Spring Renewal

A reflection of the season just past

Whilst the world adapts to a new norm in light of Covid-19, the PII market faced its own set of challenges that in-part, rose from the virus and other factors. To reflect on the season past, we provide commentary into what happened during the spring renewal period, a review of the data that we have gathered from over 500 practices and guidance on how to navigate the challenges ahead.

Firstly, I hope that you are all safe and well during these extraordinary times. Despite being several weeks into the Covid-19 lockdown, life still seems very strange. I am not sure I will ever get used to having my two-year-old son, Alfie, joining some of our Zoom team meetings or springing up from nowhere and demanding attention while I am on an important client call.

What has become clear from speaking to numerous clients across the country is that the pandemic has paused large amounts of activity for many legal practices. This is particularly the case in Conveyance and Commercial practice areas, although there has been significantly increased demand in other practice areas like Matrimonial, Wills and Probate work.

However, regardless of your practices' unique circumstances and the impact Covid-19 is having on your business, it remains the case that every Regulated Practice in England and Wales is legally obliged to hold Professional Indemnity Insurance.

Private legal practices regulated by the Solicitors Regulation Authority (SRA) are permitted to renew their insurances at any time during the year. Despite this freedom, there continues to be two peak policy periods: the first at the end of the summer (normally around 1st October) and the second at the beginning of spring, around March and April.

The reason for these two popular renewal windows is largely due to the previously compulsory renewal date being 1st October, coupled with the 18-month maximum period of insurance that is generally permitted by the Insurers' Reinsurance treaties. This has resulted in practices continuously purchasing either a 12 or extended 18-month policy.

Naturally, all practices' Professional Indemnity Insurance (PII) spend will be dependent on their own characteristics and on different factors, such as location, turnover, staff number, work profile, claims record and internal approach to risk management

The aim of this article is to provide:

- Insight into what happened in the insurance market during the spring renewal period, with a focus on three main points in terms of Pricing, Claims and Underwriting scrutiny
- Statistics to support what happened during the spring renewal period
- Commentary on what to expect in the near future and guidance on how to navigate the challenges ahead

Insight into the Solicitors PII Market During the Spring Renewal

In my November report on the October 2019 renewal season, I highlighted that the PII market was a challenging environment and that many practices were paying more for their insurance. This trend of increased premiums continued into the spring renewal season.

However, just like in October 2019, some practices had a different experience and saw their PII premiums remain unchanged, with a minority actually saving money on their annual PII spend.

Those practices that purchase coverage above the compulsory primary limit of indemnity would have seen the cost of the working layer (the first excess layer above the compulsory primary limit of indemnity up to £10m) rise significantly. This increase was primarily driven by both a lack of insurer competition and increased claims activity within this layer in recent years.

A basic principle of insurance is that the premiums received from the many pay for the claims of the few. Over the last few years this principle has been tested within the solicitors PII market. Claims previously made by the few are now being made by a larger number within the profession and they are of even greater value (severity) than before.

This claims activity is having a negative impact and has served as a catalyst for creating the prevailing difficult insurance market conditions experienced by many practices. The vast majority of insurers have been applying actuarially-driven rate increases for the areas that have been generating the inflated claims, which have resulted in premiums becoming more expensive.

Increased claims activity naturally influences insurers' risk appetite and leads many to refine their strategy accordingly. It appears that no practice area is immune from claims, but some clearly have a higher frequency and others have a much greater severity of claim. While we have seen only a gradual rise in frequency of claim, the severity of claims continues to increase to unprecedented levels.

In light of this increase in claims severity, we experienced further demands and requests from insurers to share in both the risk of claims and the reward of the premium, with many advocating Co-insurance.

Co-Insurance is where two or more insurers participate on a placement, each sharing a defined percentage of the risk for the same defined percentage of the premium. Although common in the insurance market, this approach has not been regularly used for Solicitors PII despite the breadth of coverage afforded under the SRA's Minimum Terms and Conditions.

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However, this is a changing trend. When you consider that the insurers who underwrite the compulsory primary limit are putting at risk £2m or £3m of their company's funds on an any one claim basis, a Co-insurance approach would appear logical.

It is widely believed among stakeholders in the PII insurance market that the current environment will get tougher before it gets easier. This view was perhaps reinforced most clearly by the fact that we witnessed a further reduction in the availability of longer term policies. Historically, a number of insurers would actually incentivise policy holders to accept policies longer than 12 months, or they would present terms on a straight pro-rata basis.

