

# The Willis Index

# Willis

## FINEX Professional Indemnity Newsletter

The Professional Indemnity Insurance and Risk Management Quarterly

Edition 1 2007

### Market News

During the third quarter 2007 we have witnessed the continuing reduction in rates across the entire Professional Indemnity arena. With no prospect of a change in direction in the near future, the continuation of this process effectively means that rates could at some stage touch the low point of the period between 1999 and 2000. This may not occur for some time, but with increasing market capacity available, insurance buyers are finding that they can in some cases utilise premium reductions to purchase additional limits for their problematic exposure areas.

Insurance classes where coverage remains limited are "single projects" for the construction industry and patent infringement for the technology and telecom industries. Rates continue to remain high within both these segments due mainly to the limited number of insurers who can actively provide capacity.

Part of the overall market resilience is due to the abundance of capacity on offer in the UK sector through Lloyd's and the company market. New capital has been attracted by the low impact of catastrophic claims emanating from the US hurricane season, aviation sector and the general US litigation arena. However, our current intelligence is still compiling loss information related to the recent UK floods, Hurricane Dean and the continuing fallout from the sub-prime lending saga. Will these losses have a material impact on insurance rates?

As always the real litmus test will be whether the reinsurance market is hit by significant claims. The reinsurance treaties which allow the direct insurers to have flexibility when setting rates and where possible broadening coverage, have the ability to deliver the "death blow" to declining premiums if they are

materially affected by losses settled by the direct underwriters. Insurance practice dictates that the reinsurers begin to rein in the direct underwriters as they impose heavier costs and more stringent coverage conditions upon them.

In the short term, all the indicators suggest that rates will continue to fall. However, we are beginning to witness certain mature carriers declining to renew risks where the rate reduction means that their cost base on an account basis is higher than their rate of return. Effectively this means that financially it makes more sense to keep capital invested in a bond with a bank rather than underwrite a particular risk. This has only occurred on a limited number of occasions to date, but it could occur more frequently as senior management begins to impose specific business disciplines on individual underwriters.

Once the premium has fallen to a minimum level in relation to the capital being provided, it is in the Insured's interest to try to extract further broadening of the primary contract wherever possible – and at this point, the selection of a broker with the necessary experience and market knowledge is key.

#### Case Study

Notwithstanding the above, we have continued to obtain premium reductions for several of our clients who have been able to demonstrate a good risk profile combined with a low level of claims. The graph below highlights the results for one client which has shown a 1,000% increase in its gross fees over a period of 12 years – despite which we have been able to negotiate a reduction in the premium rate of 81% over the same period.



The Willis Index is a quarterly publication reporting on the relevant issues affecting the Professional Indemnity Insurance sector.

Our quarterly analysis will provide buyers with an overview of insurance market conditions, our assessment of the outlook in the coming months, articles of interest to Professionals, and relevant breaking news.

Willis voted "European Commercial Broker of the Year 2006" by StrategicRISK magazine for the second consecutive year.

Willis voted "Best and Most Innovative Insurance Broker of the Year" by Reactions magazine for the second consecutive year.

Willis voted "National Broker of the Year 2006" by Insurance Times for the second consecutive year.

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# IT Security Risks

The internet and electronic forms of communication have become a way of life in both our personal and professional lives. However, our familiarity with such technologies can lead to a blasé approach to the risks associated with their usage.

Reliance on computer and telephone networks within organisations has increased to the point where it now represents a key risk exposure. Real time business processes have brought numerous productivity advantages to organisations. Procurement systems, stock monitoring and the quality of information management have improved through the use of such technologies. However, this dependence also generates additional risks.

IT security risks are a very real threat to every firm; Deloitte & Touche conducted a Global Security Survey in 2006 which found that of the global Financial Institutions sampled, 82% had suffered some form of security breach

IT security risks are faced not just by e-commerce companies and those doing transactions over the internet - any company reliant on computer or telephone networks, digital information or the internet faces these exposures. In other words, almost every business faces these risks.

## Some of the key exposures include:

### Denial of Service

A systems outage can materially affect the profitability of an organisation – and although some companies will argue that they have a disaster recovery plan in place, this may not provide sufficient protection to the business. The disaster recovery plan may not have been properly tested and unfortunately, experience shows that often these plans remain static as the business evolves. So the business could still be exposed to financial losses as a result of “downtime”, or could face “activation costs” or an increased cost of working.

### Security Breach

A security breach may result in a variety of losses. There may be litigation expenses and fines associated with the breach, but the more significant losses are likely to arise from the interruption of business, and the associated loss of income. Additionally, the reputational cost may be incalculable; no one will choose to do business with a firm that cannot ensure the privacy of its customers’ data!



