Financial Guaranty Insurance Brokers, Inc.

## INSURANCE CONSIDERATIONS FOR BANK MERGERS:

So you want to buy another bank? These are some of the things that you should be aware of as it pertains to your bank's insurance to avoid expensive surprises after the transaction is completed. During the pre-merger process, we have found that there are many assumptions of what insurance policies will or will not do. These tips may help you to more effectively determine your purchase price.

TAIL INSURANCE – More often than not, the first discussion of any type of insurance between the acquiring and selling banks is Extended Claims Making Coverage (Tail Coverage). Directors and Officers Liability (D&O) policies are claims made policies. This means that the notification of a potential claim must be made during the policy period. There are provisions built into D&O policies which state that if there is a change of control the policy automatically cancels. If the claims have not been made during the policy period, they will not be covered. Tail coverage extends the claims making period of the selling bank's policy so potential claims can be made for acts prior to the merger date. The acquiring bank's policies will typically exclude acts which happened prior to the merger. Hence, the need for Tail Insurance. Make sure that the selling bank's carrier will offer Tail Coverage, for how long a term and at what cost. This can benefit the acquiring bank especially if they are indemnifying the directors and officers of the selling bank. It also protects the directors and officers of the selling banks in the event that they are not indemnified for some reason. Also to make sure there is an adequate aggregate limit because instead of renewing your aggregate each year, you are extending that aggregate limit for the Tail term once for the entire period.

D&O policies typically have two parts: Directors and Officers coverage and Entity coverage (coverage for the bank). Tail Coverage generally does not pick up the entity liability of the selling bank. This is a potential gap in coverage. Contact your broker to see how you may insure this potential gap and for how much.

The acquiring bank should disclose the impending merger to their current carrier because they could be subject to additional premium and modification of terms and conditions.

Real Life Example: Bank A was in the process of purchasing Bank B. Bank B had recently had a large D&O claim. Bank B, at renewal, was non-renewed by their D&O carrier so they placed coverage with a new company. Bank A's D&O carrier was the same company that non-renewed Bank B's D&O policy when Bank A notified their D&O carrier that they were going to purchase Bank B. The D&O carrier, at first, was unwilling to add Bank B to their policy. The carrier, after further negotiation, agreed to add Bank B at a substantial additional premium and increased the deductible of Bank A's D&O policy.

WORKERS' COMPENSATION – If you acquire another bank, your payroll will increase and you will inherit their loss history, which will potentially affect your loss ratio. You should notify your current Workers' Compensation carrier of the additional payroll and of the selling bank's losses to see how this will affect your premium going forward.

As with the Workers' Compensation, this process should be repeated with all of the bank's policies to determine all additional costs and concerns.

CLAIMS – Another area of concern is claims. You should request the selling bank to provide a list of all potential losses or claims, current or pending. The selling bank should provide you with copies of loss history from all carriers which they have been insured by for the last five years. This will allow you to verify if there are any unreported losses/claims and to reveal any unknown or undisclosed claims in the due diligence process. This will help prevent expensive problems which could have been insured.

Real Life Example: Bank A's management was made aware of a potential employee embezzlement from one of it's customer's account. At the same time, Bank A was negotiating to sell their bank. The circumstances of the embezzlement were disclosed to Bank B, the acquiring bank. Bank B assumed that Bank A's Bond carrier was notified but it was not. The merger was completed and after the merger, Bank B realized the management of Bank A had failed to notify their Financial Institution Bond (Bond) carrier. Bank B filed a claim with their Bond carrier. Bank B's carrier declined because of prior knowledge. Bank A's policy was cancelled at the merger date. It was too late to file a claim. Ultimately, Bank B became liable to the customer and it had to reimburse the customer's account. This could have been avoided by reviewing Bank A's Bond policy loss runs and which would have determined that no claim was made, and which could have been submitted to Bank A's carrier before the merger date.

DUE DILIGENCE CHECKLIST:

1) Request copies of all the selling bank's insurance policies
2) Request an updated list of current and pending litigation, potential fraud losses including employee dishonesty for the last 5 years.
3) Confirm all claims made by the bank to all carriers for the last 5 years. Also request loss runs from the carriers for the last 5 years.
Get a list of the locations, with the values of the buildings' furniture fixtures and tenant improvements, with copies of each location's leases which need to be reviewed to make sure that your existing Property and Liability carriers will cover those locations as per the terms of the lease, and determine what the additional premiums.
4) Verify the type of services the selling bank offers to customers
(other than traditional banking services) i.e. insurance sales, security sales, escrow services, consulting services, items processing. Make sure that your carriers will offer coverage for these services.

It is granted that there is a lot of work involved in a merger transaction. But it is worth the effort to take the time to review these very crucial insurance matters early, which can help save the acquiring bank money and problems after the merger.

By:
Joseph Scully
Financial Guaranty Insurance Brokers
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All calls will be answered personally, please contact:

***Joe Scully, President***
***Bud Scully, Chairman***
**Financial Guaranty Insurance Brokers, Inc.**
709 E. Colorado Blvd., Suite 230, Pasadena, CA 91101
Agency License #0658767
Phone (626) 793-3330 or Fax (626) 793-1886
E-mail: Joes@fgib.com; Website: www.FGIB.com