

The Willis Index

Willis

Directors' and Officers' Newsletter

The Directors' and Officers' Liability Insurance and Risk Management Quarterly

Winter 2004/05

Market Conditions

and Results of the Market Survey; Good news for buyers

The start of 2004 was a testing time for the global Directors' and Officers' (D&O) market. High profile claims and investigations made insurers nervous about potential losses and as a result premium rates were still generally increasing. In the second quarter of 2004 there was, however, a noticeable levelling out in the market as the influx of new carriers increased competition levels.

The Willis Index, looking at international (non US) listed companies, asked all participating insurers, company, Lloyds' and Bermudian based, for their views about the past 3 and next 3 months, revealing a favourable perception of the future market for clients. Responses were invited from 95% of the market and the results on premium rate movements are shown below in Figures 1 and 2.

These figures show that 61% of the insurers who responded felt that Primary premium rates had dropped in the past 3 months. 69% of the market also anticipated this trend to continue, rates decreasing further in the next 3 months.

This sentiment was echoed for Excess layer premiums, 46% of insurers stating that rates had dropped on average of between 11% and 25% in the past 3 months; 75% anticipating a similar drop in the forthcoming months.

D&O Primary Premium Movements

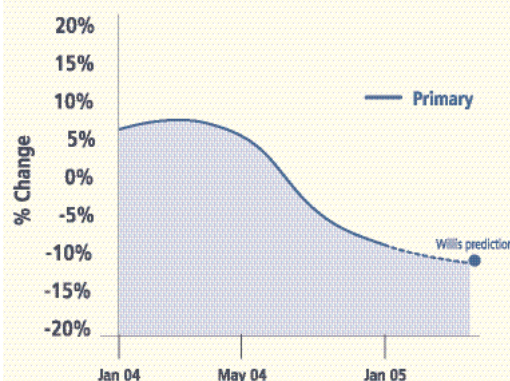


Figure 1

D&O Excess Premium Movements

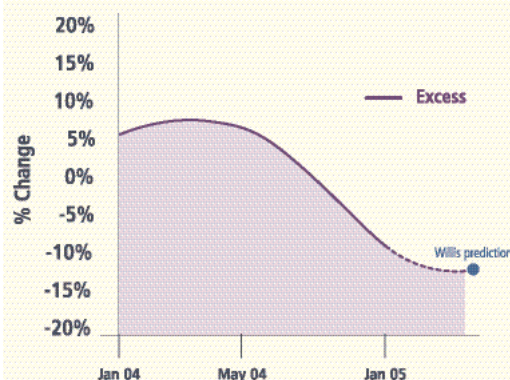


Figure 2

The Willis Index is a quarterly publication reporting on the relevant issues affecting the insurance industry and the impact they have upon our clients. The main feature is a market survey, providing insurer responses on key indicators such as premium, excesses and cover.

Our quarterly analysis will provide buyers with an accurate picture of the conditions in the insurance market and its future outlook.

In this issue we investigate the results of the survey and limits of indemnity purchased. Our 'technical corner' examines Outside Directorship Liability and the impact it has on your D&O Liability policy.

Regular features will include updates on the market conditions through the market survey, case studies, technical analysis of coverage specifics and special features highlighting significant changes in regulation, insurance market news and forthcoming events and seminars.

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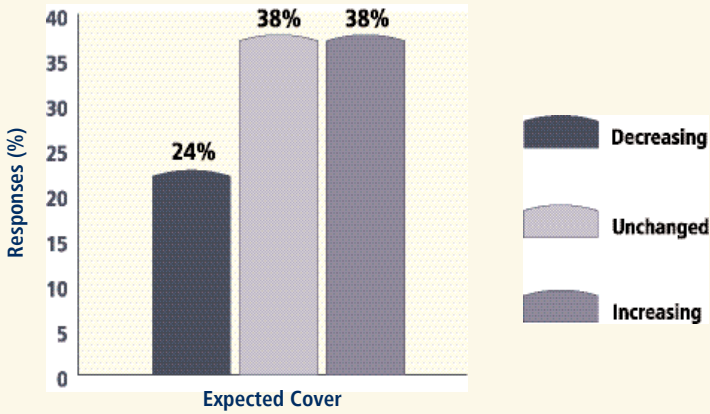


Figure 3

Coverage Terms

The positive outlook for insured's continues in responses from the market on levels of cover offered. While cover was shown to be generally static in the past 3 months, results suggested that there might well be a move to broaden levels of cover offered in the future.

