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Insurance Companies On Offense

Law360, New York (April 21, 2009) -- In the wake of the current financial crisis, large multiline insurance companies find themselves defending the Directors and Officers ("D&O") and Errors and Omissions ("E&O") policies issued to financial companies and the individual directors and officers.

Investors are also bringing securities class actions and other suits against certain insurance companies, particularly the monoline companies, claiming misrepresentation of purported risk exposure and inadequate internal underwriting and ratings systems for various classes of asset-backed securities.

However, there is a third situation — large multiline insurers with large investment portfolios have themselves experienced significant financial losses due to some of the actions of various financial companies and their directors and officers.

Some insurance companies are beginning to file cases to recover their investment losses, rather than sitting by as passive parties to various securities class actions or not seeking any recovery at all.

Insurance Companies as Defendants

Multiline insurers are receiving numerous claims notices related to their coverage under D&O and E&O policies issued to financial institutions.

Investors seeking to recover losses from their investments in financial companies such as Lehman Brothers and Fannie Mae are looking to trigger these companies' D&O and E&O policies as a means of recovery, most commonly through securities class actions.

Where insurers find themselves having to potentially cover millions and millions of dollars of insurance coverage, many are looking to exclusions that may apply when the directors and officers were participants and were actively involved in issuing these toxic assets.

Certain of these claims which are denied due to exclusions may very well end up in litigation. In other instances, the value of the policy may be ceded to the securities class without a significant amount of litigation. Either way, the insurance companies may have to pay significant amounts due to the current financial crisis.

Numerous publicly traded insurance companies, both monoline and multi-line companies, are being sued for securities violations based on claims that the insurance companies misrepresented their exposure to the toxic securities market.

For example, a consolidated class action filed in October 2008 by the Teachers' Retirement System of Oklahoma, plaintiffs specifically claim that MBIA, a Connecticut holding corporation which principally operates through its insurance subsidiary, MBIA Insurance Corporation, "fundamentally misrepresented its exposure to billions of dollars of the most toxic securities in the market: collateralized debt obligations ("CDOs") containing residential mortgage-backed securities ("RMBS")," and did so in violation of federal securities law. In re MBIA Inc. Securities Litigation, 08-cv-264, (S.D.N.Y. filed on Oct. 17, 2008).

Plaintiffs claim that MBIA affirmatively assured investors that its toxic-asset exposure was limited and was being monitored, despite alleged knowledge and actions to the contrary.

However, insurance companies are not only defendants in suits associated with toxic asset and financial company losses; insurance companies are also starting to place themselves in the position of plaintiff to recover their investment portfolio losses.

Insurance Companies as Plaintiffs

One recently adjudicated decision and a few recently filed Complaints illustrate the type of asset recovery that insurance companies are seeking related to their investment portfolios.

Adjudicated Case

AIG Global Corp. et al. v. Banc of America et al., 01-cv-11448 (S.D.N.Y. filed Apr. 30, 2002)

AIG Life Insurance Company, Allstate Life Insurance Company, The Travelers Insurance Company and others successfully brought suit against Banc of America Securities and First Union Securities Inc. where a jury awarded the plaintiffs $141 million on Dec. 5, 2008.

The jury held that Banc of America Securities defrauded investors where it acted as underwriter and sold asset-backed securities backed by high risk, high-loss investments. First Union had settled with plaintiffs prior to trial.

The case involved investments in the Helig-Meyers Master Trust which was formed by the then largest publicly held specialty retailer of homer furnishings — Helig-Meyers Co.

The Trust pooled a substantial number of installment sales contracts and then sold multiple series of asset-backed securities to investors.

Upon Helig-Meyers' cessation of servicing the installment sales and subsequent filing for bankruptcy, the collection of amounts due under the installment sales deteriorated and the value of the underlying asset-backed securities dropped significantly. The insurance companies sued to recover their lost value.

The complaint alleged that Banc of America Securities was instrumental in setting up the trust and effecting the issuance and offering of the asset-backed securities offered by the trust.

The complaint alleged violation of federal law where defendants made an "intentional omission of material facts ... in formal offering memoranda, in sales memoranda and otherwise ..."

Plaintiffs asserted that if those omissions had not been made and if instead the representations made to investors had communicated the significant risk to which they would be exposed, the plaintiffs would not have invested in the asset-backed securities.