The demand for longer policies was driven by clients and their brokers against the backdrop of a competitive pricing environment. However, the spring renewal window saw almost all insurers charging policy holders for the privilege of having extended policy periods, with some insurers no longer offering any longer policy periods at all.

The additional cost applied by insurers varied quite considerably with some actively discouraging longer-term policies through their proposed pricing. Very few primary insurers offered pro-rata and premiums for the additional period, and premiums were loaded up to 30.7%, with the average additional premium being charged a little less than 10%.

We also saw that Insurers who were providing capacity in the working layer charged on average an additional c.67% above the standard pro-rata, for the longer policy period.

For firms that purchased limits above £10m, insurers charged on average c.38% more for the additional period above the standard pro-rata. A key reason for these excess layer increases was most likely due to a lack of competing capacity. The claims inflation experienced by PII insurers resulted in the current environment where there was no new insurer capacity entering the solicitors market this year.

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Each year brings changing appetites from certain insurers and, as a result, some practices have to source a new insurer partner, while others have to actively seek a new partner because of dissatisfaction with the incumbent's service. In addition to these two common triggers for change, the last 18 months have seen a greater number of practices without an insurer due to the lack of participant insurers.

For example, two Managing General Agencies (Maven and Omnyy), who wrote on behalf of Lloyd's of London Participating Insurers, exited the marketplace in 2019 after they both implemented an aggressive growth and pricing strategy at previous renewals. However, a number of their policy holders were coming to the end of their extended policy periods during the spring renewal period, which meant that hundreds of practices were seeking a new insurer.

The tougher insurance market environment has led to more questions being posed. Underwriters who were already inquisitive were posing even more questions to get a greater understanding and comfort about practices before they deployed their company's capital. Also, in light of heightened controls at many insurers with peer reviews taking place among underwriters, the list of additional questions raised could be significant.

The financial viability of a practice, what that practice does and how best to manage the risk associated with those practice areas were key focuses for insurers. Insurers seek to deploy their capital on well run businesses and, due to increases in claims severity, the most prudent underwriters were on alert, asking more questions and simply declining opportunities if they were poorly presented.

Additional questions did not just come from compulsory primary Participating Insurers. For the first time since the abolishment of the Solicitors Indemnity Fund in 2000, leading excess layer insurers introduced a specific questionnaire rather than just posing the odd question.

This new questionnaire ran to seven pages and included 18 questions that had to be answered. The first nine questions were focused on specific types and values of work undertaken within the practice, along with a focus on the practice's financial controls.

Question 10 asked for details on the Cyber Policy that practices have in place, although it didn't ask whether the practice had actually purchased one. The remaining eight questions only applied to practices undertaking Commercial and / or Residential Conveyance.

With an increase in questions and new forms being introduced, this naturally had the effect of slowing down the entire renewal process. Matters were made worse by the fact that many firms wish to explore options at renewal and hundreds of practices were having to seek a new insurer. All of this happened before the Covid-19 lockdown, so the situation became even more chaotic in the final weeks leading up to 1st April once lockdown had been implemented.

In early March, before the stricter measures were introduced by the Government, many insurers across the London market began to encourage their underwriting teams to work remotely. Covid-19 questions were being introduced and risk appetites for business were being refined as underwriters became increasingly cautious, particularly to any practice with Property exposures. Reviewing the financial strength of a practice had become an even more important part of the underwriting process.

On Friday 13th March, Lloyd's of London shut its underwriting floors for the first time in its 330 year history to test out its emergency protocols. A week later, the insurance market was almost entirely working remotely. While some underwriters worked very efficiently and service levels remained unchanged, others didn't do so well and service levels dipped considerably.

Once the Government's lockdown measures were implemented, a practice's financial resilience became even more important to insurers. This resulted in the traditionally "late shoppers", specifically those with Conveyance exposures, experiencing difficulties sourcing coverage at all.

In some instances, these practices did not have all of the required information as they left it too late. This resulted in a second peak renewal period, with multiple practices falling into the Extended Policy Period (EPP). Most practices which inadvertently found themselves in the EPP have been able to find cover, but we expect given the present market conditions that some may fall into the cessation period this year and sadly may be forced to close their business.

The SRA recently introduced a waiver of the rules to permit Insures some flexibility of granting an extension to these specific periods in extreme circumstances. It will be interesting to see if Insurers will exercise such an option in the coming months.

