

Professional Indemnity Forum 2006

PI market - an actuary's view

13 July 2006

Agenda/Contents

Pricing

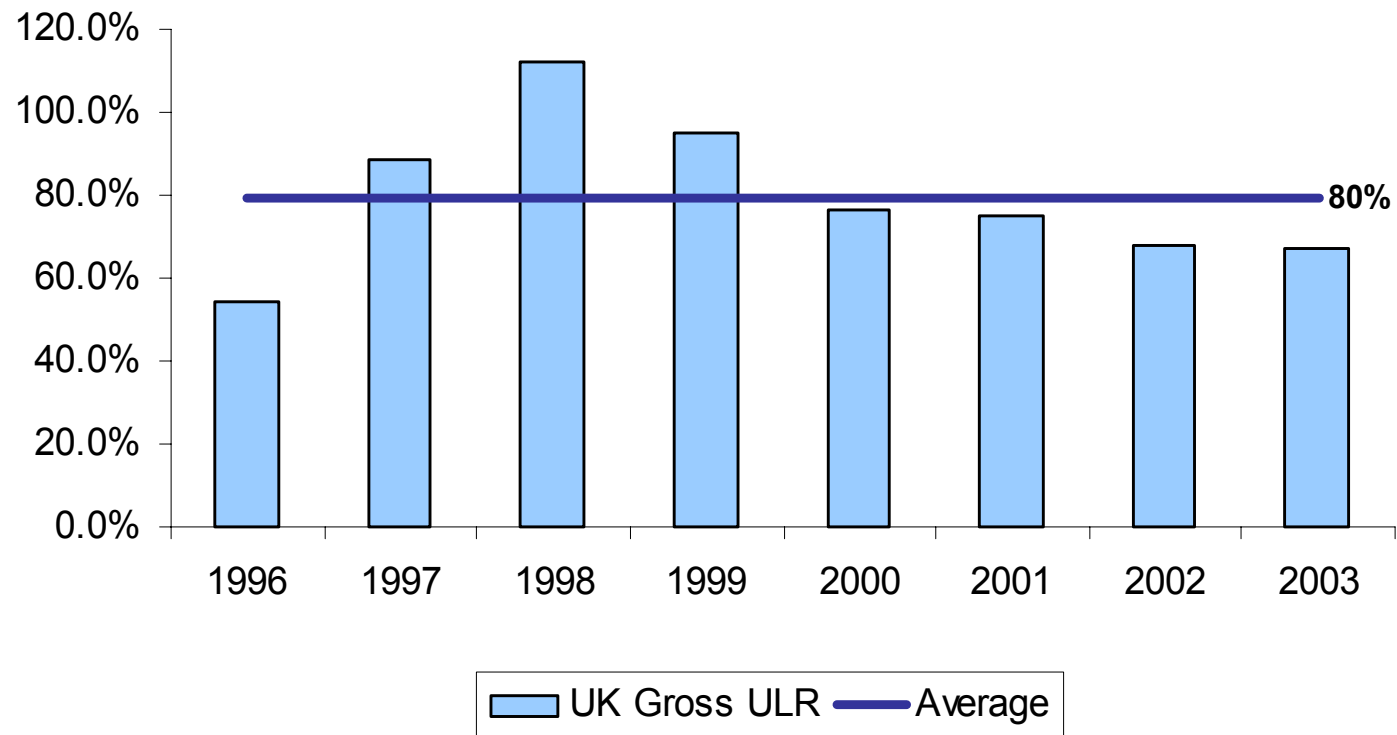
Underwriting cycle

PI market environment

Pricing

Insufficient pricing for risk?

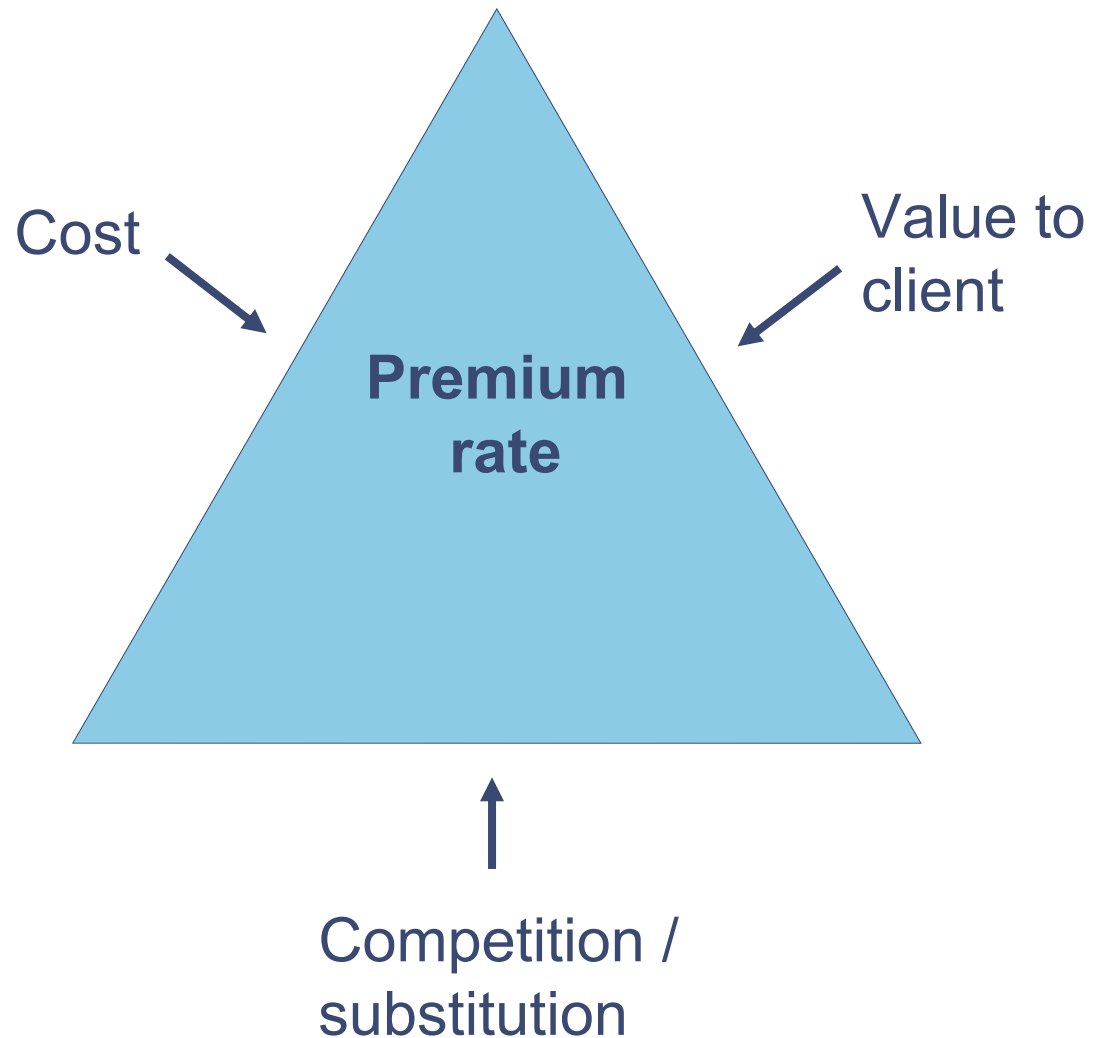
UK market loss ratio has followed a typical 'cycle' pattern



