

Professional Indemnity



Professional Indemnity Forum Conference
Oxford University
8th-10th July 2014

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Christian Stanley
Performance Management
Directorate
Lloyd's

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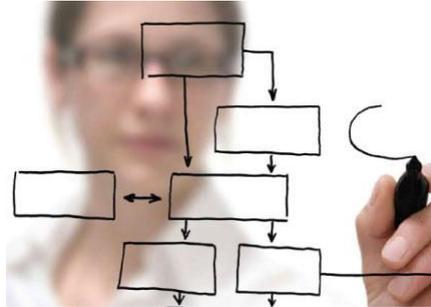
Agenda

- ▶ Dynamics of the PI tail
- ▶ The PI (non-US) Market in Lloyd's:
 - Components
 - Performance
 - Pricing
 - Outlook

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Dynamics of a long tail class



'Examining influencing factors driving the performance of the PI class'

The luxury of positive cash flow



PI is characterized by a delay between the year in which cover is afforded and the year the claim is paid.

The Float... it's Other Peoples Money

- Float arises because premiums are prepaid and there is an interval, often over years, before losses are paid.
- It doesn't belong to us, we temporarily hold it.
- What other form of financing is better than this:
 - No collateral
 - No interest
 - No repayment
- Then we invest it.....

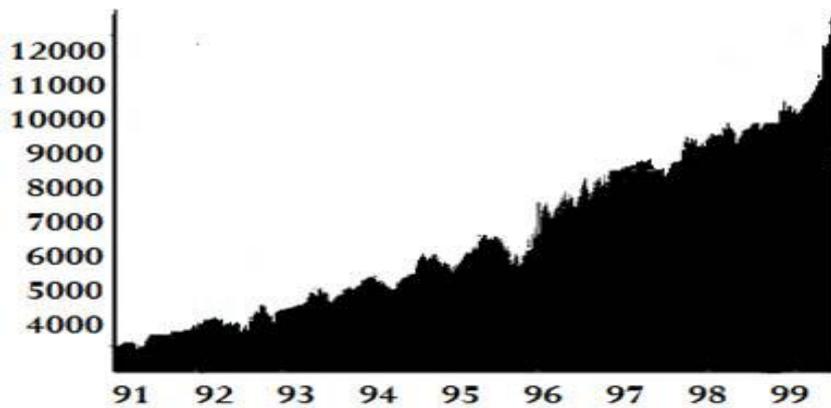
OPM.... It's Addictive



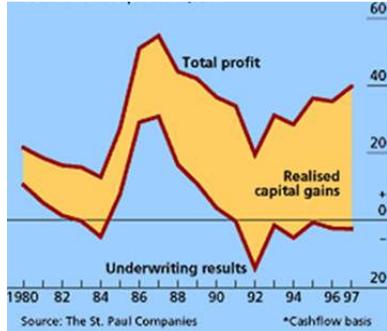
And didn't we all get used to that rising investment environment.....



Well it was the 90's man !



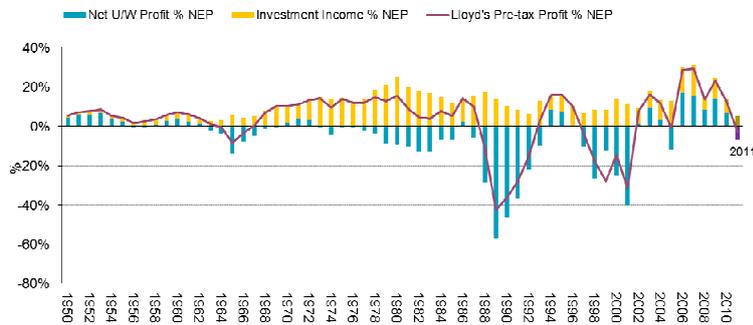
'Saved by the Bull'



