

MARKET UPDATE

At the half way point of 2009 it is evident that the financial institutions insurance marketplace has become an increasingly difficult arena in which to transact business.

The recent financial turmoil has resulted in a deluge of predominantly professional indemnity and directors and officers notifications to insurers. Underwriters are reluctant to give official figures for loss ratios drilled down to individual classes of business but it is probable that for some financial institution insurers the 2007 and 2008 years of account are already well in excess of 100% (i.e. claims exceeding premium). In time they are highly likely to deteriorate further due to the long tail associated with such claims. Underwriting losses of this magnitude combined with a climate of continuing uncertainty have caused a notable hardening of the insurance market.

How are underwriters approaching renewals?

- Premium increases: Underwriters are looking to enforce premium increases across their entire portfolio regardless of risk profile. It is becoming increasingly difficult to counter this trend as more underwriters than ever are prepared to 'walk away' from risks that do not in their opinion attract adequate premium.
- Reducing exposure: In a very difficult marketplace it is common for insurers to reduce their overall participation on a programme.
- Restricting policy coverage: Underwriters are examining existing wordings in detail with a view to restricting various areas.

Under particular scrutiny is the extent and breadth of extended claims reporting period language, broad form fidelity language and mortgage fraud.

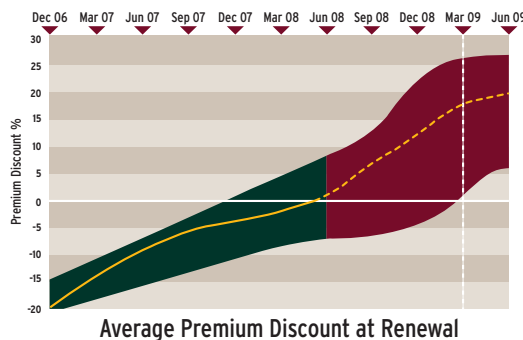
So should financial institutions simply resign themselves to paying more money for less policy coverage and limit?

Not necessarily – there is no need to accept restrictions in all three.

There is no doubt that underwriters are looking to secure as much of the above as they can but their primary focus is on premium. For stable clients with loss free renewals a 15% increase is commonplace, but this percentage can increase dramatically where underwriters have concerns over exposure or where the financial institution has experienced significant growth. That said, it is still possible to drive competition and dilute premium increases as we have not seen a widespread withdrawal of insurers from the class. For most limits of indemnity there is still a surplus of capacity but it is more difficult to access given increased due diligence from underwriters. Financial institutions should be wary that whilst securing 'below average' renewal increases is still possible, it could mean replacing old insurers with an entirely new panel which can raise issues over claim notification and sacrifice the benefits of long-term relationships.

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

In many cases we are still able to secure improvements and minimise any underwriter required restriction.

It has always been the case that the higher the sum insured that is purchased, the less easy it is to generate competition between insurers. In the past we have set GBP50 – 75 million as the sum insured ceiling where competition generation becomes less effective, however given the current difficulties in the market we would lower this to GBP25 – 50 million. In other words, financial institutions buying smaller limits will be more able to counter a hard market.

Whilst we have observed many underwriters attempting to push back on policy wordings, we have also had considerable success in rejecting this pressure. In many cases we are still able to secure improvements and minimise any underwriter required restriction.

Undoubtedly renewals are more time pressured at present. Negotiations are generally more difficult with an increased demand for

disclosure and as a result take longer to conclude. The best way to mitigate this is to start the renewal process early and be pro-active in answering underwriter queries. This avoids running out of time and limiting capability to secure placement at the best possible terms.

To summarise, Q2 2009 has proved to be a difficult time for financial institution insurance buyers. Despite this there is no need to accept all the worst excesses of a hard market, but it is key to partner with a broker that fully understands his clients' business and insurance requirements. The pressure to accept premium increases is strong, but effective marketing and intelligent use of competing markets can help minimise this and in addition help counter restrictions to wordings and deductibles.



