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SELF-INSURANCE & BLANKET VS. CPI:

Choosing the Right Program to Protect Your Portfolio

When economic trends point to reductions in delinquencies and charge-offs of collateralized loans, financial institutions may question the need for a robust, full-service collateral protection insurance (CPI) program in favor of slimmed down portfolio protection solutions like blanket insurance policies or self-insurance. State National Companies, the leading provider of CPI in the United States since 1973, has had firsthand experience with lenders that have opted for blanket portfolio coverage or that have self-insured their portfolios.

This executive summary of our white paper "Blanket and Self-Insurance vs. CPI: A No-Nonsense Guide to Choosing the Right Program for Your Financial Institution's Portfolio" is intended to provide you with a clear and simple look at how self-insurance, blanket, and collateral protection insurance (CPI) programs compare. It discusses the relative advantages and disadvantages of each, and how to assess which type of program is best for your organization.

Self-Insurance

A self-insured lender assumes all risk and absorbs any losses that occur. Understanding your loan portfolio and evaluating current losses is critically important to managing the risk that could result from a sizable charge-off or a wave of charge-offs that would be absorbed by your financial institution. It's also important to recognize signals that may impact the stability of your portfolio. Risks associated with unforeseen events, such as natural disasters or economic catastrophes, could leave self-insured lenders on the hook to cover potentially massive expenses virtually overnight.

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Other less-than-obvious sources of potential loss include loan programs geared toward first-time buyers or other borrowers who pose a greater overall risk. Coupled with a natural disaster, economic downturn, or other negative event, loan losses can quickly compound into a serious problem. The greatest disadvantage of self-insurance is that risk is not transferred.

To minimize uninsured losses, some self-insured lenders add follow up procedures such as:

- Requiring evidence of physical damage insurance at the time of loan closing.
- Writing or calling borrowers when evidence of insurance is not received.
- Writing or calling borrowers who receive cancellation notices from insurance carriers.

These procedures are time-consuming and difficult to execute. They are also rarely effective without a sophisticated automated tracking platform nor any mechanism to effectively compel borrowers to correct the insurance lapse.

Blanket Portfolio Insurance

With a blanket insurance policy, lenders pay a premium based on the total number of loans, typically a fixed dollar amount per vehicle or a percentage of the outstanding balance. Although state laws are constantly changing, many jurisdictions allow the cost of blanket to be passed on to all borrowers, regardless of their individual histories. In states that do not allow borrowers to pay the costs of a blanket policy, these costs must be borne solely by the financial institution.

Without the ability to monitor the loan portfolio, the number of uninsured drivers will increase over time and losses will rise. Because insurers must recover not just losses, but also expenses, every $1 increase in claims filed can result in nearly a $2 increase in premium. Absorbing this cost could lead to less favorable lending terms and put lenders at a competitive disadvantage.

While the vast majority of borrowers fulfill their contractual obligation to maintain private insurance to cover the loan collateral, a few never purchase insurance, or let their policy lapse. This non-compliance can be an early indication of financial difficulties. Because blanket policies do not include individual loan tracking, the financial institution would not have access to information about lapses in private insurance, and might miss warning signals that a borrower is at risk of loan default or other financial problems

Collateral Protection Insurance (CPI)

CPI enables lenders to manage and mitigate risk by transferring the risk of uninsured collateral to an insurance provider. A third-party insurer administers the program, and only borrowers who actually fail to purchase their own insurance pay the cost. CPI is a guaranteed-issue, no-underwriting-required insurance product. A borrower who does not comply with the loan requirement to procure private insurance is “written” regardless of age, driving record, or location of residence. Loan balance is the only criteria for acceptance. Insurance coverage placed as part of a CPI program offers financial institutions the same protection as would the insurance that should have been procured and maintained by the borrower.

Importantly, by passing the premiums of CPI to uninsured borrowers, it costs financial institutions little or nothing to obtain this protection. And because only uninsured borrowers are charged, they avoid having to either absorb costs within the institution or pass them on to borrowers who are compliant.

While it’s impossible to avoid all risk (other than by stopping writing loans altogether), a CPI provider can help you, the lender, find a point of equilibrium at which the protection provided by the program complements the level of risk your institution is willing to assume.

Summary

Financial institutions tend to consider self-insurance or blanket portfolio insurance at times when delinquencies and charge-offs are decreasing within their loan portfolios. However, CPI is a fundamental part of a comprehensive risk management strategy that offers consistent protection for your loan business.

With today’s tight auto loan margins, consumer credit woes, and the particular perils of indirect lending, it has never been more critical to consider how your portfolio protection strategy can impact you and your borrowers. Increasingly, the surest, fairest, most effective way to insure against loan portfolio losses is CPI.

No other risk management mechanism can claim a similarly positive impact on your bottom line, and no other risk-transfer strategy is more effective and efficient than CPI, given the tools used to power it.

For more detail on this topic, see our comprehensive White Paper **“Blanket and Self-Insurance vs. CPI: A No-Nonsense Guide to Choosing the Right Program for Your Financial Institution’s Portfolio”**

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