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

**Agenda**

► Dynamics of the PI tail

► The PI (non-US) Market in Lloyd’s:
  - Components
  - Performance
  - Pricing
  - Outlook
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......

And didn’t we all get used to that rising investment environment.........
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!’
Inflation...... is always and everywhere a monetary phenomenon
Milton Friedman (1970)

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

5%pa?
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
A 100 Combined Ratio Isn’t What It Once Was..... Investment Impact on ROEs

Worst of Both Worlds

-Crashed investment yields
-Devastating compounded, superimposed inflation
Increased Claims & Reserve Deterioration

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

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

Correlation to the Economic Cycle?

![Graph showing correlation between economic cycle and claims](image-url)
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

Main Causes of Insolvency:
- 34% Insufficient Reserves
- 20% Rapid Growth & Under Pricing

Some standouts that we can all recall:
- HIH 2001
- Independent 2001
- Quinn 2010
- Lemma 2012
- Balva 2013
The PI (non-US) Market in Lloyd's

Components

- Size
- Profession
- Placement Method
- Territory
Size

Lloyd's
6.5%
[US $5bn, 256.9bn]

Estimated Total Non-US PI
Premium Income £ 9bn

80% European
15% Australia / Canada
5% Other

Profession

Lawyers 26%
Accountants 8%
Architects & Engineers 24%
Miscellaneous 41%
Placement Method

- Open Market - Direct: 42%
- Open Market - Reinsurance: 5%
- Binder: 46%
- Lineslip: 7%

Territory

- Worldwide: 48%
- UK: 17%
- Canada: 14%
- Oceania: 10%
- Western Europe (excl. UK): 10%
- Other: 3%
Performance

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

The PI Underwriting Cycle

Ultimate Premium £m
Net Written Premium £m
Gross Net Written Premium £m
As at 24 Months Net ULR
Latest Net ULR

0% 20% 40% 60% 80% 100% 120% 140% 160% 180% 200% 220%
0 200 400 600 800 1,000 1,200 1,400

09/07/2014
Solicitors

- International profile dominated by UK and Commonwealth territories
- Offshore Corporate Service Providers
- Significant participation on Top 100 firms
- < 10 ptnt 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)
Increase in recession claims:
- Failure to spot fraud
- Over valuation of assets
- Tax advice
- Corporate insolvencies
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
Miscellaneous PI

- Surveyors & Valuers
- IFA's
- Insurance Brokers
- Technology and Cyber Liability
Surveyors and Valuers

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

Source: RPC LLP

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Financial Advisors

CF ARCH CRU

Key Data Investment Services Limited
Pricing

Rate Change (2004 = 100)

- Only 20% fall from the peak?
- Churn not recorded
- Rate Increases:
  - Surveyors
  - IFA’s
  - <10 pttr. 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?
Yes…. Plenty

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

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