



BANKERS ERRORS AND OMISSIONS

One of BancInsure's insured banks recently discovered that there should be a limit to how accommodating a bank should be in dealing with a customer who apparently has cash flow problems. The customer was an escrow agent and was authorized by a national title company to issue title insurance for mortgaged properties. She maintained her trust/escrow checking account at the bank. She had financed her \$400,000 home and several automobiles and recreational vehicles at the bank. She had her business operating account at another bank. In addition she had borrowed from both banks for business purposes.

During 1999 our insured bank's customer, who had been in business since 1997, began diverting funds from her trust/escrow account for personal use to fund her extravagant life style. She began a check kite in an attempt to cover-up the shortage and to be able to continue to fund the mortgage loans she was closing as an escrow agent. Eventually overdrafts began to occur in her trust/escrow account. The bank's personnel apparently believed that the overdrafts were due to timing problems with the funding of the loans she was closing rather than the real problem. In 2002 the check kite collapsed and the bank experienced a loss of \$162,000. The customer's parents mortgaged some property and paid the bank \$100,000 reducing the loss to \$62,000. The bank had a Financial Institution Bond issued by BancInsure, but had elected not include check kiting coverage in the coverage package. Therefore, there was no coverage for the loss.

Additionally, because there was no money to fund several loan commitments, the title company had to fund the loans resulting in a loss of approximately \$400,000 to the title company. The title company sued their agent (the bank's customer), the other bank and BancInsure's insured bank.

The bank's customer had no money to fund a judgment or contribute to a settlement. The other bank involved was able to settle for \$80,000 since the account at that bank was not a trust/escrow account. There are special requirements for trust/escrow accounts in the state where this claim took place, including reporting overdrafts to a regulatory body. The bank did not report the overdrafts as required. The bank's failure to report the overdrafts put it in more precarious position as to potential liability. The title company had "audited" the trust/escrow account, but failed to detect the kite. These facts allowed a settlement to be achieved rather than going to trial.

The bank had purchased a Bankers Errors and Omission Endorsement to their Directors and Officers Liability Insurance Policy. The Endorsement provided coverage for the situation described above. BancInsure paid \$170,000 to settle and also has paid approximately \$88,000 in defense costs after the application of the self insured retention.

This is an example of one type of situation that is covered by the Bankers Errors and Omissions Endorsement that would not be otherwise covered. Please note that coverage for similar claims would depend on the particular facts of that claim and the applicable coverage in effect.

BancInsure's Directors' and Officers' Liability Insurance Policy offers protection for a broad range of claims made against directors and officers. BancInsure also offers entity coverage to the bank for certain claims in the form of endorsements to the Directors' and Officers' Policy covering bankers errors and omissions, professional services, employment practices liability, lender liability, trust department errors and omissions, and mutual funds, insurance and annuity sales. If you would like to learn more about BancInsure's Directors' and Officers' Liability Insurance Policy and its entity endorsements, please contact your BancInsure marketing representative.