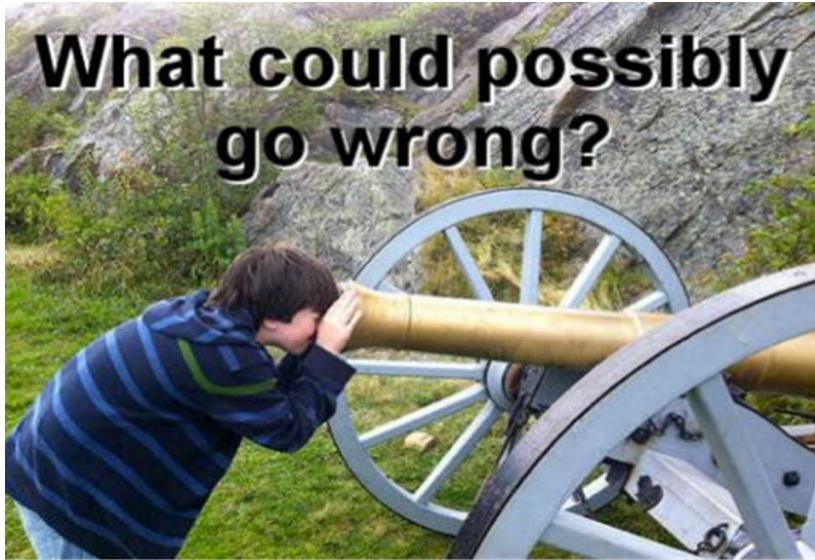
But hold on... 'A cost free Float is not an outcome to be expected'

'In 37 of the 45 years ending in 2011 the industry premiums have been inadequate to cover claims.'

'One comes to rely on the support!'



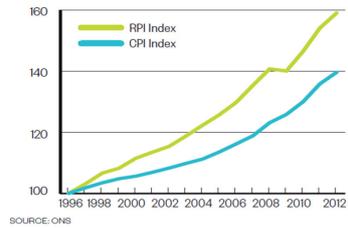
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Inflation..... is always and everywhere a monetary phenomenon
Milton Friedman (1970)

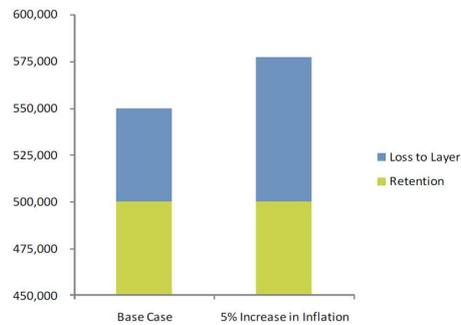


- Monetary
- Superimposed
 - Legal
 - Social
 - Medical Cost
 - Emerging Risk

↑ 5%pa ?

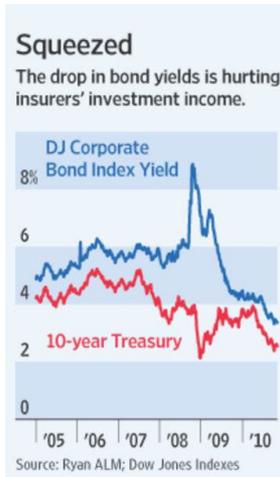
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Gearing effect of inflation on an excess layer



- In the base case a £550,000 claim gives the excess layer a £50,000 loss.
- After a 5% claim inflation the loss to the excess layer is £77,500.....A 55% increase !
- Just imagine how this scenario would ramp up over several years of compounded inflation !

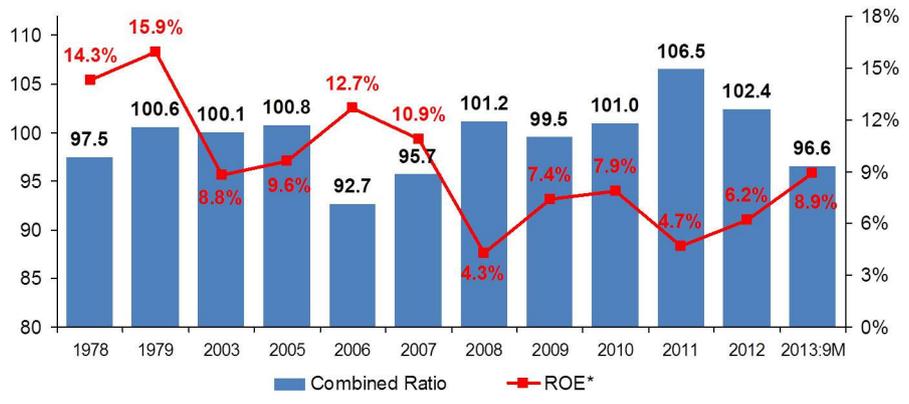
Poor investment yields.....



