



**A perfect storm describes an event where a rare combination of circumstances will aggravate a situation drastically. Commentators like the expression (and it is perhaps overused), but do we have one building in the PI Insurance market for Solicitors?**

Let us have a look at the main pointers:

- Law firms generally believe they are paying too much for their PI Insurance coverage;
- Insurers believe that the profession are paying too little; and
- There has been regulatory inaction on firms which, in any other profession, would have ceased to trade and instead continue to cost stakeholders dear.

The only true failing of the use of perfect storm in this context is that for the Solicitors' profession these are not really a new or rare combination of events. When we look through the previous market updates which we have delivered to the profession we have been saying something similar for a few years now. Each of the last few years has then seen events which have prevented the problem from escalating. This has encouraged some stakeholders to perceive Insurers have been over-stating the case.

What may, however be different this time round is that following the extensive and well received Charles Rivers Associates report from the Summer of 2010; and then the extended **consultation period** to the end of February 2011, very little has been done.

To re-cap, the Solicitors Regulation Authority commissioned Charles Rivers Associates in July 2010 to undertake a '**root and branch**' review of the (then) current financial protection arrangements. Bear in mind that one of the key objectives of the SRA is 'to protect consumers by ensuring effective professional indemnity and compensation fund arrangements'.

The review considered:

- The scope of protection offered to the consumers (both individuals and institutions);
- The means by which the protection is delivered; and
- The impact of those arrangements on consumers, individual firms, the legal services sector as a whole and the SRA.

All this was to be considered against the backdrop of the changes to the profession, after the advent of the **Alternative Business Structures** (ABS).

Also, it should be remembered at this stage that the review had been prompted by 'some difficulties arising in the PII market including the substantial increases in the claims made, as well as an increase in the number of firms unable to obtain insurance in the open market'.

As stated the report was generally well received (and if you haven't done so already it is available to read / download from the SRA's web-site [www.sra.org.uk/how-we-ork/reports/cra-financialprotection-arrangements](http://www.sra.org.uk/how-we-ork/reports/cra-financialprotection-arrangements)). Following this and the lengthy consultation period the SRA executive met on 13<sup>th</sup> April 2011.

*After all the consultation discussions, what changes were eventually agreed for the renewal in October 2011?*

It had been widely anticipated that changes would be made for the renewal on 1<sup>st</sup> October 2011, and broadly there seemed to be agreement amongst all the parties to a change to the common renewal date, a change to qualification for the Assigned Risks Pool, as well as possible changes to the Minimum Terms and Conditions (MTC), particularly the opportunity to remove the broad cover afforded to Financial Institutions.

Actually what happened was an announcement, as follows:

- A change to the common renewal date from October 2013;
- Possible changes to the MTC from October 2013.

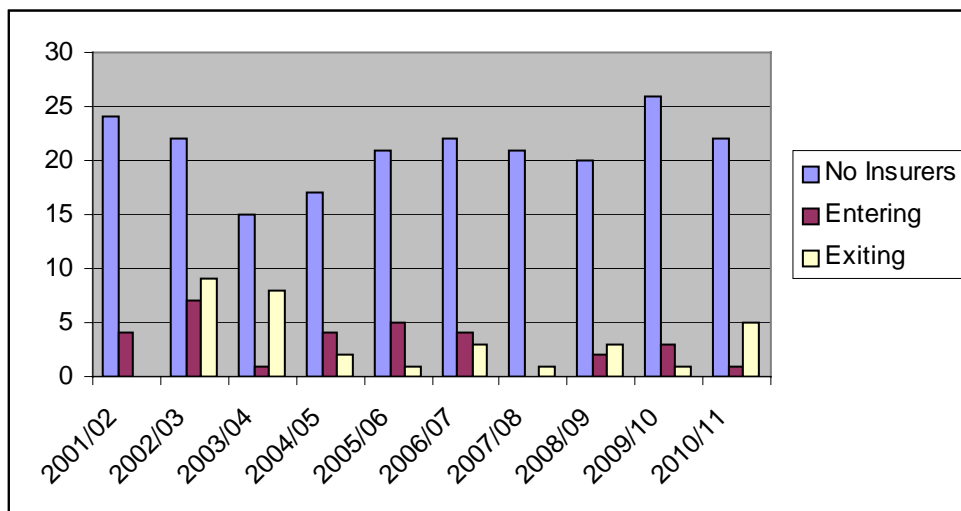
In the shorter term, there are changes to the Assigned Risks Pool and these are to be staggered, as follows:

- From October 2011, the period which a firm can remain in the ARP is reduced to 6 months;
- From October 2012, the ARP will enter its final year with liabilities split between the profession and the Qualifying Insurers (the profession's liabilities will be capped at a maximum of GBP30m); and
- In October 2013 the ARP will cease and the final Insurer of record, if the firm can not find Insurance, will be responsible for the run-off liabilities of that particular firm.

