The Art of Underwriting:

A guide to understanding how insurers price for your practice

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A fundamental of insurance is that "the premiums of the many, pay for the claims of the few." This means that all firms can and will be impacted by claims experienced by their professional peers.

This is not in the same way that you would experience under a mutual, but it will have an overall bearing upon the premium charged for your professional insurances by insurers.

It is important to appreciate that Solicitors PII is a difficult class of insurance, some may even describe as a volatile due to the breath of coverage afforded under the SRA's Solicitors Minimum Terms.

The main body of the SRA Minimum Terms and Conditions policy is identical across all participating insurers, so what makes them different?

Insurers can only differentiate their offering on a small number of factors; these include their run off rate calculation, their security rating, claims handling function, and the premium they are willing to charge to deploy their capital along with their general appetite for business e.g. the size and profile of practice that they are willing to write. Finally, any value added services that they may provide or policy enhancements that they make available.

Depending on your unique circumstances, these differences may have more weight in your consideration of who is the appropriate insurer for your practice, but no doubt whatever your circumstance the premium charged will have some bearing on your decision.

How does the underwriter get to their proposed premium?

There are two important and very different functions undertaken at an insurer, there is the actuary whom will mine data to establish pricing, then there is the function of the underwriter. The actuaries' role is more empirical whereas the underwriter is the more human element; they will have the authority to deviate from the actuary's suggested pricing within agreed threshold after undertaking their risk assessment.

The role of the Actuary

Every insurer will employ actuaries that review their pricing based upon their own claims experience to establish a base rate to be applied to each area of law that is undertaken. This will help the underwriting team determine what type of firm will meet with their general appetite for business along with providing them with a base price to charge, based upon the areas of practice undertaken.

An established insurer will have underwritten GBP billions in legal fees, and paid out GBP millions in claims. This claims data will be matched against the areas of practice undertaken by practices to help establish benchmark pricing. This data will show that certain areas of law, such as conveyance can be multiple times more expensive to insure than other lower risk areas of practice.

