

# The Willis Index

Willis

## Accountants' and Auditors' Newsletter

The Accountants' PI Insurance and Risk Management Quarterly

Edition 2 2007

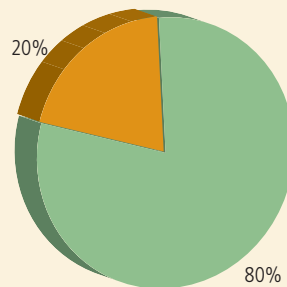
### Market Survey

#### The Enron Effect?

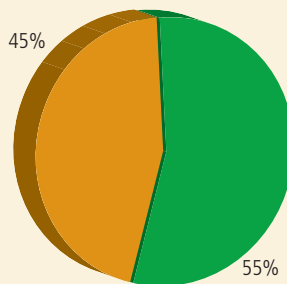
In previous editions of the Accountants' & Auditors' Index we have commented on the effect of external factors on the Professional Indemnity (PI) market, with occurrences such as 9/11 and Hurricane Katrina. The repercussions of the collapse of Enron, which led to a number of legal proceedings being launched against its former auditors, Arthur Andersen, could still lead to a large claim hitting the London market. On 9th March 2007, a settlement was reached between the firm and the class action suit, with Andersen agreeing to pay \$72.5million to the former investors and shareholders. The fact that a potential claim of this size has induced little less than a murmur is an illustration of the capacity and resilience of the London market. As Guy Robinson, a Willis PI broker, commented: "Whilst the Enron claim has had a knock-on effect to Accountancy PI rates as a whole, the market has managed to absorb the loss with little change to the base premiums."

It appears that, rather than external factors, it will be more mundane occurrences, (such as profitability of certain insurance lines) that will affect PI rates during the coming months. In the Q1 2007 Accountants' & Auditors' Index there was an analysis of the professional indemnity reinsurance market rates, which at first glance looked to be experiencing a 5-10% decrease. However, sitting behind this is that fact that reinsurance rate decreases were focused on specific professions, where rates were stable, and loss history low. Accountants' and auditors' professional indemnity rates have been consistently lower (and have decreased faster) than the PI market as a whole. This has led many reinsurers to move their interest and focus to other more profitable and stable lines. Consequently there has been an effect on the PI rates. As our Market Survey shows, many underwriters see their rates starting to flatten out, and even starting to increase again in the run-up to 2008. However, in the immediate term we see it as still being a "buyer's market", especially for small-to-medium sized firms.

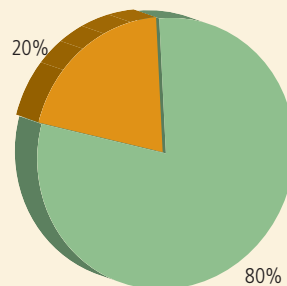
Primary Premium Rates - Last 3 Months



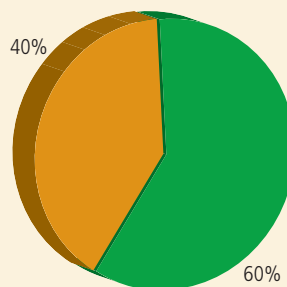
Primary Premium Rates - Next 3 Months



Excess Premium Rates - Last 3 Months



Excess Premium Rates - Next 3 Months



- Unchanged
- -1% to -10%
- -10% to -20%

The Willis Index is a quarterly publication reporting on the relevant issues affecting the insurance industry and the impact they have upon our clients.

Our quarterly review provides analysis of the Professional Indemnity Insurance Market, assisting buyers and their advisors on available solutions.

Regular features include updates on the market conditions, 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" 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

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# Sector Audit



“The heads of the country’s six largest audit firms and head of the American Institute of Certified Public Accountants will form the bulk of the seats on the 12 person CAQ board.”

