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Terrorism Insurance Update

The events of September 11, 2001 caused a major upheaval in the insurance industry that severely affected most insurance companies and in some cases led to complete failure.

Following these events, insurers globally sought to exclude terrorism coverage in total. Deliberately broad exclusions were applied to ensure that insurers would never be called upon to respond on similar occurrences if and when they happened. This move meant that businesses would either have to accept this risk as being uninsured or seek specific terrorism coverage from the commercial market specialising in such products. In many cases the costs involved for such products were prohibitive especially considering the fact that regular insurance premiums were rising considerably due to the hard market.

Companies soon found themselves in a bind where financiers began requiring that assets under finance had to be "adequately" insured which in many cases also meant the purchase of terrorism insurance. This situation rapidly became untenable and demanded a broad based community response to deal with the problem.

AUSTRALIAN RESPONSE

The Federal Government moved in 2002 to establish a terrorism insurance pool to augment coverage that would be made available from the commercial insurance market.

Following strong representation by the banking and finance sector, consultation with the insurance industry and other industry bodies (as well as review of other terrorism insurance schemes), the Treasurer announced the details of the proposed Australian scheme.

AUSTRALIAN TERRORISM INSURANCE SCHEME

The main features of interest in the scheme are:

Cover will be provided for:

- Property and resultant Business Interruption
- Public Liability

*Cover will **not** be provided for:*

- Government assets
- Domestic
- Motor Vehicle
- Marine
- Aviation
- Life
- Health
- Mortgage risks
- Medical malpractice
- Professional indemnity
- Reinsurance

Workers compensation and compulsory third party will also be excluded, however, the scheme will consider State Government submissions for inclusion. At the time of writing terrorism is not excluded from these State based ordinances.

Damage caused by a "terrorist act" will be broadly defined as one that causes serious bodily injury or endangers lives, causes serious property damage or seriously interferes or disrupts telecommunications, transport systems and other public utilities.

The ultimate responsibility for determining whether an event is an act of war or terrorism lies with the Treasurer but will rely on a definition that states a "terrorist act" as being an act or threat that:

is done or made with the intention of advancing a political, religious or ideological cause and with the intention of coercing or intimidating a Commonwealth, State or Territory Government, a foreign country, or the general public in either Australia or a foreign country.*

The wording of this definition closely resembles the insurance industry imposed exclusion thus effectively "plugging a hole". We believe the broadness of the definition is problematic and wait with interest to observe how it is interpreted if and when an incident occurs.



Continued on page 2...

Terrorism Insurance Update (continued)

OPTIONS FOR CLIENTS?

The scheme will be compulsory for all insured's who will be required to pay contributions towards the scheme by way of a levy on premiums.

Charges will be based on the location of the risk, e.g.:

- CBD Commercial Property** – 12% on base premium.
- Urban Commercial Property – 4% on base premium.

This levy will be charged before other Federal and State charges and as a demonstration of the effect, we show below the before and after results based on a \$100 premium charge for a CBD property:

| | Victoria | | NSW | |
|----------------|-------------|------------|-------------|------------|
| | Before Levy | After Levy | Before Levy | After Levy |
| Premium | \$100.00 | \$100.00 | \$100.00 | \$100.00 |
| Terrorism Levy | – | \$12.00 | – | \$12.00 |
| Fire Services | \$28.00 | \$31.36 | \$30.00 | \$33.60 |
| GST | \$12.80 | \$14.34 | \$13.00 | \$14.56 |
| Stamp Duty | \$14.08 | \$15.77 | \$7.15 | \$8.01 |
| Total | \$154.88 | \$173.47 | \$150.15 | \$168.17 |

Cover will be provided under a hybrid structure made up of an insurance "pool", a commercial loan facility and a commercial government indemnity.

In the event of the scheme being depleted or exhausted by an occurrence, increased rates would be chargeable to replenish to prior levels. The proposed maximum increase would be up to three times the initial charge.