As shown in Figure 3, 38% of insurers expect the level of cover they provide to increase in the next 3 months as the market continues to soften and they vie for ways to attract business. This is an excellent opportunity for purchasers of D&O insurance to bring back cover to their policy, removed through exclusions imposed in previous years.

Limits Next 3 Months

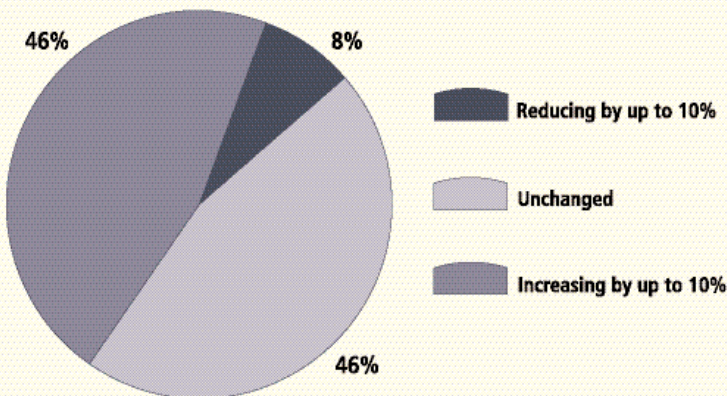


Figure 4

Limits

When questioned on the size of Limits purchased, insurers responded that limits had generally remained static. Figure 4, showing insurers views on the future, states that 46% of the market believe Limits will remain unchanged.

Another 46%, however, anticipate an increase in levels of cover purchased by up to 10%. The merits from a purchasers point of view, are discussed in further detail in the article 'What is an adequate Limit?'.
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The Willis Prediction

This general perception of the market is consistent with Willis' views in terms of both Primary and Excess layers. On a recent renewal, we have even seen a 20% premium drop on the Primary layer. Enhancements in cover do largely depend upon your company's situation and the account's history. Where premium rates are already competitive we have looked to enhance cover in other ways – improving automatic acquisition thresholds, reducing excesses, increasing investigation costs which are usually sub-limited and removing any specific exclusions sensitive to a clients' exposure.

NB: The Willis Prediction is based on a multiple of criteria and does not reflect the situation for every company.



What is an adequate Limit?

This is a popular question that Directors ask and unfortunately there are no scientific formulas or significant trends in litigation to act as a guide. Settlement amounts can only be predicted where the particular class of litigation has a cap at law. Outside of this, the extent and severity of awards and settlements are in the hands of the Courts. Settlements relating to the reduction in the value of shares are often calculated using the difference in market capitalisation pre and post the stock drop. The following criteria should be borne in mind when determining the level of protection:

- Do any of your bonds or stock require SEC registration and filing?
- If some of your equities are in the form of American Deposit Receipts (ADR's) what level are these and what percentage of the overall company's equity do these represent?
- Are there any planned mergers, acquisitions or disposals?
- With regard to employee litigation how many employees are employed in the USA and in what states?
- Is the sector in which the insured operate regulated?

Companies with US traded securities tend to buy considerably higher Limits to meet the increased exposures they face. Table 1 (below) shows key market sectors and some of the Limits bought split between those with ADR's and private companies.

Some points to consider...

Within the last 24 months the importance of the duties and responsibilities of Directors has reached unprecedented levels throughout the world. Never has the role of the Director received such large media coverage and controversial debate among business commentators.

Regulation is driving tighter legislation, increasing the required levels of due diligence for Directors and Officers within the UK FSA controls may well further increase their duties and accountability.

A number of high profile cases, both in the US and increasingly in Europe have attracted worldwide interest, bringing D&O insurance to the forefront of people's attention.

Recent reports show that an increasing proportion of class actions have been made against international companies who have shares traded in the United States. This increase in claims highlights the importance of having adequate levels of cover for Directors, for even if a claim does not materialise, substantial defence costs may be incurred, eroding the policy limit.

Is now the time to buy?

At Willis we believe that now is an excellent time to investigate purchasing an increased

Limit. Increased Limits are being sought as clients increase protection against potential claims. In any case Limits of indemnity should be reviewed every 2 to 3 years to reflect changes in your companies exposure and external market. Martin Beagley, Executive Director of Willis' D&O Team, comments that "Major claims in the market are a result of shareholder claims in the USA. Considering their global sensitivity, only 1 or 2 claims are required for rates to potentially falter. Newer insurers could potentially be deterred from competing for new business, allowing established markets to increase their rates. With the ever increasing risk of litigation against Directors and the current market conditions, many clients are considering increasing their Limits."

