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Insurance coverage eyed in Madoff claims

Karen Sloan / Staff reporter

February 09, 2009

Marshall Gilinsky's phone has been ringing with increasing frequency during the past two weeks.

The calls are coming from a variety of people involved in the Bernard Madoff scandal, from investors who lost money in the scheme and the attorneys who represent them, to those involved in funneling money into Madoff's bogus investment funds.

What the callers want from Gilinsky — a shareholder at Anderson Kill & Olick, a New York firm that specializes in representing policyholders in recovery claims against insurance companies — is an indication of what role insurance coverage is likely to play in the legal wrangling over financial losses tied to Madoff.

Gilinsky and several attorneys representing Madoff investors say that insurance claims are going to be one of many avenues investors opt for in seeking to recover their losses.

Those insurance claims, however, aren't likely to be the primary thrust of litigation. The amount of losses suffered by investors — perhaps as much as \$50 billion — will dwarf any insurance coverage maintained by Madoff or by the so-called feeder funds — those investment advisers or auditors that helped direct money to the fraudulent funds.

The best that most investors can hope to recover from insurance companies is mere cents on the dollar of their losses, Gilinsky said.

A 'financial 9/11'

Tim Mungovan, one of about 20 Nixon Peabody attorneys representing dozens of individual and institutional Madoff investors, also sees the role of insurance being somewhat limited.

"I've heard people refer to Madoff as the financial 9/11, and insurance litigation was the main financial driver of that event, partly because the federal government stepped in and created a relief fund," he said. "I don't think insurance will take front and center stage [in the Madoff case]. It will be a piece, but it won't be the main focus."

Moreover, any insurance claims made by investors may well come in the later stages of the legal process and are likely to take place out of the public eye, said Mungovan and his Nixon Peabody colleague Jonathan Sablone.

It's still too early in the process to gauge exactly how much insurance coverage will come into play, said Alan Reisch, a litigation attorney who focuses on risk management and insurance at Boston-based Goulston & Storrs. He has been poring over Madoff investors' insurance policies as part of his firm's Madoff response team.

"A lot of this depends on the coverage that is available," Reisch said. "It's difficult to say. The facts are unraveling quite slowly."

Madoff was arrested and charged with criminal securities fraud on Dec. 11, 2008, after he allegedly confessed to his sons that his investment firm was running a massive Ponzi scheme. The case has sparked a flurry of legal action. Some investors have already filed lawsuits against an array of people and entities that directed money to Madoff's firm, and many more such suits are expected.

Several avenues

Although it's difficult to gauge the potential for individual and institutional investors to recover losses through insurance claims because insurance policies and coverage varies, Gilinsky said there are several insurance avenues in which investors may look.

Most financial firms, investment advisers and auditors have third-party insurance policies that cover liability for wrongdoing to outside parties, known as directors and officers coverage, or errors and omissions coverage.

Investors are likely to file claims against those intermediaries, alleging that they did not perform due diligence when they funneled money into Madoff's funds. But the problem for investors is that hundreds of others who also lost money with Madoff will be looking to the same intermediary's insurance policy. That means the pie of available insurance money is likely to be sliced extremely thin.

Coverage limits for those insurance policies will vary depending on the size and nature of the institution, Gilinsky said, but it's highly unlikely that any policy has a limit high enough to cover all of the related investor losses.

"You've got a great claim for liability against them, but so do a thousand other people," Gilinsky said of the larger feeder funds that directed money to Madoff. "The best you can hope for is to run in there and extract a quick settlement."

Gilinsky said the picture is a little brighter for investors who dealt with small financial firms or auditors that had few clients who lost money with Madoff. Even if those "cameo players in the Madoff drama" had just \$10 million in professional liability coverage, investors may get a larger cut of the money, Gilinsky said. But even for the few investors in that scenario, insurance isn't likely to cover their entire loss.

It's even less likely that investors will see any insurance money from Madoff himself. It's not clear if Madoff had insurance coverage, and any payout from such a policy would be an almost insignificant drop in the bucket compared to investor losses, Gilinsky said. Not only that, but any insurance Madoff may have had on his fund could become tied up in the resulting bankruptcy case, said Mungovan.

In fact, the biggest role third-party insurance may play in the legal fallout of the Madoff scandal is in covering defense costs for those firms and individuals who are sued by Madoff investors. The insurers' responsibility to pay the policyholder's legal costs depends on the terms of the insurance policy, but in some cases the defense cost is deducted from the coverage limit, further reducing the amount of money available to investors making claims.

First-party insurance

Madoff investors may have another way to recover some of their losses: first-party insurance. That includes homeowner insurance, since some homeowner insurance policies offer limited coverage for securities losses due to theft. The benefit of individual homeowners policies is that there is no competition from other investors to get that money, Gilinsky said. The drawback is that those policies aren't likely to cover more than \$100,000 in losses. Still, homeowner insurance may be the most easily available source of recovery for investors, he said. Mungovan and Sablone said they are looking at homeowner insurance as one potential source of recovery for clients.

Much of the recent discussion about the Madoff case has focused on the potential for so-called clawback suits brought by the bankruptcy trustee against investors who pulled out money prior to the collapse of the Madoff fund. The idea is that the clawback funds would be shared with other victims who saw their entire investment with Madoff wiped out.

Gilinsky said institutional investors facing a clawback suit may be covered under their own third-party liability policies, though it remains to be seen if and how that situation would play out. Reisch said he has been fielding many questions from clients who want to know if their insurance policies offer protection in a clawback scenario.

"I tell them, 'Get me your insurance policy and let me read it,' " Reisch said. "The answer is, 'Maybe.' "

The Nixon Peabody team is also in the early stages of unraveling insurance liability and the potential for claims.

"We haven't gotten into specific policy terms, but the issue of insurance coverage has come up repeatedly," Sablone said. "The insurance out there is certainly going to be swamped by the size of the claims. Investors know they won't be made whole by Madoff, so they are looking to insurance."