MARKET CONDITIONS
AND THE RESULTS OF
THE MARKET SURVEY

Our first survey of the year leads us to believe that 2008 may see a slowing down of the soft market that we have enjoyed for the last few years. Underwriter respondents to our quarterly survey replied that rates fell on average 10% in the final quarter of 2007, and this is matched by our own experience. However, when looking forward underwriters are taking a more conservative view with the majority predicting that rates will flatten out in 2008, or in other words, there will be pressure on insurers to obtain flat renewals this year. It is perhaps understandable that with rates dropping for several consecutive years, combined with the backdrop of the credit crunch, many underwriters are looking to reverse this trend by looking to hold rates. We believe, however, that the picture is somewhat more complicated due to two contrasting factors:

- Firstly, insurers are holding their healthiest balance sheets for some years. 2007 was for some insurers a record profit year, rating agencies issued several upgrades and many carriers continue to regard the financial institutions arena as an attractive market. This is demonstrated by the number of start-ups commencing financial institution business in early 2008 – for example Aspen Re and Antares, both of whom will need to generate new business. In addition it is thought that the recent Charter Communications decision* will lead to a more favourable US litigation environment as it should reduce the number of securities class actions plus in general, class certification is becoming a less plaintiff-friendly procedure.

- Secondly, 2007 also saw the emergence and resulting turmoil of the sub-prime and credit crunch scenarios. The immediate effect for insurers was that throughout Q3 2007 there were several directors and officers and professional indemnity notifications, mostly from US mortgage providers. This was soon followed by notifications from several other sources including a number of banks, fund managers and fund administrators and was no longer limited to US-based institutions. Many observers have drawn the analogy with a virus in a period of incubation as the true cost of sub-prime to the insurance market will only emerge over a long period, at least the duration of 2008. A research note from Bear Stearns recently trebled estimates for insured management and professional lines losses relating to the

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sub-prime crisis from USD 3Bn to USD 9Bn. A mitigating factor is that only very few of the Wall Street banks currently purchase professional indemnity insurance plus in recent years a number of US large cap companies have taken the decision to self insure large proportions of their risk or limit D&O coverage to side A only, hence insurers are likely to be spared this potential source of claims.

Taking the above considerations into account we predict that underwriters will be looking to take a tougher stance in 2008. In particular, insurers will require increased disclosure regarding potential sub-prime exposure and financial institutions that give underwriters cause to believe they could be materially exposed should not expect any improvement in rate or terms. In addition placements which are widely recognised to be already competitively priced or which purchase large limits may also struggle to secure a discount this year.

Despite the above, the marketplace still has an excess of capacity and underwriters will continue to offer competitive terms to secure new business in classes of business that they see as attractive. We expect such classes of business to include small-to-medium sized financial institutions with little or no US exposure, which are able to demonstrate insulation from Sub-Prime. We expect maximum limits available to remain stable, i.e. Directors & Officers and Crime at GBP400m, Professional Indemnity at GBP300m and Unauthorised Trade at GBP120m. There is a possibility though that if insurers accrue enough evidence to suggest that the sub-prime will have a significantly serious effect on their profits that available capacity could contract in 2008.


**BREAKING NEWS**

- WILLIS LONDON ON THE MOVE

Willis is moving into an iconic, 28-storey headquarters directly opposite Lloyd’s of London.

From 31 March 2008 our address will officially be:
The Willis Building
51 Lime Street
London, EC3M 7DQ

Switchboard number L +44 (0) 20 3124 6000

“The Willis Building is a reflection of how far we’ve come, but also symbolises a new chapter in insurance broking. Risk is rapidly evolving and we are challenging the status quo to deliver cutting-edge solutions to you our clients. We look forward to working with you as partners in this evolution.”

- Joe Plumeri, Chairman and CEO, Willis Group Holdings
UNAUTHORISED TRADING

In recent weeks, major French bank Societe Generale has revealed that it has incurred a €4.9bn loss due to Unauthorised Trading of one employee.

Jerome Kerviel took advantage of his back office knowledge to hide the scale of his exchange-traded equity futures. It has been reported that at one point, his trading gave the bank an exposure of above €50bn, which is greater than the market capitalisation of the bank.

Since Nick Leeson's unauthorised trading at Barings in 1995 caused the institution to fail and ultimately for it to be taken over, we have seen a series of infrequent yet very severe losses.

The latest incident demonstrates that large, well-established banks with rigorous risk management procedures face serious risks and that risk management procedures can, and do, fail. The Societe Generale revelations raise major questions about the nature of risks that financial institutions are facing and how they can mitigate these risks.

