The Willis Index

Willis

FINEX Financial Institutions Newsletter

The Financial Institutions Insurance and Risk Management Quarterly

Q2 2007

Market Conditions and Survey Results

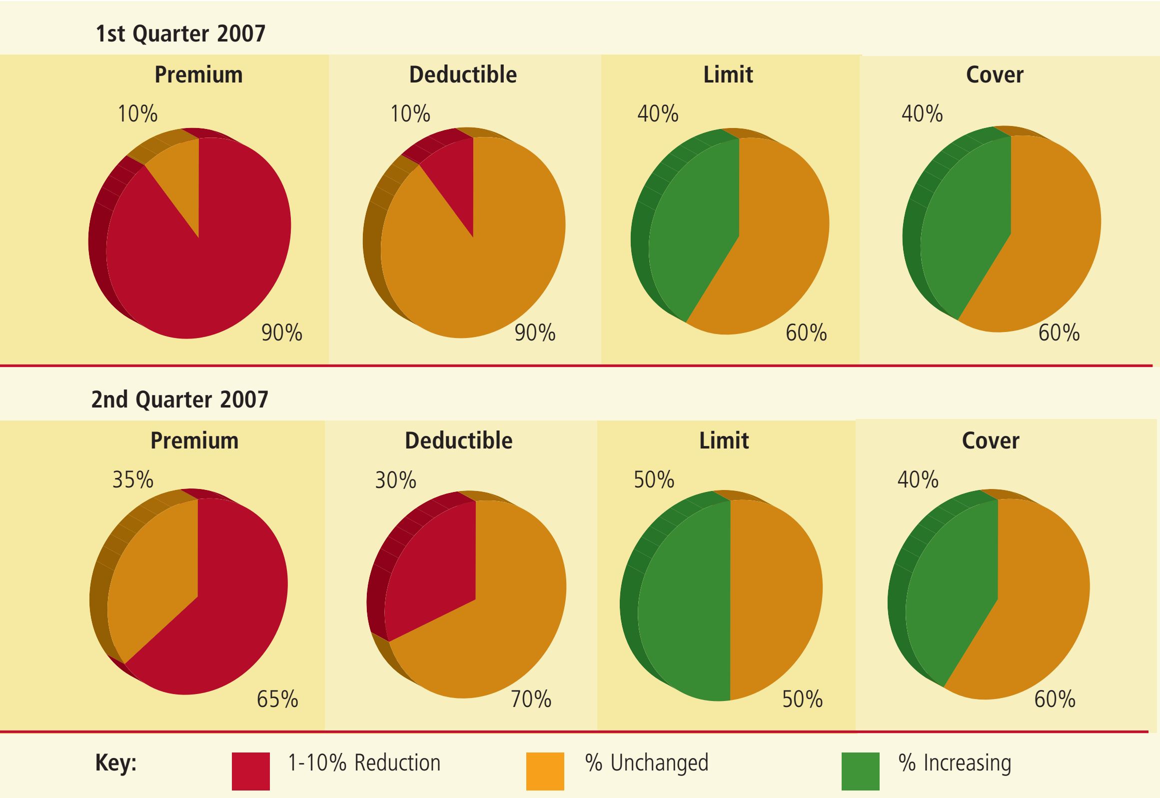
The downward pressure on rates we reported in Q1 2007 has continued and looks set to run until at least the end of the year. Our quarterly survey of Financial Institutions underwriters has revealed that in the first quarter of 2007 the majority of assureds benefited from a discount on their renewal premium, and looking forward most underwriters are predicting that this will remain the case. This is backed up by our own experiences where average discounts throughout the first quarter of 2007 averaged approximately 10%.

We continue to see insureds purchase increased limits and maintain their levels of self insurance, as well as a continuing willingness from most markets to review and improve wordings when driven.

A popular talking point amongst underwriters and brokers at the moment is the possibility of insurers offering two year deals. Since 2001 insurers have generally been unwilling to offer policies that exceed 18 months, a restriction that is often self-imposed by insurers or enforced by reinsurers. History suggests that whenever the market has offered two year deals it has signified the approach of the bottom of the pricing cycle.

One market is currently offering two-year deals for Directors' and Officers' insurance programmes for investment funds with options to stretch or annualise aggregates. They are also available in the commercial (i.e. non financial institutions) Directors' and Officers' insurance market, albeit with break clauses that apply at the first anniversary.

However, in the wider Financial Institutions marketplace there is still continuing resistance to two-year deals for blended programmes (i.e. Crime, Professional Indemnity and Directors' and Officers' insurance). Some would argue that it is only a matter of time before two year deals become widely available for financial institutions and we will report on such developments closely.



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.