'Legacy' bond portfolios deliver much higher yields than will be available when they mature and are reinvested

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A 100 Combined Ratio Isn't What It Once Was..... Investment Impact on ROEs



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Worst of Both Worlds



- Crashed investment yields
- Devastating compounded, superimposed inflation

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Increased Claims & Reserve Deterioration

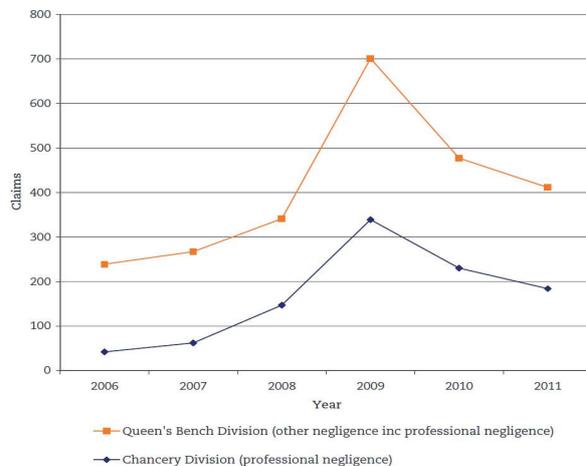


“You only find out who’s swimming naked when the tide goes out”
Warren Buffett

- ▶ Economic cycle related losses
- ▶ Systemic Claims
- ▶ Legislative and Regulatory changes

Correlation to the Economic Cycle ?

Professional negligence claims in the Chancery and Queen's Bench Division in the Royal Courts of Justice, in London



The Walking Dead

Insolvent insurers don't run out of cash until long after they have run out of net worth.

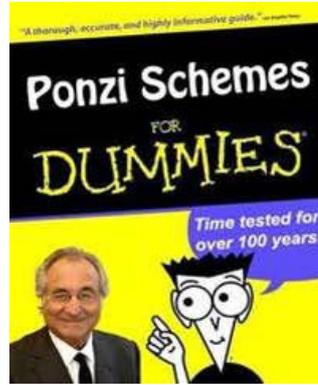


In fact, these **"Walking Dead"** often redouble their efforts to write business, accepting almost any price or risk, simply to keep the cash flowing in.

So, how does one survive such an onslaught...
Run away from the tail ?



Familiar Characteristics ?



Casualty Laden Graveyard



Yearly Pattern of Failures



- Some standouts that we can all recall
- HIH 2001
 - Independent 2001
 - Quinn 2010
 - Lemma 2012
 - Balva 2013

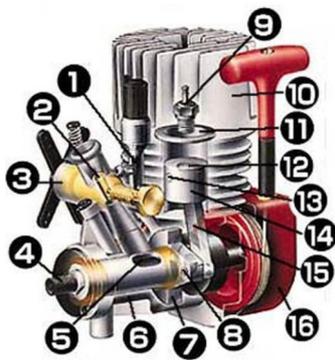
Main Causes of Insolvency:

- 34% Insufficient Reserves
- 20% Rapid Growth & Under Pricing

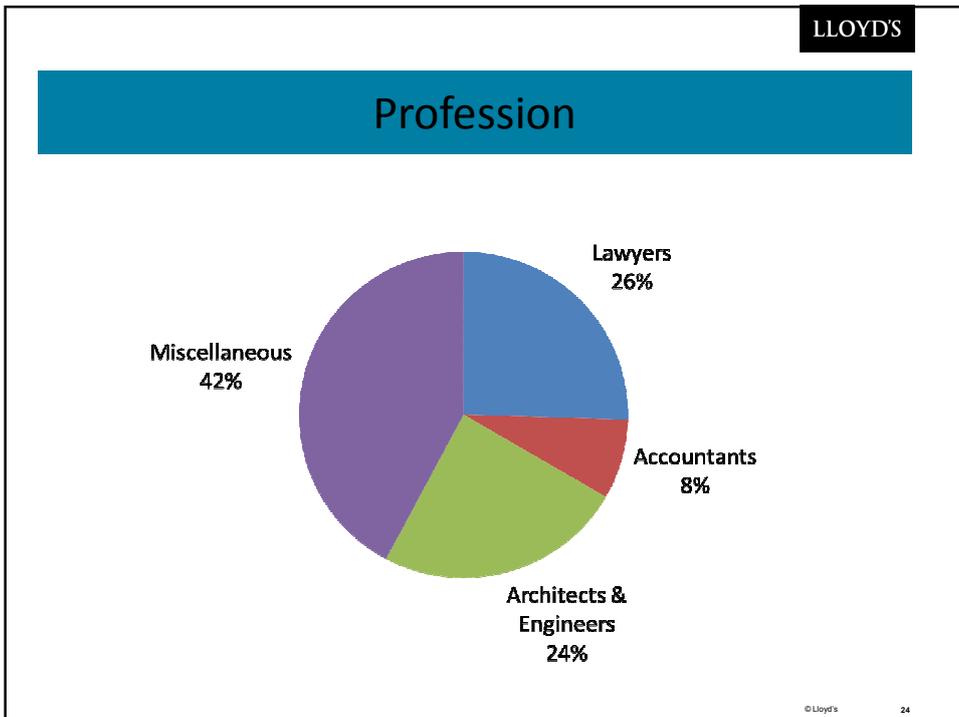
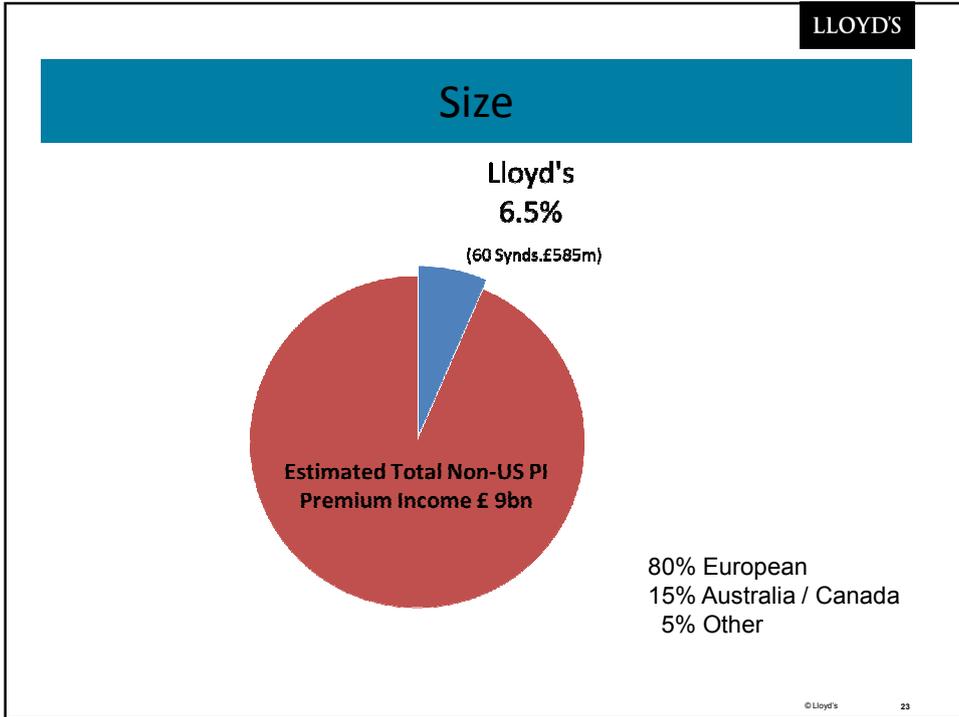
The PI (non-US) Market in Lloyd's



