# BROKER/DEALER E&O
## POLICY LIMITS AND THE PROBLEM OF INTERRELATED WRONGUL ACTS

APRIL, 2012

## ARE YOUR E&O POLICY LIMTS *REALLY* WHAT YOU THINK?

"B-Ds sue insurers over coverage caps"- Investment News, February 20, 2011. "Broker-dealers lack E&O savvy"- Investment News, April 24, 2011.

Finding out that your policy limits are not nearly what you believed them to when you have claims is too late. Both of the above referenced articles deal with legal disputes between high-profile broker/dealers and their E&O carriers. These disputes center on the applicability of insurance limits and the E&O policy's "Interrelated Wrongful Acts" provision. In short, the broker/dealer asserts that they should have the full Policy Aggregate Limit of Liability available for multiple claims. Not so, say the insurance carriers, pointing to the Interrelated Wrongful Acts provision and stipulating that only the smaller, Per Claim or Per Occurrence limit applies.

## TYPICAL E&O POLICY LIMITS

**Per Claim Limit**-The most the insurer will pay for any one (1) claim.

**Per Policy Aggregate**- The most the insurer will pay for all claims in a given policy year.

Sounds straight-forward, right? Read on.

**Note**: Some insurers insert a third limit of liability, known as a Registered Representative Aggregate limit, which further caps the coverage available for all claims involving any one (1) representative. If you have such a provision in your policy, it is extremely important to confirm that the coverage limitation applies only to the representative, and not to the firm. Failure to do so can result in greatly restricted coverage availability.

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INTERRELATED WRONGFUL ACTS

## INTERRELATED WRONGFUL ACTS PROVISION-WHAT IS IT?

A provision intended to tie a single claim, or related claims, to a single policy and a single limit of liability, restricting the insurer's exposure.

Varying by carrier, these provisions generally stipulate that any and all claims that have as a common nexus any fact, circumstance, cause or series of related facts, circumstances, situations or causes, shall be treated as one (1) claim. Some policies go further, stating that the provision applies, "regardless of whether such claims involve the same or different claimants or legal causes of action". Some form of the provision exists in all broker/dealer E&O policies available today.

To be sure, the provision is vague. Nowhere do the insurers define "common" or "related". With E&O insurance, vague is often good, but not in this case.

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INTERRELATED WRONGFUL ACTS

## POTENTIAL APPLICATION

Assume an E&O policy carrying $1M Each Claim/$5M Total Policy Aggregate. Next, assume that the firm received four (4) customer arbitrations all arising out of the sales of a particular product, for a total demand of $2.5M. The E&O policy carries a $5M aggregate limit, more than enough to cover the worst case outcome, right? The E&O carrier may well see the matter differently. The carrier could point to the Interrelated Wrongful Act provision, the fact that the claims all pertain to the same investment, and treat the four (4) arbitrations as one (1) claim, subject to the $1M Per Claim limit of liability.

## HOW CAN A FIRM ADDRESS THE ISSUE?

Can the insurance company do this? The answer is as vague as the policy provision itself. The applicability depends on the specific circumstances, and case law is all over the board.

Can the firm challenge the insurer's position? Perhaps, but the provision is often an issue at a time when the firm is facing great financial strain over multiple claims, and may not be in a position to do so.

The largest issue presented by this provision is the lack of adequate policy limits for a string of large claims arising out of related events. The only true "fix" is to purchase increased Per Claim limits of liability. Typically, it is more cost effective to purchase an excess "follow-form" E&O policy from a different insurer. The excess coverage terms follow those of the underlying primary policy. Because the excess carrier doesn't attach to a claim until the underlying limits are exhausted, the pricing metrics tend to be lower. Using the previous example, purchasing a $2M/$2M excess policy to sit on top of the existing $1M/$5M policy will provide the firm a total of $3M for any one (1) "claim", and $7M in the aggregate.



## WHAT ABOUT PRIOR ACTS?

"I am not worried about what we are selling or how we sell it *today,* I am worried about five (5) years ago." Such sentiment is very common. In the current market climate, most E&O carriers will not offer prior acts coverage on newly issued excess limits of liability. The excess limits will apply to activities occurring on or after policy inception. In reality, the broker/dealer typically desires higher limits of liability for the same reasons that the insurance carriers are cautious about providing them. Namely, worries over past activities and exposure. As is always the case, there are exceptions. If a firm is squeaky clean, and/or willing to pay enough premium, prior acts coverage is possible. Regardless, the need for higher limits exists, and the firm must begin somewhere.

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