The collection and management of reinsurance premiums will be the responsibility of the newly formed Australian Reinsurance Pool Corporation.

It is proposed that the scheme will incept from 1 July 2003. However, there will be free cover for the period 1 July 2003 until 1 October 2003 with any liability for losses between those dates to be borne by the Corporation.

The delay in the commencement of premium payments will give insurance companies more time to put the necessary administration procedures in place.

The Terrorism Insurance Bill 2002 will ultimately become the governing legislation. This insurance is now proceeding through the relevant processes with the likely date of passing being June 2003.

USA RESPONSE

The US Government passed the Terrorism Risk Insurance Act of 2002 (TRIA) late in 2002. TRIA was designed to cover acts certified as "acts of terrorism".

in Luxembourg by some of Europe's leading insurers and reinsurers to write terrorism risks, has recently ceased operation due to lack of interest by clients.

We are waiting on clarification of several aspects of the legislation, including issues such as the position where insured's have already effected individual cover in the open market and also the treatment of captives. Willis will provide updates when more is known.

** Terrorism Insurance Bill 2002, Bills Digest No. 110 2002-03 Department of the Parliamentary Library.*

*** Includes agriculture and forestry but excludes marine, property, transport and farms not covered for business interruption risk.*

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TRIA has certain shortcomings in terms of coverage and uncertainties as to what would ultimately be declared a certified act, leaving many insurance buyers apprehensive about relying solely on this programme. Reportedly, only around 20% of insured's are opting to buy TRIA coverage.

Many clients are electing to pursue coverage via insurers and Lloyd's syndicates who are offering coverage that is wider than required by TRIA, in that it covers domestic terrorism in addition to foreign terrorism.

GLOBAL MARKET FOR TERRORISM INSURANCE

The market for terrorism cover remains buoyant with significant capacity available at more stable prices. The stand-alone market capacity is increasing, with total capacity in the region of US\$600m. It is however, interesting to note that Special Risks Insurance and Reinsurance Company, established

Directors and Officers Liability

Over the past twelve months the corporate world has experienced an unprecedented increase in litigation with accounting scandal and fraud underpinning many allegations. Pictures of main board directors being handcuffed by police and led away from their offices has left an enduring image on many people's minds.

DIRECTORS AND OFFICERS (D&O) CLAIMS

To help mitigate and remedy this in Australia, there have been recent pronouncements about corporate governance including a suggested code from the Australian Stock Exchange, but perhaps the most pointed change for directors will be found in CLERP 9. Under CLERP 9, the Federal Government appears to be seeking to limit auditors liability which will encourage plaintiffs to focus on directors.

The spotlight in Australia has been turned brightly onto corporate governance issues by the report of the HIH Royal Commissioner.

In the US, the newly created statute, the Sarbanes Oxley Act, has introduced a broad range of accounting and corporate governance reforms.

In the UK, the Department of Trade and Industry has sponsored an enquiry into the future of the British boardroom. Derek Higgs, who is heading up this enquiry, has recommended a number of changes in the way boardrooms work. As a result of the increase in litigation and thus the knock-on effect this has had on D&O claims, the D&O insurance market has significantly hardened.

Worldwide media coverage has documented the recent demise of some of the world's largest companies. Regulatory bodies have been very active in instigating investigations which has sometimes led to litigation where actions such as bad practice, fraud or non-compliance with industry practices or statutes have been alleged or found. While fraud itself is excluded defence costs are covered up to final adjudication.

INSURERS RESPONSE

The D&O market has suffered substantial losses worldwide and has reacted very quickly to counter mounting claims by increasing rates, deductibles and restricting cover and capacity. Premium increases depend on a number of areas but key features that underwriters consider more closely now include:

- What sector the company operates within.
- Is this sector heavily regulated.
- Structure of debt levels and ability to service debt.
- Corporate governance.
- Merger, acquisition and divestiture activity.

