



TRUST DEPARTMENT ERRORS AND OMISSIONS

Managing a customer's wealth through a trust account can be a rewarding experience, but during a volatile stock market it also can be a perilous one. BancInsure has recently paid a claim involving a trust company's management of assets in a couple's IRA's and trust accounts. This claim is an example of a trust company that properly handled the account, but was the victim of an unfair arbitration award.

A couple, we will call them Jim and Judy Johnston, (not their real names) were referred to the trust company by one of its outside directors in the fall of 2000. The Johnstons' investment portfolio was valued at approximately two million dollars, but had recently declined to that level after several years of successful market timing trading. After discussions with the trust company, the Johnstons moved two IRA accounts from another institution and opened a personal trust account. Total value of the two IRA accounts and the trust account was approximately \$770,000 when it was placed with the trust company. The trust company carefully reviewed and documented the Johnstons' income requirements, desired investment return and risk tolerance and developed an investment strategy based on these factors. The strategy included approximately 60% in large-capitalization "blue chip" equities, was not highly speculative and was based on a long-term investment horizon. A portfolio heavily invested in fixed income securities could not have achieved the Johnstons' investment return goals and income requirements. The investment strategy was fully disclosed and discussed with the Johnstons. The Johnstons signed financial planning and investment management agreements. Monthly statements disclosed that the accounts values and the securities included in the accounts. As noted above, the Johnstons were not novices, but experienced investors.

Due to the general market decline in 2001 into 2002, the value of the Johnstons' accounts declined to approximately \$503,000, a decrease of approximately \$267,000. The Johnstons transferred the accounts from the trust company in the fall of 2002 and filed a claim against the trust company and the trust officer alleging fraud, negligent misrepresentation, breach of fiduciary duty, breach of professional duty, negligence, breach of contract and violation of the state consumer protection laws. The Johnstons further alleged that the securities in the account were not truly conservative "buy and hold" securities and that the trust company failed to monitor and timely sell selected investments. The Johnstons later filed a lawsuit against the trust company and the trust officer with similar allegations. These allegations were made in spite of the account opening procedures and receiving monthly account statements. The Johnstons demanded \$600,000 to settle the claim against the trust company including lost investment opportunity of over \$300,000.

The account agreements included compulsory arbitration clauses. The arbitrator agreed to by the Johnstons and the trust company appeared to be competent and fair. The arbitrator awarded the Johnstons \$225,000. It appears that the decision was driven more by sympathy for the Johnstons than based on the facts and the law.

BancInsure paid the \$225,000 arbitration award and indemnified the trust company for approximately \$20,000 in defense costs in excess of the self-insured retention.

This is an example of a case where the trust company basically handled an account properly, but the customers were unwilling to accept responsibility for the risk they assumed and points out the need for insurance protection even when accounts are properly handled.

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