

The Willis Index

Willis

FINEX Directors' and Officers' Newsletter

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

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.

Sudden Downshift in Market Rates

The last quarter saw a significant drop in reported rates, with large reductions of up to 20% being seen again in underwriters' renewal books. This conforms to Willis' own experience where we have been witnessing even greater reductions on claims-free risks, and suggests that insurers are still prepared to battle it out for market position in an increasingly competitive environment.

Primary Premium Rates

Insurers in our last Index had overwhelmingly predicted small reductions (31% of underwriters) or flat renewals (69%) across the board, however their actual experience was of significantly reduced rates with 25% of respondents experiencing reductions of between 11% and 20%. The remaining 75% reported reductions of up to 10% and none reported flat

renewals. For the next three months insurers are expecting that significant savings will remain, with 25% of respondents anticipating reductions of up to 20%. The remainder have predicted flat renewals (25%) or up to 10% reductions (50%).

Excess Premium Rates

In a similar pattern to primary rates, our respondents experienced a downturn in reported rates, with 37% of insurers reporting reductions of between 10% and 20%. The remaining 63% reported smaller reductions of up to 10%. Looking ahead, the excess premium rate predictions match those for primary rates, with 25% of insurers expecting continued reductions of between 10% and 20%, and the remainder predicting small reductions (50%) or flat renewals (25%).

A Soft Market into 2008?

Rebasing our anticipated rate trend line (see Fig 1), it would seem that rates are set to continue on their downward path beyond the end of 2007 and into 2008, suggesting that despite the recent emergence of multi-year agreements, insurance buyers should avoid being tied into such agreements without careful consideration.

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.

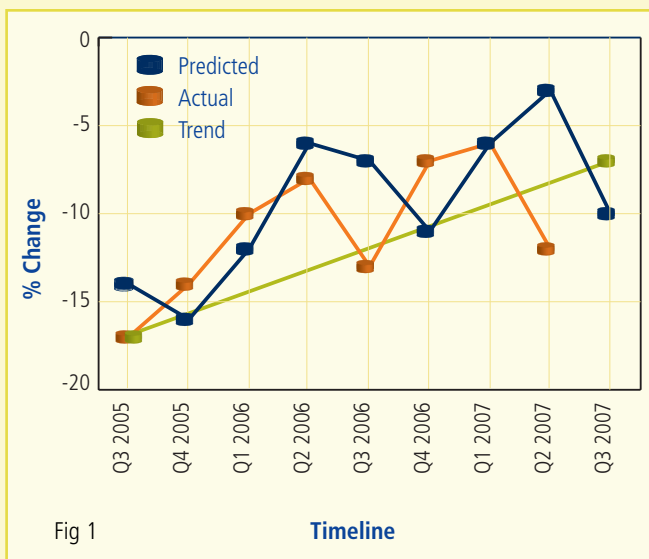
Regular features will include updates on the market conditions through the market survey, case studies, technical analysis of coverage specifics and special features highlighting significant changes in regulation, insurance market news and forthcoming events and seminars.

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

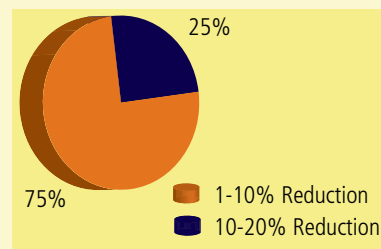
Willis voted "Best and Most Innovative Insurance Broker of the Year" by Reactions magazine for the second consecutive year.

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

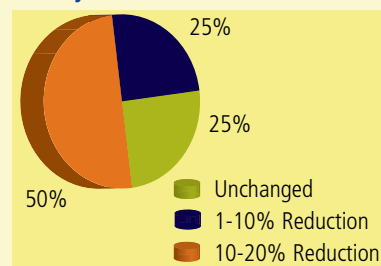
Predicted vs Actual Rate Change



Primary Premium Rates Last 3 months



Primary Premium Rates Next 3 months



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Solutions for Pension Trustees

The basic duties of a Pension Trustee can simply be defined as follows:

To pay the right person the right amount at the right time.

In recent years the duties and obligations placed on the trustees of pension funds, be they directors of a Sponsoring Employer Company or employees appointed by the members, have grown under a raft of new legislation. This started with the Pensions Act of 1995 that was brought in following the Maxwell scandal, with a further duty of care imposed by the Trustee Act 2000. Other legislation that may need to be considered by trustees includes issues relating to age, sex, disability and religious discrimination.

The Pensions Act 2004 introduced legislation which covered areas such as Scheme Funding and winding up procedure regulations; put in place the Pension Protection Fund; empowered a new Pensions Regulator (replacing the Occupational Pensions regulatory Authority (OPRA)), and imposed new requirements on Trustees.