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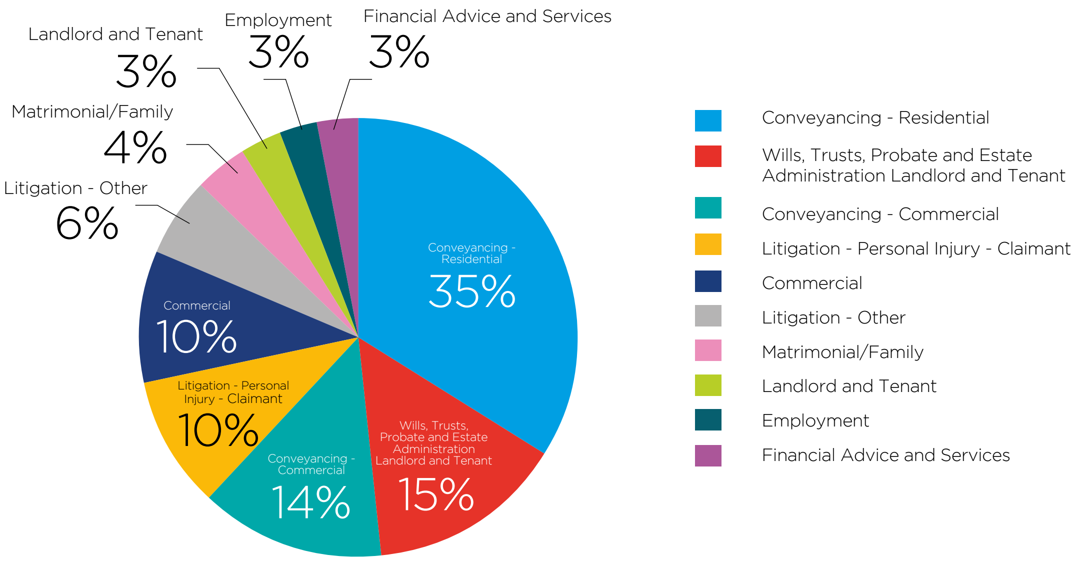
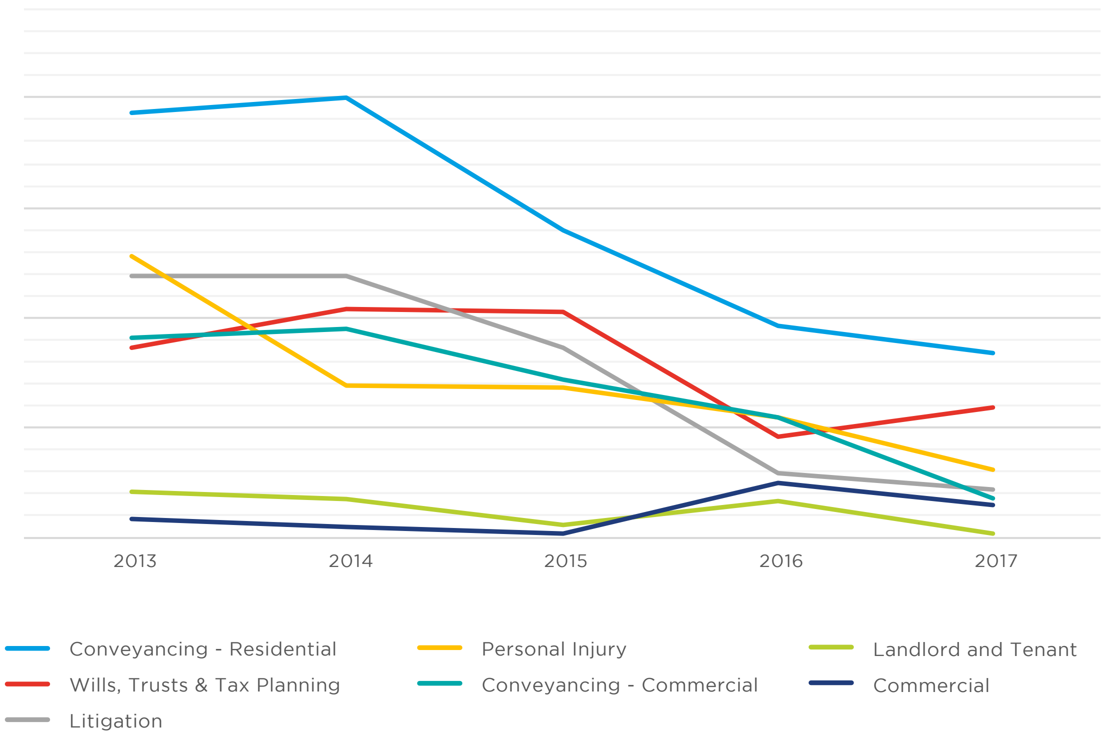
We have seen a consistent pattern in terms of work types that have commonly caused claims. This chart summarises claims frequency against the profession since 2012.

Total Notified in Last 6 Years



Claim Trends - Last 5 Years



HIGH/VERY HIGH	• Commercial - Excluding Public • Commercial- Public Companies	• Conveyancing - Commercial • Conveyancing - Residential
HIGH	• All Other Litigious Work • Commercial Litigation • Estate Agency, Property Valuation and Property Management • Financial Advice and Services regulated by the Financial Services Authority • Marine Litigation	• Financial Advice and Services regulated by the SRA • Intellectual Property including Patent, Trademark and Copyright • Probate, Wills and Estate Administration • Trusts
MEDIUM/HIGH	• Landlord/Tenant (Litigious) • Landlord/Tenant (Non Litigious)	• Personal Injury - Claimant • Tax Planning
MEDIUM	• Defendent Litigation (Insurers) • Employment (Litigious) • Employment (Non Litigious)	• Matrimonial • Personal Injury - Defendant • Town & Country Planning
LOW MEDIUM	• All Other Non-Litigious Work	
LOW	• Adjudication /Arbitration/ Mediation • Agency Advocacy • Childrens Work, Mental Health Tribunal and Welfare	• Criminal • Debt Collection • Immigration • Offices & Appointments

Categories of Risk

The risk rankings will differ from insurer to insurer, however we have provided below an aggregated view from each of the participating insurers due to the claims that they have experienced.

It is important to note that wills are likely to move up the risk ranking due to an increased volume of claims emanating from this area of practice.

The next stage of the process would be for the actuaries to factor in their desired minimum premium. A minimum premium is what an insurer is willing (or allowed) to deploy their companies capital. This helps to ensure that they have the appropriate reserves and resources in place in the event of claims materialising.