Source: 2004 FSA return data

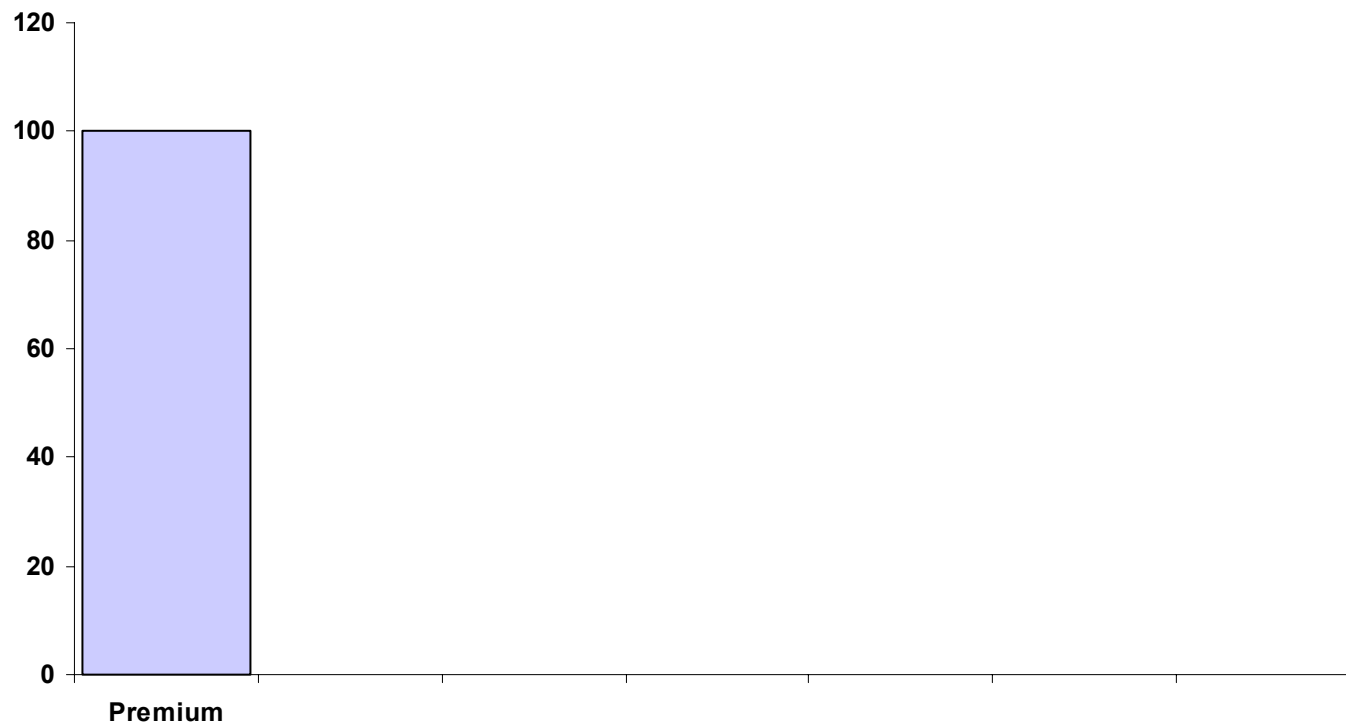
Pricing

How to price insurance business



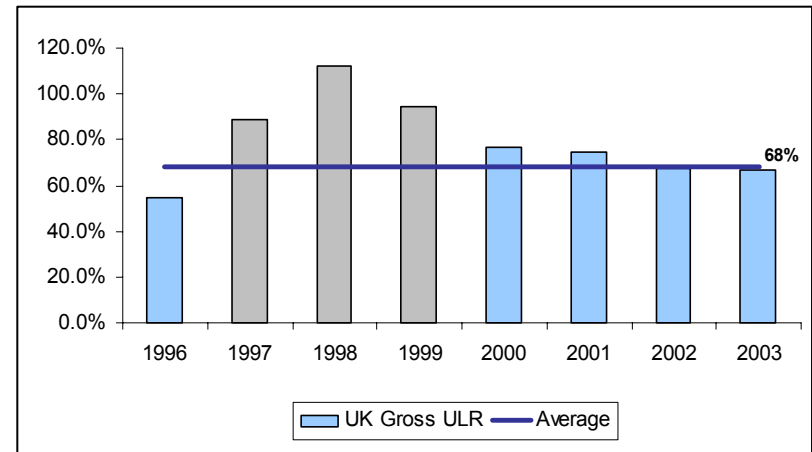
When pricing, what goes wrong?

Start with the gross premium

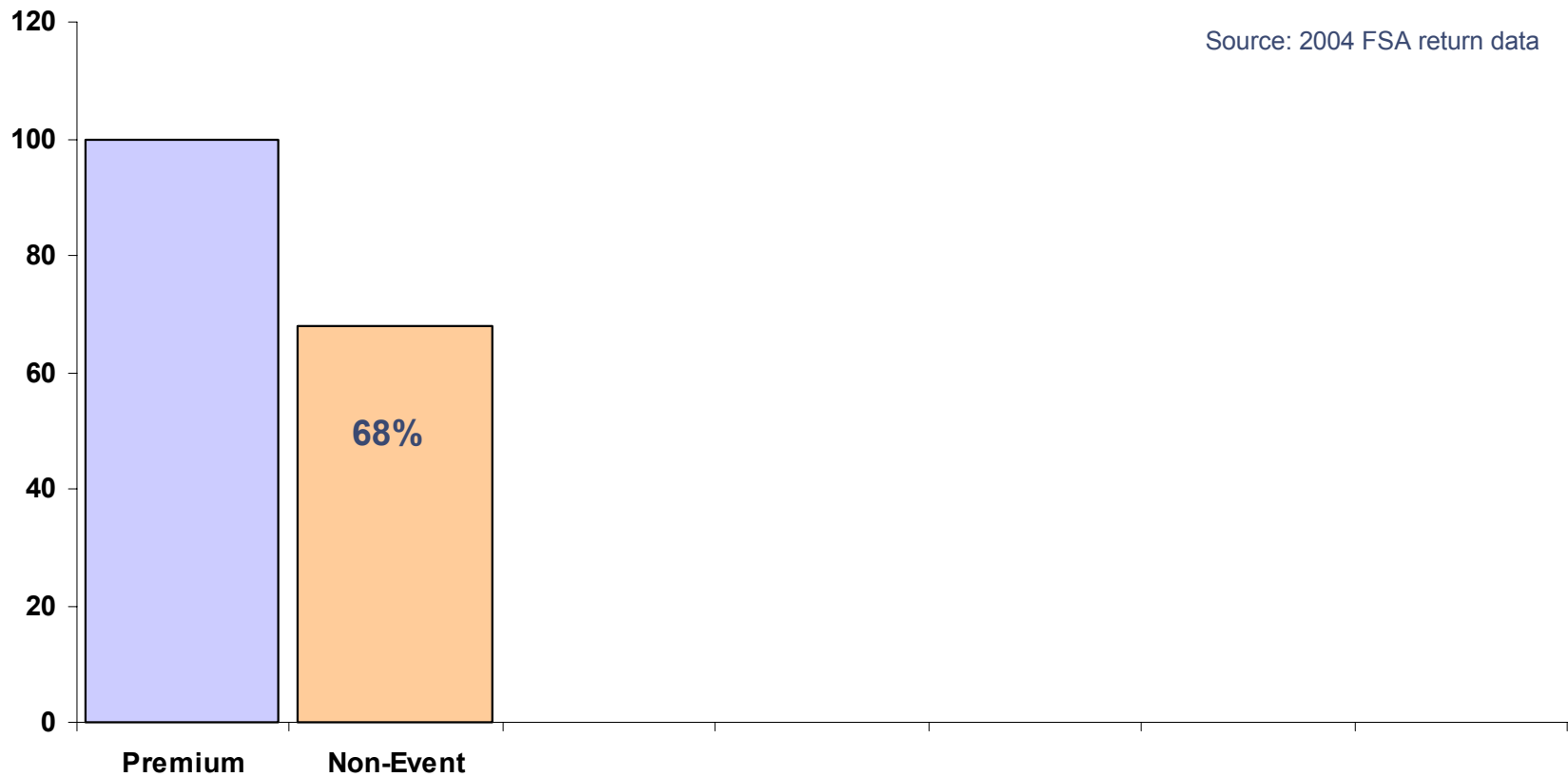


When pricing, what goes wrong?