Statistics to Support What Happened During the Spring Renewal

Our data sample comes from placing more than 500 practices in March and April 2020. In this period, we introduced over £42m of gross written premium to 16 leading compulsory primary insurers. When reviewing the statistics below, it is important to note that each firm's risk profile may change or alter during a policy period. This is so when we reflect on what we experienced during this renewal period, we are not comparing like-for-like scenarios.

Fees can fluctuate, new partners may have joined, others may have exited, additional practice areas could be added and existing practice areas may have increased or decreased during the period. The overriding fact is that, unless a practice has elected run off and therefore parked their historic risk exposure, their tail of liability increases and the likelihood of claims greater.

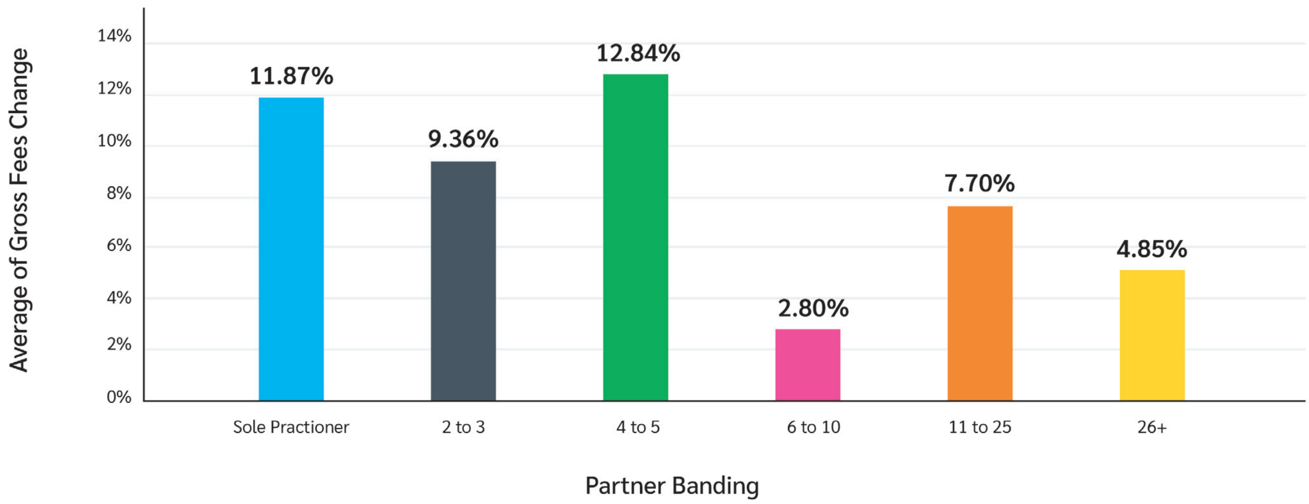
Please note, it is important to also appreciate that the statistics below do not include a small number of insureds who took the decision to place business with insurers that adopted aggressive underwriting pricing strategies and have since exited the marketplace. Including these firms would have provided a distorted picture.

Fee Income

Our clients that renewed during this period recorded on average an increase to their fee income of 9.56%. The size segment that experienced the largest growth in percentage terms was 4-5 partner firms at an average rate of 12.84%, followed very closely by sole practitioners at 11.87%.

11-25 partner firms grew on average by 7.7% and the largest practices (those that have in excess of 26 partners) grew on average by 4.85%, whereas 6-10 partners remained relatively flat year-on- year.

Fee Growth by Partner Banding



Primary Layer

Rate increases were experienced by many. Excluding anomalies such as relatively new practices that could have experienced exponential growth during the last policy period as well as those 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 15.06%.

Surprisingly, non-Conveyance practices saw the higher increase of 17.89% against an average of 12.31% for practices with Conveyance. It is important to note that the starting rate position is naturally much higher for those practices with Conveyance so there is already a significant delta between them. 6-10 partner practices experienced the highest rate movement at 33.87%, with 4-5 partner practices experiencing the lowest rate increases of 10.21%.

The Working Layer (up to £10m)

Just like in October, the pricing for the working layer (the first excess layer above the compulsory primary coverage) experienced the most dramatic increase with an average rate rise of 75.64% compared to October, when rates had increased by 47%. Furthermore, in stark contrast to the results identified for the compulsory primary layer, practices with property exposure felt the greater rate increase than those without.

