

The Willis Index



FINEX Directors' and Officers' Newsletter

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

Autumn 2006

Market Conditions and the Results of the Market Survey

The Willis Index conducts a quarterly survey of the Lloyd's and London company market. We invite responses from over 90% of D&O insurers and ask them to comment on premium rates and coverage terms for the preceding three months and over the next three months. The results are aggregated anonymously in this report.

Premiums are still declining, however moderation is in sight

In contrast to our Summer 2006 publication of The Willis Index, respondents to the third quarter survey have shown early signs of predicting a stabilisation in premium rates ahead. After well over two years of declining rates across the board, this may come as no surprise, although over the last year the actual reported rate of decline in rates has generally exceeded the market's predictions in every quarter, suggesting that the insurers' hoped-for stabilisation of premiums has not been realised.

Primary Premium Rates

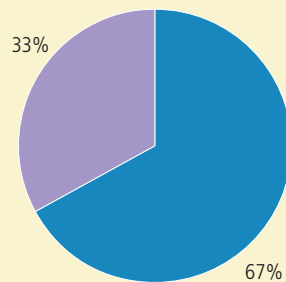
As a historic picture of the last three months, 67% of respondents reported that primary premium rates had fallen between 1% and 10%, a similar proportion to Q2. However, interestingly 33% believed that rates were flat, with no change being reported. This data is in stark contrast to the our last report where none of the respondents reported 'No Change' and 34% reported premium rates falling between 11% and 20%.

Looking forward to the next three months, an even larger proportion of respondents (42%) predicted that primary premium rates would be static. This change in consensus is significant, having jumped from just 8% of respondents in Q2.

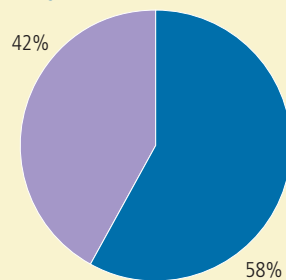
However, 58% still believe that primary premium rates are set to fall between 1% and 10% in the next quarter, down from 75% in our last survey. Significantly, no respondents reported reductions of more than 10%, a contrast to the feedback received from 17% of respondents in our previous survey.

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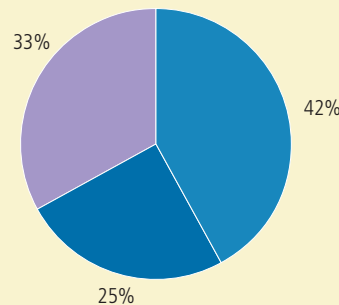
Primary Premium Rates - Last 3 Months



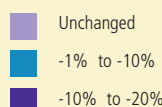
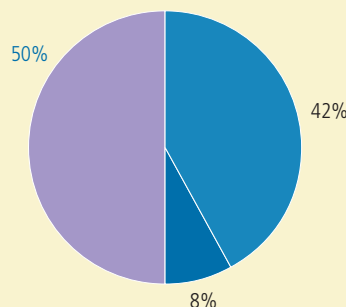
Primary Premium Rates - Next 3 Months



Excess Premium Rates - Last 3 Months



Excess Premium Rates - Next 3 Months



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.

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.

Willis voted European Commercial Broker of the Year 2006 for the second year running

Willis voted Best & Most Innovative Insurance Broker 2006 for the second year running

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Market Conditions Continued

Excess Premium Rates

As a picture of the last three months, 42% of respondents believe that excess premium rates had fallen between 1% and 10% during the period which is less than the 54% of respondents within the second quarter survey.

Moreover, only 25% of our respondents believed that excess rates had declined between 11% and 20% during the period, down from 38% of respondents in Q2.

However, the most significant change in consensus was the number of respondents predicting 'No Change' in excess rates over the next three months. This reading more than quadrupled to 50% from just 8% in our last report, indicating that excess insurers, like their primary counterparts, are increasingly looking for future stabilisation of rates.

removing the requirement on the US to provide prima facie evidence when requesting an extradition, and implementing the EU-US Treaty on extradition.

Despite the fact that similar arrangements are now in place with a number of other territories, including some with questionable human rights records, the most vocal criticism has been directed at the UK-US arrangements. This is in part due to the apparent lack of reciprocity regarding the requirement for evidence (although some commentators have noted that under the 1972 UK/US Treaty there was already an imbalance in favour of the UK which had to satisfy the less rigorous test of 'probable cause' in order to make an extradition request) but it has been the high profile of some US Extradition cases against UK businessmen that has created the most media coverage. In particular, critics have expressed their concerns that the US is particularly swift to exercise extra-territorial jurisdiction in cases of corporate and financial crime, with a greatly heightened risk for a UK Director if they were or are a Director of a USA subsidiary or if they have undertaken business in the USA.