Average non event year - ULR 68%

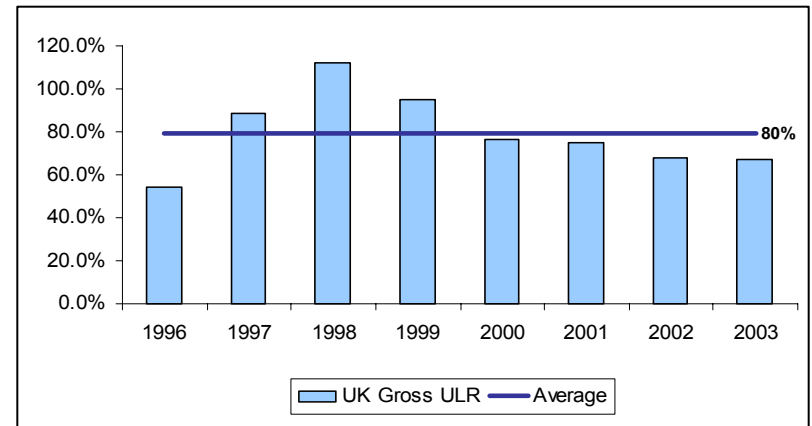


Source: 2004 FSA return data

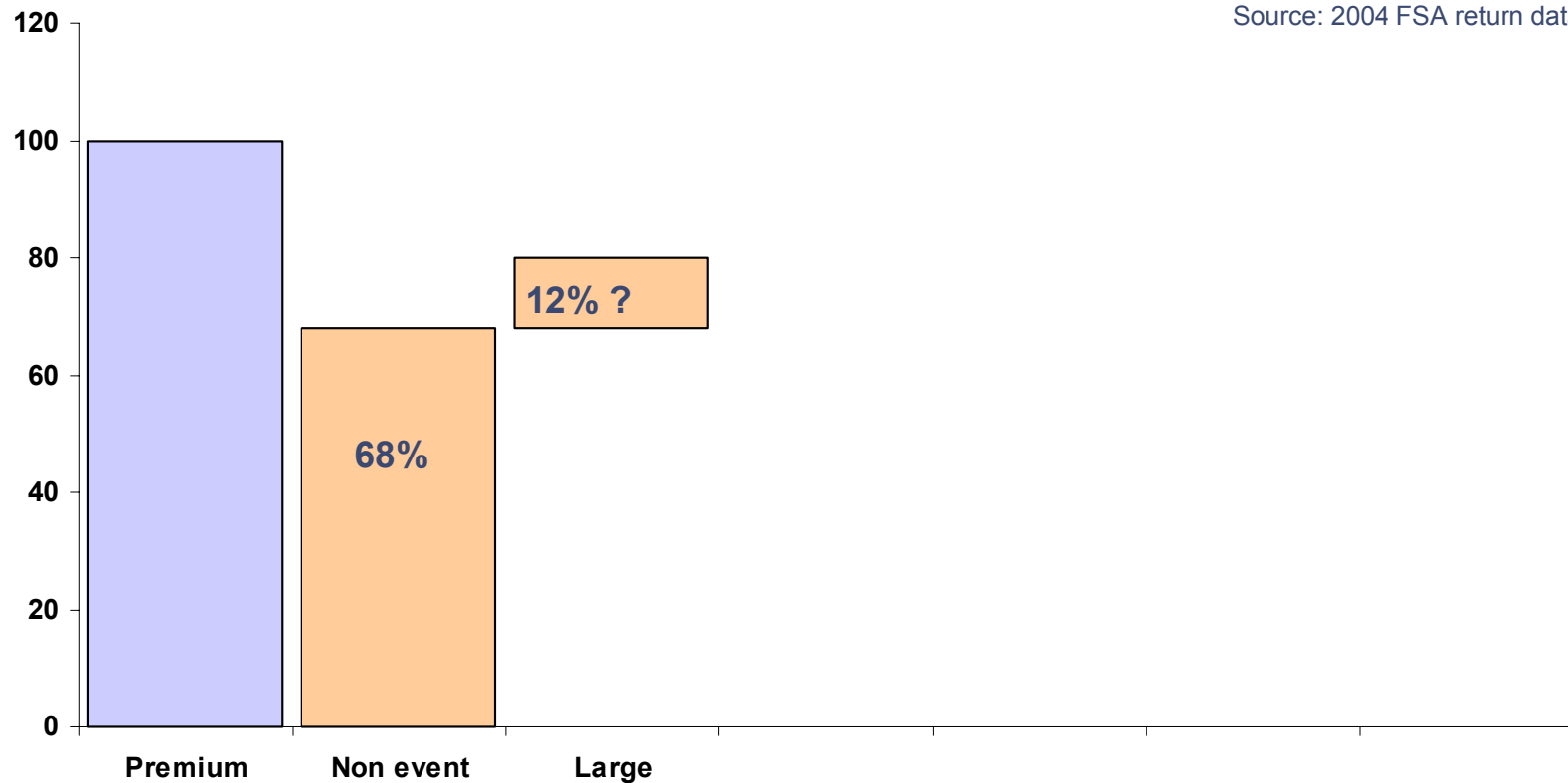


When pricing, what goes wrong?

Large claims loading of 12%?