Insurers generally have reacted badly to these changes, as they considered the review and consultation period to have been a worthwhile process, in which they themselves had invested significant time and resource only to see the suggested changes pushed back. It is clear that the ARP is a significant disincentive to new Insurers entering the market. Those which had been lining up to enter the market with the perceived likelihood of changes, now look like they will wait or deploy their capital elsewhere. Those Insurers with significant percentage participations and peripheral players will be looking very carefully at their ongoing involvement with one eye on the likely ARP contribution.

The graph below shows the number of Insurers underwriting Primary Solicitors PII and those entering and exiting the market. The danger is clear because it is certain that the ARP will cost Insurers again this year (2010/11) and at the coming renewal (1/10/2011).

**Number of Insurers and those exiting and entering**



In many of our discussions we get asked “How bad is the ARP?” At the end of January 2011, the overall statistics showed that over the course of the period since the open market (2000 to 2011) the ARP was due premiums of £32m of which nearly £13m had been collected with a total of £110m of claims “incurred”. Incurred claims are paid and reserved claims and, as a result, this figure is likely to get worse over time.

*In April 2011 the Qualifying Insurers were asked by the managers of the ARP to contribute £38,625,000 towards the claim funds for previous years; £17,500,000 for the 2008/9 year alone*

Just to make the point, in early April 2011, there was a cash call on Qualifying Insurers by the managers of the ARP (to fund claim payments for a number of previous years), as follows:

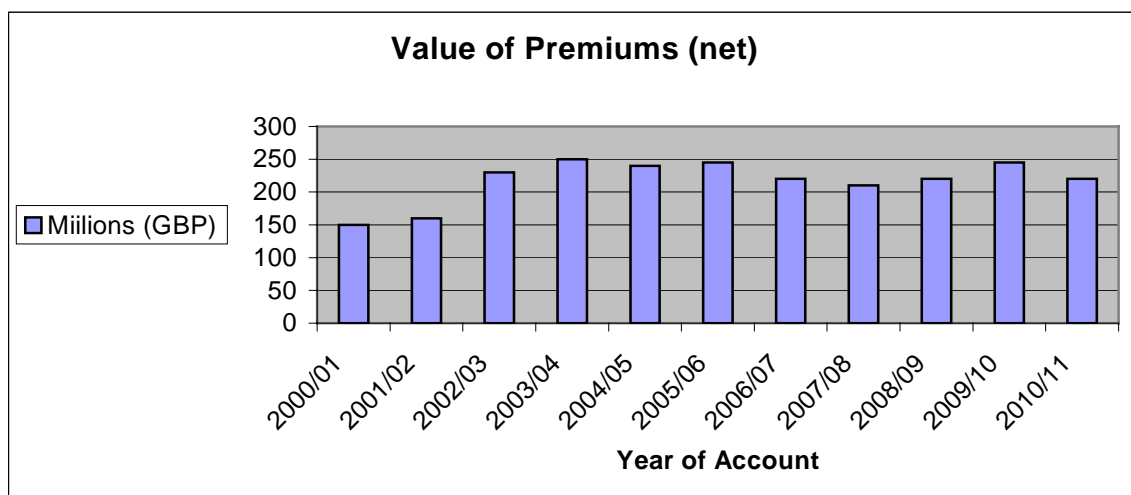
2005/6	£125,000
2007/8	£3,000,000
2008/9	£17,500,000
2009/10	£15,000,000
2010/11	£3,000,000

The number of firms in the ARP have risen as follows: 2007/8 – 28; 2008/9 – 168; 2009/10 – 274; and 2010/11 – 295. The 295 is a lower number than many expected but still on the upward curve. The fact that the managers of the ARP are already collecting funds through cash calls this early (bearing in mind how much time it usually takes for claims to come through and then to proceed to settlement) and means the portents for this year of account are again very poor.

That they are already collecting from the current year is particularly worrying! As mentioned earlier, this is likely to hasten the departure of some and / or prevent new Insurers entering the market.

There is another area which needs to be reviewed and that is the net premiums collected by the Insurers from the Solicitors profession at primary layer level. Most firms would have expected the premium value to have risen quite significantly, certainly over the last 3 policy years. However these are the actual figures.

### **The premiums collected by Qualifying Insurers at the Primary layer level since the demise of the Solicitors Indemnity Fund**



**Note** – the 2003/4 policy year was for a 13 month period. The 2004/5 year was the year that the compulsory policy limit was increased from £1m to £2m for partnerships.