Companies who have US traded securities and US assets and operations continue to have a greater exposure compared to those who don't.

To gauge average rate increases in 2003 is difficult, as no two companies are the same, however, we can expect premium increases between 20% – 75%. A few companies have faced far higher increases, in excess of 500%, but unique exposures and circumstances pertaining to these companies are the reasons for this. A private company in a traditional sector can expect to see increases towards the 15% – 30% level though once again, this does depend on the risk.

On the coverage side the key changes currently being imposed are:

- Deductibles for all claims falling under the Company Reimbursement section.
- Separate deductible levels for securities claims.
- A co-insurance clause for securities claims.
- Sub-limits for investigation costs.
- Increase in the additional premium for the Extended Reporting Period provision.
- Restricted cover for outside directorships.

PRESENTING THE RISK

Brokers need to spend more time with clients whose directors are considered in the higher risk category by underwriters. The days of a simple proposal form are over and brokers need to fully understand the levels of corporate governance and business planning in all companies.

THE FUTURE

The US has always been the front-runner for D&O litigation but the speed with which Australia is catching up has surprised many in the industry. The current position looks unlikely to change for at least the next twelve months.

D&O is no longer a bolt-on cover to a general insurance programme. The increased pressure that new statute law, regulation and litigation are putting on directors means main D&O coverage is now being taken considerably more seriously than ever before. Whilst we have looked at other ways to cover the liabilities of directors and officers, a standard D&O policy is still the best solution for 90% of companies.

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State of Alternative Risk Transfer

HARD MARKET BRINGS BACK A STRICTER APPROACH TO ALTERNATIVE RISK TRANSFER (ART)

Hardening premium rates across the spectrum of insurances are forcing clients to decide on the future affordability of cover.

In many instances, clients have not had to confront this in 20 years. They are now analysing in-depth the economic effect of “unknowingly” entering an informal ART type programme imposed by insurers via substantial deductibles or excesses.

To assist the research process, clients need to focus on their risk profiles and usually need guidance and assistance, as this is a ground-breaking area for them. As well as balancing the fiscal issues, they still need to recognise the importance of safeguarding the organisation they work for.

The Willis Business Risk Practice (Richard Oliver International) is ideally placed to assist with the recognition of an organisation’s risk profile as well as its wealth profile. By melding these profiles, the organisation can decide on its ART strategies with much more comfort.

Should the initial study point to the probability of a captive insurer related solution, we have staff in Australia and all key captive domicile locations, providing advice and ongoing management in respect of captive insurance companies and other ART strategies.

CAPTIVE MANAGEMENT CAPABILITIES

Our team is fully qualified in insurance and financial consulting, providing a truly comprehensive management service.

This incorporates all aspects of the management and administration of a captive including:

- Development of a business plan;
- Domicile application and negotiation;

- Underwriting and policy administration;
- Claims management;
- Accounting;
- Management information reporting;
- Regulatory compliance;
- Coordination of cash and investment management services;
- Company secretarial services.

CAPTIVE REINSURANCE CAPABILITIES

Our contacts in the global reinsurance and insurance arenas, supported by our marketing expertise, ensure that we are able to provide reinsurance for all classes of insurance for captives, located in domiciles around the world.

CAPTIVE CONSULTING CAPABILITIES

Willis understands that companies do not stand still. Changing conditions in the external environment as well as internal developments may call for a fresh approach to risk financing. Our team is on hand to help you establish or evolve your captive and where it is no longer viable or applicable, to look for alternative solutions.

Services include:

- Captive feasibility studies;
- Evaluation or audit of captive operations and insurance programmes;
- Loss portfolio transfers of insurance liabilities;
- Migration/relocation of captives.

Captive business planning and formation services are also provided.

WILLIS GLOBAL CAPTIVE SERVICES CAPABILITIES

Willis is the third largest global captive manager with 240 captives under management. Supported by over 100 dedicated staff, we maintain presence in all major captive locations including Singapore, Bermuda, Guernsey and various US localities.

