October Renewal

A reflection on the season just past.

Since the abolishment of the Solicitors Indemnity Fund, the October PII renewal season has always been a challenge. Many law practices have had fluctuations in premium, but it has been a number of years since a renewal season has had such a significant financial impact on the Legal Profession of England and Wales.

Despite the freedom of renewal date, there are still two main renewal periods; one is in the Spring and the other, in the late Summer that we have just experienced. The season just past, resulted in a vast number of practices paying more for their insurances.

However, some practices will have bucked this trend and their premium remained unchanged whilst other practices may well have even paid less this year. Those practices unimpeached by the market will have been quite few and far between.

We have found that more practices are falling into the EIP than ever before. When analysing the new business enquiries seen following the 1st October renewal there seem to be a plethora of reasons for this, including; Insurer exits, a change in risk appetite from participating Insurers, but also worryingly, because many practices are simply leaving their insurances to the last minute.

The purpose of the article is to provide you with a greater understanding of what happened during the recent Solicitors renewal season and some reasons or rationale as to why. Prior to reflecting on what we saw during the season, it is important to contextualise the market conditions first and then provide a detailed summary of what we experienced.

Market Conditions

The PII market has been incredibly competitive for a number of years, awash with capital finding its way into the insurance market resulting in an increased appetite and hunger from insurers' often looking to achieve top line growth.

Whilst the claims environment was previously quite benign, this would seem perfectly logical. The problem is that Professional Indemnity is long tail liability insurance, meaning it can take months but more often years before claims crystallise and as such, insurers will not know for a substantial period of time (multiple years) to establish whether they have turned a profit in any given year.

With an increase in both claims frequency and severity impacting Insurers, a change in market conditions were obvious, however, no one could quite predict when this would come. A key catalyst for the change in market conditions was the 2018 Lloyd's of London review, where the published results painted quite a dim picture of the Professional Indemnity Marketplace.

The review highlighted significant losses within Lloyd's, with losses reporting to be in excess of £500M with numerous known claims yet to crystallise, indicating a figure in excess of half a billion pounds.

Lloyd's took dramatic steps, forcing those syndicates operating within its framework to make significant changes to their business plans with the hope to return this class to profitability. It is true, that some syndicates did not have to change much, or even at all.

Whereas other Syndicates had to change quite dramatically. This limited the amount of business they could write and those Syndicates where the change was too great were forced to close or made the decision not to continue in the class.

Lloyd's doesn't operate in a bubble, Insurers and Syndicates operating inside of Lloyd's compete on a daily basis with those Insurers outside of it. Therefore, if the results of Lloyd's are poor then it is quite feasible for the results outside of Lloyd's to also share similar characteristics.

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The attention caused by the Lloyd's results and well publicised remedial action seemed to create a greater focus on underwriting performance across the insurance market. Insurers were looking to review their portfolio in greater detail, including review of their risk exposures which naturally has led to a change in appetite for business from certain Insurers along with some insurer casualties too.

Looking specifically at the Legal Profession of England and Wales, we have seen a steady rise in the frequency of claims whereas severity of claims has increased dramatically. With the number of claims breaching the compulsory primary layer of insurance and impacting on the layers of insurance above reaching unprecedented levels.

Annually, there has always been a minority of claims that have impacted on the layers above the compulsory primary limit of indemnity, however, we have never seen such a volume of losses since the open market began in the year 2000. To think just over a year ago, the SRA were consulting on reducing the mandatory limit of cover for practices too.

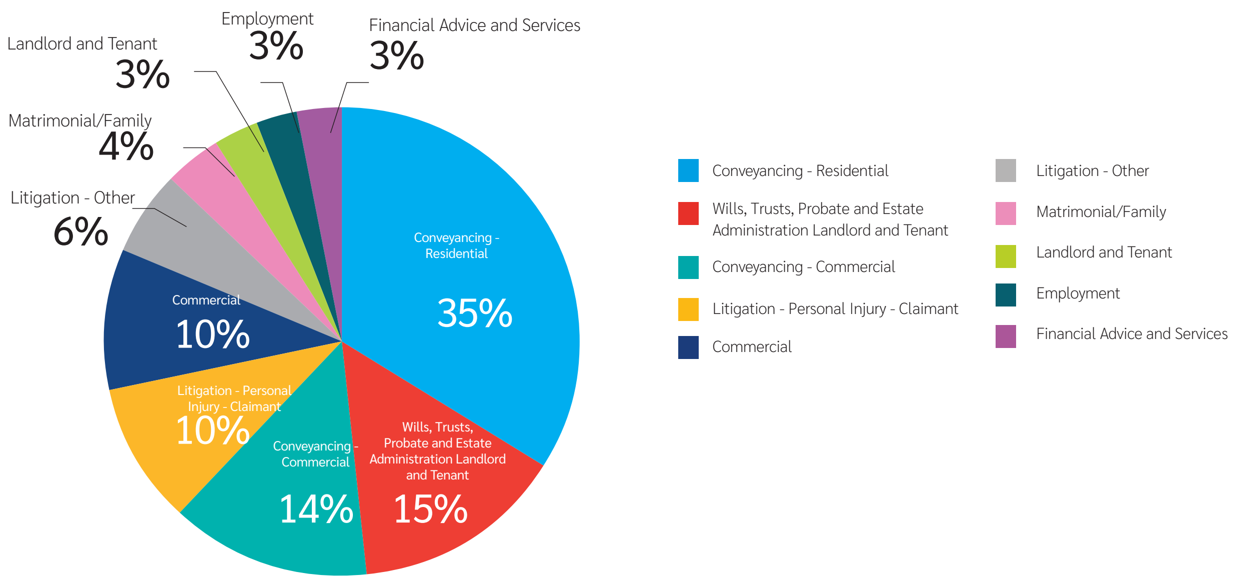
In terms of claims and where they are emanating from, no practice area seem to be immune from claims activity. We have seen claims materialise from almost all practice areas, even those that are traditionally considered to be 'low risk' areas.

