What the Hard Insurance Market Means for Community Banks

By Amy Hymes

The St. Paul Companies, an ACB Business Partner, is the leading insurer of community banks nationwide. Serving community banks for more than a century, The St. Paul provides unmatched expertise in insurance coverage, including directors and officers liability, financial institution bonds, employment practices liability, and a wide array of products to manage e-business risks.

Craig Collins is the national director of community banks for the Financial and Professional Services Division of The St Paul. He has been with The St. Paul for 15 years, including two years as manager of financial institution and management liability underwriting operations in the United Kingdom. Amy Hymes, ACB's senior marketing manager, interviewed Collins recently to learn more about what is happening in the insurance market and how it relates to community banks.

Q: We hear the term "hard market" used to describe the insurance industry. Can you explain what this means and how it relates to the current insurance market environment?

Collins: The insurance market operates in cycles moving between soft and hard conditions. Historically, a cycle lasts about seven years. The soft market portion of the current insurance cycle lasted for about 10 years. The market has now shifted to its hard phase. The main reason for the shift is because the insurance industry as a whole has been experiencing less than desirable results for several years. The terrorist attacks of September 11, 2001, exacerbated the hard market.

A hard market can be characterized by three elements: the first is a reduction in capacity, when insurance companies do not offer as much in insurance limits; the second is increasing rates (the insurance industry as a whole has increased rates over the past several years); and the third is coverage restrictions, where the terms of contracts that were broadened during the soft market are restricted, providing less coverage than what was previously available. While all three of these elements are present in today's insurance marketplace, they impact different lines of business in varying degrees.

Q: How do you describe the current market relative to community banks?

Collins: The community bank sector is fortunate in that the hard market does not impact it as much as it does the money center banks. Unlike community banks, money center banks have high insurance capacity requirements and need more complex coverages, so they've experienced the full brunt of the hard market. Since community banks focus their efforts on the local community, they have less of a need for large amounts of insurance capacity, thereby reducing the impact of the hard market.

Q: Where do you see potential risks for community banks and how do these risks affect claims?

Collins: The Gramm-Leach-Bliley law has enabled community banks to enter areas that historically do not fall within the scope of traditional banking practices. This increases a community bank's exposure in terms of the new and different types of services it can now offer.

Community banks are branching into insurance agency services, security broker/dealer services, and asset management services. All of these services increase the bank's potential risk for errors and omissions. Over the past several years, the directors and officers liability policy has become very broad and can include coverage for bankers professional liability, employment practices liability, trust errors and omissions liability. Losses in these areas have the potential to erode the coverage available for the directors and officers personal liability, which is the main reason for buying this type of policy.

Q: What loss trends are you currently seeing among community banks?

Collins: Community bank loss trends tend to follow the economic conditions of their community. With the economic slowdown, we see some areas that are showing increases in loss activity. For example, in the fidelity area, we have seen an increase in employee dishonesty losses. These types of losses move in lock step with difficult economic conditions.

For much the same reason, workers' compensation has also seen some increase in claim activity. Another area that has seen an increase in loss activity is forgery involving collateral taken on a loan. In many cases, the collateral's true ownership may be misstated or forged outright. Lastly, in the directors and officers liability coverage arena, we have seen increases in bankers' professional liability losses due to past due loans and the litigation associated with them.

Q: The St. Paul has been an ACB Business Partner since 1993 and you've recently introduced a new product specifically for community banks. Can you tell us about it?

Collins: The St. Paul's recently released SelectOne℠ for Community Banks product line was designed specifically to meet the insurance needs of community banks. One of the main advantages of this product portfolio is the $1 million excess directors and officers liability coverage. SelectOne also allows community banks to customize a wide range of protection, including D&O liability and the St. Paul e-Banking Portfolio, to fit their individual risk profile.

Q: Given the state of the current hard market, what should a bank be looking for in an insurance provider?

Collins: A bank should look for flexibility. While there are many similarities among community banks, each one has a different structure, loan portfolio, and deposit base. When choosing insurance, a community banker should look for the ability to customize the policies to fit their needs. For example, when choosing a directors and officers liability policy, it should include the ability to choose either a "duty to defend" or a "pay on behalf" provision. Lastly, a community banker should look for a strong partnership between themselves, their local independent agent, and their regional insurance underwriter.

To learn more about The St. Paul, call Helen Sullivan, senior vice president, Financial and Capital Markets for ACB Business Partners, at (202) 857-3157 or e-mail hsullivan@acbankers.org.