Contents

Stockbrokers – An Alternative Insurance Solution

The widely recognised Stockbrokers Scheme (the "Scheme") was devised over 25 years ago and it continues to provide UK stockbrokers with an insurance solution to their financial risks such as Professional Liability, D&O Liability and Direct Financial Loss.

Background

At the outset, the London Stock Exchange Rules were such that it was mandatory for all Stockbrokers to arrange a minimum level of insurance protection for Direct Financial Loss (DFL). One particular aspect of the mandate was that the policy limit was to apply to "each and every loss", irrespective of the number of losses during the policy's period.

It soon became clear that for the market to provide a sustainable long-term commitment with regard to coverage, limits and pricing, a pooled approach to underwriting the risks in question would be necessary. The result was that a panel of insurers committed to write the Scheme on a basis that allowed them to manage their exposure such that losses would be sensibly spread over the extent of the panel. Over time, the number of participating insurers has expanded and currently a large proportion of London Financial Institution insurers are involved in some way.

Scheme Developments

The late '80s and early '90s saw the advent of the Financial Services Authority and an increasing demand for the Scheme to provide insurance beyond simple DFL cover. As a result, the Scheme expanded its scope by way of:

- providing a suite of financial lines insurances including DFL, Professional Liability and D&O Liability
- allowing any regulated financial services company to access the Scheme.

The mandate for DFL insurance was eventually withdrawn but the Scheme continued to meet the demand for continuing DFL cover from prudent stockbrokers.

In general the Scheme has been very well supported and at its height it was suggested that over 80% of APCIMS members sourced the Scheme for their insurance.

Benefits of the Scheme

The main distinction of the Scheme was that it was able to provide benefits that competitors could not or would not offer, most notably "each and every loss" limits for DFL. In fact, during some periods of a soft market, "each and every loss" limits were also offered for Professional Liability risks.

For Private Client stockbrokers the "each and every loss" limit remains important as it provides a degree of comfort to interested clients who have their money/assets managed by the stockbroker.

The Scheme operates through its lead insurer who determines the terms, conditions and premium for each risk. Thereafter, a few selected supporting insurers are required to agree to such terms and all other remaining insurers are subsequently committed to the risk in question. Thus large limits can be quickly placed with administrative ease.

Competition

Underwriting financial institutions is a specialist practice and therefore the overall capacity is fairly limited. A natural consequence of the Scheme's success and prominence was that it was difficult to negotiate a realistic alternative solution.

However, the current soft market conditions have persuaded many insurers to review their position and we are now seeing healthy signs of many reputable insurers actively competing with the Scheme.

For 2007 and the years beyond, we see the market continuing to challenge the Scheme and this can only be beneficial for clients.

Our commitment

We are committed to working with our clients to ensure we clearly understand and appreciate their risk profile such that we can arrange a suitable and sustainable insurance solution.

We take a prudent approach to managing the market with our clients' interests paramount. The Scheme continues to provide many clients with what they require but most importantly, we can deliver alternative options that can offer:

- broader cover than that offered by the Scheme for all lines
- "each and every loss" limits for DFL coverage
- improved pricing.

Jonathan Hodson
Tel: +44 (0)20 7975 2299
Email: hodsonj@willis.com

Current Banking Insider Fraud Trends

There has been a sharp rise in banking insider fraud cases, which according to some recent press is linked to certain socio-economic factors, such as criminals increasingly seeking lavish lifestyles and taking some of the banking industry’s booming profits, and low morale caused by high employee turnover due to mergers and cost cutting exercises. This suggests banks' high profits could be nullifying the losses from fraud and offsetting investment in crime prevention systems.

According to the crime department at the City of London Police, another reason for the rise in insider fraud can be attributed to much improved internal controls implemented as an industry standard to avoid external attacks. Improved security procedures to combat external fraud has meant that fraudsters are now having to approach employees of financial institutions to collude in accessing and extracting accountholders’ funds.

The FSA had previously warned the City that it was necessary to do more to fight insider fraud. The newly set up financial crime and intelligence division is examining vetting procedures and the scope staff currently have to access and use customer information to commit fraud.

The government has stepped up efforts to improve monitoring and investigation, after criticism that prevention is under resourced, intelligence gathering is poor – as most of the information obtained from insider fraud is anecdotal – and jail sentences are not severe enough to be a deterrent.

Here we outline a number of examples of banking insider scams which are new or still prevalent:

Bill Discounting Fraud

This particular method of fraud is currently in use in the banking sector. Essentially a confidence trick, a fraudster uses a company at their disposal to gain confidence with a bank, by appearing as a genuine and profitable customer. To give the illusion of being a desired customer, the company regularly and repeatedly uses the bank to get payment from one or more of its customers. These payments are always made, as the customers in question are part of the fraud, actively paying any and all bills raised by the bank. After time, when the bank “knows its customer”, the company requests that the bank settles its balance with the company before billing the customer. Again, business continues as normal for the fraudulent company, its fraudulent customers, and the unwitting bank. Only when the outstanding balance between the bank and the company is sufficiently large, the company takes the payment from the bank, and the company and its customers disappear, leaving no-one to pay the bills issued by the bank.