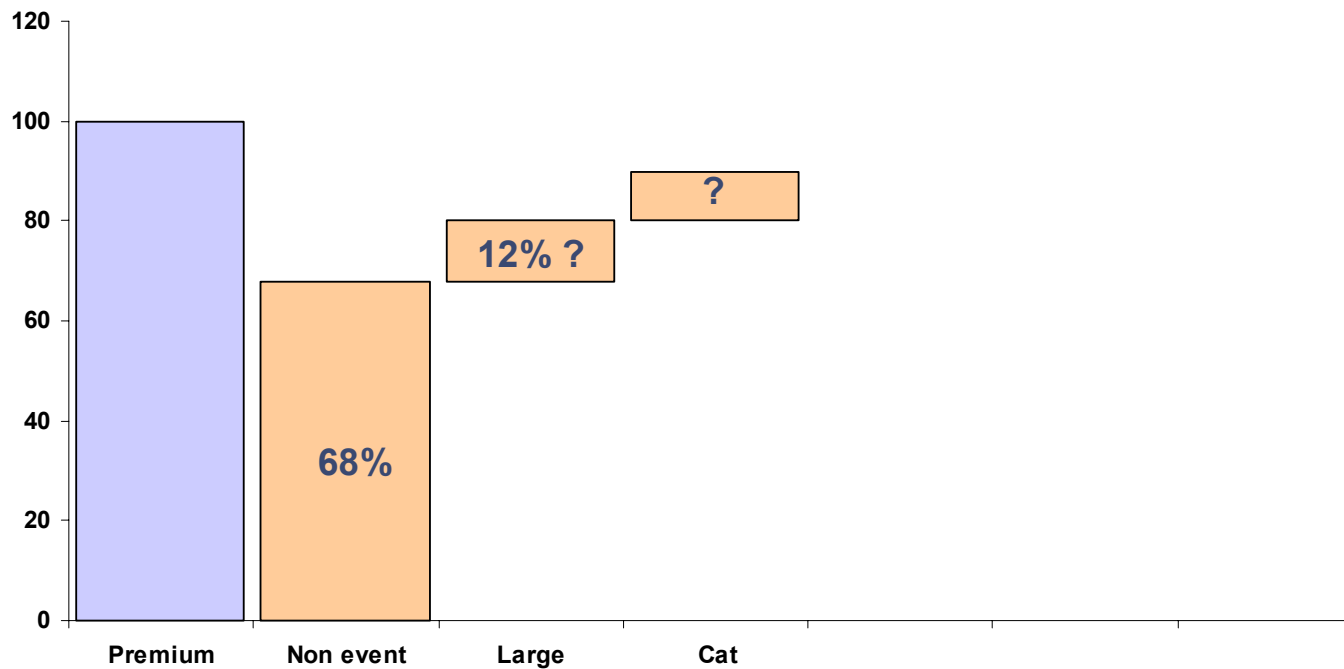


Source: 2004 FSA return data



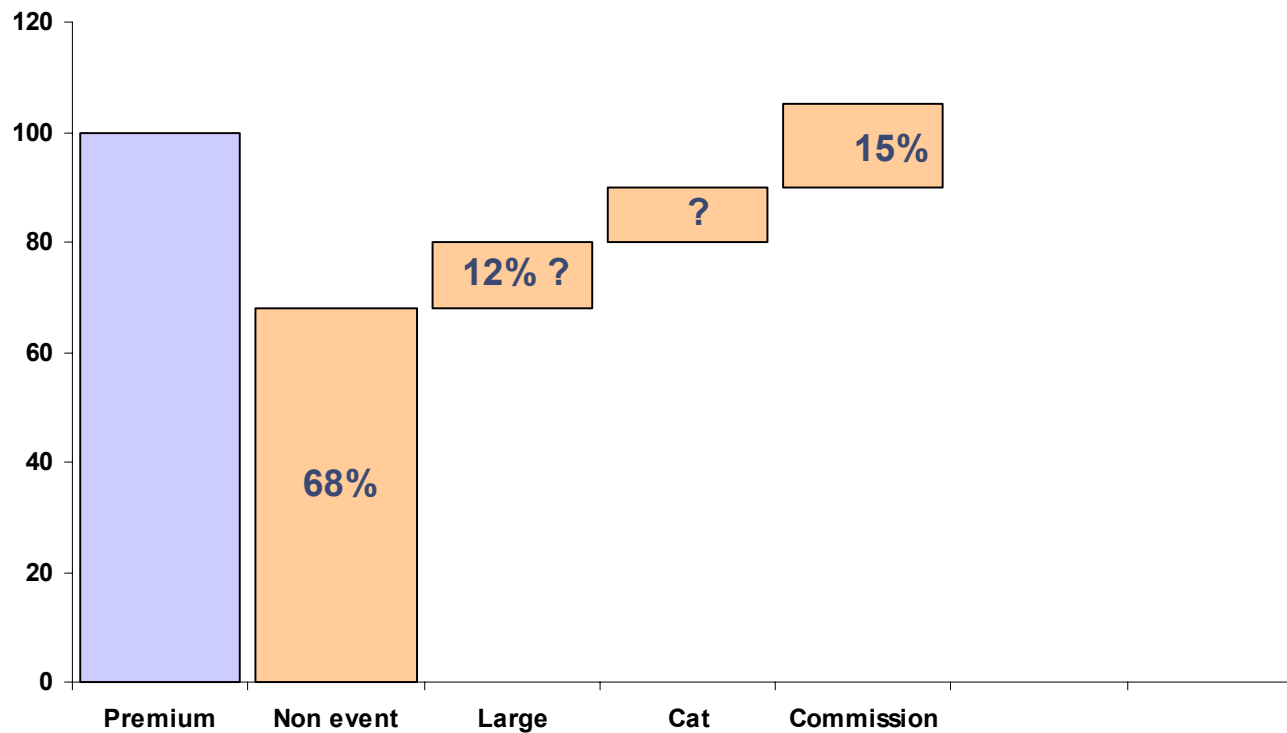
When pricing, what goes wrong?

What allowance is made for larger event years?



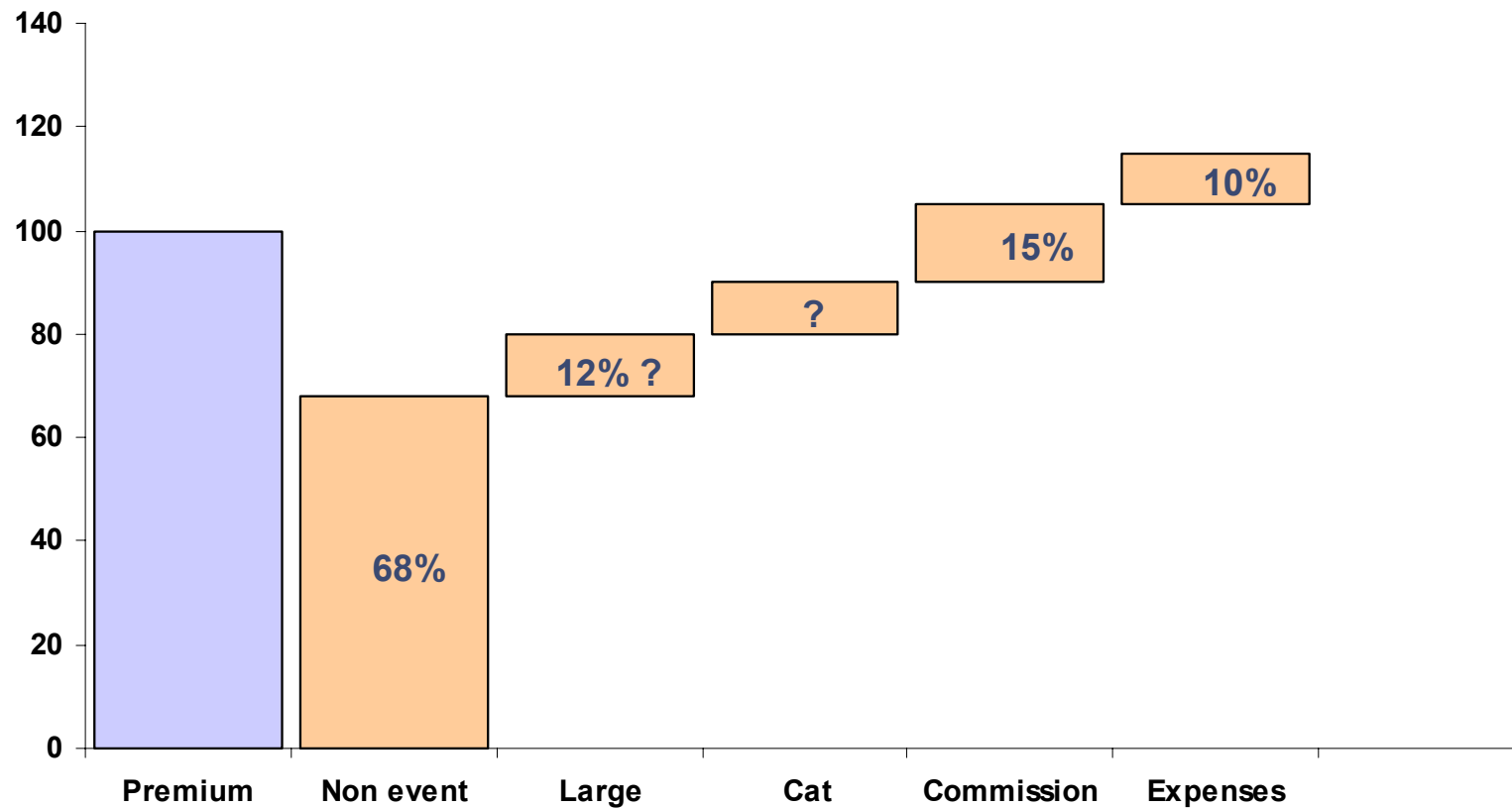
When pricing, what goes wrong?

Assume commission is 15% of gross premium



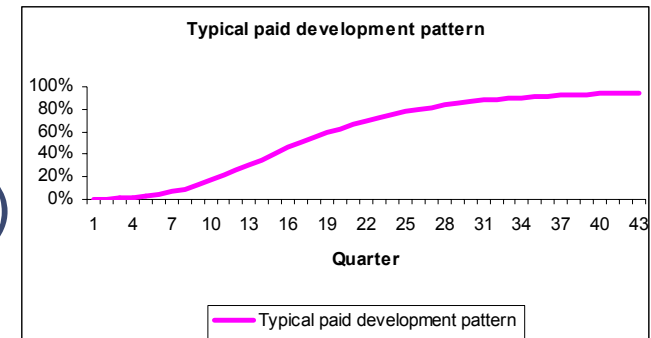
When pricing, what goes wrong?

