What You Don't Know Can Hurt You

A Primer to Help Small Banks Evaluate Their Insurance Programs

••Is your bank's insurance anemic or vibrant? You can find out by reviewing your bank's program—and then get the maximum from it by taking advantage of a competitive insurance marketplace.

BY SCOTT SIMMONDS

BUYING INSURANCE—and thereby transferring risk to an insurer—is a common approach used by banks to manage operational risk. A bank's insurance program is determined by risk appetite, loss exposures, and the coverage available in the current insurance marketplace. It's essential to review your bank's program, particularly in terms of coverage and pricing. Here are some issues that are commonly found.

Check Your Buckets and Aggregates in Directors' and Officers' Insurance

Directors' and officers' insurance includes several sections—directors' coverage, lender liability, entity coverage, employment practices, and trust department protection.

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Bank Insurance Checklist

Consider the following as you review your bank's insurance:

- ❑ Check your directors' and officers' buckets and aggregates.
- ❑ Review the breadth of your bond coverage.
- ❑ Add a "per location aggregate" to your general liability policy.
- ❑ Consider your umbrella liability limits.
- ❑ Review your deductibles.
- ❑ Review your mortgage impairment insurance.
- ❑ Be sure all locations are listed.
- ❑ Remember the pollution exclusion.
- ❑ Use competition to improve coverage and control premiums.

Many policies are structured so that a claim in one area reduces the amount of coverage available for future claims in other areas.

To simplify the discussion, let's think of coverage limits as buckets of protection. You can maximize your coverage by maximizing the buckets your policy allows. For example, push for coverage that keeps trust claims from reducing coverage available for employment practices and that keeps entity claims from restricting directors' coverage. Policies often include an aggregate limit of coverage for all claims that restricts coverage for multiple events.

Adding an endorsement to the policy that applies the aggregate limit to each location expands your coverage at very little cost.

Review What's Included in Your Bond

Look at your banker's bond (also called the *financial institution bond*). You will find a laundry list of coverage sections: fidelity, off premises, counterfeit currency, safe depository, debit card, and others. Some policies have more than 20 different coverage areas. Ask your insurer to describe coverage options you currently don't purchase. Get optional quotes that increase current limits and for areas not covered. Beware of low aggregate limits on your bond, too.

Add a "Per Location Aggregate" Limit to Your General Liability Policy

Your bank's general liability insurance provides coverage for bodily injury and property damage. The policy contains an aggregate limit of coverage—the most the policy will pay for all claims at all locations. Adding an endorsement to the policy that applies the aggregate limit to each location expands your coverage at very little cost. In many cases, your insurer will add the coverage at no additional premium.

Consider Your Umbrella Liability Limits

Umbrella liability insurance provides protection above and beyond what's offered by your general liability, auto liability, and employer's liability insurance. It's an inexpensive way to increase your level of protection against lawsuits. Premiums can be as low as $750 per $1 million of coverage. Consider doubling whatever coverage you have now. Get proposals from your insurance agent and make your decision based on the value of the extra coverage and the cost of the additional premium.

For banks, the most likely catastrophic liability loss (a multimillion-dollar loss) is an automobile accident. For example, a bank officer is driving to see a customer. She spills hot coffee on herself and crashes into another car, causing serious injuries. Even if your officer is driving her own car, the bank will be named in any lawsuit. Umbrella liability insurance is inexpensive protection against such catastrophic losses.

High Deductibles Can Save on Your Premium

If your bank is willing to handle smaller claims and let the insurance company take care of larger ones, you could consider a property deductible of $10,000 or more. Look at your auto policy's collision insurance. Review your directors' and officers' insurance and your bond. Ask your insurance agent what the premium savings would be if you doubled or tripled your deductibles.

Review the Perils Included in Your Mortgage Impairment Insurance

Mortgage impairment coverage pays for a loss to a building on which you hold a mortgage if the mortgagee has no insurance. The policy protects the bank's interest in the property. Review the perils (causes of loss) included in the policy. Many banks have limited coverage requirements on the mortgage contracts. Some impairment policies follow the coverage required by your mortgage contract. Claims for damage from frozen pipes, for example, may not be covered. Look for policy wording such as "balance of perils" to see if you have coverage beyond the events required by your mortgage. Consider getting flood coverage, too. Ask your agent to explain your coverage to you.

Are All of Your Locations Listed?

Locations need to be listed both on your property insurance and on the liability section. This is a simple issue that often gets overlooked as policies are renewed from one year to the next. Don't forget to add liability coverage on vacant land your bank owns.

Having a constantly updated spreadsheet of locations is a helpful way to track the coverage you buy and the exposures you have. What locations are covered for flood? What locations are listed on the liability? What limits of extra expense coverage do you have at each location? Such a spreadsheet can reveal inconsistencies in your treatment of risk.

Remember the Pollution Exclusions

Over the past 20 years, the courts have hammered the insurance industry on pollution claims. The result is that most standard insurance policies have pollution exclusions so broad that the industry calls them "absolute pollution exclusions."

Liability arising out of pollution is excluded from most general liability insurance policies. If the oil tank for your heating system leaks and pollutes a neighboring stream or basement, there is no coverage. Directors' and officers' policies also have pollution exclusions. Your property insurance probably has an exclusion for damage to your property caused by pollution—your pollution or that caused by others.

The only exception to the above is for the cleanup of pollution on your premises caused by a peril included in your property insurance. Coverage is usually limited to $25,000, which is often not enough. Consider an environmental liability insurance policy that will pay your costs of cleanup and remediation. The greatest area of exposure is undoubtedly foreclosed properties. Your insurance adviser should be able to help you review proposals from a variety of insurers.

Competition Can Improve Your Coverage and Control Your Premiums

The current insurance marketplace is extremely competitive, and insurers are aggressive in their pursuit of new business, particularly that from high-performing banks. But even struggling banks are better off having several insurers working on policy renewals. Better coverage and better pricing at renewal are possible if you manage the process correctly.

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You can work with your current agent or bring in additional competition. The key is to get proposals from several insurers. Multiple agents bidding for your business multiply the competitive pressures and will usually yield the best coverage at the best price. When agents and insurers compete, the marketplace is at its most aggressive, and the buyer wins. ❖

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Letters to the Editor

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