

# SafeTalk

THE LOSS CONTROL NEWSLETTER FOR THE ABA • SPONSORED INSURANCE PROGRAM

## *Potential Gaps in Coverage:*

## **INTERNET BANKING LIABILITY ISSUES**

Even with the best review and controls in place, Internet banking losses may occur. The institution's insurance program should be reviewed closely to determine the extent of applicable insurance coverage and to ensure that losses stemming from Internet banking are covered.

A brief description of the potential gaps in coverage that may exist within your institution's insurance portfolio is outlined below.

### **DIRECTORS & OFFICERS (D&O) LIABILITY POLICY**

The D&O Policy protects the personal liability of the directors and officers against suits brought against them for actions while acting in the capacity as a director or officer of the financial institution. Although there is typically no exclusion to limit coverage, the absence of specific references to Internet banking in existing policies may be used as a defense by some carriers in the face of a large Internet banking loss.

As the D&O Policy was developed long before the advent of Internet banking, online activity presents newer risks that may be excluded under the traditional policy. For example, this medium introduces a whole new universe of liability exposures related to invasion of privacy, advertising, libel and slander, and intellectual property claims--all of which are currently excluded under most D&O Policies.

### **ENTITY ERRORS & OMISSIONS COVERAGE**

In the impersonal world of Internet banking, it is likely that lawsuits will name the financial institution only, or the institution in conjunction with its directors and officers. Such lawsuits may be brought by shareholders, regulatory agencies, customers or other third parties.

Some insurance policies provide entity coverage for "professional services," or delineate specific activities or covered parties. These policies need to be scrutinized closely to ensure that the institution is adequately protected for its Internet banking services. Given that technology is changing rapidly and that all risks are not yet known, broad-form coverage is preferable to a named peril or "professional services" approach to providing entity coverage for Internet banking.

### **COMMERCIAL GENERAL LIABILITY POLICY**

Personal and advertising injury offenses are typically covered under the Commercial General Liability (CGL) Policy. Liability resulting from Internet banking activity may not be

covered under the bank's CGL Policy because:

- Most CGL Policies include a "Banking Practices" or "Professional Services" exclusion that may exclude losses from Internet banking.
- Advertising liability coverage only applies to offenses committed in the course of advertising the financial institution's own goods, products or services. Financial institutions may use their websites for linking or banner advertising to generate additional fee income; liability arising from advertising for others is specifically excluded under the CGL.
- Intellectual property claims such as copyright and trademark infringement are not covered under the CGL Policy unless they are associated with an advertisement.
- Although the Internet has no geographic boundaries, coverage provided under the CGL Policy is territory-specific, and is often limited to the U.S., Canada and Puerto Rico.

### **COMMERCIAL PROPERTY COVERAGE**

The property component of the Commercial Package Policy provides coverage for damage or destruction to financial institution property resulting from covered causes of loss. E-commerce-related property includes hardware, software and electronic data. Damage or destruction to e-commerce-related property can result in remediation costs, business interruption and extra expenses. Traditional property coverage may not apply to these losses:

- Electronic data does not constitute "covered property" under the newly revised ISO Commercial Property Policy.
- Most property policies have a Y2K exclusion to exclude losses arising out of computer malfunction "for all years."
- Covered causes of loss include physical perils such as water, wind and fire; not damage or destruction caused by cyber-perils such as computer viruses or hackers.

- Property insurance does not recognize the inherent value of assets in electronic form such as intellectual property or proprietary software.
- Geographic considerations may be an issue because property coverage is generally limited to physical premises in the U.S., Canada and Puerto Rico.

### **BUSINESS INTERRUPTION AND EXTRA EXPENSE COVERAGE**

The potential loss of computer systems or programs due to a virus or hacker could realistically threaten the institution's ability to conduct business for a period of time. Business Income (BI) coverage pays for the loss of income sustained by the institution due to the suspension of operations during the time it takes to return the business to normal operations. Extra Expense (EE) coverage indemnifies the institution for additional expenses incurred to maintain operations during the period.

Banks entering the Internet arena should purchase catastrophic BI coverage to address this exposure. Be sure that any BI coverage contemplated does not contain the following gaps found in standard BI/EE coverage:

- Traditional BI coverage requires that the suspension of operations be the direct result of a covered loss such as fire, wind or water. Computer viruses, hackers or employee sabotage would not constitute a covered cause of loss.
- The suspension of operations must be caused by direct physical damage or loss of use of property at the financial institution's premises. If the institution is using a third-party service provider, which most financial institutions do either in whole or in part, databases and servers may not be physically located on the institution's premises.

- The "period of restoration" generally begins anywhere from 12 to 72 hours after the time of the direct physical loss. The 72-hour downtime is unrealistic in the Internet banking environment.

### **FINANCIAL INSTITUTION BOND**

The Financial Institution Bond covers first-party losses but does not cover many exposures related to Internet banking and other electronic forms of communication. The traditional Bond does not cover:

- damage or destruction of electronic data or computer programs due to viruses or hacker activity;
- employee sabotage of electronic data or computer programs;
- loss of inherent value to intellectual property or proprietary software resulting from misappropriation;
- loss of income resulting from an interruption of service (business interruption coverage);
- extra expenses associated with an interruption of service;
- loss of confidential information;
- loss resulting from programming errors, omissions or malfunctions; or
- the cost to hire a public relations firm to mitigate damage to reputation.

### **INTERNET BANKING COVERAGE**

If your financial institution is offering Internet banking, be sure to explore the coverages available to maximize protection for you and your directors. The Internet Banking Liability Policy from Progressive was designed specifically to address the needs of community banks entering the Internet arena. For more information, call 800-274-5222 or visit our website, <http://banks.progressive.com>

Interested in learning more about this unique program?  
**Call us at 800-274-5222** (or have your local insurance agent call us).



#### **About Our Program**

This ABA-sponsored insurance program is supported by over 1,700 community banks, the American Bankers Association, Progressive Casualty Insurance Company, and 27 state bankers associations. With the knowledge of professional bankers and strength of an A+ rated insurance company, the ABA-sponsored insurance program was created specifically to address the needs of community bankers for professional liability and fidelity insurance coverages.

#### **Coverages Available**

- Directors & Officers Liability • Broad Form Company Liability • Financial Institution Bond
- Employment Practices Liability • Internet Banking Coverage