## Our objective is to assist our clients:

- to identify and quantify their IT security and related risks
- to reduce their exposure to these risks
- to improve their protection against such risks by better risk management or the purchase of the appropriate specialist insurance solution.

## Specialist Insurance Solutions

- Specialist insurance products are now available which combine first- and third-party coverage for many IT/cyber exposures, including those involving privacy, hacking, viruses, network disruptions and online advertising and publishing risks.

## Features of coverage currently available include:

- Indemnification for loss of revenue following unplanned system outage
- Fines and penalties
- Indemnity for you in respect of your liabilities to third parties following your negligent transmission of a virus
- Compensation for your revenue loss arising from internet revenue interruption (caused by a hacker)
- Indemnity in respect of defence costs/settlement costs incurred resulting from your failure to protect the security and confidentiality of customer records and information
- Indemnity against your liabilities resulting from defamatory comments made by staff members over email
- Payment of fees of a public relations firm to assist you in re-establishing your business reputation and those of a security consultant to review your electronic security measures, following a successful hacking attack.

## In order to fully protect your business, we recommend the following steps:

- Ensure all your risk exposures are identified by an expert
- Make sure that your policy wording is tailored to your specific needs
- Seek out a sensibly priced/commercially acceptable insurance solution
- Review how the risks/exposures within your organisation are changing on a regular basis and that any insurance policy continues to fulfil its key objectives

The e-Solutions experts within our Professional Indemnity team can assist you. For further information please contact::

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0207 975 2074

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0207 975 2086

# The Resource Gap

In November 2006 Willis hosted a successful dinner at which Paul Darling (Construction Silk of the Year 2006) chaired a thought-provoking discussion with some of the foremost construction professionals in the United Kingdom and one of the "hot" topics was the potential resource gap for architects and technical engineers given the anticipated increased construction output during the course of the next five years.

Three main potential solutions were discussed, each of which brings with it risks to the business and potential increases in Professional Indemnity exposures. Such risks obviously do not apply just to the construction industry – but to all disciplines/sectors where a professional firm has more work than it can manage effectively with its existing resources.

## The options discussed over the dinner include:

- 1 To outsource certain services to territories outside the United Kingdom which have the resources to perform such work. However, it was agreed that it is vital at the outset to agree clear parameters around which services can be outsourced and what is expected of the outsourced service providers. Careful management of the level of service and the service providers will be key as will the establishment of clear lines of communication – and in particular where there are language and cultural differences. It should also be borne in mind that overseas consultancy practices may not purchase any Professional Indemnity insurance or there may be significant differences

in the breadth of coverage and the limit of indemnity purchased.

- 2 Architectural and Engineering practices to work more efficiently to cope with the increased workload ie squeezing a "quart" into a "pint pot".
- 3 To acquire another firm with the resources available or to merge with a firm with similar resources and use the efficiencies and economies of scale to cope with the forecast increased workload. Any merger or acquisition will require a significant amount of management time and a structured due diligence exercise. Whilst financial and legal due diligence are the main thrusts of any due diligence exercise, with construction professionals having to confirm or reaffirm their insurance arrangements in contractual agreements on an almost daily basis, insurance is increasingly recognised as a significant factor in the overall due diligence process.

Willis has one of the most respected Mergers & Acquisitions Practices in Europe and we re-affirm below some of the "Do's and Don'ts" which we have shared with you before and which should be considered when undertaking any insurance due diligence exercise.



We will be hosting two more dinners during the final quarter of 2007 – one in London and one in Leeds with guest speakers on topics of interest to construction professionals. If you would be interested in attending either of these dinners (dates to be confirmed in early October), please contact **Michael Earp on 0207 975 2356 or by Email: [earpm@willis.com](mailto:earpm@willis.com)**.

## Do:

- Do consider three-year projected estimates of insurance premiums and benchmark against similar business risk profiles using accepted market data.
- Do consider the financial impact and collateral requirements of self-insured exposures (including deductibles).
- Do consider "change of control" clause implications on the existing insurance policies.
- Do review 6-12 years' claims experience to identify any claim trends of concern (frequency and magnitude).
- Do ensure asset valuations are current to confirm appropriateness of sums insured to prevent under-insurance.
- Do review the potential for transactional insurance solutions such as Warranty & Indemnity and/or Tax Liability insurance as a tool to smooth Sale and Purchase Agreement negotiations.
- Do review and quantify any contingent liabilities and consider methods by which to minimise or insure against them.