Unauthorised Trading Insurance was launched at the end of 1997 by Lloyds underwriters in response to the Nick Leeson incident at Barings.

The insurance provides protection to the institution in the event that an employee trades the bank's own funds (proprietary trading) in excess of financial limits, outside of permitted lines of business or non-designated counterparty which is concealed or falsely recorded.

UNAUTHORISED TRADING INCIDENTS

1995  Barings lost £827m in futures trading by Nick Leeson, from their Singapore office.
1996  Sumitomo Corporation recorded a deficit of £2.6bn for copper trading
2003  Allied Irish Bank incurred trading losses of $691m. John Rusnak is sentenced to seven and a half years in prison after admitting concealment at Allfirst Financial, the bank's US subsidiary.
2004  National Australia Bank's former head of foreign currency options desk, Luke Duffy, in collusion with three other traders, falsified trading losses resulting in losses of $266m for NAB.
2007  Calyon disclosed a €250m loss after a trader made unauthorised credit market transactions.
2007  West LB suffered losses exceeding €600m after failed investments by its proprietary trading desk.

Unauthorised Trading does not provide coverage where;
- An employee makes a financial gain for themselves – this is covered by the Fidelity insuring clause of a Bankers Blanket Bond.
- A customer makes a claim that the employee is trading dishonestly with their funds – this is covered by a Professional Indemnity policy.

The market capacity for Unauthorised Trading Insurance for a financial institution is between GBP 150 million and GBP 200 million.

The vast majority of major financial institutions have decided not to purchase Unauthorised Trading Insurance and rely on risk management processes to ensure they did not suffer a loss.

From our recent experience, we know that a number of financial institutions are reviewing their position on Unauthorised Trading and their mitigation strategies following the Societe Generale revelation.

Willis has extensive experience in placing Unauthorised Trading insurance for major financial institutions and is ideally positioned to offer advice on Unauthorised Trading coverage.

If you would like to discuss the issue of Unauthorised Trading, please contact the individuals listed below to discuss further.
Willis has extended the Cyber Risks Products to include Cyber Property (CyPro), which will provide to existing and prospective clients the ability to reduce their exposure to the risks associated with technology use, such as electronic processes and interactions arising from technology / e-activities.

Property and liability policies do not traditionally cover damage to intangible assets. This can leave companies vulnerable in the event of a network failure caused by a malicious attack by hackers or accidental damage to the system. Whilst technology seeks to protect network security, it is not infallible. To help protect intangible assets and reduce liability exposures, specialised insurance solutions and consulting expertise can play a major role.

The threat of data loss and systems failure can have severe repercussions for businesses. With an ever increasing reliance on technology, an IT security incident can lead to significant damage to revenues, may create substantial legal liabilities and can seriously undermine public confidence in a company’s brand and products.

We can deliver bespoke insurance policies that provide indemnification for non-traditional risks, which include the following risk transfer:

**RISK TRANSFER**

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<thead>
<tr>
<th>INTERNAL THREATS (FROM EMPLOYEES)</th>
<th>EXTERNAL THREATS</th>
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<tr>
<td>PHYSICAL LOSS OR DAMAGE OR HUMAN ERROR IN DATA PROCESSING</td>
<td>NATURAL DISASTERS COMPUTER VIRUSES</td>
</tr>
<tr>
<td>EMPLOYEE MALICIOUS ATTACK THEFT OR MISUSE OF DATA (BY EMPLOYEES). EXTORTION</td>
<td>OTHER MALICIOUS ATTACKS</td>
</tr>
<tr>
<td>HACKERS / CYBER TERRORISM DENIAL OF SERVICE ATTACKS / AGAINST DATA OR SYSTEMS OUTSOURCING: FAILURE OF IT PARTNERS OR SUPPLIERS TO MANAGE THEIR KEY RISKS ELECTRICAL OUTAGE</td>
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Using our experience within the Business Interruption and Cyber Risk arena the Willis Cyber Risks team is able to carry out a gap analysis between traditional insurance and a company’s reliance on technology.

For further information please contact Terri Driscoll-Cooper on +44 20 7975 2610 or driscollcoopert@willis.com

**MEET THE TEAM**

**DAVID ROGERS**

Having graduated from University College London David joined Aon in 1999 as a financial institutions placing broker and in 2003 took the opportunity to join Willis. David leads the broking team within FINEX Financial Institutions and assumes day to day responsibility for managing relationships with a wide range of London market underwriters both within the Lloyds and company arenas.

Away from the office David lives in Shad Thames and is a keen road cyclist and cook. He is also an accomplished skier, although having raced in one downhill event has vowed that once was enough.

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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.