Assume management expenses are 10%

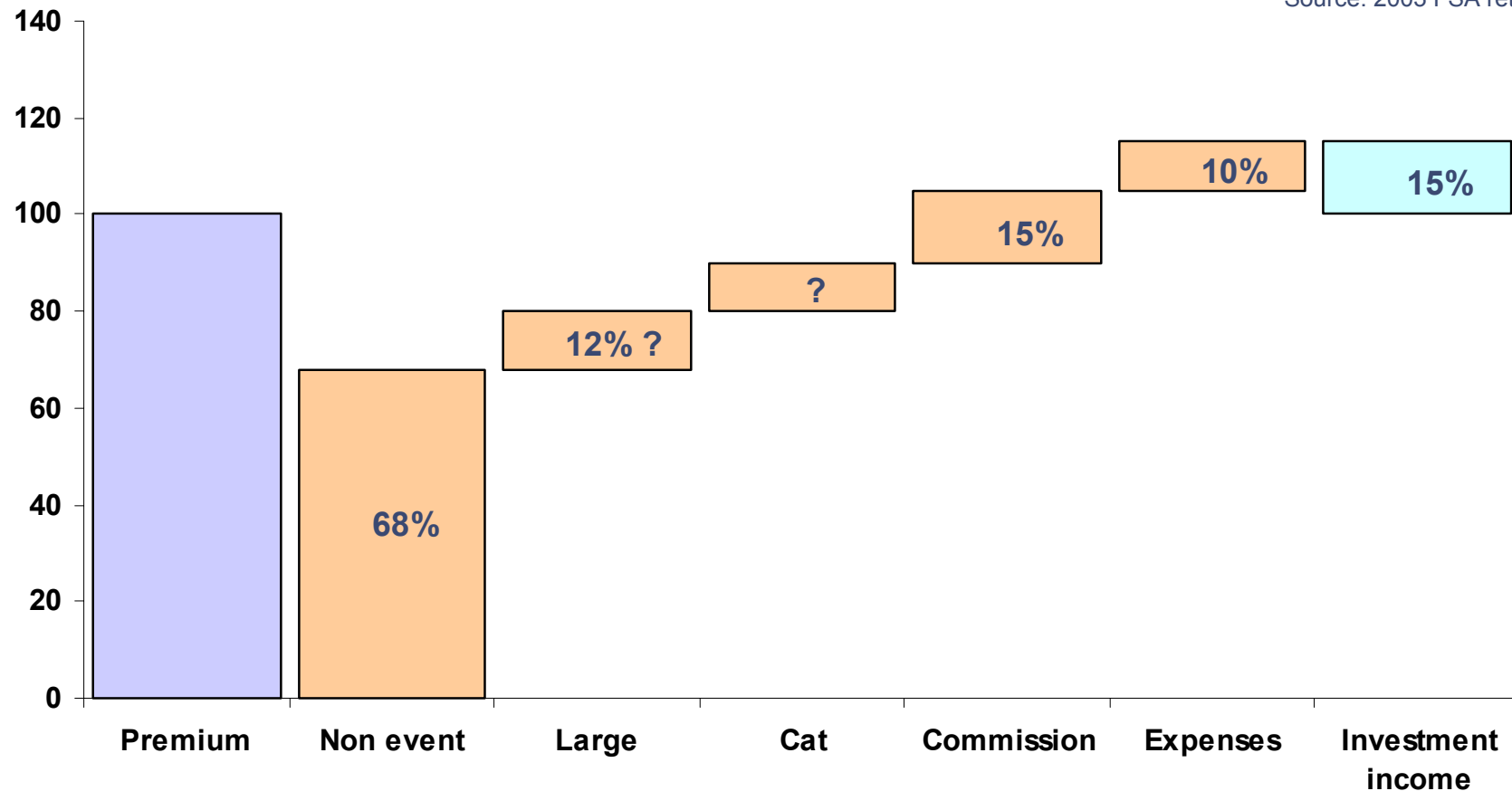


When pricing, what goes wrong?

Payment pattern implies investment income is 15% of premium (at 5% return)



Source: 2003 FSA return data



Pricing

Return on capital influencing pricing

Assuming;

- Minimum capital charge for liability business is 14%
- Required return on capital is 15%
- Risk free rate is 5%