## **Companies Act 2006: Full implementation timetable published**

The Act, which comes fully into force by October 2008, has several key units which are implemented earlier. Amongst those of note are: Directors’ duties in October 2008; Audit, including auditors’ limitation of liability being April 2008 (except those auditors appointed by a private company — October 2007); and Accounts and reports in April 2008 (October 2007 for Business Review). The full timetable is available via email from the Willis Accountants & Auditors team, or online: [www.dti.gov.uk/files/file37975.pdf](http://www.dti.gov.uk/files/file37975.pdf)

## **Audit disclosure obligations may widen:**

Under ISA 580, the IFAC is seeking to widen the disclosure obligations, reports Accountancy Age. Rather than the current situation, where only company directors need to obtain legal sign-off before speaking to auditors, the Federation would seek to extend the need for ‘written representation’ to all company officials who speak to auditors.

## **Issue of limitation of auditor liability raised by CEA**

The European insurance body, the Comite Europeen des Assurance (CEA), in response to a planned European Commission report on the subject, has noted that a liability cap would not prevent large fraud losses, or losses which originate from outside the EU. The Commission is to publish a report analysing the potential impact of introducing a limitation on auditor liability in EU law.

## **Centre for Audit Quality (CAQ) formed in the US**

In a bid to restore public confidence in the American accountancy profession, US accountants have formed the CAQ, Accountancy Age reports. The heads of the country’s six largest audit firms and head of the American Institute of Certified Public Accountants will form the bulk of the seats on the 12 person CAQ board.

## **4Q 2006 company winding up statistics published**

The DTI statistics show that in the fourth quarter of 2006, company winding up petitions were up 8% on the same quarter in 2005. In the same period, debtors’ petitions were up 23%, while creditors’ petitions were down 4%.

## **ISA changes moved forward a year**

Originally announced in the 2006 Pre-Budget Report,

the planned ISA reforms will now come into effect a year earlier, in April 2008. Aiming to introduce more flexibility for savers, these changes will include the removal of the Mini/Maxi distinction currently seen, and enable transfers from the cash unit into the stocks and shares unit. The Government also announced that it will allow Child Trust Fund accounts to roll over into ISAs.

## **Lloyd’s Three-Year Plan**

Lloyd’s of London has published its Three-Year Plan identifying the benefits of operating at Lloyd’s, as well as the possible issues to be tackled in that time. The Plan is available via e-mail from the Willis Accountants & Auditors team, or online: <http://www.lloyds.com/NR/rdonlyres/716184A1-A770-423B-B40A-F081217498DF/0/ThreeYearPlanscreenfinal.pdf>

## IT Security Risks for Accountants and Auditors

### **Steve Bonnington Technology and E&O Specialist**

Today, we all use the internet and electronic forms of communication in both our personal and professional lives. Indeed, it is difficult to recall how we were ever able to manage without such technologies, and the benefits they bring. 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, dependence generates risk.

“Hacking” is a word that now forms part of our everyday vocabulary, and stories appear every week about the theft of electronic data. We have read with interest how a British man was able to break into systems belonging to the US Army, US Navy and US Airforce and cause millions of dollars of damage.

But, hacking attacks always happen to other people and companies, right?

Wrong.



Cyber risks are a very real threat to every firm. Indeed, Deloitte & Touche's 2006 Global Security Survey found that of the global financial institutions sampled, 82% had experienced some form of successful security breach. But, we're not an e-commerce company, and we don't transact our business over the internet. We don't have to worry, right?

Wrong.

Cyber 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; this means just about every business in the world today.

**Denial of Service**

Most organisations would argue that the effects of a system outage to their bottom line are manageable, because they have disaster recovery plans. Setting aside the fact that many disaster recovery plans have never been tested and the tendency for plans to remain static as the business evolves, you could still be exposed to financial losses as a result of "downtime". You may 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!

Data Protection legislation is developing rapidly across the United States and Europe. For instance, in California there is already legislation in place requiring any firms experiencing a systems breach to notify those whose personal information may have been compromised. Equally, the Health Insurance Portability

and Accountability Act (HIPAA) places limitations around the disclosure of individual's medical records.

Willis advocates a '3m' model to assist its clients with protection against cyber exposures:

**Manage**

In some firms, there is an accepted mentality that cyber risks are not worthy of consideration by management at the highest level because they are "dealt with by the IT department." Reference is made to the existence of an IT policy, firewalls, anti-virus technologies, security protocols etc, as evidence of risk management. But have you quantified your exposures? What would be the impact if you were subject to a denial of service attack and were unable to access your network? Did you remember to upgrade your anti-virus software? Since the Turnbull Report, management has been obligated to take a more interactive approach.