The largest losses experienced by the profession have come from multiple areas of practice but most notably from Commercial and Conveyance work. Conveyance work includes both residential and commercial – traditional conveyance matters, depositor funded developments and break clauses in relation to Commercial conveyance work.

Probate claims have become increasingly costly too, with contentious Probate being a growth area for a number of practices, this stands to reason. Cyber related claims remain particularly prevalent and costly too, as do claims emanating from Pension Trustee work. If solicitors get this area wrong then the claims can be vast in nature.

This chart summarises claims frequency against the profession since 2012.

Total Notified in Last 6 Years



In light of the claims environment, considering the breadth of coverage afforded under the Minimum Terms and Conditions, it is quite understandable why co-insurance is becoming increasingly common, as Insurers look to reduce any potential volatility in their portfolio by sharing both risk and reward.

This has been the case for some larger practices for some time and now it has become more common for smaller practices too. This is particularly true if a practice is involved in complex areas or are involved in high value transactions or if they undertake work for Large PLCs or global enterprises and Ultra High Net worth individuals.

The market for the additional layer of insurance experienced further rate increases, this is in part due to the claims environment but also through a distinct lack of choice. This led to very few willing insurers wishing to deploy their capital at the first attachment point above the compulsory limit of Indemnity.

This may be driven by Insurers' actuaries looking at claims performance or this could have been forced upon them as a requirement under their reinsurance treaty. This effectively does not permit insurers to attach below a certain level, a common minimum attachment point appears to be £10m, due to the claims activity in the first excess layer above the compulsory limit.

Underwriters are traditionally quite inquisitive characters, in light of the market conditions, even more questions were frequently being posed than perhaps they have been in recent years. This also included excess layer Insurers who required a lot more information than they have ever requested before.

Short proposal forms were not ideal unless they were accompanied with a covering note about a practice, therefore giving insurers some insight into - who they are, what work they do and who they do the work for etc. along with some consideration as to how they manage the risks associated with their chosen areas of practice.

Insurers were generally holding firm on rate. In recent times economies of scale were often achieved when a firm had experienced fee growth. Discounts would be applied so the overall premium may not have changed whereby for many Insurers, if fees had grown by 10% the proposed premium would often increase in line with the growth and therefore increase by 10%.

It is widely believed that market conditions will toughen further before they get better, only time will tell if this comes to fruition. As such, Insurers were often charging an additional premium to provide an extended period of insurance.

In the recent past, some insurers even incentivised practices to take longer term deals whereas this year, they either would not offer any long-term arrangement or they were charging practices for the privilege to lock in for longer periods. Just as you may agree to if you were looking to fix a rate for a longer period of time on your mortgage.

Reflection and analysis of the season

To provide you with an idea of the data sample that we have used in preparation for this article, during this period alone we have placed 701 practices PI Insurance, introducing £39,014,372 Gross Written Premium (GWP) to 15 different leading compulsory primary insurers.

Providing our clients with choice of Insurer regardless of the size or profile of a practice, helps us maintain very high client retention rates where over 97% of our clients continue to renew with us.

Evidencing the choices that we provide to our renewal accounts, during this period we have placed PII Policies across 15 different primary Insurers, however this is reduced in number for the new business accounts that we are now proud to represent. As these placements were with 10 of those 15 Insurers, this perhaps is further evidence that some Insurers had a reduced appetite for growing their portfolios during this period.

When reviewing the statistics that are contained below, it is important to note that each practices' risk profile may change during the policy period so when we reflect on what we saw during the season we are not comparing like for like scenarios.

Fees can fluctuate, new partners may have joined, others may have exited and additional practice areas could now be worked upon or existing practices areas could have increased or decreased during the period. What is a fact is that unless a practice has elected run-off and therefore parks their historic risk exposure, their tail of liability increases.

We are looking at providing some generic information on the profession whilst also drilling down a little further into providing information specific analysis on size segmentation too.

Fee income

From our renewal client base that renewed during this period, we saw on average that fees had grown by 7.5%. The partner size segment that experienced the largest growth in percentage terms was 11-25 partners at 11.3%. This was followed by 4-5 partner practices at 8.9% and the largest practices (those that have in excess of 26 partners), growing on average by 8.6%.

