

Crime Losses: A Primer for the D&O Professional

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While the claim count of a D&O professional is comprised primarily of D&O claims, the professional may also be confronted with a commercial crime loss. These losses may be noticed under the Crime section of a Blended Policy, or under some other Commercial Crime Policy or Bond issued by the Insurer, which could find its way to the D&O claim handler. While separate, dedicated units may be established within the Claim Department to handle these losses, staffed by crime or fidelity claim professionals, the D&O claim handler may on occasion be confronted with a crime loss. Accordingly, it is useful for D&O claim professionals to understand the claims handling process involved in such crime losses.

By the same token, the D&O underwriter issuing a Blended Policy should be aware of certain provisions that may serve to limit or enhance Crime coverage, which are not typically found in D&O Policies, and may be particular to the Crime section of the Policy. For example, Crime Policies or Bonds will often contain a discovery period or "tail," which afford coverage for losses discovered up to one year after expiration. Such a provision is typically found in the Crime section of a Blended Policy. In contrast, the D&O or professional liability Policy will contain only a sixty-day tail during which claims made during the Policy Period can be reported. A reduction in the discovery period of a Crime Policy or Bond from one year to sixty days will reduce exposure for losses discovered during the ten-month period after expiration of the sixty-day tail and bring the Crime Section of the Blended Policy in line with the other coverage sections.

Generally speaking, Fidelity or Crime claims are comprised of Crime and Financial Institution losses. Generally speaking, a Crime Bond or Policy will cover a commercial or nonfinancial entity, whereas a Financial Institution Bond or Policy may cover banks, broker-dealers, mortgage banks and other similarly situated entities. What many people not familiar with fidelity losses do not realize is that these are all fidelity matters, i.e., employee dishonesty or fraud in some capacity, and they simply fall into different categories based on the type or nature of the entity being insured. In addition, Crime and Financial Institution Policies tend to focus on different types of coverage based on the required needs of the particular entity.

Initially, it should be understood that crime coverage, either Policies or Bonds, are written as contracts of indemnity, not liability. It is first party property coverage for direct financial loss to the Insured. As with D&O coverage, no duty to defend exists in Commercial Crime Policies. Instead, the coverage applies to property owned or held by the Insured or for which the Insured is legally liable. No coverage is afforded for liability for loss to third parties, except to the extent such liability arises out of direct loss of property covered by the Bond or Policy.

The typical crime loss is noticed as a potential Claim by the Insured or broker after "discovery" of loss or a situation that may result in loss. Discovery is defined in the typical form of Financial Institution or Banker's Blanket Bond; it is generally not a defined term in the standard Commercial Crime Policy. Where it is a defined term, discovery occurs when the Insured first becomes aware of facts, which would cause a reasonable person to assume that loss of a type covered by the Policy has or will occur.

The claim handler may, but is not necessarily required to, commence his or her investigation upon receipt of notice of potential Claim. The actual Claim is not "made" until the Insured submits the Proof of Loss, and the time limit for submission of such Proof is set forth in the Policy. After notice of potential Claim is received, the claim handler should acknowledge receipt of the notification. It is useful in the acknowledgment to request background facts from the Insured. This background information may include the employee's personnel file, a description of the manner of discovery, the name and identity of any police investigators or regulatory authorities and information about any in-house investigations. Receipt of this information, prior to receipt of the Proof of Loss, will allow the claims handler to identify key issues at an early date, which may serve to streamline the investigation process after receipt of Proof of Loss.

The acknowledgment letter should also enclose the Insurer's Proof of Loss Form for use by the Insured and request submission of the Proof within the time requirements of the Policy. A number of jurisdictions provide that, where the Insurer does not provide the Insured with the Proof of Loss Form, the Insurer may be precluded from arguing there was an untimely submission of the Proof. The acknowledgment letter should also fully reserve the Insurer's rights, remedies and defenses under the Policy and at law and equity, pending submission of the Proof of Loss.

The Proof of Loss should be submitted within the time prescribed by the Policy. Should the Insured or broker request an extension of time to submit the Proof, any such extension should be provided on a non-waiver basis and without waiver of the Insurer's right to contend that the extension does not cure an otherwise tardy Proof, which would have been untimely when the extension was first requested. Where extensions are granted, it is prudent for the claim handler to so notify the underwriter that an open, potential claim exists and may impact coverage down the road, particularly where the extensions are for long periods of time. Otherwise, the underwriter may be of the mistaken view that no further adverse losses will develop. By this time, it is equally important for the claim handler to have identified persons or entities from whom recovery may be sought and to determine the limitations period within which to bring suit against such persons or entities. Of course, the Insured must undertake reasonable efforts to mitigate its loss and not do anything to prejudice the Insurer's subrogation rights. The claim handler should be aware of any limitations period to ensure that such subrogation rights are preserved until resolution of the Claim.

The next step in the process is submission of the Proof of Loss, which should be sworn to by the Insured. Once submitted, the Proof should be acknowledged in writing. The claim handler should then prepare a list of documents or information to be sent to the Insured. In some instances, it may be useful to meet with the Insured after submission of the Proof, either just before or after issuing the document request. Such a meeting may serve to identify key areas of inquiry and streamline the investigation going forward. The document request should advise the Insured that the initial production of documents will not necessarily result in the conclusion of the coverage investigation. The Insurer may request additional documents or conduct interviews. In any event, the claim handler should be mindful of statutory law in the applicable State, which may limit the time period within which to complete the coverage investigation.

After receipt and review of documents, the claim handler should formally request the interview of employees, if it is necessary to do so. These interviews should include the defalcation employee, supervisors, risk managers and other relevant individuals with knowledge of the loss. Once sufficient information is gathered to properly evaluate the Proof of Loss, the claim handler is then in a position to prepare the coverage position letter.

As with D&O claims, the preparation of the coverage position letter involves an analysis and application of facts to Policy wording. However, unlike "claims made" coverage, the Crime Policy is triggered on either the date of discovery of loss, or the date the loss was sustained, depending on Policy wording. Accordingly, as a threshold matter the date of discovery or the date loss was sustained must be reviewed. In addition, it should be immediately verified that the Insured has timely submitted the Proof of Loss. The untimely submission of the Proof should be brought to the Insured's attention immediately by way of reservation of rights. Other issues are whether the loss involves "Covered Property," whether an "employee" of the Insured has caused loss, whether the employee's acts constituted "fraud" or "dishonesty," and whether the employee acted with "manifest intent" to cause loss and to obtain financial benefit other than salaries, commissions, fees or bonuses. Again, from an underwriting perspective, the substitution of the word "or" for "and" in the manifest intent provision of the Crime Policy can significantly enhance coverage.

The typical crime loss is no more complex than a D&O claim. Once familiarity with the process is obtained, the D&O claim professional should not shy away from handling the typical crime loss.