Professional Indemnity Insurance Market Insights Q3 2020

As we head into the second half of 2020, pricing adequacy continues to be at the forefront of insurers' underwriting approach. While the global insurance market continues to be well capitalised, the focus has shifted to long-term profitability and portfolio balance. This has been a marked change from the oversupply of insurance capital that has dominated the past decade leading to years of competitive pricing and broad coverage terms. Some would argue that we have now entered what is colloquially known as a "hard market". Whether this is a true hard market or just the beginning remains to be seen.

The dramatic change in professional indemnity market conditions started in 2019 and has continued to accelerate into 2020. This acceleration has made it increasingly difficult to predict market conditions, in respect of pricing, coverage, and capacity, even in the short to medium term. COVID-19 and the associated global economic downturn are compounding the hardening market and increasing uncertainty.

Why is the market changing?

The Australian Prudential Regulatory Authority (APRA) released its Quarterly General Insurance Statistics on the 28 May 2020. This data is sourced from the regulatory returns submitted to APRA by authorised general insurance companies. It does not include data from Lloyds. The report shows that the average premium increase between year-end March 2019 and year-end March 2020 for professional indemnity was 42% with an 8% increase in incurred claims.

The uplift in premium has meant that the insurers' gross loss ratio has decreased from 108% in 2019 to 98% in 2020.

Clearly, a loss ratio of 108% is unsustainable for insurers and requires correction. It is therefore pleasing to see this number fall below 100% in 2020. Noting the focus on underwriting profitability mentioned above, insurers will still be looking to get this number lower as a 2% margin is not viable. It is important to note that the above numbers include Directors & Officers liability which has been particularly challenging for insurers.

As advised in our 2019 market update, Lloyds undertook an extensive review of their worst-performing classes of insurance and underperforming syndicates towards the end of 2018, known as the Decile 10 review. Syndicates who were unable to demonstrate a road to underwriting profitability were forced to close immediately, while others had to cease insuring underperforming classes. This was particularly relevant to professional indemnity which was flagged as one of the worst-performing classes for Lloyds and led to a significant drop in capacity for Australian clients.

This reduced supply of underwriting capacity from London has continued into 2020, with many of the syndicates managing their portfolios by reducing the limits they are prepared to offer. It is unfortunate and untimely, but for the remainder of 2020, we do again have to navigate an insurance market cycle where all insurers are being selective on risks, reducing capacity, and attempting to push price where they participate.

Table 1. APRA Quarterly General Insurance Statistics[1]

	Year-End March 2019	Year-End March 2020	Increase
Gross Written Premium	$2,039,000,000	$2,531,000,000	24%
Incurred Claims	$2,134,000,000	$2,304,000,00	8%
Average premium	$2,798	$3,987	42%
Gross loss ratio	108%	98%	

[1] Source: www.apra.gov.au/quarterly-general-insurance-statistics

How are the insurers responding?

We have seen insurers become more selective about the industries they are prepared to insure as well as the individual risks within those sectors. Some of these decisions are being made off the back of an increase in actual claims and some stem from projections of future volatility and uncertainty. There is a bottom-line focus with little appetite for poor performing risks. Similar to the Lloyds Decile 10 review, several Australian insurers have done profitability reviews of their portfolios and are taking corrective action. Corrective actions may range from withdrawing from the profession in total to increasing premiums/deductibles and reducing the breadth of cover. This is particularly true of insurers that underwrite building certifiers, design professionals, valuers, financial planners, mortgage brokers, and lawyers.

Professions that already had limited insurance options are being more heavily impacted. Valuers, mortgage brokers, and financial planners have long been limited in the number of alternative markets available. More recently, this has also applied to building certifiers due to combustible cladding concerns following several significant high-rise fire disasters. Any loss of insurance capacity for these professions can lead to significant challenges in maintaining existing limits of indemnity and additional cover restrictions.

Hard insurance market conditions inevitably lead to a more centralised decision-making process for some insurers. Underwriting authority becomes centralised to control the balance of their portfolio. Where insurers have focused on particular industries in the past, they are now looking to minimise their overall exposure to any one industry. Directives around allowable professions, rating increases, and policy terms and conditions take the discretion away from the front-line underwriters. Exceptions to these directives require an extended authorisation process and considerable supporting documentation. Insurer response times have become frustratingly slow as their workloads increase. Previous high-level overviews of submissions have been replaced with in-depth underwriting processes and an increase in referral points. Even the insurers who maintain front-line underwriting discretion undergo a much more detailed and thorough underwriting process. Insurers are also much more likely to adopt a walk-away position on accounts. This is especially true if they are unable to get the correct information or charge the “appropriate premium”.

Impact of COVID–19

Similar to the September 11, 2001 terrorist attacks that preceded the last hard market, COVID-19 impacts insurance market capital and adds an element of fear to the future. In May 2020 Lloyd’s projected that the insurance industry would be facing $107 billion in underwriting losses from COVID-19. This was on the basis that lockdowns did not extend into another quarter which they now have. The losses are expected to exceed historical events including September 11 and the 2017 hurricanes Harvey, Irma, and Maria. It was also noted that unlike these events, COVID-19 is not geographically contained and will have long-lasting effects.[2]

For underwriters to be able to set prices confidently they need to be reasonably confident of what is going to happen in the future. Where uncertainty exists, insurers tend to price for the worst-case scenario or just withdraw capacity altogether. As such you must educate the insurers on the likely impacts to your profession and the risk controls you have put in place to minimise the risks.

Insurers are expecting an increase in professional indemnity claims due to economic uncertainty. Many insurers have told us that they have only just finalised claims arising from the global financial crisis (GFC) of 2007-2008. In our experience, past recessions have seen increases in claims against valuers, real estate agents, financial planners, accountants, and mortgage brokers. Claims tend to arise as losses are crystalised in a recessionary market.