The eagle eyed will spot that, against a back drop of doom and gloom for the profession with widely reported significant increases in premium for many firms, it does look a bit odd that the overall premium at primary layer level reduced last year. In fact, this has been the case at least since the 2008 renewal, and one of the real expected game changers was the removal of Quinn Direct from the market last year. Many, therefore, forecast significant increases, as well as a further hike in the number entering the Assigned Risks Pool. There is no doubt that there have been some unusual practices by some of the Insurers in how they declare their primary layer premium shares for their resultant share of the ARP. There is a separate investigation underway, which will probably close any loopholes for the future, which should, in turn, make the whole process a little more transparent. It is of course possible that closing off these opportunities could lessen the appetite of some Insurers still further.

We usually refer to the information contained in the next chart as the “winners and losers”, but this could be a moot point with some of these Insurers this time round. It shows the shares of each of the Qualifying Insurers for the 2010/11 year and the change from the previous year

Rank	Insurer	2010/11 Participation		2009/10 Participation	
		Percentage	Value (£)	Percentage	Value (£)
1	Chartis Insurance (UK) Ltd (formerly AIG)	18.06%	38.560m	14.91%	36.02m
2	International Insurance Company of Hannover	14.41%	30.780m	4.48%	10.82m
3	XL Insurance Ltd	13.33%	28.470m	7.12%	17.19m
4	Zurich Professional Limited	12.90%	27.500m	12.77%	30.83m
5	Travelers Insurance Co Ltd	11.04%	23.500m	13.37%	32.27m
6	QBE International Insurance Limited	8.22%	17.550m	9.97%	24.08m
7	Allianz Global Corporate & Specialty AG	6.41%	13.200m	4.54%	10.96m
8	Aviva Insurance Limited (prev Norwich Union)	4.24%	9.056m	3.94%	9.52m
9	Lemma Europe Ins Co Ltd	2.93%	6.140m	1.04%	2.50m
10	Royal & SunAlliance Insurance PLC	2.24%	4.780m	5.87%	14.17m
11	W. R. Berkley Insurance (Europe) Limited	1.83%	3.880m	2.04%	4.93m
12	Alpha Insurance	0.86%	1.820		N/A
13	Liberty Mutual Insurance Europe Limited	0.66%	1.350m	0.59%	1.43m
14	Solicitors Indemnity Mutual Insurance Assoc Ltd	0.55%	1.170m	0.50%	1.21m
15	Aspen Insurance UK Ltd	0.54%	1.150m	1.00%	2.41m
16	QBE / D A Constable Syndicate 386	0.52%	1.100m	0.51%	1.32m
17	Chubb Insurance Company of Europe SE	0.47%	0.990m	0.44%	1.05m
18	Pembroke Syndicate 4000	0.44%	0.930m	0.29%	0.81m
19	Barbican Syndicate 1955 C/O Libra	0.24%	0.500m	3.51%	8.46m
20	AG Dore & Others Syndicate 2526	0.16%	0.330m	0.33%	0.81m

You will note that, of the traditional major players (by which we mean those which usually remained in the top 6 since 2000, whom one would expect to have the best management information and general statistics) a number have reduced their participations significantly.

A brief summary of their earlier participation provides some food for thought:

Insurer	2006 participation and ranking		2010 participation and ranking		Increase / (decrease) (percentage)
Zurich Professional	44,136,269	1	27,500,000	4	(37.70)
QBE International	33,512,101	2	17,550,000	6	(47.60)
Travelers (St Paul)	28,748,398	3	23,500,000	5	(18.30)
Chartis Insurance (AIG)	23,054,110	4	38,560,000	1	59.80
Royal & SunAlliance	19,473,577	5	4,780,000	10	(75.50)
Aviva (Norwich Union)	16,271,925	6	9,056,000	8	(44.35)

What have these Insurers seen and at what stage did they look to rein in their participations? Our discussions reveal that pure underwriting profit was certainly available in 2006, was questionable in 2007 and was missing in 2008. The contributions to the ARP can make for a 15% deterioration in the overall profitability of a Solicitors PI account for Insurers. Therefore a marginal underwriting profit for an Insurer will move them to a loss with the impact of their ARP contribution. A further factor, which exacerbates this, is that for any relatively long tail insurance class (such as PI) there has been little opportunity for meaningful investment returns for the last few years.

**So do we have the conditions for a perfect storm?**

We feel that the traditional Insurers have too much invested in this market to move away at this stage. They will not be looking to grow their books and some are likely to look at reducing their participations further. New entrants which had been ready to enter the market if the proposed changes had taken place will now not do so. However if one of the newer Insurers was to look at their participation or to look at their rates, there would not be too much friction to prevent forcing rates up very quickly!

**This document was originally produced by our fellow Unitas member Windsor Partners Limited**



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