As we approach the end of Q3 for 2005 the most recent Willis Index survey illustrates that most financial institutions continue to enjoy the benefits of a softening market. Respondents suggest that rates for renewals are at lower levels than last year but do not anticipate a further reduction in rates for the coming months. Willis believe that this is, perhaps, optimism on behalf of the market as we predict that rates may continue to decline steadily at least until the end of the year. However, in our experience, some of the larger financial institutions with activities deemed by underwriters to be of high risk or those that have experienced significant growth, may find that rates remain reasonably flat or even in some cases experience a small increase. Whilst some insurers are resisting the downturn in rates ultimately by not renewing certain business, this is more than countered by the various start-up markets in combination with some of the more long-standing markets striving to meet growth targets.

Most respondents comment that deductibles, limits and coverage remain unchanged however, this is an opinion that we have difficulty in agreeing with. A trend is emerging that underwriters are attempting to differentiate themselves from competing markets by lowering attachment points instead of purely lowering premium. It is worth remembering that during the previous hard market, many financial institutions opted to purchase higher retentions in an attempt to mitigate the elements of punitive pricing increases, it seems reasonable that this trend would be reversed in an soft market. We have observed that, if negotiated appropriately, significant expansion of coverage can be achieved for the majority of financial institutions through changes to exclusionary language or the enhancement / inclusion of additional insuring clauses.

Uncertainty remains over the settlement of a number of major outstanding claims to the market such as Enron, Worldcom, Parmalat and Laddering, for example. With no clear ‘end-date’ foreseeable in any of these events we expect the market to continue in the current trend unless substantial settlements are made by Insurers, even after this we would not expect a significant impact until insurers renew their reinsurance treaties, which would normally occur at year end.
Class Actions Migrate To Europe

In today’s litigious society, multiple claimant litigation commonly referred to as a ‘class action’ is increasingly becoming part and parcel of everyday business life around the world. A litigation tool that was previously thought to be peculiar to the USA has begun to migrate to Europe.

Multiple claimant litigation is designed to seek damages for and on behalf of a group of injured individuals. In practice there are several forms of multiple claimant litigation including:

- **Class actions;** where a group of claimants litigate as representatives for and on behalf of a larger class of individuals. Any judgement on the case is binding for the class and any resulting award of damages is allocated between the members of the class.

- **Collective claims;** where a single claim is filed for and on behalf of a group of identified individuals who have decided to bring the litigation. Any award of damages is made to the group as a whole.

**The North American Scene**

High-profile class actions in the U.S., particularly those relating to the liabilities of directors and officers (D&O), are always well covered in the press. Over the last ten years, the annual probability of a class action has increased by 25%. This factor has been offset to some degree by the effect of the 1995 Private Securities Litigation Reform Act which was introduced to avoid the progress of frivolous D&O litigation. Therefore, there is a greater likelihood of settlement for damages in the cases which are allowed to progress.

The average settlement is approximately $26m, with the previous high of $3.5bn set in 1999 by Cendant overshadowed by the WorldCom settlement of $6bn, with the outcome of the Enron litigation possibly pushing this figure higher.

It is anticipated that during 2005, £6bn will be awarded to European investors in US organisations with many claimants yet to seek recourse for previous years. Reports indicate that from the 2003-4 period, £1.3bn is still awaiting collection by these investors meaning that only 5% of the settlement awards have physically been collected. This demonstrates a lack of knowledge of class action protocols by European investors.

Outside of D&O specific litigation, we need to recognise the additional impact of multiple claimant litigation relating to products liability and professional services.

Driving the multiple claimant litigation in the USA is the ‘contingent fee’ system whereby plaintiff’s lawyers can charge as much as 40% of the settlement award. Such awards are determined by the jury as opposed to by an objective judge hearing the case. European legal systems differ in this regard and it may be for this reason that the pure class action has not yet taken hold in Europe.

**The European Scene**

The mood in Europe is to ensure that an injured group of investors or consumers have access to a legal device that allows them the opportunity to seek damages for and on behalf of the group. There are also moves to adopt a restricted version of contingent fees in order that injured parties are not disinclined to litigate due to the high cost of the action. Numerous initiatives have commenced in many European territories to support this view including the UK, Sweden, Germany, France and Holland.

