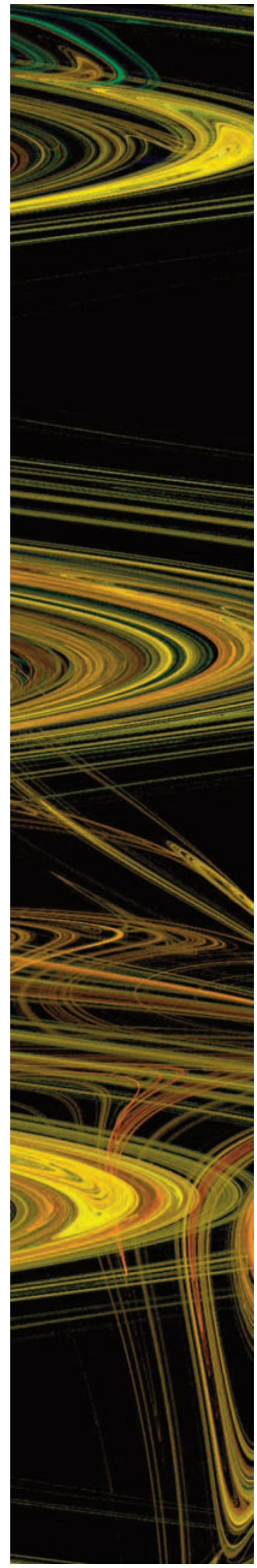
FIDELITY

CLAIMS RISE SHARPLY; PRICES, GENTLY



Some of the most complex and largest claims in the Executive Risks sector are Fidelity claims. The number of Fidelity claims we are managing is growing at a rate in excess of 50% per year. The Willis claim group has noted not only a rapid increase in the number of claims reported but a spike in their size. Claims in the low eight-figure range, once viewed as rarities, are occurring with alarming frequency.

Human nature never changes. Fraud exists in all economic conditions. We uncover more of it when times are lean, however, as management becomes more vigilant toward expenses and exposes schemes that previously went undetected. The current downward economic spiral has revealed several such schemes.

Given these trends, we believe that many who face significant Fidelity exposures are underinsured. Some carry no protection at all in this area – even some non-traditional financial institutions who would seem to be the best candidates for it. Although the majority of both financial institutions and commercial entities carry Fidelity policies, the spike in loss severity means that the exposure is starting to exceed the limits carried by many firms.

PRICING

Despite the increase in claims, the pricing of Fidelity coverage has not responded as one might expect. A long soft market is turning, but gently. Pricing is flattening on a primary basis for many commercial accounts. Financial institutions are starting to see flat to 10% increases. London is already mandating 10-15% increases on all Fidelity renewals. Certain organizations have faced fairly serious increases. However, the cost for excess Fidelity coverage remains exceedingly competitive, and generally, opportunities can be found.

The main reason is a series of new entrants into the marketplace who are not only looking to write excess but have an appetite for primary placements as well. In another marketplace note, we have seen many AIG clients staying put, perhaps more so than in other Executive Risks lines. This is likely because Fidelity exposures have a shorter tail than those of, say, Directors & Officers insurance, where claims can take several years to work through the court system. Fidelity claims are usually resolved within 12 months. AIG has also done a good job of convincing the marketplace of the solvency of its underwriting companies.

HOT SEAT FOR HEDGE FUNDS

Hedge funds have always had more trouble than most financial institutions in buying Fidelity coverage – when they have tried. The situation has only grown more extreme. While clients of hedge funds may be looking more carefully at the FI bonds carried by these funds, the number of underwriters willing to write the cover has dropped significantly. Most are waiting to see what, if any, increase in regulatory oversight will be applied to these institutions before offering them FI bond coverage.

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