**Monitor**

Technology develops at such a rate that it is not adequate to simply put protection mechanisms in place and assume that risks will be managed. Hacking techniques evolve quickly, and so must your response.

**Mitigate**

Once you have quantified your exposures, and have implemented forms of protection, you may wish to consider the extra security offered by a specialist insurance solution.

In many cases, traditional insurance policies — property, commercial general liability, crime and many E&O policies — may not respond to losses involving information systems. A bespoke cyber insurance policy may be a valuable business asset.

**What Insurance Solutions are Available?**

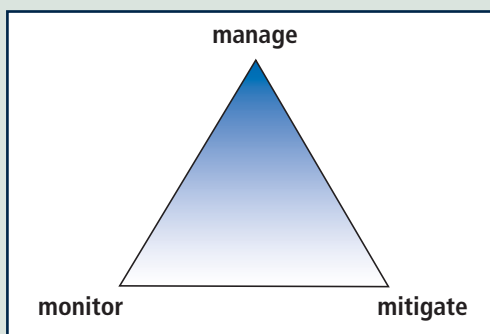
Products are available that combine first- and third-party coverage for many cyber exposures, including those involving privacy, hacking, viruses, network disruptions and online advertising and publishing risks.

**Features of Coverages**

**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.

As in all areas of risk management, however, buying insurance is only part of the puzzle. What is really needed is strong exposure identification, policy wording tailored to your needs, and communication about exposures within your organisation. The e-Solutions experts within our Executive Risks/Professional Risks team can help you put all of the pieces in place.



# Meet the Team



**Laura McDonough**

Laura is an Account Executive with FINEX UK & Ireland, and joined Willis in June 2006 from the National Farmers Union (NFU) – a long-term client of Willis. Her previous role as a client and insurance buyer gives her a unique perspective for an insurance broker, and

provides a valuable asset to clients as well as the Willis Professional Indemnity team. In the time that she has been with the team she has worked with various professions, from surveyors to IT consultants to international law firms. With this wealth of experience and knowledge, we now welcome her to the Accountants & Auditors team.

## What was your role at the NFU?

I was the Assistant NFU Secretary and responsible for negotiating and purchasing all the General Insurance and specialty insurance products that an organisation the size of the NFU required.

## What were the major insurance concerns that you had?

For me one of the most important parts of the insurance process was ensuring that our broker and our insurers had a clear understanding and picture of what we did. Broker communication was key to ensuring that the underwriters knew what the NFU did as an organisation, and therefore where our exposures lay. As the union's finances are formed from members' fees and contributions, price and added value were significant factors, and sources of concern in the hard markets. As a dedicated insurance buyer scheduling to meet with the board in time to get our insurance renewed also added to the entertainment.

## Why the move to Willis?

My interest lay with insurance and I wanted to move to a more commercial operation. Through my work with Willis, I had met many London underwriters, and this encouraged me to work in the London market. Willis had a strong ethos and I liked the Account Executives who I had worked with.

## What experience/knowledge have you gained most from your first year?

The most interesting part has been seeing the other side of the client-broker relationship, and building upon the knowledge I had of what a client wants and expects.

## Why did you want to move to the Accountants' & Auditors' team?

It's a young and dynamic team who are enjoyable to work with, and having worked with several other professions, I wanted to gain experience within this sector.

## What challenges do you see for firms buying PI in the immediate future?

With the onset of a hard market looking more likely in 2008, this year is looking like the last one where firms will be able to make the large premium savings that we have seen in recent years. Now is also the time to take an objective look at your current broker, and see if you think that they will be able to negotiate for you the best price and cover in a hard market.

## What do you like to do outside of work?

I have been a keen athlete since my university days, when I represented Great Britain at Under-21 level in netball. Since graduating I have concentrated on running and horse riding. I've also just bought a new house, and so most of my time has been occupied with that.

## Laura McDonough

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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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