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NEWSLETTER

No Coverage for Payments To Investors in Mortgage-Backed Loans Where Policy Excepts Amounts Paid "as the Result of" Any Loans

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Applying Georgia law, the United States Court of Appeals for the Eleventh Circuit has held that where the definition of "loss" excepts amounts paid "as the result of" a loan, no coverage exists for settlement payments made by a bank to third-party investors in the bank's loan business. *Sw. Ga. Fin. Corp. v. Colonial Am. Cas. and Sur. Co.*, 2010 WL 3705991 (11th Cir. Sept. 23, 2010).

The insurer issued a D&O policy to a bank that originates, sells and services commercial real estate loans. The bank made two loans to a developer, each secured by an apartment complex. The bank sold ownership interests in the loans to other banks, subject to a participation agreement. Under the agreement, each "participating bank" was entitled to a *pro rata* share of the monthly loan payments in exchange for funding a portion of the loan principal. In the event of default, the bank was obligated to foreclose on the apartment complexes and distribute the proceeds to the participating banks *pro rata*. The bank also promised the participating banks that the loans would not close until 30% of the apartment units had sold. The vice president of the bank, however, neglected to include this pre-sale requirement in the loan commitment letters and closed on both loans before the requirement was met.

The developer subsequently defaulted on the loans, and the bank foreclosed on and sold the apartment complexes. The bank made the required *pro rata* distributions of the sales proceeds, but the participating banks demanded the return of their full investments, pointing to the vice president's error as the cause of their losses. The bank then reached a settlement with each of them pursuant to which the bank made additional payments to the participating banks equal to the difference between their principal investment and *pro rata* share of the sales proceeds. Afterwards, the bank sought coverage under its D&O policy for these additional payments. The insurer, however, determined that the additional payments did not constitute "loss" within the meaning of the policy.

The court of appeals agreed. The court noted that the policy defined "loss" to mean "any amount which any [i]nsured is legally obligated to pay as a result of a claim." The policy explicitly excepted from the definition "any principal, interest or other monies paid, accrued or due as a result of any loan, lease or extension of credit." Here, according to the court, the additional payments made by the insured to the participating banks

in settlement of their demands represented amounts paid "as a result" of a loan—namely, the loans to the developer for the apartment complexes. The court held that it was of no consequence that the loans at issue were not loans to the participating banks because, on its face, the exception applies to "any" loan, which does not mean "some" loans but, instead, means "all" loans.