In 2003 Sweden introduced a class action Act that allows for a group of identified individuals to bring an action whereby any award will be binding on all of them.

Germany has recognised that shareholders require greater protection following litigation against Deutsche Telecom where the 15,000 individual shareholders will have to abide by separate rulings for each shareholder. Clearly this is unworkable for the future and a draft law currently before the German parliament proposes that the outcome of a test case should be binding on all other similar cases. Germany is also looking into expanding this approach to embrace a more general class action device.

France’s President, Jacques Chirac, has recently asked his government to examine how “groups of consumers could bring collective actions against abusive practices that have been observed in certain markets”.

Holland currently allows for groups to pursue collective claims but they are now considering new legislation that would allow for settlements to be binding on all members of a defined class.

In the UK, we have seen a great deal of litigation that bears trademarks of the class action. Amongst many examples, one recalls the litigation against the directors of RAC over the sale of their motoring services arm and the 55,000 former shareholders of Railtrack pursuing the Government for substantial damages over alleged misfeasance when the company was put into administration.

In the last decade UK Financial Services firms have experienced numerous problems with allegations of ‘mis-selling’ financial products. Following on from Pension Transfers, we have seen problems with Free Standing Additional Voluntary Contributions, Mortgage Endowments and Split Capital Trusts. Non-performing financial products have generated multiple claimants each seeking their own redress in their own right.

However, we are now beginning to see law firms advertising for business in the hope of acting for a large number of clients each with essentially the same complaint. Where consumers ‘opt in’ to such an arrangement they will benefit from a litigation strategy supported by a pooling of costs.

**The European Future**

In Europe, the majority of multiple claimant litigation is in the nature of a collective action. We would anticipate this framework being further developed and refined allowing the consumers greater access to the law in the event of abusive practices or wrongdoing. It is reasonable to suggest that if Europe controls lawyers’ contingent fee proposals it will avoid the major problems faced in the US. Notwithstanding this, the advance of multiple claimant litigation across Europe can only lead to an upward trend in awards or settlements.
Insurance Considerations

Increased accountability for wrongdoing, coupled with a legal system that allows injured parties to pool their resources for litigation purposes, will prompt most companies to review their financial risks insurance arrangements. Whilst it would be prudent to purchase increased limits, it is important to fully understand just how insurers will treat multiple claimant litigation in terms of applying any self-insured deductible. The key issue here is “will the self-insured deductible apply once (in respect of the class action) or to each and every individual claimant?”

D&O and product liability insurers accept that multiple claimant litigation should be treated as a single claim, but professional liability insurers often take a contrary view as reflected in the Lord Hoffman decision in the Lloyds TSB case. In today’s environment it is vitally important that insurance programmes are designed to respond robustly to multiple claimant litigation which can only be the case when the policy language truly reflects the intent of both parties to the contract.

Hedging Your Bets

Hedge funds are the latest form of investment to occupy the interest of the media, the current downturn in performance leading to concerns that mediocre returns may lead to a rush of redemptions. The reasons for specific underperformance are varied but collectively they have contributed to the industry-wide negativity that currently prevails.

Hedge funds have historically avoided the spotlight and, with the exception Long Term Capital Management’s failure in 1998, significant losses have been few and far between. This factor has allowed hedge funds to operate in a relatively secret world escaping the spotlight of investors and regulators alike.

The global hedge fund industry is now estimated to have a record $1,025bn of assets under management. The Financial Services Authority provides a more relaxed regulatory regime in the UK when compared to other European countries. Partly as a reflection of this approach to regulation, almost 75% of Europe’s hedge fund assets are managed out of the City, with a value of approximately $190bn.

The landscape is changing, as the demand for such investments continues to grow, regulators and tax authorities are beginning to invest more of their time in studying the rules which currently govern hedge funds.

