

thinkingahead



A parting of the ways

So much money has been lost in the credit crunch, it's inevitable people will throw mud. Whether it sticks is another matter, says **Paul Towler**, but we won't know that for some time.

It is bad news for financial institutions that have US exposures and want to buy directors' and officers' liability (D&O) and professional indemnity (PI) insurance. For everyone else, it is pretty much business as usual; if anything, we could see prices go down for this group. It is increasingly becoming a two-tier insurance market.

Two-tier market

Virtually all of the direct notifications of potential claims from the sub-prime market collapse and credit crunch received by insurers relate to US risks. An informed commentator lists over 100 legal actions so far, while a report published by consulting group Advisen in February estimated the insured losses at \$3.6 billion.

For banks with US business – and anyone in the US mortgage and property business – the D&O and PI market is very expensive, retentions are high and conditions are demanding. Wall Street

investment banks are becoming almost uninsurable, a trend that began when the dotcom bubble burst in 2001.

Outside the United States, class actions that fuel D&O claims are either impossible or difficult to bring, even under the new provisions of the UK Companies Act 2006. We believe any increase in activity will relate to securitisation transactions brought by pension fund trustees under pressure to protect the fund's assets. They will then most likely target all parties involved in the process, including professional advisers.

It is plausible, therefore, that competition for insuring financial institutions outside the United States will increase. Insurers reducing their exposure to US banks will need somewhere else to deploy their capacity and they will be keen to write plain vanilla risks. The only way the non-US market might turn is if insurers' own bond portfolios suffer losses, causing a general increase in premium rates to cover the loss of investment income.

The main change for financial institutions outside the United States will be more demanding criteria from underwriters – and especially their managements – who want to be sure that the account they are writing does not expose them to US or mortgage-related risks. If it does, then the company will have

to dig deep to get its proposal accepted. Insurers today must have that audit trail.

Unauthorised trading cover

Despite its superficial appeal, unauthorised or rogue trading cover – introduced after the Barings Bank scandal in 1995 – has not proved itself fit for purpose and very few policies have been sold. In general, financial institutions decided they were better off spending the money on improving internal controls. The Société Générale debacle has raised the profile of such cover and insurers are now more flexible in their underwriting attitude, allowing a more bespoke approach.

The question now is whether insurers can offer financial institutions policies that are compliant with Basel II. Banks ideally want operational risk policies that allow capital relief, but the insurance industry is still some way from providing appropriate coverage. Current concerns regarding the global financial markets are not going to assist the process and it remains unclear whether insurers will be prepared to take those risks onto their balance sheets.

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“Competition for insuring financial institutions outside the United States will probably increase as insurers look to reduce their exposure to US banks.”



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