

FINANCIAL INSTITUTIONS MARKET REVIEW

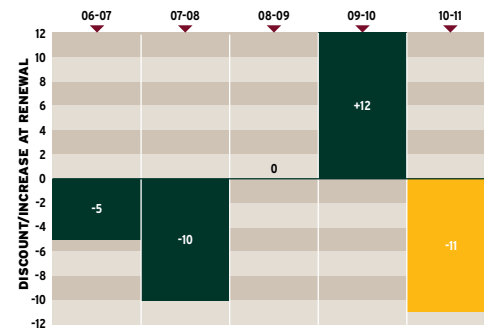
Three quarters of the way through 2010, the tough conditions in the market during 2008 and 2009 are beginning to feel distinctly historic. We reported in our last quarterly index how the market seemed to have two tiers – the new entrants looking to fill empty budgets, and the ‘old guard’ of established insurers still reeling from loss making years and trying to come to terms with a market that, in their view, was softening early. The environment has changed slightly with time, the new entrants have had a chance to get their feet under the table and have gained some market share. In addition, there is greater recognition from the more established insurers that the market has softened and they are more open to discussion than before about reducing premium rates. As a result, competition for financial institution business is fierce from both new and old insurers, and we continue to observe premium discounts at renewal averaging at around 10%. Furthermore, we continue to have success in securing broader policy wordings at renewal.

There is little to suggest that this state of affairs will change for the foreseeable future. At the time of writing, the global insurance market for property and casualty business is extremely competitive and commentators have suggested that only a catastrophic loss in the region of USD 50 billion in this sector will be sufficient to alter this. Given this background, combined with a more benign claim environment, financial institutions insurance is seen as an economically attractive class of business, hence we have plentiful capacity available.

We should take this opportunity to consider the January 2011 renewal season for underwriters’ reinsurance treaties, as these typically have a significant effect on premium rates for the following year. Negotiations for these contracts are well underway by now and initial feedback is that most reinsurance

treaties will renew flat, or with discounts, adding more weight to the argument that 2011 will see a continuation of the current favourable conditions.

ACTUAL AND PREDICTED MARKET CYCLE



Contents

- Financial Institutions Market Review1
- A Self Regulatory Organisation for Hedge Funds?2
- Your guide through Pension Reform.....3
- Meet the Team4



A SELF REGULATORY ORGANISATION FOR HEDGE FUNDS?

A GOVERNMENT ACCOUNTABILITY OFFICE STUDY ON SELF-REGULATORY ORGANISATION FOR PRIVATE FUNDS.

Hedge Fund managers that take the time to read the new Dodd-Frank Bill may be lulled into thinking that only Title IV entitled 'Regulation of Advisers to Hedge Funds and Others' deals directly with them. That would be a mistake. Many provisions throughout the bill deal, directly or indirectly, with the management of investment funds.

The Comptroller General of the United States shall:

- (1) conduct a study of the feasibility of forming a self-regulatory organisation to oversee private funds; and
- (2) submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of such study, not later than one year after the date of enactment of this Act.

Fund managers need to be alert to the **many provisions that may have a significant impact** on their business and may alter their risk management in the near future. Perhaps the most powerful weapon in the government's arsenal in the fight against systemic risk is the oversight authority granted the newly created Financial Stability Council. The Council now has oversight of nonbank financial companies. The Act defines 'nonbank financial companies' as those companies 'predominantly engaged in financial activities.' Hedge funds meet that requirement.

If the Council determines that a hedge fund may be in material financial distress and that that distress could pose a threat to the financial stability of the United States, the Council is authorised to require that the fund register with, and be supervised by, the Federal Reserve Board of Governors and be subject to 'prudential standards'. If the Council determines that a fund presents a 'grave threat' to financial stability the Council has broad powers to limit a fund's continuing operation and may force it to sell assets. In fact, the **Council may force a fund into bankruptcy** nominating the Federal Deposit Insurance Corporation (FDIC) to act as receiver.

If a hedge fund has been forced by the Council to report to the Federal Reserve, there will be assessed fees (along with large banks) to help support the Office of Financial Research, which in turn, funds the Council. The scale of the assessment is determined by the Council based on a variety of factors. When other institutions supervised by the Federal Reserve fail, the cost of that failure may also be assessed to hedge funds supervised by the Federal Reserve. A fund that is subjected to Federal Reserve supervision could, potentially, be **liable for substantial fees** in the form of these assessments.

