

Your D&O Insurer Might Be Scouring Your Call Report Looking to Cancel Coverage

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Here's more bad news for struggling banks: Some insurance carriers have buried clauses in Directors and Officers liability insurance policies that allow them to cancel the policy if the bank's financial condition changes or if there is a "material change of risk," insurance brokers tell *FinCri Advisor*. And that's just when a bank would need the policy most.

The brokers say they have seen the cancellation provision in policies issued by the American Bankers Association-sponsored plan underwritten by Progressive, as well as in ones issued by Kansas Bankers Surety, Zurich NA and BancInsure in Oklahoma City. Usually, the insurers give the bank up to 90 days to find other coverage.

"The problem there is generally if the bank is cancelled by its insurance carrier, it's for a reason that makes them extremely hard to underwrite for anyone else," cautions Patrick Corey, agency principal of Independent Bankers Insurance Services in Chandler, Ariz.

Although the mid-term cancellations are rare, "the clause is there," notes Hank Bahr, of Bahr Consultants in Knoxville, Tenn. And that's why bankers "need to take a look at these things very carefully."

"It's incumbent on the bank to read the policy and incumbent on the broker to tell them of onerous language," echoes Corey.

No one from Kansas Bankers returned repeated phone calls from *FinCri Advisor* seeking comment about their cancellation policies. One BancInsure rep acknowledged the existence of the cancellation clause, but did not elaborate further. Jennifer Nowacki, Zurich's media and public relations manager, at first said that "the word 'mid-term' cancellation is not apparent in our D&O policies for banks." When asked about Zurich's cancellation policies, she said they differed by state and declined to answer any more questions.

Progressive said its policy is not to "publicly comment" about its business practices. But in a sample D&O policy on its Web site, Progressive notes that "this Policy or any Insuring Agreement may be cancelled by the Insurer by giving to the Named Insured written notice stating when such action shall become effective and the reason(s) therefore." Progressive adds that it will provide 60 days notice if it intends to cancel the policy "for any other reason" other than nonpayment of the premium.

Underwriters seek clues to changes in risk profile

Some underwriters are combing through Call Reports and enforcement orders for clues that a bank's risk profile might have changed, Corey says. "Underwriters automatically review Call Reports on insured banks," he explains. "If they see deterioration, they'll get in touch with their broker."

If a bank has a high percentage of non-performing loans, he points out, it is more likely to be involved in collection efforts to get its money back. And typically borrower lawsuits emanate from those efforts, which would increase

the insurance company's exposure. Banks struggling to make money might cut back expenses and trim staff, Corey notes. But that could lead to employment suits, which would also worry the insurer.

Bahr says several years ago one of his banking clients saw its CAMELS rating drop to 4. The insurance company said that constituted a "material change in risk" and threatened cancellation. But before that could happen, the insurance company was sold and the new company honored the policy.

LaVonda Alleman, a VP and senior account executive at Lockton, an independent insurance broker in Kansas City, says she has seen the cancellation clauses on multi-year deals, but has asked the insurance carriers to remove them before giving her a quote. She says the clauses give the carrier "the opportunity to give notice" if the bank's financial stability falls. "They really don't define what the fall means," she says, echoing a point raised by other brokers who noted that the insurers are not defining what constitutes a "material change" in risk.

The carriers which tend to have the cancellation clauses say on their Web sites that they cater to community banks. Those smaller banks may not hire lawyers or brokers to review their policies before they sign up. Attorneys with large banking clients say they haven't seen the cancellation provisions in their policies.

Some insurers won't negotiate their policies, so shop around, Alleman suggests. "Utilize a broker that is familiar with financial institution products. There are a lot of direct writers out there. They are not going to negotiate any language for you," she says.

If your policy does have a mid-term cancellation clause, make sure you have "frequent and good communication" with your underwriter and broker, advises Barbara Ewing, VP for underwriting at FinSecure in Towson, Md.

"When a bank starts to have financial problems, it would be good for the bank to proactively address the issues with their D&O carrier, even before receiving any indication that their policy may be cancelled," Ewing notes. "The bank should have a candid discussion with their D&O underwriter about their financial condition. The discussion should include the cause of the financial issues and the steps being taken to address them. The bank should also let the underwriter know if there are any regulatory issues and the corrective actions being taken."

If your bank is on the FDIC's troubled bank list, rest assured that "your underwriter is going to be looking at you," Ewing says.

Scour your policy for cancellation language

Above all else, read your policy carefully. "The problem with the D&O coverage in general is the institutions buying the coverage don't always look for the language. They tend to look at the price," says attorney Mark Miller, a shareholder at Greenberg Traurig in Washington, D.C. "You want non-rescindable and non-cancellable coverage. The main reason to buy D&O insurance is to protect against insolvency. It's counterintuitive to cut off coverage at the very point you need it."

Although Miller has not seen the cancellation clauses in any of the policies he has reviewed for clients, he says he is not surprised it's there. He advises all his financial institution clients to buy non-cancellable coverage.

Indeed, attorney Thomas Bentz Jr., a partner at Holland & Knight's D&O and Management Liability Insurance Practice in Washington, D.C., says he would never advise a client to buy a policy that has a cancellation clause. "I wouldn't buy that policy. Why would anyone buy that policy? It doesn't make a whole lot of sense to me," he says.

Brokers uniformly say that the financial institutions market right now is unlike anything they have seen in years. "Pricing is all over the place," Alleman says, adding that she recently had one banking client whose premiums went from \$120,000 for \$10 million in coverage to \$1.2 million for just \$5 million in coverage. "It depends on the stability and financial condition of the banks."

Corey says underwriting is getting "a lot more restrictive" and premiums are increasing. "It will be harder for a bank to get insured in the next two or three years," he says. He, too, has seen a bank's annual premiums recently increase by 10 times.