Components

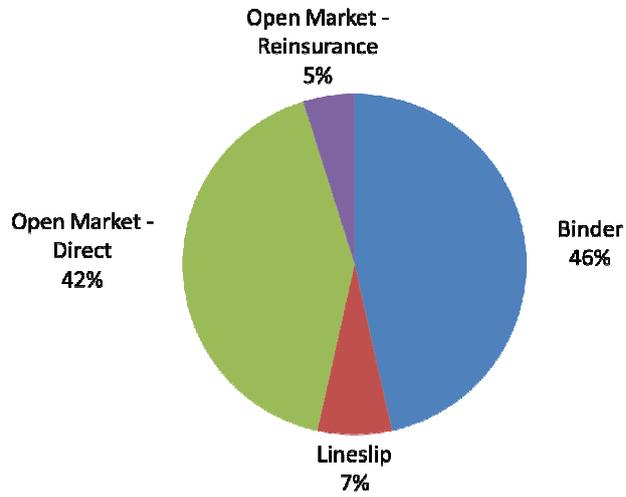


- Size
- Profession
- Placement Method
- Territory



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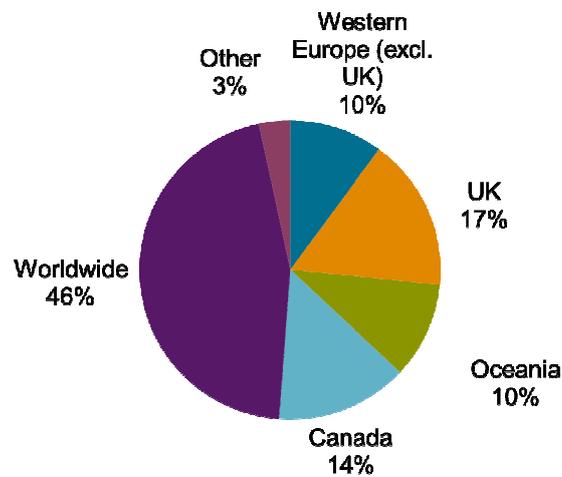
Placement Method



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Territory



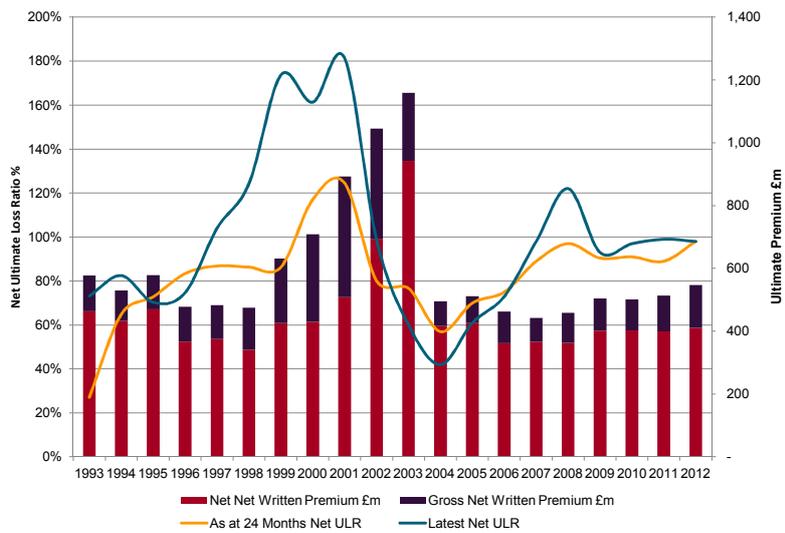
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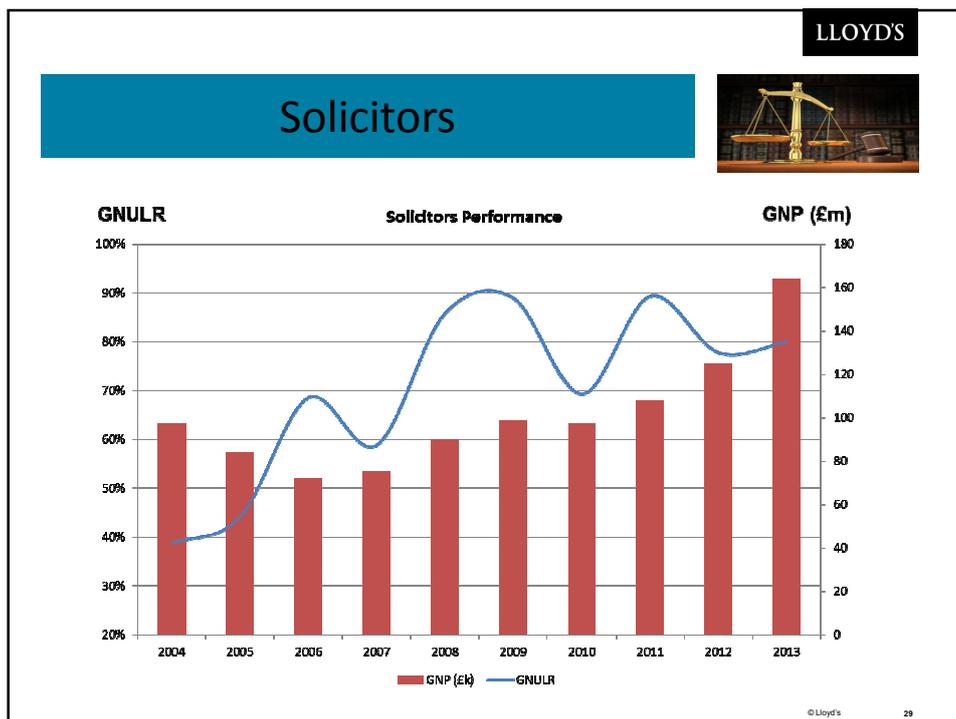
Performance



