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ALERT

Mortgage Backed Securities Are Not "Securities of an Organization"

February 28, 2013

The United States District Court for the Central District of California has held that a directors and officers liability insurer did not owe coverage to a home loan mortgage company for claims alleging misrepresentations in offering documents for residential mortgage-backed securities because the securities were not "securities of an Organization." *Impac Mortgage Holdings Inc., et al. v. Houston Cas. Co., et al.*, Case No. SACV 11-1845 (C.D. Cal. Feb. 26, 2013). The court also held that the D&O insurer did not owe coverage because the policy's professional services exclusion barred coverage for the claims under the language of the policy at issue.

The mortgage company and its subsidiaries sold residential mortgages, securitized them and deposited them into trusts. The trusts then issued certificates that the mortgage company sold to investors. Subsequently, several investors asserted claims against the mortgage company alleging that they suffered losses caused by the mortgage company's false and misleading statements in connection with the sale of the certificates. After the D&O insurer denied coverage for the claims, the mortgage company filed suit against its D&O and E&O insurers.

On cross-motions for partial summary judgment by the D&O insurer and the mortgage company, the court ruled in favor of the D&O insurer on two grounds. First, the court held that the D&O insurer did not owe coverage because the claims against the mortgage company were not "Securities Claims," which the D&O policies defined as claims "brought by any person or entity alleging, arising out of, based upon or attributable to . . . the purchase or sale of or offer or solicitation of an offer to purchase or sell any securities of the Organization." The court rejected the mortgage company's argument

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that the phrase "securities of an Organization" included the mortgage-backed securities sold to investors. Instead, the court interpreted the phrase to mean securities of the mortgage company itself, reasoning that this was consistent with the policy's plain language and with the traditional purpose of D&O policies. The court also dismissed the mortgage company's argument that federal securities regulations supported its interpretation of the D&O policies on the grounds that the interpretation of the policies was a question of state law, and there was no indication that the regulations reflected the parties' intent for purposes of the insurance policies.

Second, the court held that the D&O insurer did not owe coverage because the claims were excluded by the D&O policy's Errors and Omissions Exclusion, which barred coverage for claims "made against an Insured arising out of, based upon or attributable to any Insured's or Organization's performance of (or failure to perform) any professional services, or any act, error or omission relating thereto." Opining that mortgage securitization was a fundamental part of the mortgage company's business, the court concluded that the E&O exclusion barred coverage for the claims. In so holding, the court emphasized that the mortgage company had also sought coverage under several E&O policies, maintaining that the same claims arose out of its provision of professional services.