[2]Source: www.lloyds.com/news-and-risk-insight/press-releases/2020/05/covid19-will-see-historic-losses-across-the-global-insurance-industry

Outside of COVID-19 impacted professions, insurers also have concerns around changes to working practices required by the COVID-19 environment. Having a large segment of your workforce working from home could lead to a reduction in the quality of advice or services if not managed properly. Insurers are therefore very interested in how this is being managed in professional service firms. Some concerns that should be addressed in your submission to insurers, where appropriate, include:

- Lack of access to specialist equipment – how are you ensuring employees can access the equipment required to perform their job
- Reduction in collaboration – impact on work quality and innovation
- Reduction in supervision – how is work being checked and signed off where escalation is required
- Reduction in IT support – the speed of resolving IT issues
- Employee adaptability – mental health, work/family balance
- Inability to perform some work remotely – surveying, valuation, property management, auditing

The more comfort you can give insurers that you understand the impacts to your profession the more likely they are to consider your submission. Insurers are likely to assume the worst in the absence of additional information. In some cases, it is easier for insurers to decline a risk than to ask additional questions. Therefore, as much information as possible should be provided at the start of the renewal process.

Specific Industry Comments

The Aon broking team have provided industry specific commentary in the table below. This is based on Aon's experience in the professional indemnity market during the first half of 2020.

Accountants

Insurers are pushing for rate increases across all accounting practices. Activities that insurers consider higher risk are being more heavily scrutinised. This includes auditing of listed entities and financial institutions, mergers and acquisitions, and valuations.

Construction Consultants

There has been a significant contraction in the cover provided by insurers to construction consultants particularly around cladding exposures, loss mitigation costs, costs estimates and cross liabilities. In addition to the contraction in cover, insurers are looking for significant increases in both premium and self-insured retentions. Insurers are also concerned about the changes to the duty of care provisions under the Design and Building Practitioners Act 2020 (NSW) which came into effect 10 June 2020. The new registration and certification scheme that comes into effect 1 July 2021 may impose additional insurance requirements.

Credit/Mutual Banks

There is still a reasonable amount of competition for credit unions and smaller banks which is keeping increases at the lower end. The cover is being pared back when it comes to investigation and mitigation costs. This may change going forward as we have recently become aware that one of the main insurers has decided to stop writing new business.

Design Professionals

The market for design professionals has seen a significant retraction with several insurers exiting or stopping new business. This retraction in supply is allowing the remaining insurers to increase their rates.

Financial Planners

Insurers are concerned that financial planning claims will increase due to the deterioration in economic conditions. Regulatory activity following the Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Industry also remains a concern for insurers. This is a very difficult profession from a professional indemnity perspective. There is still some competition for smaller firms with 20 planners or less. Large financial planning organisations have struggled to maintain high limits due to a retraction in capacity. Pricing increases have been significant.

IT Professionals

IT liability is one of the few bright spots as several insurers are still competing for market share. Given the complexity of some IT risks, it is still important to ensure underwriters understand your specific risk exposures. The generic proposal forms do not provide enough clarity and we recommend face to face (or virtual) meetings with insurers. Underwriters who excel in this field, have very specific questions to ask and can establish very quickly if they are comfortable writing the account.

Lawyers

This year's law firm top-up renewals saw many underwriters reducing capacity, some as low as $5 million. For most renewals, we also saw a further increase in rates. Insurers are being more cautious with their attachment points requesting to be moved higher up a program. Some areas of practice are more challenging than others such as mergers and acquisitions, conveyancing, corporate advisory, and plaintiff law firms.

Real Estate

Future economic uncertainty, a rise in unemployment, and new tenant powers under COVID-19 conditions are causing premium increases for property managers. Again, insurers are expecting to see an increase in claims activity.

Valuers

There continues to be cover restrictions imposed by some of the main markets around the assignment of property valuations required under changes to Section 90 of the Banking Code of Practice. The insurers did respond well to the Valuation Protocol – Guidelines for API Declared Time of Crisis and/or State of Emergency Impacting Physical Inspections of Real Property with appropriate writebacks to cover added. We have seen a loss of overall capacity for valuation firms as insurers expect a reduction in property prices off the back of COVID-19 and the resultant economic conditions.

How can you get a better outcome?

The market volatility described above makes it very difficult to set renewal expectations for many professions. Differentiation of your risk from your peers is critical to help secure the most competitive terms available in the market. With the help of your Aon broker, it is important to demonstrate to insurers that you understand the risk exposures of concern to them and are prepared to articulate your risk profile. If you have not already done so, it is also important to develop and build relationships with insurers (as well as alternative markets) to help minimise the impact of insurance market cycles.

Some key strategies to help get a better result include:

- Start the renewal process early. Additional time will be required to address any queries the insurers may raise. Allow time for insurers to go through their internal referral processes.
- Given the volatility of the insurance market, you may need to adjust the renewal strategy multiple times to deal with unforeseen challenges in insurers' strategy/ appetite. Work with your Aon broker to develop a backup plan (or two) to deal with last-minute surprises.
- Speak to your Aon broker to understand the insurers' risk concerns for your particular industry. Provide as much information as possible to ensure the underwriters understand your risk exposure and the risk controls you have in place to manage them.
- Stand out from the crowd. Given the reduction in insurer appetite and a requirement to balance their portfolios, insurers will have to make choices about which policies to write and which to decline. Differentiate your risk profile and set yourself apart from your peers in the insurers' minds.
- Be prepared to meet with your insurers for a Q&A session. This is a chance to build some trust and strengthen relationships.
- Develop a plan to deal with changes in cover. Work with your Aon broker to understand what elements of cover are negotiable and what cover is essential to your business.

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