- The Underwriting Cycle
- Solicitors
- Accountants
- Architects & Engineers
- Miscellaneous

The PI Underwriting Cycle





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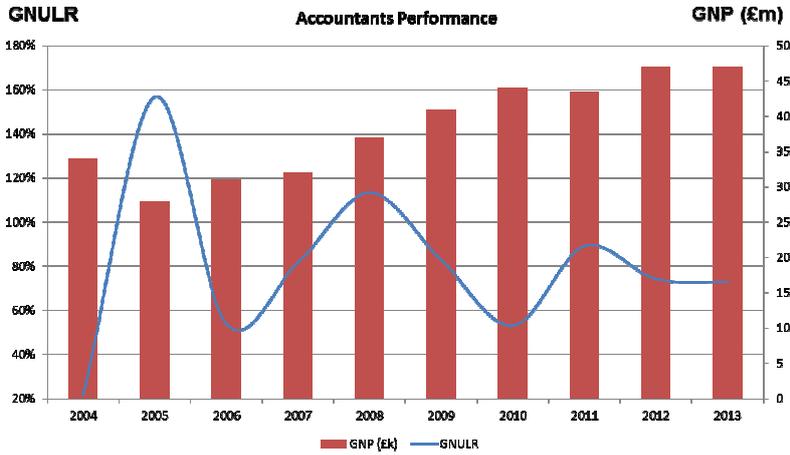
Solicitors



- ▶ International profile dominated by UK and Commonwealth territories
- ▶ Offshore Corporate Service Providers
- ▶ Significant participation on Top 100 firms
- ▶ < 10 ptnr firms not widely written
- ▶ Increased recession related claims :
 - Fraud
 - Commercial transactions
 - Conveyancing
- ▶ Law firm insolvencies
- ▶ Consolidation of Firms
- ▶ Alternative Business Structures (ABS)
- ▶ Increased interest in UK Solicitors as a result of abolition of ARP and common renewal date (136 firms could not obtain cover)

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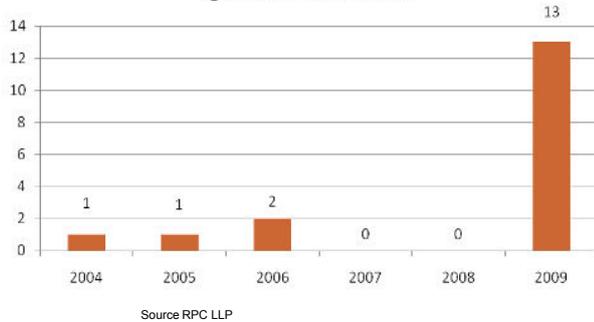
Accountants



