2000s that Lehman Brothers and Bear Stearns would go out of business and some of the largest brokerage/investment banking firms in the world would merge with commercial banks to stay alive. In addition, compliance tools and supervision have improved at the major broker-dealers and large investment banks. Consequently, there have been far fewer quality claims to file against these large companies in recent years.

Instead, plaintiffs' lawyers have focused their energies on smaller broker-dealers and registered investment advisors who do not have the same compliance tools or manpower to supervise their employees and registered representatives. A sizeable number of these smaller financial services firms have sold a variety of speculative private placements to their client bases, many of which were focused on real estate. Consequently, when the real estate market declined dramatically, so did these illiquid investments.

Many of these smaller financial services companies purchase errors and omissions insurance policies or require their registered representatives/agents to do so. Because these companies tend to be thinly capitalized and product failures typically result in a large number of claims filed against them, the claims are often uncollectible without insurance coverage.

It is therefore critical for plaintiffs' attorneys to understand the available insurance coverage. Nevertheless, I have witnessed on many occasions plaintiffs' counsel appearing at mediation without an understanding of the details of the financial services companies' insurance coverage. In fact, I have experienced plaintiffs' counsel showing up at mediation with no idea whether the defendants even have insurance.

Insurance carriers have become major players in the resolution of claims involving financial services companies, and it is extremely important for plaintiffs' counsel to understand 1) if insurance coverage exists; 2) if so, the size of the policy, the number of claims filed against the policy and the remaining policy limits; 3) the types of claims that are covered; and 4) what coverage defenses exist. Errors and omissions policies have become quite complex. For example, I have seen policies that exclude certain types of investments from coverage. I have even seen specific private placements excluded from coverage by name.

Without understanding the scope of coverage provided by a policy, plaintiffs' counsel can easily plead their

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clients out of coverage. In this regard, any assumptions regarding coverage are potentially dangerous. For example, I have encountered situations where a broker-dealer did not have coverage but its registered representatives did. Plaintiffs' attorneys in FINRA arbitration matters often do not name the brokers as respondents. In those cases where only the broker has coverage, the failure to name the broker eliminates the best opportunity for collection. I have also understood for as long as I can recall that selling away claims are routinely excluded from coverage. Nevertheless, I encountered a situation recently where selling away claims were specifically covered under a policy, which significantly contributed toward the plaintiff obtaining a favorable settlement.

Certain states have statutes requiring companies to provide applicable policies relevant to potential claims upon request. When contemplating suits against smaller financial services companies, plaintiffs' counsel should request such information prior to filing a complaint. If the policy is complicated, counsel may want to retain insurance counsel to assist in reviewing the policy.

This is a challenging time for small and regional financial services companies. Many have gone out of business, and others are on the brink. No rational person could argue that collectability is less important than liability and damages. Unfortunately, insurance is sometimes the only way to recover against these firms. Therefore, in order for plaintiffs' counsel to represent their clients effectively, they must understand whether insurance coverage exists and what it covers. The failure to do so could make for a very unhappy attorney and client. ■

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