Extradition proceedings: How will your D&O Policy respond?

Background

Recent press coverage on the "NatWest Three" and other extradition cases has increased the focus of company directors on how their Directors' & Officers' Liability (D&O) insurance policy would respond in the event that extradition proceedings were brought against them. While this case is high profile, there have been more than 40 applications for extradition since the 2003 Act (the Act) and the establishment of the extradition Treaty between the USA and the UK. The majority of these relate to white collar crime. However, since the USA government has never ratified the Treaty, all of the applications have been one-way.

Extradition

The principal concern with the 2003 Extradition Act is that no prima facie evidence of wrong doing has to be established by a foreign Category 1 authority in order to instigate extradition proceedings against a UK director. It could be sufficient therefore for a Category 1 authority to have only hearsay evidence in order to initiate an extradition request. (Territories designated as category 1 territories include: Austria, Belgium, Cyprus, Denmark, Finland, France, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Spain and Sweden).

In order to qualify for extradition under the Act the activity has to pass two tests:

- It has to be a crime under both English law and the law of the country bringing the action.
- It has to be punishable (in both countries) by a custodial sentence of at least 12 months.

Therefore insider dealing, fraud, tax evasion, and health and safety offences which lead to fatal accidents are all potentially within the ambit.

A territory may not be designated as Category 1 if a person found guilty in the territory of a criminal offence may be sentenced to death for the offence under the general criminal law of the territory.

Although the USA is designated a Category 2 territory for the purposes of the Act, by reason of a Statutory Instrument coming into force on 1st January 2004, the USA along with around 40 other territories, was designated a territory in respect of which the requirement of evidence which would be 'sufficient to make a case' may be dispensed with under section 84(7) of the Act. This effectively brings the US into line with the provisions between European countries by

The D&O Market View

Most if not all D&O insurers are currently of the view that the costs incurred in fighting extradition would be covered under a normal D&O policy. This opinion is formed on the basis that a D&O policy provides coverage for 'defence costs', which commonly embraces all reasonable costs that are incurred in defending a claim against an individual director or officer. This is not an unreasonable view especially as D&O policies do not specifically exclude the extradition risk.

To date the issue has not been tested and when faced with substantial costs insurers will naturally examine the specifics of the issue in conjunction with their policy language.

Most insurers are clarifying their policy language to state that 'extradition costs' - which would extend to the costs of bringing an action to fight an order - would be included within the definition of defence costs. Others are going further and providing cover whether a formal allegation has been made or not, in



much the same way as they would for investigation expenses. This additional confirmation is important when one considers the lack of prima facie evidence required to commence proceedings.

Policyholders need to look more carefully at their policy since it would be imprudent to rely solely on this 'market' view. One needs to consider some of the issues involved before taking comfort in the protection offered by one's own policy.

Practical Considerations

Insurers tend to treat criminal allegations differently from civil allegations. To understand the practical reality of how and when coverage will operate, one needs to appreciate the following issues:

Jurisdiction

For smaller risks it is common for insurers to impose limitations relating to claims arising in the USA or filed under USA jurisdiction. The policy should provide coverage for litigation in any jurisdiction.

Dishonesty Exclusion

A director or officer cannot expect a D&O policy to provide protection for a proven illegal act. This would be against public policy and it is for this reason that today's D&O policies are designed only to include coverage for criminal prosecutions where the defence is successful. It is important to recognise that once there is a determination of guilt, the exclusion applies and insurers have the ability to:

- withhold any further payments (despite any comment relating to the cost of appeal)
- seek recovery of any advanced payments
- argue that any indirectly related claims are also excluded.

Defence Costs

The definition of Defence Costs naturally needs to be broadly drafted so as to capture the full range of legal costs involved in the defence or settlement of any claim. It is also important to be clear on what constitutes a 'claim' since many insurers only provide cover for defence costs that are related to a claim for financial damages.

Deductibles

The principle of 'presumptive indemnity' is embraced within the policy to the extent that an insurer will rely on the company indemnifying its directors and officers in the first instance of a claim. This means insurers will naturally not want to make any advance payments until the company reimbursement deductible is exceeded. It follows that each company should be clear on the extent to which it can and will indemnify its directors and officers in the case of an extradition.

Advancement of Defence Costs

Advancement of defence costs is commonly provided but the language of the provision is hugely important since no two insurers necessarily treat advancement in the same manner. Some insurers will only advance what they believe is reasonable and fair irrespective of what the policyholder's view is, at a time of their choosing. Clearly any advancement related to the defence of a criminal prosecution will test an insurer's resolve if they believe they will not be able to recover their outlay following a successful prosecution.