Accountants



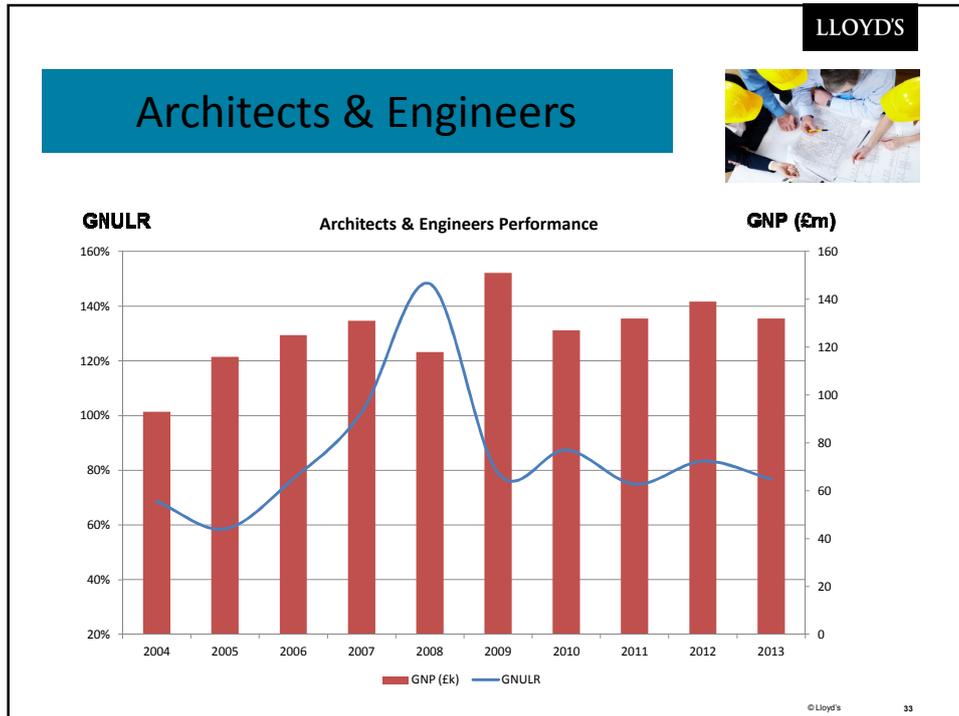
Number of major professional negligence claims in the High Court Chancery Division against accountants



- 2009 more than the past 5 years combined
- 2002 post dot com bubble and Enron/Worldcom etc.. there were 37

Increase in recession claims:

- Failure to spot fraud
- Over valuation of assets
- Tax advice
- Corporate insolvencies



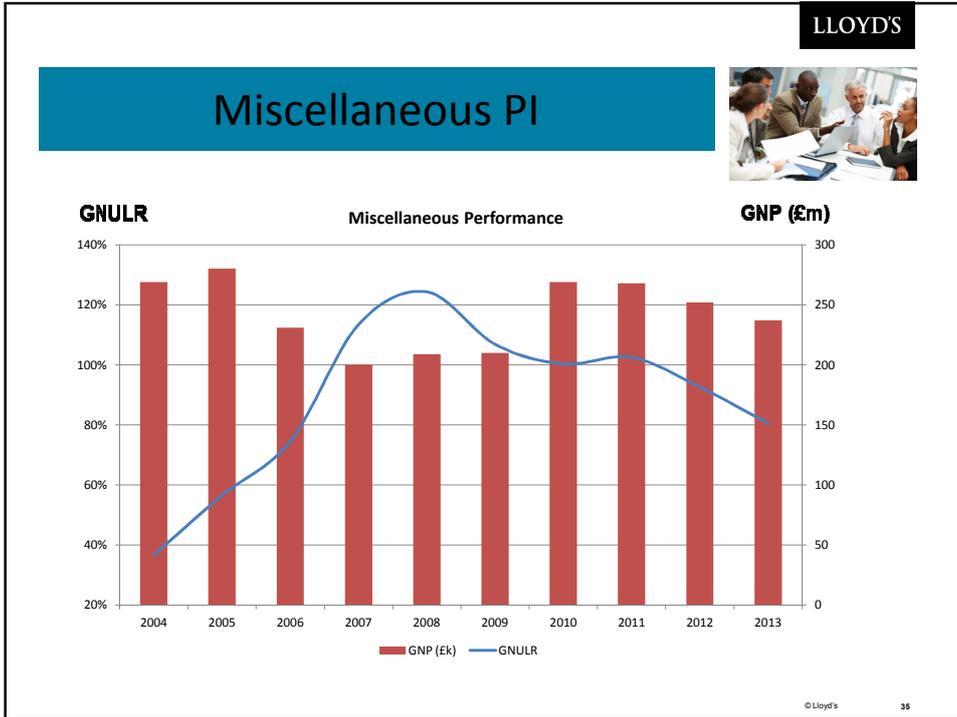
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Architects & Engineers