The Act sets out the basis of the requirement for trustee knowledge and understanding, which is a Code of Practice published by the Pensions Regulator. Trustees are required to be conversant with their own scheme documents; to have knowledge and understanding of trusts and pension law and of the principles of funding and investment. Compliance with this code will be taken into account by the Pensions Ombudsman or a court in the event of a complaint or claim. If this is taken in context with the new requirement that one third of a scheme's trustees should be nominated and selected by members (rising to half from 2009), acting as a trustee is not a matter to be taken lightly. Such plans have been put in place to avoid the conflicts that may arise between the duties of directors of the company and trustees.

Whilst a directors' foremost duty is to the company, a trustee's duty is to the members of the scheme. Conflicts can arise when, for example, the company enters a period of financial difficulty. A trustee is responsible for ensuring that contributions to the fund are both collected and deposited on time, in accordance with the trust deeds, whilst a director may be more concerned about the solvency of the company. There have been cases where monies are paid to the fund, and then loaned back to the company to keep it afloat. In the case of insolvency, the scheme would likely be under funded, and the members would be likely to have a case against the trustees for not acting in their interests.

Trustees have a number of fiduciary duties and statutory responsibilities for which they are **personally** liable. Trustees liabilities are unlimited

(despite the fact that most trustees are unpaid) and are not subject to the statute of limitations, thus going with them to the grave; this coupled with a generally more litigious society and the increasingly high profile of pensions in the press, it is easy to see how the exposures of trustees are wide reaching and onerous.

Traditional Protection Available

Trustees have traditionally relied on protection available to them from the following sources;

Section 61 of the Trustees Act of 1925 allows a court to excuse a trustee who has been in breach of trust, as long as they have acted "honestly and reasonably and ought fairly to be excused". This protection, however, relies on a courts opinion as to whether a trustee has acted as above, which is subjective.

Exoneration and Indemnity clauses are commonly written into trust deeds.

Exoneration clauses offer an absorbment of loss by the Employer Company or fund, whilst indemnity clauses offer the payment of the loss on behalf of the trustee. Both excuse liability arising out of a breach of fiduciary or other duty, provided it is innocent (but will not cover deliberate breaches or fraud). However, use of such clauses means that either the sponsoring employer or the fund suffer a loss. This relies heavily on the continued financial strength of the sponsoring employer or the plan, which is something that can no longer always be taken for granted. Further, such clauses need to be drafted to cover a broad range of eventualities.

Where authority is delegated to a third party, a claim may be pursued against the service provider. However, claims are subject to a statute of limitation of 6 years and may be time barred. A breach of trust has no such limitation and trustees may subsequently find themselves liable for the mistakes of such third party service providers.

Pension Trustee Liability Insurance is seen as offering a "belt and braces" approach, providing cover not only for the personal liability of the trustees, but also balance sheet protection for the fund or sponsoring employer where they have exonerated or indemnified the trustee, or where a claim is brought against the company or fund.



Pension Trustee Insurance

Typically, a Pension Trustee Liability Policy should provide cover for the following:

— **Individuals:**

Cover for past, present and future trustees, including their spouses, heirs and their estate (liability goes to the grave): and cover for employees, to include the director and officers of a sponsoring employer and employees undertaking administration duties relating to the fund such as the HR director, or the pensions manager.

— **Entities:**

The sponsoring employer and its subsidiaries, and the pension scheme/plan/fund. A corporate trustee company could be either a company established by the sponsoring employer to act as trustee or a third party corporate trustee company. It should be noted that professional trustees have a higher duty of care under the Pensions Act 2000, and should carry their own professional liability cover. It may be that the policy would NOT extend to cover such professional trustees.

The policy would provide cover where a claim is brought alleging a wrongful act in areas such as:

- Breaches of trust
- Breaches of duty
- Breaches of a statutory provision
- Negligence
- Errors and omissions
- Misstatements and misleading statements
- Maladministration

Some policies also provide cover for Legal expenses incurred in respect of fact finding investigations, where no wrongful act has been alleged.

Most policies will also provide cover for the civil fines and penalties imposed by regulatory bodies, providing that the premium for this cover is not paid out of the scheme assets. This can be overcome by the sponsoring employer paying the premium, or this element of cover being provided as an extension, with a separate premium attaching to it.

Loss covered by the policy will include defence costs, awards, judgements and settlements; however, the policy is not there to act as a financial guarantee to the fund. It will pay the defence costs relating to a claim for a benefit that is considered due, but will not pay the actual benefit as this is still the responsibility of the fund.

How can claims be generated?

Claims against trustees may allege the following:

- 1 **Breach of trust or breach of fiduciary duty.**
This is the most common source of litigation and comes mainly from scheme members and beneficiaries. Matters are likely to relate to;
 - the failure to pay the right pension to the right person
 - the loss or reduction of trust assets
- 2 **Breach of statutory duty**
 - usually coupled with claims for breach of trust brought by beneficiaries
- 3 **Contractual claims**
 - actions brought by those with whom the trustees contract
- 4 **Tort**
 - a breach of duty of care owed in tort for negligence. Such claims can be brought by third parties who are not beneficiaries or in any contractual relationship with the trustees

The most common claims against trustees are those brought by a dissatisfied member of a scheme or beneficiary. The cases referred to the Pensions Ombudsman are most commonly from members. Others are from employers, trustees and managers.

