

INSURANCE COVERAGE FOR SUBPRIME MORTGAGE PROBLEMS

Recent reports of losses arising from subprime mortgage investments have prompted companies involved in subprime mortgage lending, repackaging and investments to review their insurance and defense coverage under professional liability insurance policies. The potential targets of investigations and claims include: mortgage lenders, real estate professionals (ranging from real estate brokers to mortgage salesmen and appraisers), investment banks involved in packaging and selling collateralized debt obligations, investment managers, hedge funds, pension funds, auditors, and credit rating agencies. Identifying risks early and taking action to preserve coverage are the first steps to ensure that directors' and officers' ("D&O"), errors and omissions ("E&O") and pension trust liability ("PTL") insurance programs respond to claims and investigations arising from subprime activities.

The allegations arising from the subprime crisis may include material financial misstatements involving subprime securities, failure to understand and explain to investors the risks associated with collateralized debt obligations and other securities backed by subprime loans, professional liability claims against loan originators, bankers, investment advisers, credit agencies and others involved in structuring and packaging the loans, and ERISA claims for imprudent investment of employee assets in subprime loans and improper administration of pension plans. These kinds of claims, and others, by plaintiffs and government investigators may trigger coverage under D&O policies. Accountants, lawyers, investment managers and underwriters may also be able to turn to their E&O insurers to cover claims arising from subprime activities. Trustees responsible for the distribution of cash flow and trustees of major pension funds who are sued for ERISA violations may have coverage provided by their PTL policies.

In addition to reviewing the substantive coverage terms of their D&O, E&O and PTL policies, parties facing potential investigations or claims should focus on their policies' claims notice requirements. In order to preserve coverage, a policyholder may be required to disclose to the insurer subprime-related claims or circumstances that may reasonably give rise to a claim under a professional liability policy. Internally, risk management protocols should be reviewed to determine a policy's criteria for notifying the insurer of claims and potential claims, and whether any obligations to disclose potential subprime liability currently exist. More formal, written allegations or inquiries will commonly require prompt disclosure to an insurer and any failure to do so may negate or limit coverage. Early reporting may entitle the policyholder to reimbursement of defense expenses even before a claim is actually filed.

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If you have any questions regarding this memorandum, please contact Mitchell Auslander (212-728-8201, mauslander@willkie.com), Leah Campbell (212-728-8217, lcampbell@willkie.com), or the attorney with whom you regularly work.

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