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The Financial Meltdown: 5 Years Later

With the worst of the financial meltdown in the rearview mirror, agents and brokers talk about what happened, what the landscape looks like now, and how they're faring in the new normal.

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In 2008, a series of bank and financial company failures, resulting from a subprime real estate lending collapse, launched a global financial crisis from which the world is still recovering. In the U.S., Fannie Mae and Freddie Mac were taken over by the government; Lehman Bros. declared bankruptcy; Bank of America purchased Merrill Lynch, and American International Group (AIG) was saved by an $85 billion capital injection by the federal government. By Sept. 17, 2008, more public corporations had filed for bankruptcy in the U.S. than in all of 2007.

As the housing market fizzled and employment challenges mounted, many agents saw declines in both their commercial and personal books of business. Helping clients weather the economic storm was often priority No. 1.

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Kevin T. Desmond, president of Desmond Insurance in Bellevue, Ky., said his agency worked closely with its personal lines clients to make insurance more affordable. "We relied heavily on increasing deductibles and running credit scores over again," Desmond said. The agency, which writes $10 million in annual premiums, also moved clients to package discounts and even changed carriers if it reduced costs.

Personal lines clients at Ericson Insurance Advisors in Washington Depot, Conn., also voiced financial concerns during the meltdown, said Spencer M. Houldin, the agency's president. Clients looked for every way possible to cut costs. "Maybe they can't afford the $2,500 deductible, but they have to take it anyway and hope nothing happens," Houldin said.

The agency writes $30 million in annual premiums and also services a number of high-net-worth (HNW) accounts. Those clients historically have focused more on making and spending money than saving it. When the meltdown hit, that changed, Houldin said. Some suddenly had legitimate concerns about their cash

flows. Houldin worked with clients to lower expenses, through measures such as raising homeowners' deductibles, typically with the intention that it would be a short-term effort. "We said at the time, 'We can always lower it in the years to come, when you become a little bit more confident in the economy,'" Houldin said. Most of them, however, didn't revisit the issue until after a series of natural disasters hit the Northeast, at which point they realized that they actually had increased their deductibles.

Working as an independent agent on Main Street became a greater advantage during the recession, Evans said, largely because people found themselves being more comfortable "with people versus institutions." And although customers still might not fully understand what it means to be an independent or a captive agent, they often are less inclined to drift toward big companies. "There has definitely been a swing," Evans said. "People may not totally get the independent agent concept, but they get that they see the visibility and involvement of their independent agent at the community level and that was reassuring to them."

The commercial sector: No business and new business

On the commercial side of things, many agencies initially saw a number of small businesses spring up as employment options withered. Laid-off workers formed their own companies, resulting in more first-time buyers of business insurance. But those accounts didn't always last. "Six to 8 months later, we had a lot of lapses from that," Desmond recalled. At the same time, the agency realized an increase in contractors with big return premium audits, because their businesses simply evaporated. "The payroll and sales forecasts weren't accurate," Desmond said.

The team worked with their business clients to adjust projections for subsequent years, which helped level out the number of premium audits. Unfortunately, many of those same clients still haven't returned to pre-recession levels of business. And some sectors are experiencing lingering issues, such as retail lessors. "There are a lot of shopping centers vacancies, and storefronts that people are trying to keep rented, and they're having a problem doing that," Desmond said.

The recession majorly impacted the mortgage and title industries, which has since scaled back, according to Lisa Doherty, president and CEO of Business Risk Partners in Windsor, Conn. Lenders are making more decisions and brokers are making fewer, she said. In addition, there is increased scrutiny on mortgage brokers, who have a greater reluctance "to hand out a warehouse line" than in the years leading up to the crisis. "What was a large marketplace for us has really shrunk, in large part because I think a lot of those businesses have gone away," Doherty said.

Related: Read Mark E. Ruquet's column, "Recession Walloped Even the Wealthy."

Coletta Kemper, vice president of industry affairs at The Council of Insurance Agents & Brokers (CIAB) in Washington, D.C., credits a range of fallout among commercial clients—including head count reductions, closing plants and companies going out of business—for decreasing insurance demands. And while agents are accustomed to the market's cycles, this one was more difficult to weather. "The economy and the market cycles don't usually work together, they are somewhat independent," she said. "This was unusual when they both came at the same time."