Actuarial analysis

The factors that will influence the actuaries' rates will include:

- Areas of practice undertaken
- Gross Fees (hey may apply size discounts due to economies of scale)
- Claims experience
- Circumstances notified
- Self-insured retention (The policy excess that you are willing to bear)

Whilst the greatest impact on the actuaries proposed pricing would be, their claims and notification experience there may also be an element of forecast and prediction influenced by the following factors:

- Social
- Economic
- Legislation
- Regulation

the actuaries work this will provide the general appetite of the insurer, which could be defined by:

- Size of firm (normally determined in Partner/ Director size segments, however on occasion based upon fee income bandings)
- Profile of firm – to include the work undertaken or specifically how much of certain areas of work are undertaken

Once the actuaries have provided the underwriting team with their pricing mechanisms, often delivered through an underwriting or pricing platform. The underwriter will then look to undertake their own risk assessment based upon the individual characteristics of a practice.

Underwriters risk assessment:

There are four key considerations; we refer to as 'hard factors', when an underwriter undertakes their risk assessment:

1. **Activity profile** – Underwriters will review the work disciplines undertaken and how much of this work is undertaken. They will look at the percentages of each category of work, which are filtered into 'low, medium and high' risk categories following the work of actuaries.
2. **Client base** – Underwriters will look at who you are undertaking the work for. The reason for this is that not all of your clients will be considered as identical in their risk profile by the underwriter, despite the work undertaken being classified the same. If you have a particular niche or area of expertise specialism, underwriters may take a further interest in this.

Examples:

Acting for Ultra High Network clients may be perceived a greater risk than acting for the general public.

Acting for a PLC's would be a greater perceived risk when compared to a firm that is acting on for SMEs.

3. **Claims -** naturally previous claims experience will have an impact on the proposed terms. Insurers will consider the following factors:
   - Severity and/or frequency of claims experienced
   - Frequency and volume of notifications experienced
   - Types of error experienced was this a failure of process, repeated similar errors or a unique claim with unfortunate circumstances
   - Are claims outside of the declared client profile? Have these resulted from legacy issues; if so have these issues been ring-fenced? Or has sufficient time elapsed to enable the underwriter to ignore them?
   - They will also consider if you have had any issues with the regulator

All of these factors are linked to how your practice implements risk management and the steps you have taken to prevent a similar situation happening again. If this was a 'one-off' occurrence, demonstrate this to the underwriter.

New claims experienced by insurers can alter rates and quite often create new question sets for practices to answer. After the most recent recession we had new questions about subprime mortgages, and more recently, additional questions have been related to investment schemes along with escalating ground rents.

4. **Risk management** – this is the last key consideration an underwriter will look at, and arguably the most important. They will look at the specific procedures adopted within your practice, which could include:

    - Who is responsible for risk management within the firm?
    - Is there a clear Risk Management plan in place?

This may include:

- Does the firm have a clear policy on what work it will, and will not do?
- What case management system is utilised and is this used across the practice or just in specific areas.
- What is the supervision and systems of control in place for specific areas of practice
- Has the firm made investment in its IT resources, technology and Cyber Security

Does the firm seek to assess the client's experience after providing a service?

Other factors that an underwriter could consider when evaluating a practice may include:

- Staff and partner numbers:
    - Staff to partner ratio. This could include qualified staff to non-qualified to ensure that there is sufficient supervision in place
- Fee income:
    - Does this fee income support the staff numbers or is there the appropriate number of staff to handle the volume of work undertaken by a practice
- Age of firm to include:
    - Experience of your staff
    - Your areas of practice along with change – have you been undertaking a similar profile of work for a period of time?
    - Succession planning
    - Is the firm striving to stay relevant in their market, investing in the business or is it in decline – is there a new energy? With new ideas being generated from the management team
- Prior practices and their claims experience:
    - Reasons for any recent mergers/acquisitions
    - They may also request details on what due diligence was undertaken prior to assuming their past liabilities
- Any significant forthcoming changes to the business

Soft Factors

The insurers will also consider the 'soft' considerations about a practice. This could include:

- The history of the practice, how you got to where you are today, has this been through organic growth, through acquisition or a combination of the two.
- What is the culture of the practice?
- What are the accomplishments of the firm including that of your individual staff members?
- How does the firm operate on a day-to-day basis?
    - This may also include factors such as the office or team lay out within
- Financial incentives, for example are bonuses in place for hitting targets? If so, are these for fees billed or are these customer satisfaction driven?
- Approach and awareness of risk:
    - How changes are implemented - this could be after a claim has been experienced or more generally to improve efficiencies along with your customer experience

An underwriter will evaluate both the 'hard facts' with the 'soft facts' with both carrying equal weight in importance. The 'hard' facts establish the base line pricing, but it is often the softer facts, mixed with some expert broking that will influence an underwriter to deviate from the base line price or whether to even offer terms at all. If there is an unusual structure or history to a practice, with little supporting information it is often easier for an underwriter to decline rather than quote.