The Willis Index supports this comment. With premium rates anticipated to drop off on both Primary and Excess levels in the next 3 months, an increased limit of indemnity could be purchased at an improved rate. On a recent renewal, we negotiated a 10% increase in Limit purchased without incurring any additional premium cost.

With suitable expertise and experience in the field Willis is in an excellent position to provide feedback on the current market, recognise areas of potential exposure you face and provide a guideline to typical limits purchased.

Benchmarking Guides to Limits Purchase

Sector	ADR's	Private
Oil and Gas	£300M	£50M
Pharmaceutical	£220M - £300M	£50M
Telecommunications	£100M - £300M	£30M
Media	£100M - £250M	£10M
Utilities	£50M - £200M	£10M
Chemicals	£100M - £200M	-
Mining	£200M	£50M
Insurance	£80M - £200M	£40M
Tobacco	£150M	£50M
Transport	£50M - £100M	-
Construction	£100M	£50M
Leisure, Entertainment and Hotels	-	£20M - £75M
Hitech/ Software	£300M	£50M
Retail	-	£25M

Table 1

Case Study

The dangers of too small a Limit.

In a recent, well publicised case, a UK public company experienced a total Limit loss through defence costs alone. Although the outcome of their defence was successful, not all the Directors were named in the suit, and when another Director was named in a separate claim, he was exposed without cover.

The costs of defending a claim, whether meritorious or not, can be significant, even if the outcome is successful and may potentially leave you exposed to further losses within that policy period.

Meet the Team

Martin Beagley

Martin Beagley joined Willis in 1975 and worked in the North American Division specialising in casualty, Errors and Emmissions (E&O) and latterly US D&O business placed into the London market.



He has been instrumental in developing the UK Directors' and Officers' book of business into one of largest in the London market, and has been at the forefront of many of the improvements to the wordings that have been accepted by underwriters over the past few years. Martin is a frequent speaker at industry seminars and is an Executive Director heading up the D&O team, specialising in D&O, Pension Fund Trustees Liability and Employment Practice Liability.

"The D&O market continues to evolve. There are now more insurers than ever before who are looking to write D&O for UK and International companies in the London market, driving rates down because of the extra capacity available."

Breaking News

In the ongoing Enron and Worldcom sagas, 10 directors of each company have agreed to pay a total of USD 31m of their own funds to settle lawsuits.

This dramatic settlement still does not conclude the situation, but does emphasise the importance of directors performing their legal duties in a diligent and legitimate manner.

Technical Corner

1. Outside Directorship Liability (ODL)

A D&O policy often contains an Outside Directorship Liability (ODL) extension, usually offered as a standard add-on under a D&O policy.

The intention of this cover is to protect your directors, officers or employees when they serve on the Board of an 'Outside Entity'.

An Outside Entity will usually encompass the following:

- Not for profit entities
- Trade Associations
- Charities
- Associated Companies – These are generally held to be companies where you will have a shareholding. The level of this holding varies from policy to policy but is most commonly 20%–50%, although it can encompass 'any shareholders'. You may have asked one or more of your employees to serve on the board, to protect your investment in this outside entity.

For cover to be provided under your D&O policy, these positions will need to be held at your specific written request whether by completion of the proposal form or scheduling at renewal. The intention is not to extend cover for all positions held in other companies, such as those held by your non-executive directors.

Cover under a standard D&O wording will usually apply excess of any indemnity from the outside entity and also any insurance that they may have. Claims by the other party and its Directors and Officers are also often excluded. Cover available is therefore fairly contingent, and we would recommend that checks are made to the adequacy of the D&O cover carried by the outside board before positions are taken up.

In respect of Joint Ventures (JV's), we would recommend that the JV purchases its own D&O policy, not solely relying on the ODL cover available from the JV partner companies. This is especially significant if there are officers employed by the JV itself.

One further point to note is that currently most policies will exclude cover to Outside entities that are domiciled in the USA or where they have shares traded in North America. Other restrictions may include Financial Institutions. **Most underwriters will consider including additional ODL positions if there is a genuine reason.**

Willis is one of the World's leading risk management and insurance intermediaries. We have 14,500 professionals in over 300 offices around the World.

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