In the midst of the meltdown, new opportunities emerged. As bank failures increased, insurers launched new products to address new needs. "Five years ago, we weren't doing anything in the true financial institution space," Doherty said. Today, it's a sector the team at Business Risk Partners knows much about. In fact, it has developed a product specifically geared toward distressed community banks. "We define those as community banks that already have the regulators knocking on their door," Doherty said. "They've been served a consent order, or a cease-and-desist order saying, 'You need to either raise capital, change your lending procedures, change your board, or change your management.'"

These institutions are often in precarious positions, and regulators are focused on asset protection because "if the bank fails, it has to insure all of the deposits," Doherty said. In these instances, regulators proactively work to halt the progression toward even worse financial trouble. As institutions become financially challenged, many of them watch their D&O and E&O coverage choices narrow. That's where Business Risk Partners has discovered an opportunity. "We've worked with Lloyd's to create a product specifically geared to those distressed banks," Doherty said.

Regulatory defense coverage is one of the highlights of the company's offering. "Many of the individual directors and officers are the ones who are now getting sued by the FDIC," said Seth Brickman, D&O product manager at Business Risk Partners, "and upon renewals with many of the major carriers, they've been unable to get that regulatory coverage."

Strategies such as adding regulatory exclusions to the policy at renewal are an attempt to "make the renewals look attractive," Brickman said, while at the same time removing a key linchpin of the coverage. This often leaves individual directors and officers "standing in the cold" if regulators institute a suit against the bank. In fact, Brickman said the FDIC has launched more than 500 suits against D&Os in 2012 alone. The new products tailored to the financial industry close a gap that barely existed before the meltdown, but is now significant.

Survival and success in the new normal

Houldin's HNW clients mostly have moved out of reactive mode, and are beginning to spend again—on artwork, jewelry and second homes, though Houldin said the values typically aren't as high as they may have been in years past. "I think things are almost back to normal with the HNW clients," he said. "Not so much in their purchases, but they're not panicked about insurance costs like they were back in those days." The meltdown also changed the way the agency approaches client communications. "I think 5 or 6 years ago we were much more reactive," he said. His team responded to client requests for insurance reviews, but Houldin said, "I don't think we reached out like we do today."

A hard market has formed in Desmond's area, largely because of weather-related claims. He believes agents may see an increase in premium volume, but not necessarily due to new sales. "You have to really watch your policy in force, to make you're not going backward if there's another soft market," he said. Besides working proactively with clients to manage costs, Desmond said his team also boosted its communication strategy. "We adopted an aggressive retention program within the agency, contacting individual personal lines as well as commercial lines ahead of time," he said. Even with the progress made in the recovery, retention efforts continue to be paramount. "Instead of having the problem with the sharp falloff of the economy, now we have the hard market coming to play," Desmond said.

Dave Evans, CFP, senior vice president at IIABA, said that attitudes about the investment and insurance marketing have shifted during the last 5 years. "I think one of the first things that came out of the financial meltdown was a crisis in confidence," Evans said. The implosion of Bear Stearns was just one of the events that prompted people to view the investment landscape—and the institutions—differently. The P&C side fared pretty well, but Evans said we're now in "this bizarre long-term interest rate environment that is really hurting insurance companies." As a result, sectors such as the long-term care market have seen the exit of some large carriers. "Carriers are feeling like they can't cover the inflationary risk on medical care," Evans said.

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The overall lack of economic activity—from lower payrolls to reduced workers' comp premiums to a drop in business—has resulted in a general malaise that often hurts agents more on the commercial side than in their personal lines of business. But personal side lines still suffered, as fewer auto purchases and similar drops in activity combined to make agents' revenue picture less happy. One of the results, Evans said, has been reduced hiring among independent agents. "There's been more of an eye toward getting things done using technology instead of people," he said. He expects that trend to continue, with brokers leveraging technology to both market and run their agencies.

Kemper said that some agencies managed to grow despite the recession, though very little of that growth was organic. Instead, mergers and acquisitions accounted for much of the activity. In addition, Kemper said that some of the larger brokers found organic growth by looking outside the U.S. to markets such as Latin America. The domestic players, however, were "pretty much confined to U.S. business," she said.

The big question, Kemper posed, is how long this will go on and whether carriers will be forced to continue raising rates to stay ahead of the game. "The big wild card is probably always going to be natural disasters," she said. In addition, other issues affecting agents and brokers, such as the continuing uncertainty surrounding healthcare reform, should be at least somewhat settled in the next few months. In general, growth options may be limited for some time. "I think we'll see more mergers and acquisitions, and we'll see more companies getting bigger," she said.

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