This resulted in an average premium increase of 78%, which was a 87.62% rate increase for practices with Conveyance exposure and a 37.88% increase for those without.

The Layer Above £10m

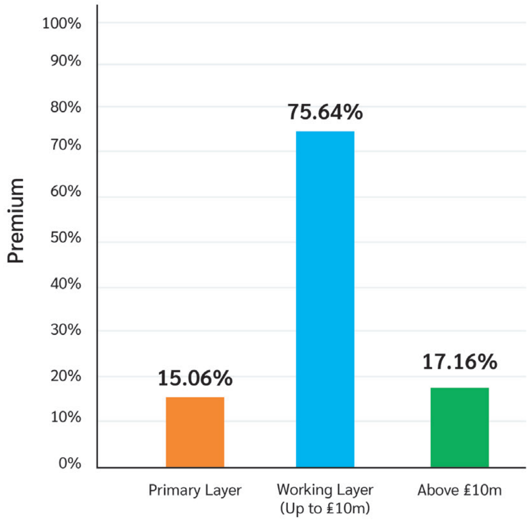
For those practices purchasing insurance above £10m and up to £50m, we saw premiums rise by 17.16% on average. The cost per million of coverage was less for practices of 5 or less partners. Practices of 26 or more partners experienced the greatest increase of 20.84%. As insurance capacity dries up, the cost of additional cover rises for the largest practices who buy hundreds of millions of pounds worth of cover.

Policy Duration

As highlighted above, many insurers were charging for the privilege of extended policy periods. This did not deter 18.5% of our clients that we placed during this period from electing for a longer term policy period.

This is a 26% reduction in policy holders electing longer term deals compared to this time last year. We believe this drop in longer policy periods was due to a reduced willingness on the part of insurers to offer them, rather than the fact insurers were charging for the privilege.

Average Premium Rate Increases Based on Layer



Continuity of Insurer

We placed our clients with 16 different Participating Insurers. This extensive market access helps us maintain our exceptional client retention rate above 97%.

Despite the array of choice that we can present to our clients, 93% stuck with their existing insurer during this period, up from 92% in October. Those clients that switched insurer did so mainly due to a change in an insurer's risk appetite, resulting in a favourable price differentiation in some instances.

New Clients

We were delighted to welcome close to 100 new clients during the spring renewal period. These clients were placed with 13 different leading participating primary insurers, which demonstrates there was still a large volume of insurers active in the market at this time despite the prevailing insurance market conditions.

Looking in to the Crystal Ball – What to Expect

Regardless of when we are out of lockdown, in partial lockdown or even if we have returned to some level of the "old normal", we do not anticipate the insurance market conditions to have improved by October. In fact, they could well be worse.

These anticipated challenging market conditions could put a greater strain on some practices financially, particularly those that have paused activity. Expect to answer Covid-19 related questions, such as describing what actions you took as a practice and how you supervised associates and partners to work remotely. Expect greater scrutiny of your financials.

Three Tips on How to Navigate the Challenges Ahead

1. **Start early.** The insurance market conditions will NOT be any easier come October. That does not mean premiums will rise for all, it will depend upon your unique circumstances. Insurer China Re exited the marketplace, but we understand that it still has a volume of policy holders who will need to find a new insurer during this renewal period. This means more practices will be vying for underwriters' time.

2. **Prepare a quality presentation** for insurers' consideration to help you stand out from the crowd.

3. **Select your representative carefully** and do not approach multiple agents as you will actually be doing your professional peers a disservice. Scattering your application across the market will slow things down even more. Not only will this reflect poorly on you, but it will also make it more difficult for you and your peers to source coverage in a timely fashion.

You may wish to consider the following when selecting your representative:

- Their expertise.
- Size of their team.
- What is their claims infrastructure? While no one wants to have claims, you should know your representative has the resources to support you in your hour of need.
- Market reach - which insurers do they have DIRECT access to? This is an important consideration in the event of claims but also to ensure you have open lines of communication so that your message does not get diluted or misinterpreted.

Once you have selected your representative, establish an action plan with your broker that covers who they will be approaching directly and a timeline for responses.

If you would like to discuss how Lockton could assist your practice, please do not hesitate to contact myself or a member of our dedicated Solicitors team. We look forward to hearing from you and, in the meantime, please stay safe.

For more information please contact:

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