Monthly Operational Losses Bulletin

Gallagher

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Our monthly bulletin reviews the insurability of the largest operational risk events reported recently. Each month Risk.net[1] issues details of the top five events and we consider the relevance of insurance and the extent to which coverage is available.

Our commentary on March 2018's top five events is as follows:

EVENT	LOSS AMOUNT	BUSINESS LINE	EVENT TYPE	RELEVANT POLICIES?	INSURABILITY	COMMENTS
Former Anbang Insurance chairman embezzles 75.25 billion yuan in illegally raised funds and insurance premium income	$11.99bn	Property and casualty	Internal theft and fraud	Crime Insurance/ Director's & Officers' Insurance		We understand that the criminal trial of Wu Xiaohui (the aforementioned former chairman) has been completed, but the verdict is yet to be delivered. Coverage is provided under D&O insurance for legal costs incurred in defending criminal proceedings against individual director's or officers' (for alleged criminal acts, errors or omissions in their directorial capacity), however such costs will have to be repaid by the applicable director or officer in the event of a guilty verdict. In addition, crime insurance will often respond to internal theft and fraud (where the insured company has suffered losses). However, coverage is limited where the theft or fraud has been carried out by a director of the insured company.
Union Bank of India loses 3.14 billion rupees in loan fraud scheme involving eight banks	$48m	Commercial banking	External theft and fraud	Crime Insurance		Reports suggest that the bank's losses relate to fraudulent loans provided to a construction company. Coverage for fraudulent loans under crime policies is typically provided for two main scenarios: (i) the insured company's employees act fraudulently in providing loans; and (ii) the insured company relies in good faith on certain fraudulent documentation provided by the borrower. There does not appear to be any reports of employee fraud in this case, therefore we presume the losses were caused at least in part by the bank's good faith reliance on fraudulent documents. If so, coverage under crime insurance can be challenging as the documentary fraud element does not apply to every form of documentation nor does it apply every fraudulent method. Indeed such coverage is typically limited to the forgery, fraudulent alteration or counterfeiting of certain original secure financial instruments such as cheques and promissory notes. It does not apply to documents such as invoices, warehouse receipts, inventory or bills of lading (indeed such documents are almost always specifically excluded).
BAML fined $42 million over various fraudulent practices relating to its electronic trading services	$42m	Equities	Improper business or market practices	Professional Indemnity Insurance		Fines are often excluded under policies purchased by financial institutions (indeed criminal fines are almost always uninsurable as a matter of public policy). The fine here appeared to relate to allegations of bad faith ('masking' trades and overstating the amount of retail orders routed to and executed in BAML's dark pool), as such it does not seem that a fine of this nature would be insurable.
BNY Mellon reaches $35 million settlement over mismanagement of trust assets	$35m	Fund management	Suitability, disclosure and fiduciary	Professional Indemnity Insurance		We understand that this matter involves allegations that BNY invested trust assets in proprietary financial products that performed poorly, thereby benefiting from higher management fees (BNY denies all the allegations). It has been reported that the settlement still requires court approval and if approved will take the form of fee concessions. The repayment of fees is almost always excluded under Professional Indemnity policies (the applicable exclusion is often entitled 'Disgorgement' or 'Fees and Commissions'), although some insurers may agree to provide coverage for legal costs incurred in defending fee claims.
State Bank of India defrauded of 2.15 billion rupees in commercial loans made by consortium of banks	$32.9m	Commercial Banking	External theft and fraud	Crime Insurance		Reports suggest that State Bank of India's losses relate to fraudulent loans provided to a jewellery supplier, which is accused of misreporting financial statements to secure loans from a consortium of 14 banks, of which State Bank of India was the largest lender. As described in the second loss above, the documentary fraud aspect of crime insurance is typically limited to the forgery, fraudulent alteration or counterfeiting of certain original secure financial instruments such as cheques and promissory notes. It does not usually apply to fraudulent financial statements.

- good basis for coverage - conditional basis for coverage - poor basis for coverage

Source: 1. Monthly operational risk losses - www.risk.net

Topical issues

Directors in the Dock

The hardening of the regulatory environment for financial institutions in the last decade appears to have increased the chances of directors facing criminal prosecutions. For example, in the UK four former Barclays directors (including the ex-chief executive) are currently facing criminal charges for certain actions taken during the 2008 financial crisis. Director's & Officers' insurance will provide coverage for legal costs incurred by directors in defending criminal proceedings against them (where the proceedings relate to directorial acts, errors or omissions). However, if the director is ultimately found guilty of criminal conduct, he or she will be required to repay those costs.

Insurance for Documentary Fraud

The coverage for documentary fraud in Crime policies is generally limited to the insured company's good faith reliance on original secure financial instruments, such as cheques and promissory notes, which have been forged, fraudulently altered or counterfeited. Coverage is therefore not provided for a significant range of documents relied upon in the course of business lending, including: invoices, warehouse receipts, inventory and bills of lading. In response to this gap, we have agreed with insurers a bespoke product for losses incurred in reliance on fraudulent account receivables and inventory (asset based lending insurance). Our Asset Based Lending product is typically purchased as a standalone policy. We are also able to provide a specific product for losses resulting from a lender's reliance on fraudulent documents used in international trade, including bills of lading and warehouse receipts.

Fees Exclusions in Professional Indemnity Policies

Professional indemnity policies for financial institutions will almost always include a 'Disgorgement' or 'Fees and Commissions' exclusion. In short, such exclusions will exclude coverage for the repayment of fees or commissions by the insured financial institution. Exclusions of this type will be of particular relevance for claims against financial institutions that relate to financial mis-selling. That is because such claims tend to relate to the repayment of some form of fee or commission received by the financial institution in selling the financial product in question. However, some insurers may agree to provide coverage in respect of legal costs incurred in defending claims for fees.

WHAT MAKES US DIFFERENT

We believe there's no substitute for reliability. Financial Institutions shouldn't have to compromise between great service and a great renewal result. Gallagher combines the strong balance sheet and market influence of one of the world's largest brokers with a dedicated service mentality.

With over 600 clients spread across 50 countries and territories, our Financial Institutions team has capabilities in a range of niche industry subsectors. Our broad specialist knowledge means we can look at insurance differently, offering clients year-round insight and a service that is reassuringly predictable, so they can leave the risks to us.

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