Defendants' complete misrepresentation of the financial health of Helig-Meyers thus resulted in enormous financial losses for plaintiffs.

Recently Filed Complaints

American National Ins. Co. et al. v. Fuld et al., 09-cv-00020 (S.D.Tex. filed Feb. 5, 2009)

In February 2009, American National Insurance Company and others sued the underwriters of Lehman Preferred Series J shares, ANICO bonds, and ANTEX bonds issued by the former Lehman Brothers Holdings Inc. and its affiliates.

The complaint alleges that the investors relied on misrepresentations made by Lehman and the underwriters associated with Lehman's subprime mortgage exposure. Lehman filed for bankruptcy protection in September 2008 and the investments became worthless.

The American National complaint alleges that Lehman "was heavily leveraged in the mortgage-backed securities market, including subprime and Alt-A loans.

However, even in the face of a crashing real estate market, Lehman actively concealed the increasingly dangerous risk it faced and failed or refused to properly value its assets

... and Lehman and each defendant [the Underwriters] repeatedly asserted to its investors that Lehman's financial condition was sound ..."

Plaintiffs allege that Lehman exposed itself to the deteriorating real estate market when it acquired the mortgage originators Aurora and BNC, and thus purchased loans whose pools consisted mainly of Alt-A and subprime loans.

Lehman then chose to focus on its role in securitizing those loans rather than on the performance of those individual loans, and repeatedly assured its investors that it was actively hedging its position to mitigate any risk, and that most of its investments were Alt-A rather than subprime.

Lehman also failed to take any write-downs as the market declined, and greatly overvalued its assets. Finally, plaintiffs allege that Lehman's underwriters and auditors were in unique positions to discover and disclose information regarding the true state of Lehman's financial situation, yet all parties failed to do so.

The complaint seeks equitable relief pursuant to Section 10(b) of Securities Exchange Act of 1934 and Rule 10b-5, Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, the Texas Statutory Fraud provision, the Texas Securities Act, and Texas common law claims for aiding and abetting fraud, fraud and negligence.

Allianz Risk Transfer et al. v. Paramount Pictures Corp., 08-cv-10480 (S.D.N.Y. filed Dec. 2, 2008)

In another matter filed in December 2008, Allianz Risk Transfer, an affiliate of Allianz, MRCM, a corporation wholly owned by Munich Reinsurance Company AG and others, filed suit against Paramount Pictures for debt investments issued by Melrose Investors LLC for the benefit of Paramount.

Melrose was established as a means for investors to invest in a slate of movies to be produced, released and distributed by Paramount Pictures.

The complaint alleges that the financial performance of Melrose was poor and the investors expect to lose their entire investment.

The complaint alleges that the investors purchased the Securities through disclosures in a Private Placement Memorandum (PPM) including disclosures related to risk mitigation techniques when producing and distributing films.

However, the complaint alleges that Paramount materially altered its production and distribution plans with regard to the films in Melrose which made the investment more risky.

The complaint seeks damages or rescission under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 and for fraudulent inducement and unjust enrichment at common law in the state of New York.

Bankers Life Ins. Co. v. Credit Suisse Securities LLC et al., 07-cv-00690 (M.D.Fla. filed Apr. 23, 2007)

Finally, Bankers Life Insurance Company has brought suit against Credit Suisse for its investments in various asset-backed securities. The complaint alleges that Credit Suisse sold Bankers such investments as sound, high-rated investments, despite defendants purported knowledge to the contrary.

Credit Suisse, as underwriter and issuer, sold eleven classes of instruments to investors such as Bankers. Bankers purchased the ABS for its investment portfolios which were comprised of various securitized and pooled loans.

Plaintiffs assert that defendants, however, originated these securities despite knowledge of their poor quality, their lack of adequate underwriting criteria, and other faulty information. Additionally, had all relevant information been disclosed, the subsequent Moody’s rating downgrades could have been avoided.

Conclusion

Insurance companies have long been defendants, both as issuers of D&O and E&O policies as well as in securities class action cases against their companies. However, insurance companies also have become plaintiffs to recover losses in their vast investment portfolios.

Whether insurers will continue to be successful as plaintiffs is yet to be seen, but given the results of the AIG et al. v. Banc of America Securities suit, and given that so many parties are victims in the current financial meltdown, bringing suit may be a solid option.

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