WILLIS SALARY PLUS

- Do you have to offer market-leading employee benefits to recruit talented people?**
- Are you struggling to do this in a tightly controlled cost environment?**
- Do you want to offer your employee benefits programme more cost effectively?**
- Are you keen to embrace new initiatives and cost saving solutions that can benefit both you and your employees?**

In the race for success, you compete not only for market share, but also for talented people. Offering attractive benefits can be key in winning this competition, but often has to be done in a tightly controlled cost environment. Overlaying a salary sacrifice arrangement across your benefit programme can help to differentiate you from your competitors and, importantly against this economic backdrop, save you money.

THE CHALLENGE

Do you want to offer a benefits programme that:

- Demonstrates you to be progressive and innovative?
- Can save you and your employees money?
- Helps you to win the talent competition?

Creating benefit programmes that attract the best often has to occur within an environment where benefit spend is tightly controlled, particularly in this economic climate.

Balancing the cost with the need to offer benefits that attract the best people is no easy task, which is why creative benefit solutions are becoming increasingly commonplace.

One such solution that is growing in popularity is **salary sacrifice** (sometimes also referred to as salary exchange) – we call our solution **'Willis Salary Plus'**. Salary Plus offers the opportunity to **increase** the take-home pay of your employees or

boost their pension savings, whilst at the same time saving you money, allowing you to spend this saving to best suit you. Some employers retain the savings, some use them to enhance their benefit spend, and others share some or all of this with their employees.

HOW IT WORKS

As the employee's pay is reduced, there is a corresponding reduction in the employee's tax and National Insurance contributions, and also your National Insurance contributions. A breakdown of savings can be seen in the chart on page 3.

The employee sees an increase in their take-home pay, and you are free to use the savings however you wish. Typically salary sacrifice arrangements are used for tax-efficient benefits such as pension contributions and Childcare Vouchers, but can relate to other benefits.

HOW WE CAN HELP

Our Salary Plus solutions are focused on your objectives, strategy and requirements. We will work with you to deliver your arrangement, including:

- Undertaking a Feasibility Study
- Designing the arrangement – benefits, utilising savings, technology, Ts & Cs
- Communicating with your employees
- Implementing your solution
- Ongoing management

EXAMPLE - PENSION CONTRIBUTION BASIC RATE TAXPAYER

5% personal contribution to contract-based pension

PRE-SALARY PLUS

	Annual	Monthly
Salary (pay)	£35,000.00	£2,916.67
Tax due	(£5,705.00)	(£475.42)
NI due	(£3,220.80)	(£268.40)
Employee pension contribution (net of basic rate tax)	(£1,400.00)	(£116.67)
Net pay after tax, NI and pension contribution	£24,674.20	£2,056.18
Gross pension contribution credited to arrangement	£1,750.00	£145.83

POST-SALARY PLUS (SALARY REDUCED BY £1,750pa)

	Annual	Monthly
Reference salary	£35,000.00	£2,916.67
Actual salary (pay)	£33,250.00	£2,770.83
Tax due	(£5,355.00)	(£446.25)
NI due	(£3,028.30)	(£252.36)
Employee pension contribution (net of basic rate tax)	Nil	Nil
Net pay after tax and NI	£24,866.70	£2,072.22
Gross pension contribution credited to arrangement	£1,750.00	£145.83
Increase in net pay	£192.50	£16.04
Employer NI saving	£224.00	£18.67

Note: All figures are based on the 2009/2010 fiscal year tax and NI bands and rates.

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HOW TO USE THE INSURANCE MARKET TO TRANSFER M&A RISK

Willis M&A sees significant increase in demand for warranty insurance in Financial Services M&A

Mergers and Acquisitions in the current environment is not for the faint hearted, although there are significant opportunities for those who have the resources and appetite. The danger in any acquisition is that unidentified risks could expose the acquirer to liabilities beyond the value of the target, as well as potential reputational damage.

In all M&A transactions, due diligence is the key risk management tool. In private sales, this process is underpinned by the obligation of disclosure placed on the seller under the warranties in the sale contract. For any acquirer the ability to recover a loss post sale under warranties and indemnities is key in transferring the unknown historical risk or identified contingent exposure highlighted in the due diligence exercise.

