FINANCIAL INSTITUTIONS

MONTHLY OPERATIONAL RISK LOSSES BULLETIN

Gallagher

Insurance | Risk Management | Consulting

Our monthly bulletin responding to the insurability of the largest recent operational risk events. Each month Risk.net[1] issues a breakdown of the top five events and in these bulletins we consider their relevance to insurance and the extent to which coverage is available. Our commentary on December 2017's top 5 events is as follows:

EVENT	LOSS AMOUNT	BUSINESS LINE	EVENT TYPE	RELEVANT POLICIES?	INSURABILITY	COMMENTS
SEC charges Woodbridge Group of Companies with running $1.22bn Ponzi scheme	$1.22bn	Asset Management	Internal fraud	Directors & Officers Insurance/ Crime Insurance/ Professional Indemnity Insurance	green	If the directors of the Woodbridge Group of Companies have the benefit of a Directors and Officers policy, then any directors that have been charged by the SEC should be able to access coverage for costs incurred in responding to the SEC charges. However, where charges are ultimately proven, coverage will be withdrawn. As a general point, recent Ponzi schemes have shown that many financial professionals transacted with such schemes without realising their fraudulent nature. Of course such financial professionals tend to become the target of litigation and recovery actions relating to the schemes. Professional Indemnity insurance should respond in such circumstances.
China Guangfa Bank pays 722m yuan in fines and disgorgement for issuing forged letters of guarantee for defaulted corporate bonds	$109m	Corporate Finance	Internal fraud	Professional Indemnity Insurance	red	Fines and disgorgement payments are often excluded under policies purchased by financial institutions (indeed criminal fines and disgorgement payments are almost always uninsurable as a matter of public policy). In some instances it may be possible to obtain coverage under professional indemnity insurance for costs incurred in defending disgorgement claims. Beyond China Guangfa Bank's losses: if lenders have suffered losses as a result of lending against forged letters of guarantee, then coverage may be available for such losses under any crime insurance policies purchased by the lenders.
QBE settles investor class action for A$132.5m over	$102.8m	Non-life	Execution, delivery and process management	Directors & Officers Insurance	green	This shareholder class action alleged that QBE breached its continuous disclosure obligations prior to issuing a profit downgrade (the unexpected announcement of a loss of A$250m in December 2013 led to QBE's shares plunging 30% in the following two days). As such, the claim appears to fall squarely within 'Side C' coverage provided under Directors and Officers policies. In short, such coverage applies for claims relating to the offering, sale or purchase of the insured company's shares and should apply to any failures to accurately report financial results to a stock exchange.
BBVA Compass ordered to pay over $98m to property developer for misleading loan renewals	$98m	Commercial Banking	Clients, products and business practices	Professional Indemnity Insurance	amber	It appears that this claim primarily related to alleged misrepresentations made by the bank prior to loan renewals (which never materialised). Coverage may be available under professional indemnity insurance for claims of this nature, subject to any loan exclusion (which applies in almost all PI policies for banks). Such exclusions vary in terms of severity. However, even the milder versions, which apply to the bank's refusal to provide a loan, may apply here.
Postal Savings Bank of China pays 520.5m yuan for aiding China Guangfa Bank to conceal defaulted corporate bonds	$79.6m	Corporate Finance	Clients, products and business practices	None	red	It appears the loss here represents a fine levied on the bank by the China Banking Regulatory Commission. Fines are often excluded under policies purchased by financial institutions (indeed criminal fines are almosts always uninsurable as a matter of public policy). As such, this does not appear to be an insurable loss.

good basis for coverage (green) | conditional basis for coverage (amber) | poor basis for coverage (red)

[1] Monthly operational risk losses - www.risk.net

TOPICAL ISSUES

- **Fraud**: fraud, cyber and security incidents against companies are increasing year-on-year. A recent report produced by accountancy firm BDO[2] has found that fraud in the UK has risen sharply, with the financial services industry particularly affected: the total value of fraud in that sector in 2017 rose to £899.7m, compared with £214.9m in 2016.
- **Shareholder Class Actions**: various factors are fuelling a rise in actions, including shareholder activism, the increase in litigation funding and the willingness of courts to find in shareholders' favour. The USA has traditionally been the main arena for such claims, although claims are now on the rise in Australia and the UK has recently seen two significant shareholder claims against banks (RBS and Lloyds).
- **Fines**: individuals and companies continue to be the subject of eye watering fines imposed by financial regulators. Notable examples in 2017 include the fines of £163m and £34.5m levied by the FCA against Deutsche Bank AG and Merrill Lynch International respectively. For more information of the insurability of fines, please see the following link to our earlier article: **https://www.ajginternational.com/news-insights/articles/insights/2017/fi-risk-bulletin-june-2017/**
- **Ponzi Schemes**: it seems that at least one significant scheme is unearthed a year. Such schemes tend to result in significant litigation for financial professionals, which has led to significant claims against professional indemnity and crime policies for financial institutions.

[2] UK Fraud hits 15 year high with value of £2bn - www.ft.com, 15th January 2018

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Founded in 1927, Gallagher is the brand name of Arthur J. Gallagher & Co. (NYSE: AJG) — the global insurance broker, risk management services and consulting firm headquartered in Rolling Meadows, Illinois.

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