

MARKET UPDATE

Credit Crunch Fallout

FINEX Financial Institutions takes stock of market conditions in 2008 and looks towards what is still to come in 2009 for buyers of financial institution insurance.

Looking back over 2008, it is fair to say that financial institution insurers are extremely worried about the significant increase in claims volume.

In November 2008 Advisen, a leading insurance consultancy, reported that the D&O losses from sub-prime and the credit crunch would total \$5.9 billion with \$5.3 billion attributable to settlement and defence costs from securities class action law suits. A large portion of these claims falls against financial services companies, sending the insurance loss ratio in USA D&O to over 200%.

Additionally, in the US there has been the scandal of Auction Rate Securities and allegations of bid rigging in the municipal bonds derivatives market.

In the UK and Europe the property slump has uncovered significant incidents of mortgage fraud against building societies and specialist lenders.

The UK asset management sector is facing a major increase in Professional Indemnity claims which range from misselling to breach of mandate.

Just when insurers thought the bad news for 2008 had come to an end and were focusing on the reinsurance renewals,

the Madoff scandal surfaced. The \$50 billion investment scandal turned attention back to the financial services sector.

There is no doubt this will lead to professional liability insurer claims alleging breach of fiduciary duty, inappropriate due diligence and/or negligence. Additionally, there may be claims for external fraud depending on the wording of the crime policies purchased.

At this stage it is too early to calculate the total value of the insurance claims from Madoff but various commentators have estimated the figure to be a minimum of \$1 billion – some predicting it to be as high as \$2.5 billion.

In summary, 2008 was a dreadful year from a financial institution insurer's point of view.

So what effect will this have for 2009?

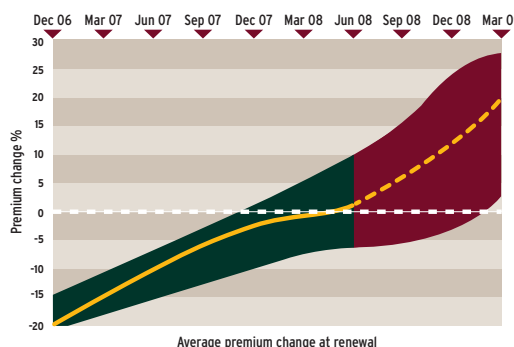
We need to consider the recent reinsurance renewal season as this is a major driver for the change in market conditions we face in 2009.

Many insurers buy a portfolio protection by way of a treaty across their book of business.

The timing of the Madoff problems was disastrous in the context of the reinsurance renewal season with many insurers having to start the process of buying reinsurance again and undertaking extensive due diligence reporting.

Contents

- Market Update1
- Mergers and Acquisitions Issues2
- Breaking News3
- Meet the Team4



With hindsight, the soft insurance market finished in the summer of 2008. The yellow line shows the average premium change at renewal.

Willis has approached 20 of the leading FI insurers to discuss the results of their reinsurance renewals and to outline their expectations for 2009.

Our findings are that the cost of FI reinsurance has increased between 20% and 50%. Insurers, in some cases, are reducing the per event exposure, due to prohibitive cost of reinsurance, or they are not being offered the same capacity as in 2008. It is unlikely that all these increased costs will be passed on to insurance buyers. However, we anticipate the average premium increase in early 2009 to be around 15%.

The level of underwriting due diligence will be extreme as most underwriters' capital providers and reinsurers will demand it.

There is still scope to improve policy wordings. However, underwriters will offer greater resistance than in previous years.

Insurers may try to exclude certain situations, such as Madoff, from ongoing policies and this needs very careful handling in terms of claims notification in order to avoid insurer disputes.

The challenge now is for Willis to work closely with our clients to counteract the constantly changing market. It is essential to plan strategies ahead, have alternative markets in mind, and commence renewal negotiations early. Only in this way will assureds be able to mitigate the challenges that 2009 will bring.

MERGERS AND ACQUISITIONS ISSUES

Management's liability is considered one of the most important aspects to consider within any merger or acquisition activity; Directors and Officers involved in transactions should be aware of the implications. Below, we highlight some of the crucial issues.

From a Directors and Officers Liability perspective policies will enter automatic run-off. The post-transaction policies will need to recognise the structure and risk profile of the new business. In certain instances, insurers will consider waiving the automatic run-off provisions.

The option to purchase Run Off cover with a six year statute of limitations extension provides protection to Directors for actions brought by new shareholders, original shareholders, employees and other parties, particularly if there are issues over disclosure or post takeover performance bringing the transaction price into question.

If new investment capital is raised for the transaction, your current Directors and Officers Liability policy will contain an exclusion for this activity. Either the policy will need to be specifically endorsed or a Prospectus Indemnity or POSI cover incepted.

The transaction will trigger run off or acquisition clauses for the Crime and Professional Indemnity policies. However, this can be amended. The scope of cover will depend on the structural integration of the target company into the new parent. Dual insurance can lead to disagreements as to which policy is the most appropriate or specific, i.e. which policy wording and underwriter is to pay for a loss. This can lead to gaps in cover and issues surrounding contribution.

Pension Fund Trustee Liability and Employee Benefits have special significance for transactions. The merger of pension funds is problematic. Differences in funding levels, investment strategies and benefits schedules for members are primary claim trigger issues. To tackle some of these problems, tax opinion and contingency insurance is available to underpin assumptions made prior to a transaction.