⇒ Profit margin required is 11%

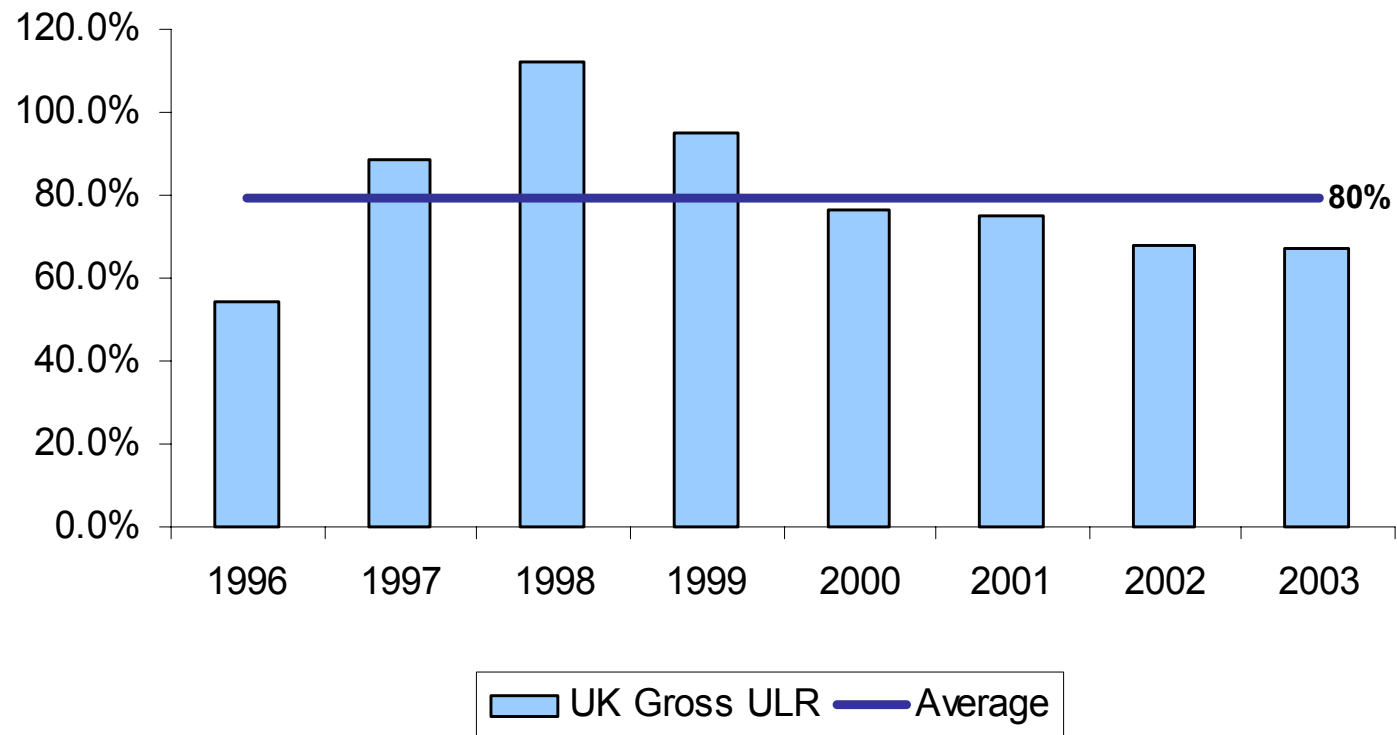
⇒ ULR is 79%

⇒ Large loss + Cat margin is 11% of premium

Pricing

Large losses

1997 to 1999 underwriting years were affected by IFA mis-selling claims

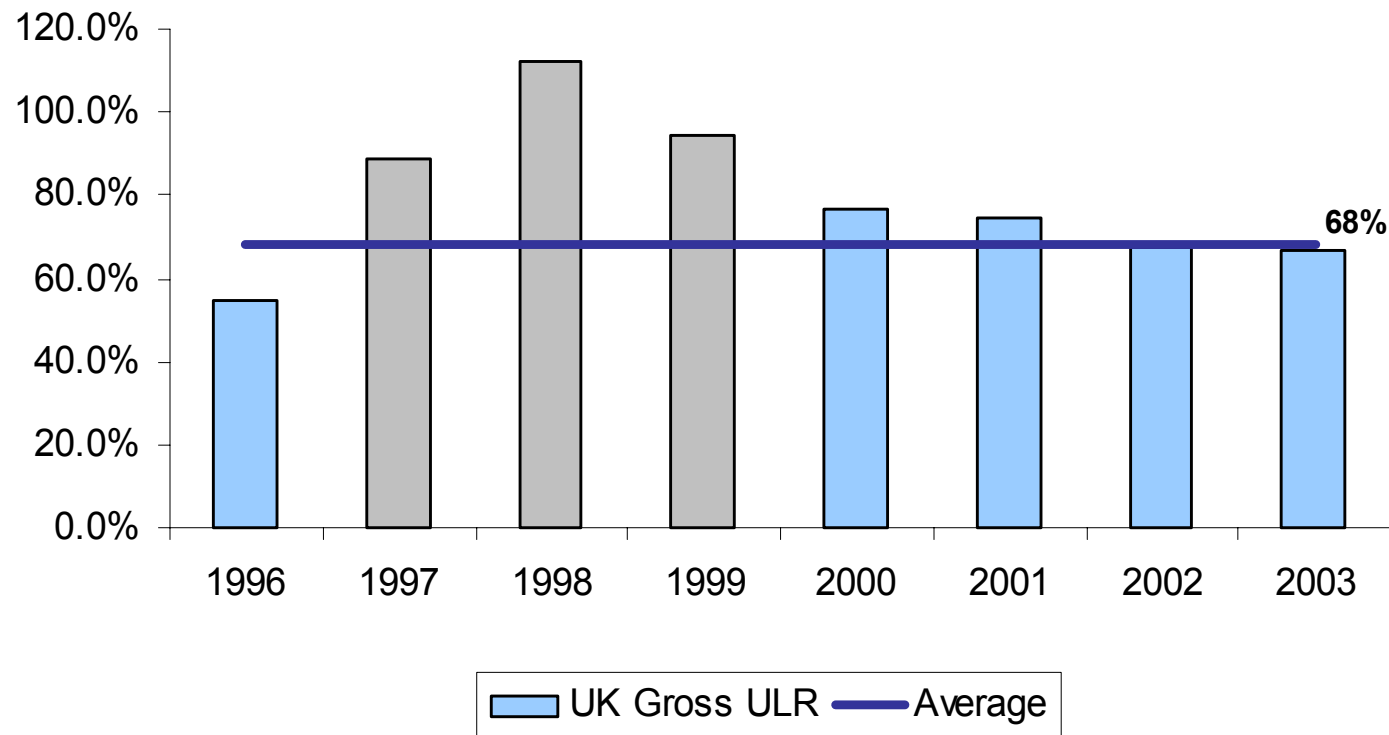


Source: 2004 FSA return data

Pricing

Large losses

With 1997 to 1999 excluded, we see that attritional claims account for 68% of gross premium.



Source: 2004 FSA return data

Large loss loading = 12% of premium
= 15% of ultimate claims (excluding cats)