► **Recession Related Claims:**

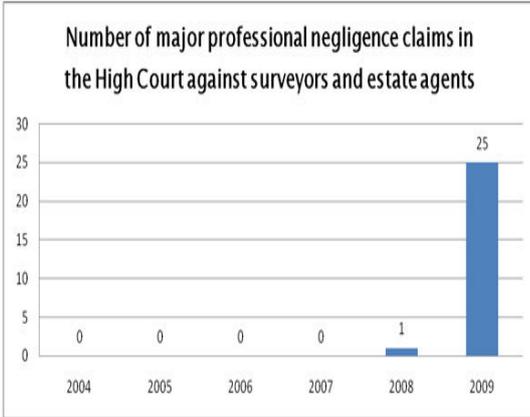
- Project loss of funding
- Counter claims following fee disputes
- Cutting corners to save costs
- Delays and increase in costs are no longer masked by rising property values
- Reduction in new projects gives opportunity to pursue negligence claims on past works

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- ## Miscellaneous PI
- 
- ▶ Surveyors & Valuers
 - ▶ IFA's
 - ▶ Insurance Brokers
 - ▶ Technology and Cyber Liability
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Surveyors and Valuers



Source RPC LLP

- Negligent over valuation of commercial and residential property
- Underestimation of cost of putting a development project on hold
- Increased fraud

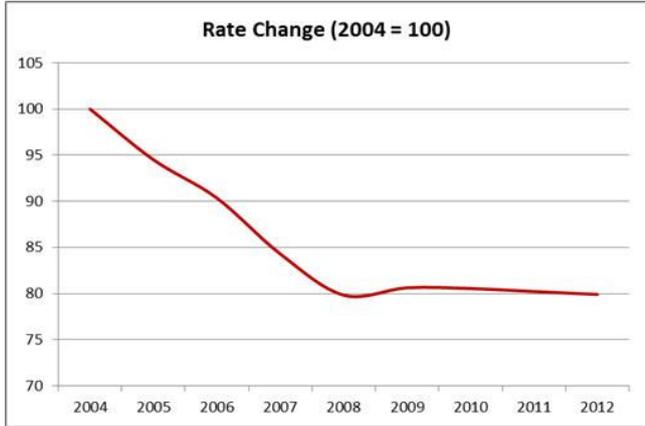
Financial Advisors



CF ARCH CRU



Pricing



- Only 20% fall from the peak?
- Churn not recorded
- Rate Increases:
 - Surveyors
 - IFA's
 - <10 ptrn. Solicitors

Pricing Adequacy - Will the margin cover the downside?

Eat Like Chickens, S**t like Elephants



The Outlook for PI



Is there a Challenge ahead for the PI market ?



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Yes.... Plenty

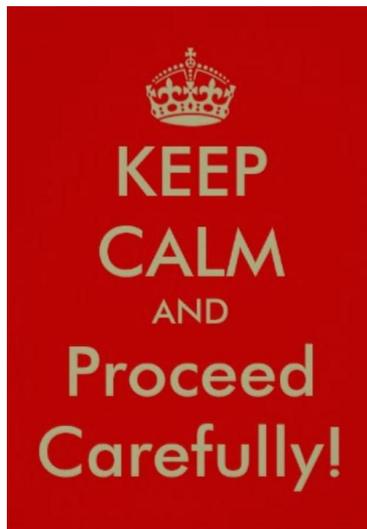


- Interest rate hike
- Class Actions
- Third Party litigation funding
- Prolonged soft market
- Increased Regulatory Scrutiny
- Recession
- More mis-selling Scandals
- Reserve strengthening

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Forward Guidance



Despite the challenges there is....

- Stronger economic growth
- Increased professionals subject to compulsory PI insurance
- Six year statutes continue to expire
- Increased regulation is improving professionals behaviour
- Higher standards of risk management
- Continued product evolution
E.G. IT / Media / Cyber

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