Severability

A D&O policy is a collective policy whereby each individual should be treated in their own right. Consequently, the actions of one director should not be imputed to any other for the purposes of determining cover under the policy. The problem is that different insurers deal with this principle in different ways and this inconsistency leads to a differing interpretation of the Dishonesty Exclusion.

Risk Management

Policyholders and D&O's need to consider the broader picture and perhaps instigate internal measures that can be made available to the D&O's in the event of an extradition problem.

Some institutions are looking at putting in place formal procedures with an easy access to funds in order to deal with the implications of an extradition such as:

- clarity of the indemnification provisions and employment contracts
- legal panels
- legal defence funds
- additional cost of living expenses in the event the individual is held overseas

This approach sits well with many institutions' indemnification provisions and it clearly has practical benefits in supporting an insurance solution.

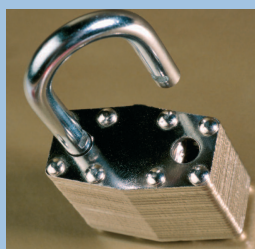
Willis' FINEX Division works extensively with D&O insurance markets to provide bespoke wordings exclusively available to Willis clients and we are in the forefront of currently negotiating agreements with insurers to address the issues discussed here. Should you have any queries about how your policy will respond, please refer to your Willis Client Advocate.

Examples

Ian Norris, the former chief executive of Morgan Crucible, recently lost his fight to avoid extradition by the US Department of Justice (DoJ) which accused him of taking part in a cartel in carbon products during the 1990s and he faces a lengthy prison sentence if convicted. This case has raised concerns that UK executives can be extradited for offences which were not even illegal at the time they were alleged to have been committed - however, the prosecutor is not alleging price-fixing, which was not a crime in Britain before the 2003 Enterprise Act introduced criminal sanctions for cartel activity. Instead, the department is seeking to fit the former Morgan Crucible chief's alleged misconduct into the much older offence of conspiracy to defraud.

Continued

Breaking News



Nigel Potter, the former managing director of Wembley Plc is currently serving a three year prison sentence in the US after being convicted of wire fraud. In 2000/2001 the general manager of Lincoln

Park in Rhode Island had suggested that Wembley Plc make a bonus payment to a third party to secure the approval of new gaming machines at Lincoln Park. Mr Potter did not approve such a bonus payment, but merely responded that he would take it under consideration with his board, and ultimately did not proceed. US authorities subsequently launched an investigation into what they alleged was a conspiracy to bribe, and he was extradited without fighting the proceeding since he believed that it would help his case to be seen to be cooperating with the authorities.

Willis Annual Russian CIS & FINEX International D&O Liability Seminar

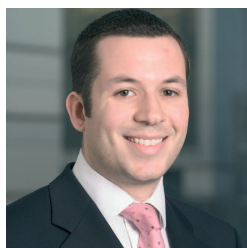
The Willis Annual Russian CIS & FINEX International Directors & Officers Liability Seminar took place in Saint Petersburg on the 25th September 2006. The FINEX International Directors & Officers Liability team in London worked with the Willis Moscow office to run the seminar which featured a claims workshop and panel discussion. The seminar was hosted by David Purdy and Ed House from FINEX and Maria Bogatyreva from the Willis CIS team. The Conference was attended by over 70 clients, prospects and market contacts making it a great success. Invited guests from the legal sector and the London Insurance Market also attended to give an update on the London D&O market. The conference was conducted in English, simultaneously translated into

Russian. This seminar followed on from the success of the last Annual Russian CIS & FINEX International D&O Liability Conference, held at the Moscow Stock Exchange, which saw people travel from all over Eastern Europe to attend.

Book your place at the next FINEX D&O Seminar

The FINEX D&O team is holding a free breakfast briefing focusing on Evolving D&O Coverage on 29th November. Three speakers have been confirmed to cover issues such as policy wordings, including Insured v Insured, Prosecution Costs and Severability, and to report on how recent changes impact on policy coverage. For more information please contact Melanie Barnes.
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Meet the Team



Mitchell McBain

Mitch graduated from Exeter University in 2002 with a degree in Economics and Statistics and a Masters in Finance and Investment.

After travelling for a few months around Central America and then working for a re-insurer, Mitch joined Willis in September 2003. He is currently an account executive, broking and servicing mainly UK based clients

in both the public and private sector for D&O, Prospectus Liability, Pension Trustee and Employment Practices Liability products.

In his spare time Mitch enjoys playing most sports, especially badminton and golf, and travelling to watch cricket and football.

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Willis is one of the world's leading risk management and insurance intermediaries. We have over 15,000 professionals in over 300 offices around the world.

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