Many insurers will adopt a peer reviewing system with their underwriting teams prior to the issuance of any terms. Whilst this can slow the process down a little, it helps ensure a consistency of underwriting approach. This method also provides the underwriter with comfort that his or her peers are in agreement with their underwriting rationale. Normally, complex decisions, will be made by a committee collectively.

Consequently, because of the unique characteristics of every practice, both hard and soft factors influence the pricing scale adopted both positively and negatively.

We highlighted earlier in this article that Underwriters are humans, as such they can be turned off by many factors even if your practice is wonderful. A poor submission is a significant factor and can come in many different formats. Whilst the list provided below is not exhaustive, underwriters may consider the following to be a poor submission:

- A poorly presented proposal form e.g. if there are scribbles, untidy handwriting, coffee stains etc.
- If you have rushed to complete the proposal form or because of its presentation you give that perception
- If your work splits do not add up to 100%
- If it is missing information that the proposal form has requested this information should be enclosed
- Providing out of date insurer claim summaries (they should be dated within 3 months of your renewal date)

Potentially more serious turn offs include:

Disclosure - beyond your presentation many diligent underwriters will explore the internet to see if there is anything about your practice or your fee earners that a google search may bring up. If after undertaking this review of information that is in the public domain, negative information materialises that has not been disclosed, this will reflect badly and will naturally turn an underwriter off.

If this non-disclosure involves any regulatory issue that has occurred (remember the SRA does publish some of their findings online) then it is almost be certain that they will not consider putting forward terms.

Discrepancies - If discrepancies are discovered between the proposal form that you have provided against the description of your activities on your website or what the law society listings advise as the areas of law that are practiced then underwriters will be turned off by this. They may pose questions to establish why there are discrepancies or they may just automatically decline, especially if higher risk areas of law are involved.

Succession – perhaps this is focussed towards smaller practices, particularly those with ageing partners or directors. The absence of a plan in respect of succession could be a turn off for many underwriters.

Multiple claim summaries – if you have continually changed insurers, underwriters may well be turned off by this. This still applies to practices that have an unblemished claims record. The reason for this is that underwriters can be pessimistic characters, they will be glass have empty rather than half full.

As such they may get the opinion about your practice that if you did have a claim, they would never get the opportunity of any return premiums as you given them the impression that you only follow the cheapest terms.

This does not mean that they expect you to have had only one insurer since the commercial market began in 2000, but if you continuously change insurers every year then this will turn them off. Whilst they understand that your decisions must make commercial sense for your practice, those practices that demonstrate loyalty to their insurers are often more attractive to a competing underwriter which could positively influence their proposed terms.

Untidy office – if an underwriter visits you at your offices and your office is in a little disarray, with files piled up and paperwork everywhere this would be a huge turn off for an underwriter. They would expect documentation to be stored securely in cabinets and not piled up in the hall ways, across the floors of your offices or numerous files being on your desk, other than a reasonable number for the day's case load.

Financials – insurers may ask for your accounts or they could undertake a discreet credit score of your business. If the business has poor financials and there is no explanation as to why, then this will turn off an underwriter.

Ultimately, insurers are interested in aligning with good quality businesses. A legal practice effectively has access to an insurer's balance sheet and a good insurer and decent insurer relationship is like having an external capital partner.

Having a greater appreciation and understanding on how underwriters assess risk can pay dividends for your practice in the both the short and long-term. Naturally we can address these factors within our presentation for insurers' consideration, we will tackle how to do this specifically in a follow up to this article, *'Your shop window – how to use it effectively'*. With the recent change in the Insurance market conditions, these two articles should aid your practice to best prepare for your renewal.

For support and guidance on how we can assist your practice in preparation for your forthcoming renewal, please contact your Lockton representative or myself.

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