Forged or fraudulent documents

Forged documents are often used to conceal other thefts. A document claiming that a sum of money has been borrowed as a loan, withdrawn by an individual depositor, transferred or invested can therefore be valuable to a thief who wishes to conceal the important detail that the bank's money has in fact been stolen and is now gone.

Fraudulent loans

One way to remove money from a bank is to take out a loan, a practice bankers are more than willing to encourage if they know that the money will be repaid in full with interest. A fraudulent loan, however, is one in which the borrower is a business entity controlled by a dishonest bank officer or an accomplice; the "borrower" then declares bankruptcy or vanishes and the money is gone. The borrower may even be a non-existent entity and the loan merely a trick to conceal a theft of a large sum of money from the bank.

Rogue traders

A rogue trader is a highly ranked employee who is authorised to invest large funds on behalf of his employer bank. This trader secretly makes progressively more aggressive and risky investments using the bank's money. When one investment goes bad, the rogue trader engages in further market speculation in the hope of a quick profit which would hide or cover the loss. Unfortunately, when one investment loss is piled onto another, the costs to the bank can reach into the hundreds of millions of dollars. There have even been cases in which a bank goes out of business due to market investment losses.

Theft of identity

Dishonest bank personnel have been known to disclose account holders’ personal information for use in theft of identity frauds. The perpetrators then use the information to obtain identity cards and credit cards using the victim's name and personal information.

Wire fraud

Wire transfer networks such as the international SWIFT interbank fund transfer system are tempting as targets as a transfer, once made, is difficult or impossible to reverse. As these networks are used by banks to settle accounts with each other, rapid or overnight wire transfer of large amounts of money are commonplace; while banks have put checks and balances in place, there is the risk that insiders may attempt to use fraudulent or forged documents which claim to request a bank depositor's money be wired to another bank, often an offshore account in some distant foreign country.

Often when financial services organisations are structuring their financial risks insurance programmes they have a perception that insider fraud could not happen to them. However, our experience shows that insider fraud remains widespread and very active. In view of this, it is always prudent to customise or update a crime insurance policy (specifically the fidelity section) to address these ever developing risks. Equally important is to pay attention to the level of sums insured and self insured deductibles.

Meet the Team

Tel: +44 (0)20 7975 2538
Email: duked@willis.com

Derek Duke

Derek began his insurance career in the mid '60s, underwriting motor insurance in the company market. He shortly progressed to underwriting a casualty book which included Professional Indemnity, Banks, Contingency and Bloodstock risks.

After spending 25 years with London & Edinburgh, in 1990 Derek jointly set up a new Lloyds Syndicate to predominantly lead Professional Indemnity risks. He took up the challenge of a move to the broking sector in 1997 when he joined Aon and began to specialise in financial lines insurances for Financial Institutions.

Derek has worked closely with all types of financial institution clients, both UK and international, and in late 2003 Derek took up the exciting opportunity to re-establish Willis as the pre-eminent broker to the Financial Institution industry.

Derek's son, Simon, has followed him into the London insurance industry where he is now underwriting global property risks.

Derek's main leisure activities involve his two German Shepherds, especially as his wife Pat is a fully qualified dog trainer/instructor. Whilst competing in dog shows and events around the country is now confined to the past, Derek and Pat remain integral to the training of a display team which performs at local summer shows and fetes. The highlight of the year is a prestigious display in the Special Events ring at Crufts.

The Willis Index

The Willis Index provides quarterly updates on the ever-changing FI Insurance Market, including commentary on market conditions, case studies and insurance product developments. FINEX also produces newsletters reporting on Mergers & Acquisitions, Directors' and Officers' Liability, Political Risks, Professional Indemnity and Environmental Liability. For further information or if you would like to receive these publications please contact us.

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.

For further information please contact:

Duncan Holmes
Tel: +44 (0)20 7975 2708
Email: holmesdn@willis.com

Derek Reeves
Tel: +44 (0)20 7975 2944
Email: reevesd@willis.com

Jonathan Hodson
Tel: +44 (0)20 7975 2299
Email: hodsonj@willis.com

Matthew Hart
Tel: +44 (0)20 7975 2344
Email: hartm@willis.com

Willis Limited, Registered number: 181116 England and Wales.
Registered address: Ten Trinity Square, London EC3P 3AX.
Lloyd's Broker. Authorised and regulated by the Financial Services Authority.

WPR/5382/06/07