Problems besetting hedge funds around the globe:

- The collapse of Toronto based Portus Alternative Asset Management has left 26,000 clients unsure as to whether they will see their money again, with millions of dollars worth of assets to be accounted for. The close ties forged with major financial services companies has raised questions over the level of due diligence performed on hedge funds by such companies. It has been inferred in this particular case that the high referral commissions paid by Portus may have proved influential in forming such relationships.
- In Singapore, the internal risk controls of one of the country’s largest hedge funds, Aman Capital Global Fund were called into question following significant derivatives trading losses of more than $43m. The manager is now facing the threat of legal action from investors, with the fund now closed.
- In the UK, it is rumoured that the Financial Services Authority is investigating claims of share trade collusion between a top banker and a leading hedge fund. According to allegations, the illegal practice known as “front-running” has been committed in return for the funneling of business and increased fees.
- Market volatility and the recent downgrades of GM and Ford could leave some funds unusually exposed and any problems could risk drawing in the counterparties with which trades are conducted. Furthermore, the crowding in similar investment strategies may have pressured managers to pursue ultimately disastrous practices, leaving some to believe that the sector’s recent dramatic growth could pose a risk to financial stability.
- London based Bailey Coates has instructed investors to redeem their holdings in its flagship Cromwell Fund due to poor returns.
- GLG partners has admitted flaws in its trading models causing a drop in its Credit Fund. This is significant as other banks and funds have used similar models and may also be facing substantial derivatives losses.

As a result of such events, regulators around the globe are raising the level of scrutiny of hedge funds. The European Commission is to determine whether a new regulatory framework is required amid the fear of a financial crisis triggered by a hedge fund collapse or sudden market shock. The FSA has published a discussion paper on how to modify the way hedge funds are monitored and regulated in the UK.

The changing landscape in the industry and the increasing potential for losses seems apparent. The directors, officers and managers of such funds need to seek assurance that in the event of a loss or potential loss, the benefit of adequate insurance protection is available to them.

Directors’ & Officers’ Liability Insurance provides vital protection for the directors’ personal liability and can prove to be crucial in advancing costs during the defence of any action. Professional Indemnity Insurance provides protection for the manager against errors, omissions and other third party liabilities. Mitigation costs can be added as a valuable extension to such a policy, enabling the manager to put right any erroneous position before it escalates further. This policy is often viewed as a ‘bonus protector’ as payments made to settle professional negligence claims would otherwise have a direct impact on the fund’s balance sheet.

It is essential that the policy forms are carefully drafted to ensure adequate protection as we have witnessed many products offering little, if any, coverage. We have a wealth of experience in ensuring that these complex policies are tailored to the specific needs of hedge funds.
Artists impression of the “Willis Building” currently under construction in the City of London, due for completion late 2007.

Meet the Team

John Newton

John began his career in 1977 with F Bolton & Co Ltd, a small Lloyd’s broker based at Poole in Dorset dealing with property and casualty insurances for the private and commercial sectors. He moved to underwriting in Lloyd’s but after realising his preference for working as an intermediary dealing with retail clients, he returned to broking with Marsh in 1984.

He has specialised in Financial Lines insurances for over 17 years and his substantial knowledge and experience has been built on having worked with all types of major commercial organisations and financial institutions. He has held executive responsibility for many of the UK’s largest banks, insurance companies and asset managers.

In early 2005, John took the opportunity to join the successful Financial Institutions team at Willis and after a short spell ‘gardening’ John has quickly settled into life with Willis.

John recently commented “The move was actually very easy because the team is highly resourced with a great mix of experience, character and talent.”

John is married to Penny, a twin and whose grandmother was also a twin. Whilst we all know that twins are supposed to miss a generation, prudent risk management dictated that he insured against the risk of a multiple birth. Needless to say the policy had to pay and he now regrets not buying a substantially higher limit!

To keep him sane, he continues to try to reduce his golf handicap and takes time to relax with some fair weather riding on his Harley-Davison, the only bike large enough to take John’s substantial frame!

Breaking News

Willis has won the Reactions Award for Insurance Broker of the Year and Most Innovative Broker of the Year 2005. The awards are voted for by the readers of Reactions and are open to all industry participants.

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