Hedge fund managers and private equity advisers with more than USD 150 million in assets will now be **required to register** with the U.S. Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940. Registration subjects funds to periodic inspections by SEC examiners. Registered funds also must hire a chief compliance officer and set up policies to avoid conflicts

of interest. They will also be required to report information about their trades and portfolios that is 'necessary for the purpose of assessing systemic risk posed by a private fund.' The data, kept confidential, may be shared with the Financial Stability Oversight Council. Non-U.S. investment advisers with more than 14 U.S. clients and U.S. investors in private funds, or that manage USD 25 million or more of assets attributable to U.S. clients and U.S. investors in private funds, may now need to register with the SEC by July 2011.

Additionally, funds that utilise non-securities based swaps (e.g., interest rate swaps) will be subject to registration with the CFTC under the Commodity Exchange Act unless exempt under certain provisions.

INSURANCE IMPACT

While the standard remains unchanged for the time being, insurers will be watching carefully. Hedge funds deemed held to the stringent standards will wish to ensure they have made appropriate disclosure to insurers. Insurers will expect non-U.S. managers in particular to be able to demonstrate how the requirements of registration under the U.S. Act are being approached and complied with. The presence of U.S. investors may have an impact on insurers assessment of risk and therefore the pricing of professional indemnity insurance in particular. Further, the potential for increased regulation in the U.S. is also a warning to review current arrangements to ensure cover will adequately respond to U.S. regulatory investigations.

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YOUR GUIDE THROUGH PENSION REFORM

Pensions look set to form the focus of discussion over the next few years as we head toward the deadline for the proposed changes in 2012. In very simple terms the change is a shift in responsibility to ensure more people are saving for future retirement by making retirement savings compulsory. Until the details are finalised certain aspects are less clear, however employers will be required to manage the process of auto enrolment into a qualifying scheme.

The details of what qualifies is not yet fully defined, however the government Personal Accounts Delivery Authority has come up with its own solution to pensions reform called the National Employment Savings Trust, NEST.

However, employers **do not** have to set up a NEST plan if they have a suitable arrangement.

There are detailed regulations surrounding the process of pension reform, and the timescale which the process must adhere to, some of

which might yet change. However most of the commentary surrounding this refers to NEST, because the rules for NEST will form the framework to compare existing arrangements. Unsurprisingly since the election NEST and pension reform has been the subject of commons debates.

Questions have been raised against the implementation plans for the proposals put forward by the former Labour government. The concerns surround the impact on public spending, and the complex responsibility it places on employers to get the administration right. In addition, concern was raised around the proposals to recoup the costs via the NEST charges, which are actually less favourable than many pension plans that already exist in the market place. No timescale has yet been set for any further announcements, but the DWP Minister Lord Freud said during the debate the reforms will be subject to cost-cutting.

SO WHAT DOES THIS MEAN FOR EMPLOYERS?

Employers will be required to pay at least 3% of qualifying earnings for those jobholders who don't choose to opt out. They can choose to pay more but the total contributions from employers and jobholders must be at least 8% of qualifying earnings. They will be required to administer the joining and opt out process.

WHEN DOES THIS LEGISLATION BECOME EFFECTIVE?

Although the general understanding is that this will start in 2012, the reality is slightly different. The legislation has defined start dates for contributions that will be staged as per the table below. The staging dates are further broken down by size of employer, with larger employers starting first. By July 2014 all employers with more than 50 eligible staff will have started the first stage.

Staging dates	Employer Contributions	Jobholder Contributions*	Total
1. 10/2012 – 10/2016	1%	1%	2%
2. 10/2016 – 10/2017	2%	3%	5%
3. 10/2017 onwards	3%	5%	8%

* Including tax relief

* Qualifying earnings will be set in 2012 however proposals in 2006 suggested a figure between GBP 5,035 and GBP 33,540

WHAT IS A QUALIFYING SCHEME?