Primary Rate

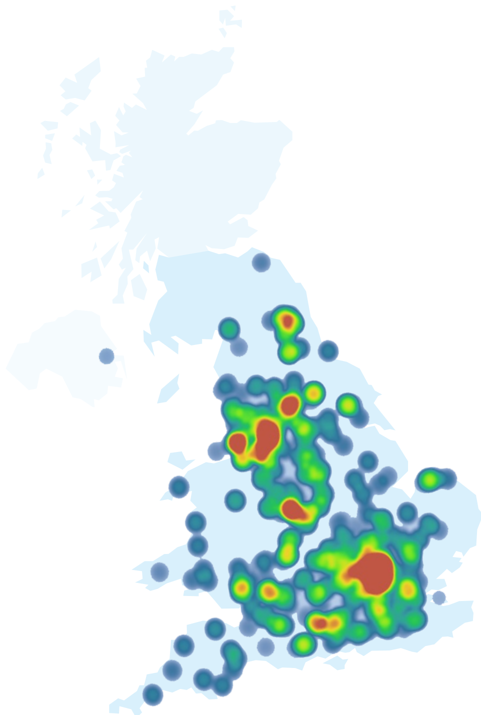
Excluding anomalies such as relatively new practices that could have experienced exponential growth during the last policy period, and those practices that have significantly altered their risk profile along with the practice areas they undertake, the average rate increase for the primary limit of indemnity was **9.5%**.

The worst impacted practices were based in the North West of England from a rate perspective.

By the rates increasing, this impacted on the actual insurance cost, by on average 22.7%. With actual premiums rising the most in London, closely followed by the North West again.

The rest of the country was closer to 15%, however, these two regions averaged closer to 30% which brought the overall average up due to the volume of practices in these two areas of the country.

Heat Map of a Geography of PII Cost



The Working Layer – First excess layer above the compulsory Primary Limit

Pricing for the working layer – which is the first excess layer above the compulsory primary coverage witnessed the most dramatic increase with the average rate increasing by 47.3%.

Some practices would have experienced a more significant rise than this due to the minimum premiums increased for this layer of insurance. The worse affected pricing change was experienced by larger commercial practices based in London, but also commercial and conveyance practices across England and Wales too.

Capacity is incredibly limited in the first excess layer of insurance, with very few willing participants due to the modest costs involved. Whilst the rate increases are of course difficult to accept, the pricing for additional millions of insurance for the Legal Profession of England and Wales is still considerably cheaper than the cost for such insurance that is experienced by other professional service practices. Those within the construction industry experience the highest of all costs for the same additional coverage.

For the layer above the £10m

For those practices purchasing insurance above £10m we saw premiums increase on average by 6%. This would have been more for those smaller practices as the insurers applied a gradient to their pricing that was steeper for the first £25m and would have tapered off for higher limits of indemnity and then this plateaued.

For some of the largest practices in the country that buy hundreds of millions of cover, as Insurance capacity dries up, the cost of additional cover rises.

Policy Durations

Just over 13% of the clients that we represent took an extended period of insurance, with a little over 86% of the clients that we represent taking a 12-month option.

When we compare this with the April renewal season, this was a 48% reduction, as during the April period around 25% of practices took extended terms. This was a similar number to October 2018, when 23% of practices took longer terms.

The reason for the decline in practice taking a long period could have been due to the additional cost applied at renewal, along with the loading of the premium if a practice wanted a longer term option.

Primarily however, we believe the drop in longer policy periods was due to a reduced willingness form insurers to offer the longer terms, largely due to limits imposed on them in respect of their total premium capacity.

Continuity of Insurer

As highlighted above, our renewal retention rates are testament to the fact that we look to provide our clients with choices. Despite an array of choice 92.1% maintained continuity of Insurers during this period. Looking specifically at 7.9% of our clients who elected to switch insurers, having reviewed these placements and the reasons for this, it was mainly due to a change in an insurers risk appetite resulting in some price differentiation.

Timing of Renewals

Due to the prevailing market conditions, the process for renewals was slower than in previous years, with insurers asking more questions whilst also undertaking their own due diligence beyond reviewing the presentation that practices prepared for them.

In light of this, we encouraged practices to provide presentations in good time, recommending these should be in with us no later than 6 weeks prior to the renewal date. Despite this recommendation we still saw a vast number of presentations coming in late in the day with some proposal form declarations being signed with less than a week to go prior to their renewal date.

Premium capacity levels were an issue for some insurers so this delay may have resulted in those practices having fewer options.

Forewarned is forearmed

For those practices that renew outside of the traditional renewal period, it's important to take stock of what has happened during the October season and to not make the same mistakes as some of your peers. It is widely believed that the Insurance market will continue to toughen before it gets any easier so it is imperative that we act in good time to navigate the challenges ahead.

We recommend that you speak with your Lockton representatives now to establish a plan of action so that we can begin preparations earlier than perhaps you may have done so before.

Six weeks prior to the renewal date should be the absolute minimum time period that you have your presentations ready for insurers consideration in order to avoid unnecessary issues and pressures. If your risk profile has changed significantly or you have experienced claims, then we would recommend that you provide even more time.

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