The Willis proposition is to provide comprehensive management, not just administration.

Our captive teams are recognised industry leaders and have experience in many industry sectors, including transport, banking and finance, retailers, utilities and the like.

By employing Willis Captive Services, our clients are able to achieve innovative programme design, advice on continued relevance and the undertaking of regular strategic and operational reviews of the captive.

As evidence of our wide experience, we provide the following details of our captive client risk profile:

| INDUSTRY | NUMBER |
|-------------------------------|------------|
| Aviation | 5 |
| Construction | 7 |
| Energy | 28 |
| Travel and Tourism and Skiing | 7 |
| Financial Services | 30 |
| Government | 2 |
| Healthcare | 24 |
| Insurance Agency | 10 |
| Insurance Carriers | 12 |
| Manufacturing and Sales | 48 |
| Professional Service | 8 |
| Retail | 10 |
| Sales and Services | 5 |
| Technology – Software | 4 |
| Transportation | 24 |
| Other and Cell Captives | 16 |
| Total | 240 |

Companies considering entering captive insurance arrangements can rest assured that Willis retain the core competencies, experience and knowledge required to achieve optimum results.

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HIH Royal Commission Report

The report by Justice Neville Owen released on 16 April 2003 concludes that the primary reason for the collapse was the failure to provide properly for future claims, essentially due to mismanagement and an inadequate response to pressures emerging in insurance markets internationally.

Copies of the full report are available on the Royal Commission website at www.hihroyalcom.gov.au

In all, the Royal Commissioner found that 56 matters should be referred to the Australian Securities and Investment Commission and the NSW Director of Public Prosecutions.

The Commissioner has also made 61 policy recommendations covering corporate governance and financial reporting; however, there is to be no fundamental change to the way insurance is regulated in Australia.

We particularly welcome the Commission's recommendation to abolish stamp duty on general insurance products, as well as the abolition of remaining fire service levies. The National Insurance Brokers Association has pushed strongly for this, especially in recent times.

Other recommendations emanating from the Commission include:

- Australian Prudential Regulation Authority (APRA) as the sole prudential regulator and removal of regulation of insurance from States and Territories.
- Create a specialist general insurance team within APRA.
- Co-ordinate regulatory activity across the States and Territories through a Ministerial Council.
- Avoid imposing levies and taxes on insurers that cannot be passed on to policyholders.

Australian Cybercrime doubles in Three Years

For many years IT security has been the domain only of IT personnel. Concerns over security have now spread not only to include risk managers but is being addressed at boardroom level. There is no excuse for a company director today to plead ignorance if his company's system is not properly protected and shareholders lose money.

IT security technology, together with relevant security and other policies and procedures are now seen as strategically important in running our businesses and maintaining competitive advantage. It is seen as one of the major components in helping directors achieve corporate governance.

With the reliance on technology and increases in directors liability, we need to continually update ourselves on the issue of IT security which is seen as the root cause of many problems.

A study by Deloitte Touche Tohmatsu shows the following alarming cybercrime statistics:

- 67% of companies surveyed had experienced criminal activity over the last 12 months – of which 89% were external attacks.

- 98% suffered some form of computer abuse, ranging from network sabotage to laptop theft.
- 60 of the 500 companies surveyed reported losses totalling \$5.78m.
- The number of organisations reporting incidents to law enforcement agencies doubled to 31%, but most attacks went unreported.