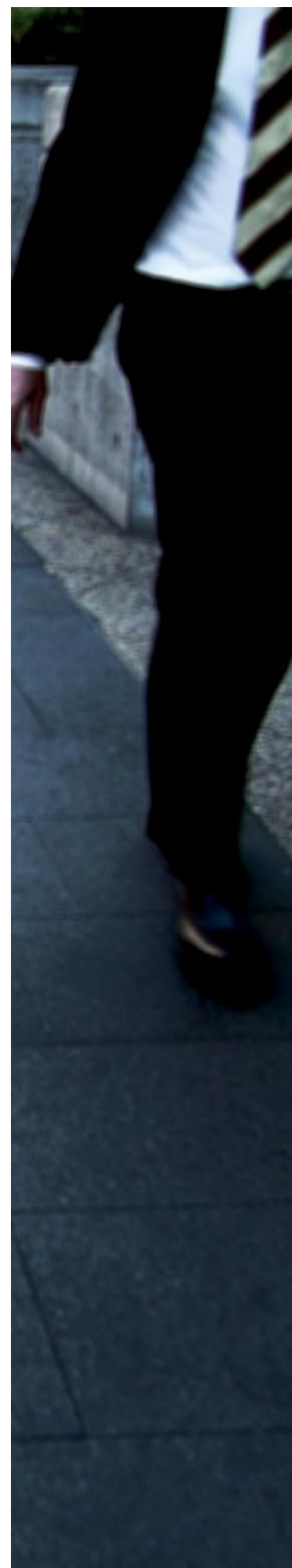
You can use Defined Benefits schemes, Occupational Money Purchase, or Group Personal Pensions provided you meet the qualifying criteria, which for personal pensions is in line with the table above. Alternatively you can use the National Employment Savings Trust, NEST.

WHAT IS NEST?

The Personal Accounts Delivery Authority (PADA) is currently establishing NEST as part of pensions reform. Although the details aren't yet finalised, it's expected to be:

- a qualifying scheme that employers can automatically enroll their eligible jobholders into when you don't want to use a private pension scheme
- a large defined contribution occupational pension scheme, aimed at low- and medium-earning employees who don't have access to a pension scheme through their employer
- run by the private sector at arm's length from the government
- governed and administered by Tata consultancy services (announced 02/03/2010)
- quite basic, e-based where appropriate, with few choices for individuals who join
- likely to include a low-risk default investment fund, with a lifestyle option and a maximum of 10 funds

Each member will have their own 'personal account' within NEST.



WHAT IS THE DIFFERENCE BETWEEN NEST AND PRIVATE PENSIONS?

At the outset the focus will be on charges, and functionality. NEST needs to recover its setup costs and will therefore charge an upfront charge of 2% on every contribution in addition to a 0.3% annual management charge. Although the upfront charge will be removed once the setup costs are repaid, it is estimated that it will take 20 years for this to happen. Most private pensions have a charging structure that erodes the fund less than the NEST proposition, combined with superior functionality to NEST, therefore it is unlikely that existing schemes will adopt this alternative, until the initial charge is removed.

The functionality differences are listed in the table below:

Option	NEST	Typical Group Personal Pension Scheme
Annual Management Charge	0.3%	0.2% – 1.0% depending on agreed basis
Allocation of monthly contributions	98% (2% charge on each contribution)	100%
Fund Range	Choice of 10 funds	87-in excess of 250 depending on provider
Can accept transfers in	NO	YES
Can allow transfers out	NO below age 55	YES
Can operate Salary Sacrifice option	NO	YES

ARE THERE ANY ADVANTAGES TO NEST FOR EMPLOYEES?

Depending on the current charging structure of your current pension arrangement there are circumstances where a NEST account could represent a better long-term charging structure. This is because the annual management charge is only 0.3%, whereas the average for a comparable Stakeholder or Group Personal Pension plan is typically higher. Initially NEST accounts do not represent good value in terms of the charges that have been agreed; however the 2% charge only occurs once per contribution, whereas an annual charge is repeated against the entire fund value.

WHAT HAPPENS NEXT?

The industry has been promised an update to the review by the end of the summer, we are keeping a very close eye on developments and will keep you updated with a series of alerts that our Employee benefits division is releasing.

STOP PRESS: OCTOBER 27, 2010.

The Government has announced that it intends to press ahead with auto enrollment and NEST. Further details will be released shortly.

MEET THE TEAM



Alex Burton Brown

Alex Burton Brown is part of the FINEX Global Sales and Marketing team. He joined in February this year with a remit to expand new business in the SME sector, focusing on the Financial Institutions market. Alex has joined Willis after nine extremely successful years in the healthcare communications industry, where he provided bespoke solutions to some of the U.K.'s largest Healthcare companies including Johnson & Johnson and Smith & Nephew.

He is a keen rugby and cricket fan and plays regular club cricket, having toured Sri Lanka a few years ago. His rugby days are now firmly behind him and Alex is happy to fulfill the stereotypical role of 'armchair expert'.

To discuss your insurance arrangements with the Willis FI team please call your Account Executive or Paul Richards on +44 (0)20 7558 9240.

Are your contact details correct? If not, please contact Susan Mint at smint@willis.com. We are also looking to move to electronic mailing of this index to all recipients. If you would like to receive future newsletters via email, please could you forward your email contact details to the above email address.

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