Overview on the markets
Premium income PI insurance
UK and Germany

**UK**

- £ mio
- 2001: 1000
- 2002: 1200
- 2003: 1400
- 2004: 1600
- 2005: 1800
- 2006: 2000
- 2007: 2200
- 2008: 2400
- 2009: 2600
- 2010: 2800

**Germany**

- € mio
- 2000: 200
- 2001: 400
- 2002: 600
- 2003: 800
- 2004: 1000
- 2005: 1200
- 2006: 1400
- 2007: 1600
Common trends

- increased demand for PI (compulsory and non-compulsory)
- more detailed definition of duties of care for professions (lawyers, accountants etc.)
- ongoing strong competition
- Higher claims activity in Financial Institutions PI
- Higher claims activity in Commercial PI for certain professions
- jurisprudence tends to raise future PI payouts
- dependancy on evolving legal landscape
- 2009 sets the course for 2010 / 2011 (claims activity/pricing)
How the recession impacts non-life insurers
A recession is not uniformly bad news for non-life insurers
Illustrative Claims Growth by business line

Claims expenditure (estimations)

- **2009**
  - Motor: 0
  - D&O/PI: 7
  - Other Liability: 2
  - Credit & Surety: 0
  - Property: 2

- **2010**
  - Motor: 0
  - D&O/PI: 13
  - Other Liability: 2
  - Credit & Surety: 0
  - Property: 2

- **2011**
  - Motor: 0
  - D&O/PI: 10
  - Other Liability: 5
  - Credit & Surety: 1
  - Property: 2
Impact of severe recession scenario on reinsurance portfolio

- **Workers' Comp.**: Higher number of midsize losses succeeding layoffs and decline in premiums
- **Liability**: Lower investments, fewer quality controls and low cost components in production lead to higher claims
- **D&O and PI**: Increase in loss frequency at early stage of recession, hardening of market with time lag
- **Motor**: Slightly positive effect on loss ratios, but possibly decrease in demand
- **Fire**: Decline in claims due to higher discipline, demand dependent on economy
- **Engineering**: Declining premiums as consequence of reduced activities in building sector; claims ambiguous
- **Accident**: Reduction in premiums, moderate increase of loss ratio due to moral hazard
- **Marine**: Declining premiums due to lower shipping volume possibly moral hazard claims
- **Credit**: Significant increase of losses due to higher default rates; higher rates
- **Aviation**: Demand will decrease due to less passengers
- **Agro**: With stable rates, insured values depending on commodity prices
- **Life**: Reduced volume, higher lapse rates, lower investment results, more suicides and disability claims

Illustrative

**Expected relative impact on premium volume**

- **High**
  - Workers' Comp.
  - D&O, PI
  - Credit
  - Engineering
  - Aviation
  - Accident
  - Life
  - Workers' Comp.
  - Marine
  - Agro
  - Motor
  - Fire

- **Low**

**Expected relative impact on claims**

Close monitoring required for lines with high vulnerability from crisis.
Professional Indemnity - Link to bankruptcies

- Professional indemnity claims depend on the economic cycle / specific claims costs drivers will vary for different types of profession and companies.
- There seems to be a relationship between the number of corporate insolvencies and PI claims as shareholders/creditors often turn to the professional advisors of bankrupt companies in an attempt to be reimbursed.

Estimation of the risk of business bankruptcy
(Index, Germany = 100)

Source: Creditreform, Insolvencies in Europe 2008/2009
Example for an exposed professional group – accountants/auditors

1. Business Bankruptcy
2. Creditors try to get back their money
3. No D&O coverage
4. Liability of accountant?
5. Indication in last financial statements?
6. Lawsuit filing
Implications for Commercial PI (Non-FI):
Exposed professional groups depend on local environment

Examples:

- **Accountants/auditors** > auditing malpractice, false financial statements

- **Lawyers** > due diligences; bankruptcy law

- **Insurance brokers** > placing of a carrier who will later become insolvent
  (remember AON Flex cover, Double A Product aiming to replace an underlying carrier who is in danger of becoming insolvent; brokers try to shift their liability by these products)

- **Real estate related professions:**
  - agents
  - ... surveyors > all types of professions that do assessment
Implications for Commercial PI (Non-FI):
Examples for local crises – surveyors

Hypothesis: Strong link between repossessions and PI LR’s

Repossessions and loss ratio portfolio with surveyors

Source: Munich Re, Impact of the Economic Downturn on Professional Indemnity Insurance in the UK
How Recession affects PI insurance
Increased claims activity will lead to:

- Demand
- Premiums
- Deductibles
- Restricted cover
- Aggregation issues
Aggregation - who & why

- Insureds & Reinsureds: aggregate to avoid multiple deductibles from one event
- Insurers & Reinsurers: aggregate to hit cap on limits for similar claims re same event

Graph:

- XL treaty without aggregation:
  - PI: 1 mio
  - RI: 2 mio

- XL treaty with aggregation:
  - PI: 2 mio
  - RI: 2 mio
Aggregation - Reinsurance

Aggregation: wordings

A certain maximum sum to be paid in respect:

- “any one event”
- “each and every loss arising out of one event”
- “each and every loss and/or occurrence and/or series of losses and/or occurrences arising out of one event”
- “claim or claims arising from one originating cause”
- “any one accident”
- “any one occurrence”
- “any one claim or number of claims arising out of the same occurrence”
Challenges for Reinsurance
Reinsurance: Challenges

Munich Re Analysis - Impact of severe recession scenario on reinsurance portfolio

Munich Re Board Decision - Managing D&O and PI in times of deep recession: quantification, worst-case scenarios, cross-balance sheet accumulations and correlations

Current Economic Environment:

Severity of the financial market crisis, impact of recession, threat of depression, low interest rates, late reporting, ongoing write-offs, insolvencies, liquidity crunch, …

At present, considerable uncertainty about modeling losses, determining technically appropriate rates, profitability in the mid-term for Financial Lines, significant risk of loss.
Reinsurance: Responses

- Reduction of Financial Lines book
- In particular scrutiny on Financial Institutions business
- Implementation of rate-change and exposure-change monitoring, both for direct and reinsurance markets
- Regular reporting to Munich Re Board of Management
- Highest underwriting standards, no leeway for deviations
- Emphasis on claims handling
- Portfolio transparency, identification of high-hazard segments
Thank you very much for your attention!

Rita Müller
rmueller@munichre.com