## Don't:

- Don't rely on non-qualified insurance professionals to quantify future cost.
- Don't forget to review the historical liability insurances, especially Employers Liability and Public Liability which are normally "loss occurring" and the purchase will require access to such post-completion in the event of a loss/claim.
- Don't assume access will be granted to your vendor's historical insurance arrangements or the other party if a merger.
- Don't assume the post-completion accounts will allow provision for any return premiums.
- Don't overlook uninsured risks.
- Don't disclose detailed information on insurance issues too soon in the transaction process as a seller/vendor.
- Don't ignore possible tacit renewals on insurance policies involving cross-border transactions in Europe.
- Don't accept lenders' restrictions within facility agreements without consultation.

# Breaking News

## How to file a claim – some must-know details

Willis advises clients to notify claims or circumstances to insurers as early as possible. Your wording will often stipulate that the notification must be made within a certain time frame. One common version of this provision says that notification must be made “as soon as practicable”. The decision of Mrs Justice Gloster in *HLB Kidsons v Lloyd’s Underwriters* contains an important lesson for clients about this phrase.

- It will be insufficient to put underwriters on notice of a claim if underwriters were told of the matter informally, for instance, as “material information”. Notification must be made formally and in writing.
- The notification to underwriters must give them sufficient detail and context to enable them to gain an understanding of what is being notified. This test is an objective one.
- Following the decision in *HLB Kidsons v Lloyd’s*

*Underwriters*, Willis would suggest the following elements are essential when notifying a claim:

- identify the error, the act, omission or potential negligence which forms the subject matter of the notification
  - identify anyone who **has** suffered loss and may therefore be in a position to bring a claim, even if they have not done so to date
  - identify anyone who **may** suffer/**may** have suffered loss and may therefore be in a position to bring a claim, even if they have not done so to date
  - make it clear that this communication is a formal notice to underwriters of a circumstance which may give rise to a claim.
- Finally, it is prudent to insist that underwriters confirm their acceptance or otherwise of the notification, to avoid later disputes.

## Mortgage Fraud Seminar

On Thursday 7th November 2007, the Willis Professional Risks team will be hosting a breakfast briefing focusing on Mortgage Fraud, how it is committed, what cover clients need under their Professional Indemnity Insurance, and the New Money Laundering Regulations which will help prevent mortgage fraud.

This topical briefing will be of particular interest to firms of solicitors and surveyors and any professional firm interested in who actually pays the price of fraud.

To reserve your free place at the seminar, please contact Kay Groves: grovesk1@willis.com.



Further information can be obtained direct from the Willis Mergers & Acquisitions Practice. Please contact:

**Simon Dodsworth**

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## Your Principal Willis Contacts for Professional Indemnity Insurance

### Solicitors:

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### General enquiries:

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# Meet the Team

The FINEX Professional Indemnity Practice continues to expand, with eight new team members joining since the beginning of 2007.



**Tim Mitchell**  
**Executive Director and Professional Indemnity Practice Leader**

Tim lived in the States for a number of years when he worked for Marsh in San Francisco. During that period he was a National E&O resource for Marsh

offices, specialising in the production and management of Marsh's professional services clients. These included a number of technology and law firm clients.

Prior to joining Willis, Tim worked at JLT where he headed up the Financial & Professional Business Unit. Tim's predominant focus in the last five years has been in developing risk transfer solutions for professional services firms working closely with both London- and US-based carriers. Tim also spent time as a professional liability underwriter at XL Brockbank Syndicate at Lloyd's where he underwrote the Professional Liability account. He has extensive experience in working with global professional services firms on the placement, servicing and management of their insurance programmes.



**Graham Nagus**  
**Executive Director**

Graham specialises in global E&O programmes, including the design of risk solutions for the Fortune 1000 Companies. Graham's expertise within the PI arena is centred on building solutions for

global organisations, including the design and implementation of new programmes, contract reviews, drafting wordings, utilisation of captives and alternative risk financing. Graham also specialises in the area of patent infringement and complex E&O coverages and has participated in a number of large M&A insurance transactions. Prior to joining Willis, Graham was a SVP with Marsh FINPRO's Professional Liability Practice and spent two years in the US on secondment to two major law firms.



**Andrew Bowyer**

Andrew has worked exclusively in the Professional Indemnity insurance market since 1996, after graduating from The University of Liverpool with a Construction Management Degree.

This academic knowledge has proved exceptionally useful over the last 11 years in which time Andrew has arranged insurance programmes and provided advice to the full range of Consultants, Contractors and Affinity Groups which make up the Construction Industry in the UK and Ireland.

Prior to joining Willis in February 2007, Andrew worked for Griffiths & Armour and specialist Lloyd's broker, Howden.