However, if the seller is an entity which is unable to provide such protection due to its shareholding/stakeholder structure, the buyer is faced with accepting lower or no protection. This is particularly relevant in the financial services sector, where most businesses will resist providing warranty or indemnity coverage. In the current environment this may be due to their own financial position and/or

because the overall objective of the transaction is to release as much capital from a disposal without any liability which may inhibit a wind-up, the full recognition of the proceeds and/or refinancing or capital requirements.

Warranty insurance and related transaction products such as tax and contingent insurance are being utilised to provide acquirers with enhanced security for a potential residual contingent risk arising from an acquisition. These bespoke policies are tailored to each transaction. In the last three months, the dedicated Willis team has been involved in an increasing number of financial services transactions where the arrangement of warranty insurance and other contingent policies have been critical for the buyer.

Insurance is also available for sellers who may have given warranties and indemnities and are looking for protection to respond to a claim from such disposal, including costs of defence. With the decline in economic conditions, buyers are looking closely at any rights of recovery under any warranties provided by sellers. Claims and litigation activity is on the increase.



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Due diligence and disclosure are critical to any M&A risk management process, but insurance is a key tool in transferring and securing contingent risks. As such, in-house legal, insurance, M&A departments and their professional advisers should be aware of these products. The Willis M&A Transaction Services team is part of FINEX and consists of qualified corporate lawyers and highly experienced insurance professionals.

For further information, please contact:
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SEMINARS AND EVENTS

UPCOMING WILLIS SEMINAR

On Wednesday, July 1 Willis Financial Institutions will be hosting a seminar entitled 'The Shape of Things to Come', where experts will give a perspective on the future of regulation and insurance for the U.K. financial services sector.

Topics covered on the day will include legislative and regulatory changes for financial institutions; the future of U.K. international Financial Services; a leading lawyer's view on the Walker Review (which may have far reaching consequences for U.K. financial institutions' corporate governance when it reports in October); the future role of the Risk Advisor and Insurance Broker; and finally the Chairman of the House of Commons Treasury Committee will comment on the importance of secure financial institutions in the U.K.

This event will be of interest to Chief Executives, Finance Directors, Chief Operations Officers, Company Secretaries and Risk & Insurance Managers at U.K. and European Financial Institutions.

To reserve a place free of charge at this prestigious event, please contact Claire Hall: hallc@willis.com or +44 (0)20 3124 6728.

MASTERS AT WORK SEMINAR SERIES CONTINUES

On Tuesday June 16, 2009, Willis and the Securities & Investment Institute jointly hosted the latest seminar in the series 'Masters at Work: a Perspective on Fund Management'. Chaired by Christopher Jones-Warner of Playing Hamlet and with special guest speaker Tony Nutt from Jupiter International Group, the presentation and discussions considered the issues of investing in the current economic turmoil.

Tony commented on key topics such as investment return drivers, the importance of cash flow, the 21st century macro economic challenges and changes in the population demographics going forward. The presentation provoked a wide range of questions and positive feedback from 120 delegates taken from a cross section of U.K. and European Financial Institutions.

MEET THE TEAM



Edward Williams

Ed started his career in the insurance industry in 1981 at a global insurance broker, moving to the Financial Institutions (FI) team after training on FI product lines in the claims department. He became responsible for the book of Offshore Banking Units in Bahrain in addition to being an account executive and broker for FI clients from all territories handled by the team.

From 1986 - 1995 Ed worked at a national broker as a director of their Professional Indemnity team, where he took responsibility for the Lloyd's market, managing and members agency lineslip. Thereafter at a specialist niche broker, he ran the FI team and arranged comprehensive insurance solutions for FIs. His account portfolio was mainly composed of Lloyd's managing agents and major U.K. asset managers.

Since joining Glencairn in 2000 and subsequently Willis in 2008, this continues to be Ed's area of specialisation and he remains Account Director for leading Lloyd's managing agents/insurance companies and Financial Institutions.

Ed lives in a 'Miss Marple' village in Suffolk with his wife and three children. Apart from enjoying his golf when he can, he is enthusiastic about wine. His ambition is to buy fine wine at a greater rate than his mother-in-law consumes it.

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