



**“..., BUT I DID NOT DO ANYTHING WRONG”**

As noted in some prior BancGuard Communiqué articles, sometimes you can do everything right and still get sued. The following true story is another example of this.

There was an insurance agency with three principals that found itself in need of additional capital. In 1997 one of the principals approached the bank with a plan whereby the employees of the agency and a few select outsiders would be allowed to invest in the agency by the purchase of stock with the bank financing the purchase. The individual investors would sign the notes and pledge the stock as collateral. The proceeds of the loans would go to the agency for use in the business. Initially the notes were to be “balloon notes” with monthly interest payments only. The principal of the agency told the loan officer that the agency would make the interest payments. The principal took the notes, security agreements, assignments, etc. to the agency. Eleven of the agency employees decided to participate in the plan with investments ranging between \$15,000 and \$30,000. The bank drew up the loan documents based on information furnished by the principal. The principal took the documents to the agency. The bank received the necessary signed paperwork from the agency, the loans were made and the proceeds were disbursed to the agency. The monthly interest payments were received in the form of checks from the agency. Everything went smoothly until 1999.

When the loans came up for renewal in 1999 the agency was experiencing financial difficulty. In the discussions with the investors/borrowers, the bank learned for the first time that the interest payments from the agency had actually been funded by itemized payroll deductions from the participating employees. The participating employees also alleged that the principal who had authored the deal had told them not to worry about paying the loans that they would never have to “pay a dime.” Bank personnel emphasized to the borrowers that they were still responsible for the payment of principal and interest regardless of any arrangement with the agency for the payment of the loans. Several of the borrowers paid off their loans.

In early 2000 the agency closed and filed Chapter 7 bankruptcy. The bank attempted to work with the remaining borrowers; however, their efforts were largely unsuccessful. The bank filed debt collection lawsuits against the borrowers. Seven of the borrowers filed counter claims against the bank. No directors or officers of the bank were named in the counter claims. The collection suits and counter claims were consolidated into a single lawsuit on a motion by the bank. The bank had a Directors’ and Officers’ Liability Insurance Policy issued by BancInsure. Because the bank had purchased the Lender Liability Endorsement to the Policy, there was coverage for the bank itself for these counterclaims.

The bank won the lawsuit on a motion for summary judgment, but defense costs were approximately \$100,000. BancInsure paid approximately \$90,000 after the application of the Policy’s retention.

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