A wide range of insurance protection is available to management to cover a wide range of transactional exposures, mitigating risks arising out of corporate transactions. Bespoke policies should be considered for the following coverage areas:

- Representations and Warranties
- Successor Liability
- Loss Mitigation/Loss Capping
- Opinion-based Contingent Risk
- Corporate Tax Indemnity

TUPE regulations can create Employment Practice Liability exposures if rationalisation follows an acquisition. The recent EU ruling on buy-out of companies in liquidation is likely to be challenged reinforcing employment protection.

Simon Dodsworth
Executive Director
Willis Mergers and Acquisitions Practice
Email: dodsworths@willis.com
Tel: +44 (0)20 3124 6094

BREAKING NEWS

GO AWAY, GO AWAY, COME BACK AGAIN ANOTHER DAY

The recession is causing employers to realign their resources to match the economic environment. In real terms, this often means cost cutting which can affect or is perceived to affect employees workloads or compensation.

Shella Snehi, specialist consultant in employment practice at Willis, gives her view on the long awaited repeal of the Statutory Dispute Resolution Procedures (SDRPs) and its impact on Financial Institutions.

For four years, the SDRPs caused havoc for both employers and employees, creating more disputes instead of 'resolving disputes' as originally intended. Thankfully the SDRPs are to be repealed and instead will be replaced by a new framework based on the provisions of the Employment Act 2008.

Subject to transitional provisions, the mandatory '3 step' statutory process for disciplinary, dismissal and grievance procedures will cease to exist from April 6, 2009. This means, and is good news for employers, that dismissals will no longer be automatically unfair in respect of a procedural failure. It also means, however, that employees no longer have to lodge a grievance before raising employment tribunal claims.

Employment tribunals will decide cases on the basis of what is 'fair and reasonable' and a revised ACAS (Advisory, Conciliation and Arbitration Service) Code of Practice and non-statutory guidance on disciplinary and grievance procedures establishes the principles of what an employer and employee should do in these circumstances.

Employment tribunals must have regard to the Code when determining the fairness of a dismissal. This document is therefore must read for all individuals involved with disciplinary dismissals and grievances, particularly since employment tribunals will have discretionary powers to adjust awards by up to 25% if an employee or employer has acted unreasonably in not following the principles in the new ACAS Code.

The main changes that will be of interest are:

- The Code covers disciplinary warnings and not just dismissals;
- The Code does not apply to redundancies or non-renewal of fixed term contracts;
- There is a new right to call witnesses to hearings;
- There is a requirement to provide any documentary evidence to the other party in advance of a hearing;
- The statutory right to be accompanied is expressly included in the Code and there is an obligation on employers (where previously it was just good practice) to advise employees of their right to be accompanied;

- Any such request must be a 'reasonable request' in order to exercise the right to be accompanied (the Code clarifies what a reasonable request is):
 - There is a requirement to 'involve' employees and their representatives in the development of Disciplinary and Grievance procedures;
 - Employees are required to make 'every effort' (rather than the current 'all reasonable steps') to attend disciplinary or grievance meetings;
 - An appeal letter must specify the grounds of the appeal;
 - Employers should help employees and managers understand what the rules and procedures are and how they are to be used.

It is hoped that, as a result, employees and employers will have greater flexibility to deal with workplace discipline and grievance issues in a way which suits them best. Whether this will be the case is yet to be seen.

It should be noted that the statutory procedures do not disappear immediately; different rules apply to disciplinary and grievances during a transitional phase. The dispute procedures will therefore continue to have an impact for several months to come.

Employers should start taking action now to ensure they will be compliant. Top of the list of priorities for employers should be amending their grievance and disciplinary policies to reflect the changes to the Code.

Sheila advises on improving the defensibility of employment claims through a service called the Employment Law HealthCheck. The HealthCheck identifies a company's ability to defend an employment claim, focusing upon documentation that has to be produced when defending a claim.

For a limited time, subject to availability, Sheila is offering the opportunity for you to receive an in house workshop on the impact of the above changes on your business. The free workshop is an opportunity for you to:

- Understand in greater detail the changes to the Workplace Dispute Resolution Legislation.
- Explore the potential effect of the impending changes on your business.
- Be provided with practical assistance in considering the amendments that will need to be made to your Disciplinary and Grievance Procedure.
- Gain an insight into Willis' risk management service, The Employment Law HealthCheck, which is designed to help you, particularly in the current climate, when faced with an increasing number of employment claims.

For further details please contact **Sheila Snehi** on 07985 532932 or snehis@willis.com. Alternatively, contact your usual Willis contact.

MEET THE TEAM



Paul Richards

Paul began his insurance career as an underwriter, obtaining training in most general insurance disciplines before becoming a Lloyd's broker in 1990.

Most recently he was the Senior Partner of Glencairn's Professional and Executive Risk team and joined the Willis FINEX team to lead FINEX National's London practice following the acquisition of HRH. Paul says "this is an exciting opportunity to grow our market share of the SME sector for FINEX, combining with the existing Ipswich and Manchester FINEX National teams. We have a unique ability to offer clients a 'boutique broker service', with Global broker outcomes by offering clients the individual skills and abilities of our professional Associates with the strength of the Willis resources and brand."

He has a bachelor of science degree in Financial Services and is an Associate of both the Chartered Insurance Institute and the Chartered Institute of Bankers.

With three small children, Paul has little spare time. But when he does have a moment to himself, he tries to improve his golf or takes his eldest children for a blast in his kit car.



Max Fenton courtesy of StructureTone