The most frequent matters reported to the Pensions Ombudsman relate to:

- 1 **Transfers:** where members may believe that they have suffered a loss as a result of the "incorrect" transfer of membership from one scheme or arrangement to another.
- 2 **Discretionary decisions:** such as death benefit where relatives may feel that the trustees have not exercised their direction properly.
- 3 **Ill Health cases:** members may not always understand why an ill health pension is not paid, despite an employee being dismissed as they are not well enough to do their job.
- 4 **Winding up:** when a scheme is wound up there may be a deficit in the funding and in the case of an insolvent employer the member's benefit will be reduced. Conversely where there is a surplus trustees can decide how this is used, and could, for example, increase the benefits for only one class of beneficiary. Others may feel that this is unfair and may make a claim against the trustees on this basis.
- 5 **Calculation of benefits:** this includes basic calculation errors or an allegation that promises of certain levels of benefits have not been kept. Claims may be made where the beneficiary has made financial commitments based on the calculations provided, that can no longer be honoured.



Delegation of duties to specialists in certain fields, including investment managers and third party administrators does not remove responsibility from the trustees, and it should be remembered that even the most unfounded claim will need to be defended resulting in significant legal costs.

Myths surrounding Pension Trustee Liability Policies

Pension Trustee Liability policies are not compulsory (although certain parties would like them to be), and the take-up is surprisingly low.

This may be partly due to some of the common misconceptions highlighted below:

- 1 **The Company carries Directors and Officers Liability Insurance which will protect the directors who are also trustees.**
A D&O Policy will usually exclude claims relating to pensions matters and therefore will not provide any protection, or at best will provide cover for indirect claims only.
- 2 **That premiums are high.**
Cost is not as prohibitive as may be thought. Obviously, as with all insurances, premiums are directly linked to exposures, but a Pension Trustee Liability policy may cost from as little as £1,000 for a £1,000,000 limit of indemnity for a scheme with assets of £10m. The premium may be paid by the employer company on the trustee's behalf or from the fund so long as the trust deed allows this.

- 3 "It will never pay out"
Claims are on the increase with 15% of all notified circumstances becoming actual claims that incur costs under a policy. With the Pensions Regulator taking a more pro active stance than previous regulatory bodies, investigations into pension funds are on the increase, which may result in costs being incurred by the trustees even if they have done nothing wrong.
- 4 "We have a Defined Contribution Scheme, not a Defined Benefit Scheme therefore the risk lies with the member not with us"
In Defined Contribution schemes the members are responsible for selecting from a choice of funds. In practice the majority of these will pick the default fund, and it is possible that claims will subsequently be made against the trustees for a failure to provide enough choice, or advice in selecting the funds. There are also issues surrounding the administration of these funds where delays in passing on contributions can have disastrous effects on the financial performance.

In Summary

In summary, whilst some cover is offered to both directors who are trustees and to nominated trustees, neither an exoneration clause, nor the indemnification provided by the company or the fund offers wholly adequate protection against the broad range of claims that may impact the trustees. Although trustees are now expected to exercise a higher duty of care and have knowledge and understanding of all areas of pension fund management, things may still go wrong.

Pension Trustee Liability Insurance provides vital protection to trustees where other sources cannot be relied on to cover their personal assets. The policy also serves to provide balance sheet protection to the employer company and/or fund where they have indemnified the individual trustees.

Most directors will not serve on a board without Directors and Officers Liability Insurance. The same consideration should be given to Trustees and Pension Trustee Liability Insurance.

D&O Seminar Success

The Willis D&O Team held a breakfast briefing on 27th June entitled, "How Global is your D&O Policy". It was attended by over 70 people. Three high quality speakers from leading law firms covered topics such as the differences between EU and US regulatory regimes, international cooperation between regulators, and problems with indemnification regimes in different territories.

The speakers' subjects provoked plenty of questions and lively debate from the floor, resulting in positive feedback from attendees.

If you would like to receive information on any upcoming D&O seminars, please email Melanie Ludlow: ludlowm@willis.com

Meet the Team



Maria Bogatyreva

Maria joined Willis in Moscow in 1996 and for the last nine years has focused on D&O insurance with responsibility for the development of our business in the Russian Federation and other CIS countries.

Maria graduated in Economics with a Diploma in Automatic Systems of Management and obtained her second Advanced Diploma in Insurance from the Chartered Insurance Institute in London in 2005.

Since November 2006 Maria has been working at Willis in London.

She is a frequent speaker at international D&O conferences in one of her fluent foreign languages which include English and Polish, and she also speaks French and Spanish.

In her spare time Maria is a keen sportswoman who enjoys skiing and swimming. When she is not hurtling down a slope she also enjoys art, classical music, and English and Russian poetry.

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

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