Section two

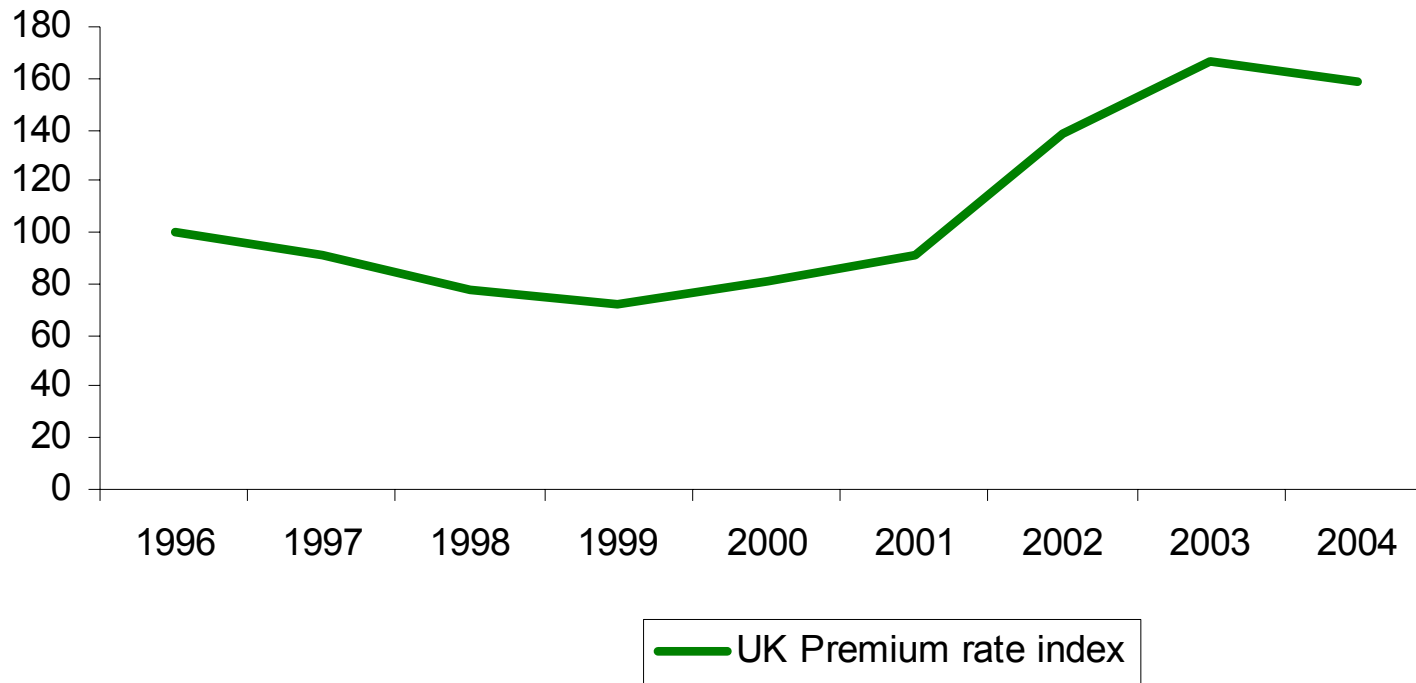
Pricing

Underwriting cycle

PI market environment

Underwriting cycle

UK premium rates have hardened since 2001

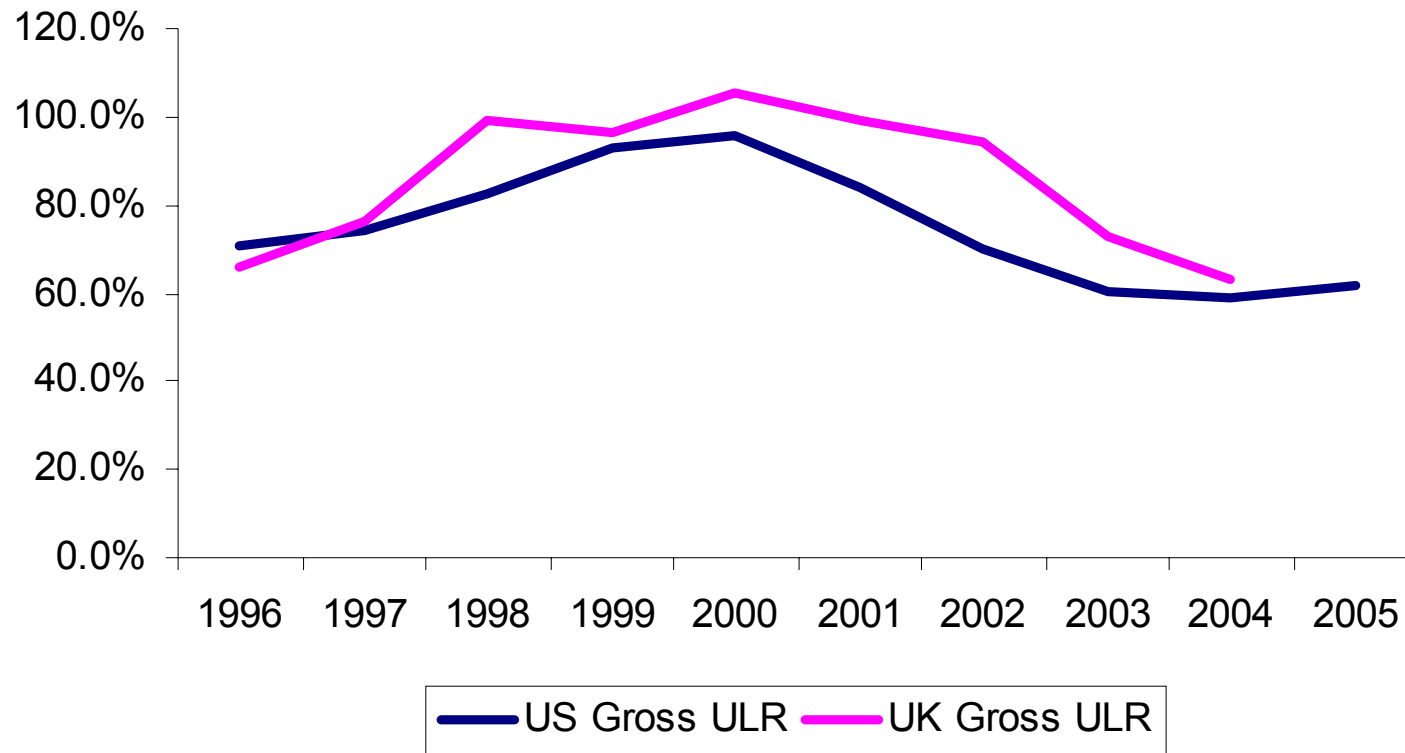


Source: 1996-2001 CBS indices (Lloyd's), non-marine
2002-2004 PwC estimates

Underwriting cycle

US and UK markets had very similar cycles over the past decade

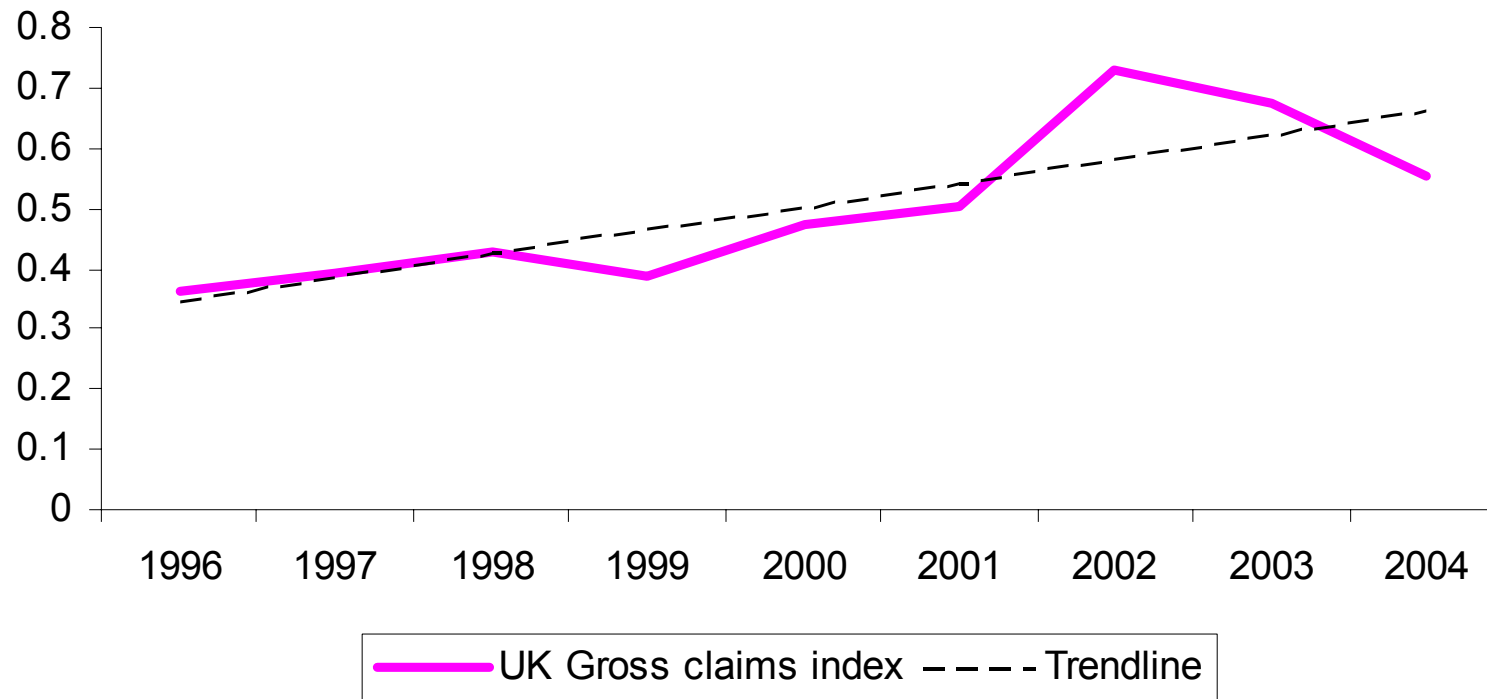
Accident year data, regulatory returns.