**Becky Coombs**

Becky joined JLT Risk Solutions in August 2001, initially working in the Business Contacts department before joining the Technical Support Unit. In December 2003, she transferred to the Financial and Professional

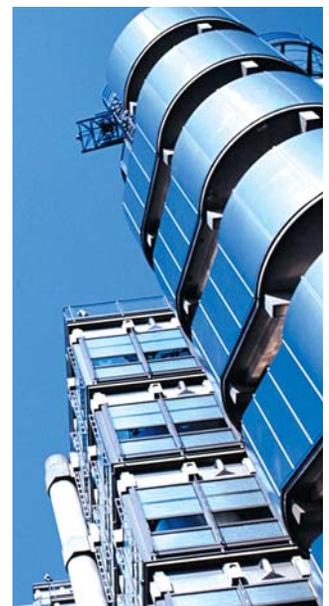
Risks Business Unit to work as a technician responsible for the production of slips and endorsements in addition to assisting with policy production for Directors' and Officers' Liability, Professional Indemnity, Crime and Financial Institutions Insurance.

Becky joined Willis in May this year, and has primary responsibility for ensuring WEM compliance for the US Professional Indemnity team. She also provides valuable technical support in terms of achieving metrics for the global Professional Indemnity team, and is extremely knowledgeable in the application and administration of overseas insurance premium taxes.



**Amie Watson**

After graduating from Southampton University in 2001, Amie joined Alexander Forbes as a broker in the Professional Indemnity Team where she worked on all classes of Professional Indemnity business – developing strong market relationships and gaining experience in placing business for a number of major clients including the development of a specialist Professional Indemnity Scheme for Irish Solicitors. Amie joins the Professional Services team where she is undertaking a broking and client servicing role on the UK and international book of business.





**Vicky Paxton**

Vicky started her career in the insurance industry in 1998 as an Aviation Underwriter's Assistant before transferring to the Specialty Lines Market in 2000. In 2001 she moved from underwriting to broking and joined Aon

where she worked as a Binding Facilities technician before moving into UK professional indemnity account handling and latterly US D&O / EPL broking.

At Willis she is responsible for broking and account handling of US Professional Indemnity risks.



**Jon Angell**

Jon graduated from Plymouth University in 2002 with a degree in Business Studies. He then spent an extended period travelling the world before joining a business services/office products group in 2004 as a Sales

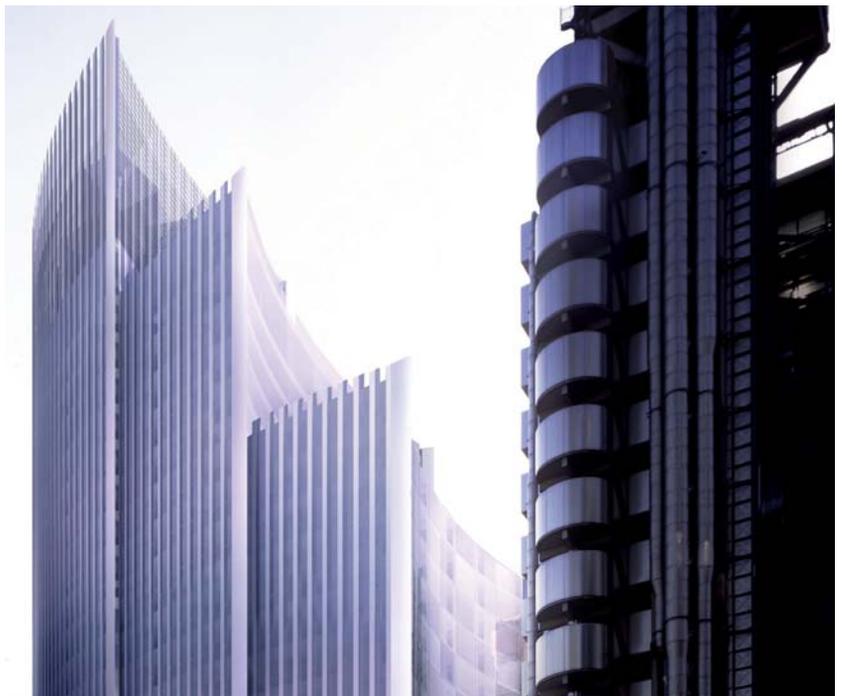
Executive. He joined the Willis Claims team in April 2007 specialising in professional indemnity claims broking.



**Dale Zincke**

Dale has been working in the London market specialising in Professional Indemnity claims since 1988. His main specialism is in the field of surveyors' claims, having spent several years at RICS Insurance Services Limited.

He has made regular presentations to audiences of both surveyors and solicitors. He has also written claims-related articles for Surveyors' technical publications. He brings this in-depth experience to our Claims team.



Willis is one of the world's leading risk management and insurance intermediaries. We have approximately 16,000 professionals in more than 300 offices around the world.

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