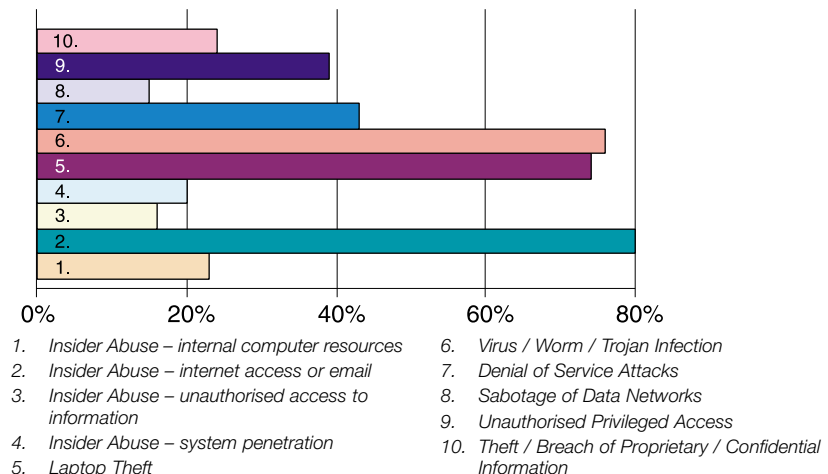
The following is predicted for 2003:

- 50 new vulnerabilities per week (30 in 2002).
- A significant rise in Identity Theft.
- An increase in complexity of attacks.

The rate of cybercrime is now greater than the rate of natural disasters.

Willis Australia through their Cyber Risks Practice can provide companies with appropriate advice on the protection of their IT assets. This includes IT insurances and IT risk management through our alliances with leading risk management companies, such as TruSecure and ITAC.

AUSTRALIAN COMPUTER CRIME AND SECURITY SURVEY – REPORTED MISUSE, CRIMES AND ATTACKS



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Workers Compensation Premium Discount Scheme

Progress Report

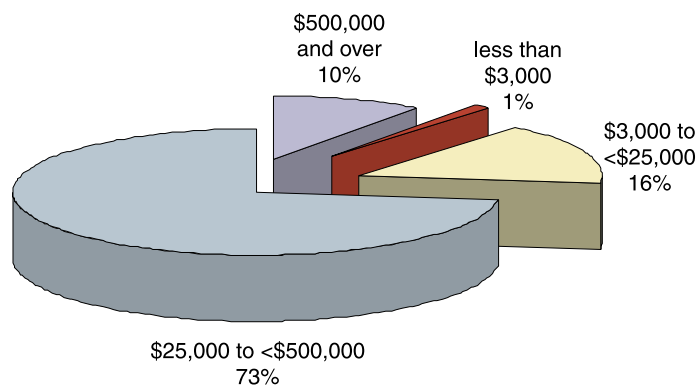
As at 31 December 2002 a total of 1,500 employers with 155,000 employees have had premium discounts verified in the 2001/2002* policy year with a combined discount total of \$26.8m. Of these, 1,066 employers have to date also received discounts in the 2002/2003 policy year totalling \$10m as they continue their participation in the Premium Discount Scheme.

The combined total discount for all participating employers since the Premium Discount Scheme commenced is \$45.7m.

TARGET EMPLOYER GROUPS

The Premium Discount Scheme is aimed at small and medium sized employers particularly those with poor claims history. These employers have a base tariff premium** in the range, \$25,000 up to \$500,000 and the scope to reduce their claims costs. A total of 766 (73%) of Premium Discount Scheme participants are in the target base tariff premium range between \$25,000 and \$500,000 (see chart above).

Our Business Risk Practice (Richard Oliver International) has been



accredited as a Category 3 Premium Discount Adviser. This is the highest level of competency of a Premium Discount Scheme Adviser. They are authorised to audit NSW employers who participate in the Scheme and approve workers compensation premium discounts of up to 15 per cent to employers who satisfy prescribed health and safety and injury management benchmarks.

Our Business Risk Practice also have the experience to provide occupational health and safety and environmental support to clients wishing to improve their performance in these areas.

* Each policy year period is for the period immediately after 4pm on 30 June to 4pm on the 30 June one year later.

** Wages multiplied by WorkCover Industry Classification rate.

For further information please contact:

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STOP PRESS STOP PRESS STOP PRESS STOP PRESS

PERTH OFFICE IS ON THE MOVE!

Please note, effective end July 2003, Perth's new address will be ...

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