Source: 2004 FSA return data, 2005 SAS Schedule P

Underwriting cycle

By stripping out the rate changes, assumed claims inflation is isolated



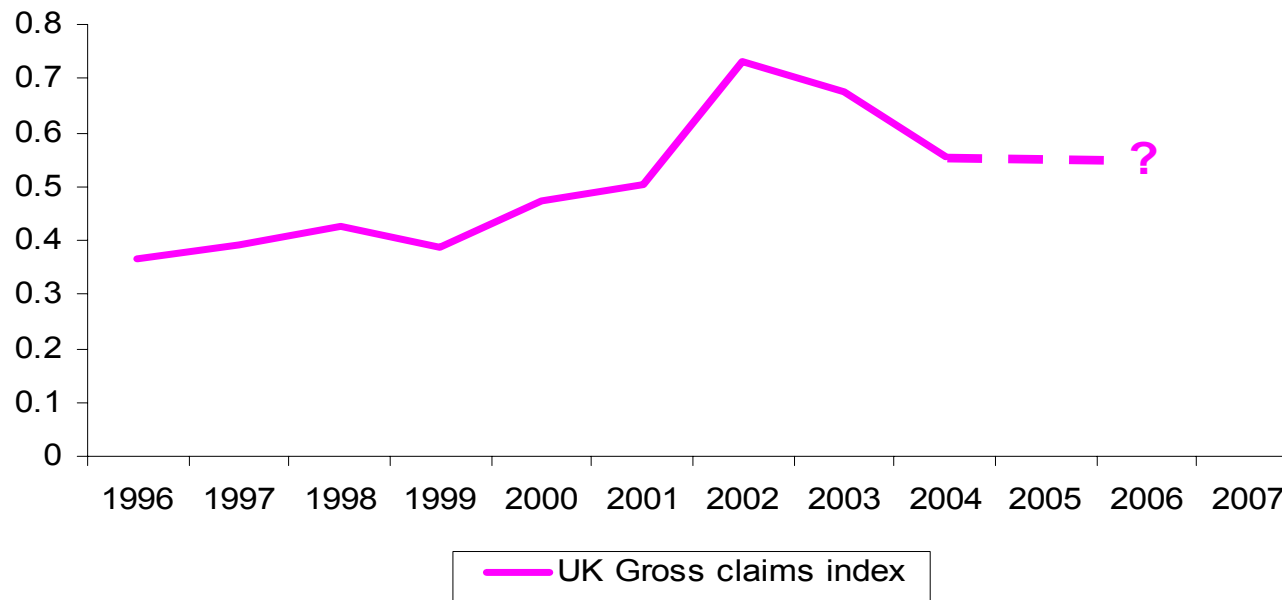
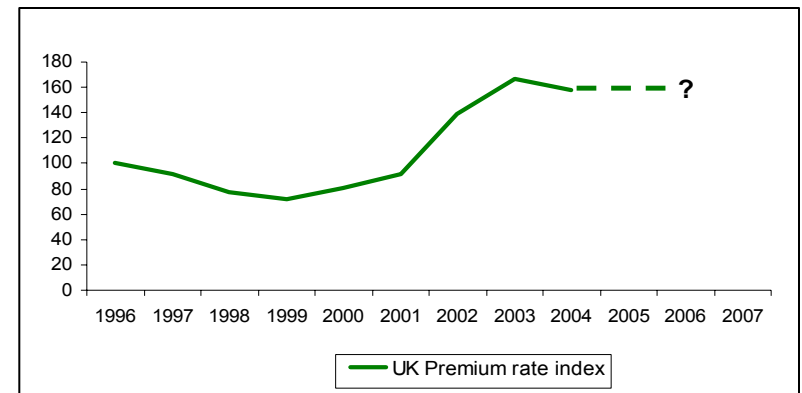
Linear trendline shows average UK claims inflation of 7.8%

Source: 2004 FSA return data,
2005 SAS Schedule P
CBS indices (Lloyd's), non-marine
PwC estimates

Underwriting cycle

Trends

How will these claims and premium rates patterns develop in 2006, 2007....?



Source: 2004 FSA return data,
2005 SAS Schedule P
CBS indices (Lloyd's), non-marine
PwC estimates

Section three

Pricing

Underwriting cycle

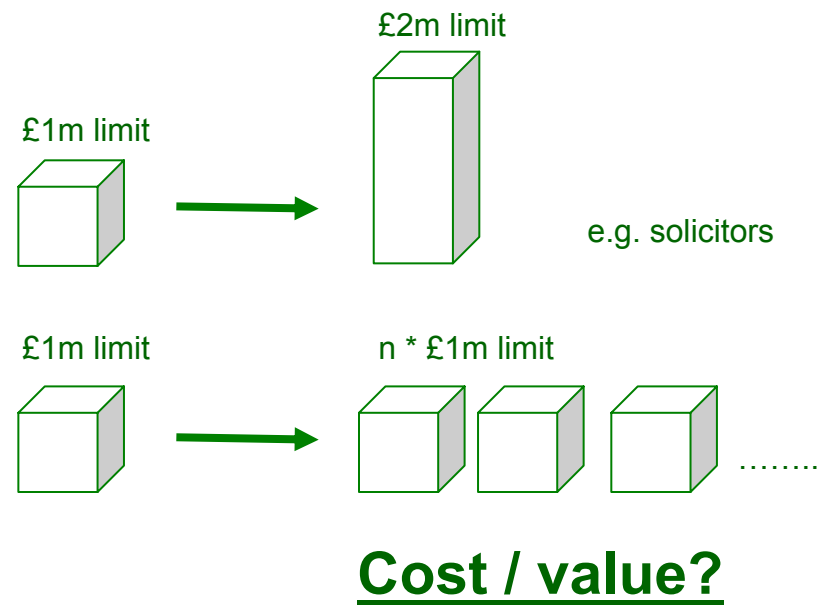
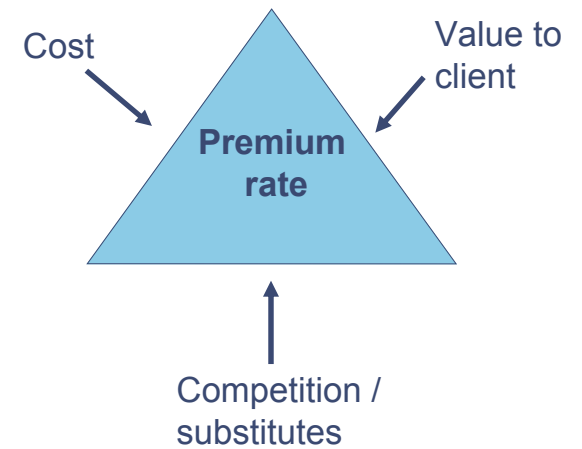
PI market environment

Issues

Allowing for sideways cover.

PI standard contracts currently leave insurers open to many claims from one source.

- IFA mis-selling
- No aggregate policy limits?
- RI aggregation clauses



PI market environment

Threats

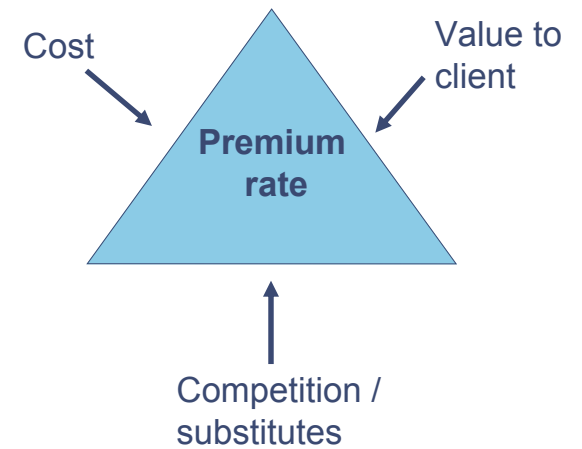
Increasing capacity in the market

Underwriter discipline

Claims inflation

- Solicitors fees
- Property values
- Court award inflation

£140m claim by the F.A. thrown out last week – a high profile award might have produced upwards pressure on rates ahead of September renewals?



Cost / competition

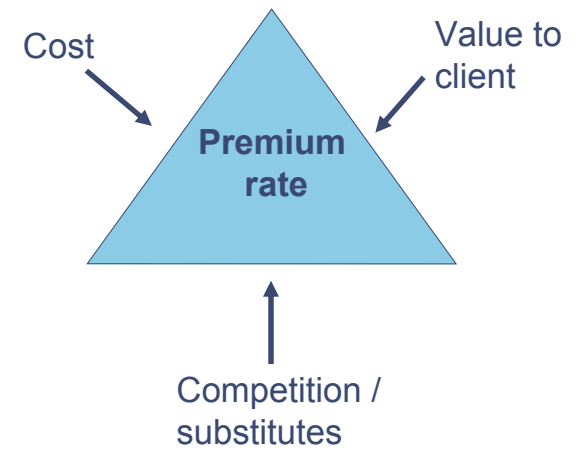
PI market environment

Opportunities

Market growth – increasing penetration

- IT consultancy
- Media / advertising
- PR consultants, travel agents, interior designers....

£140m claim by the F.A. thrown out last week – may deter some negligence claims against solicitors?



Value / competition

Summary

- Are prices going forward going to be sufficient?
 - underwriting cycle
 - cats
- If competition continues, where can margins be improved?

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