Professional Indemnity Insurance Market Insights

Q3 2018

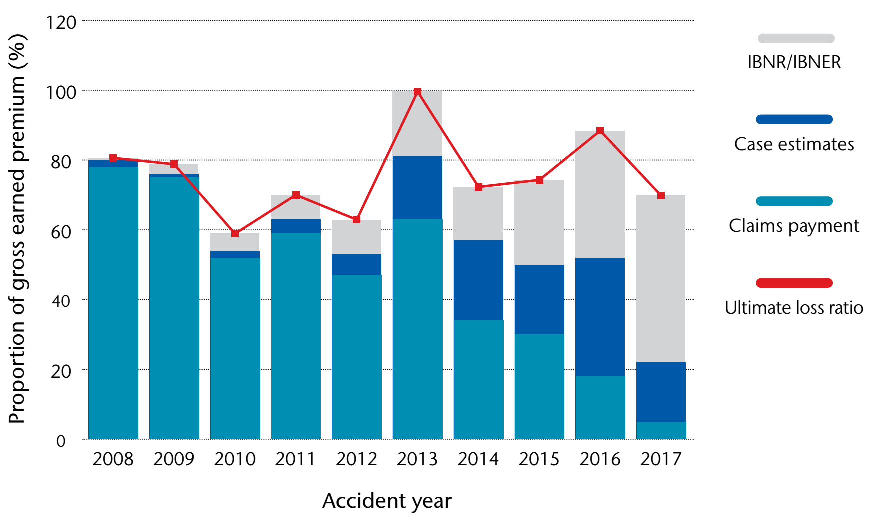
Overview

- The Professional Indemnity (PI) insurance market is showing early signs of hardening – high loss ratios are materialising; and the increase in D&O securities class actions is having a flow on effect
- PI exclusions are being introduced to insureds with cladding material exposures; and any organisation involved in the banking and financial services royal commission
- Increased regulatory investigations are stress testing the breadth of investigation and loss mitigation cover available under PI policies
- Cyber insurance - with the introduction of new data privacy legislations, it's important to understand how your PI policy will respond; and what gaps can be covered by a standalone cyber policy
- Rate increases are expected to continue. Despite several PI insurers withdrawing from writing PI insurance, there continues to be available capacity in the London market

State of the market

The PI insurance market is showing early signs of hardening. The latest Australian Prudential Regulation Authority (APRA) statistics released 28 June 2018 show a deterioration in claims development. Being a claims made class it takes several years for insurers to have a true guide on their ultimate loss ratio for any one year. If we go back to 2013, the loss ratio is sitting at 99.6% and hovering around 80% for the subsequent 3 years. This means for every $1 in premium an insurer collects they are paying out $0.99 in claims. This figure excludes the insurer's operating expenses which on average sit at $0.30. Insurer loss ratios need to be under 70% - taking into account operating expenses - in order for them to generate a profit. It is therefore understandable why insurers are looking to push rate.

Claims development as at 2017 financial year end



Source: APRA general insurance claims development statistics December 2017

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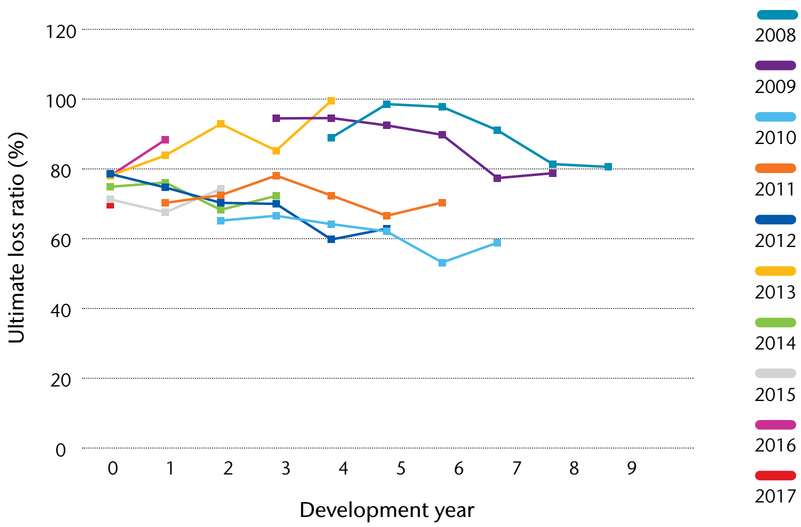
Insurers writing PI are generally also D&O underwriters. The heightened securities class action environment in Australia has drawn focus from insurers' global head offices. Off the back of this PI is either, also under scrutiny, or seen as a class to grow and utilise to diversify insurer financial lines portfolios. Combine this with the deteriorating PI loss ratios, trusted and well-established PI insurers are pushing rate; and new inexperienced underwriters, often with a lack of product, are trying to buy market share.

Ultimate loss ratio development



Source: APRA general insurance claims development statistics December 2017

Cladding exclusions

The Grenfell Tower UK, Lacrosse Victorian building fires and subsequent state government bans on certain cladding material, has materially impacted PI insurers' underwriting approach to builders, developers, manufacturers of building products, engineers, architects, property managers, certifiers and quantity surveyors. Without strong risk management practices, a standard cladding exclusion is being applied to PI policies. Insureds must satisfy the underwriter that they have undertaken a full review of past projects to identify where external cladding and aluminium composite panelling has been used. Insureds must demonstrate strong risk management practices are in place to ensure compliance with the building code, testing of products and built in identification processes.

Scrutiny on those involved in The Royal Commission

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (The Royal Commission) has had an industry wide impact. Financial advisors, life and retail insurance companies, superannuation companies, lenders and mortgage brokers can expect detailed questioning from insurers. Like the cladding issue, any insured that has been served a notice to produce documents, or appear in front of The Royal Commission, will see a specific exclusion applied to their PI policy.

Insurers attempting to contain their exposures

Whist completely different sectors, insurer concern - with The Royal Commission and use of cladding material - is the contagion impact. Advice, poor practices and use of product has been occurring over several years with the impact to customers only just starting to be realised. Insurers are trying to ring fence their exposures to a single policy year. This is a material concern for insureds - any future claim arising from The Royal Commission or cladding would be excluded. It is extremely important clients work with their broker to notify any potential claims or circumstances before their current policy expires.

Increased investigations – PI coverage being tested

The Royal Commission, heightened ASIC investigations and the building authority review into combustible materials is stress testing the breadth of investigation and loss mitigation cover available under PI policies. Not all wordings are the same and require specific review to ensure the broadest available cover is negotiated into the policy. Coverage may come at an additional premium. Insureds should understand how these specific coverages work to gain the greatest use of their PI policy.

New data privacy regulations; understanding your exposures

Cyber is a hot topic across all boardroom tables and it is no different in the insurance world. PI policies will typically respond to third party customer claims for breach of privacy or failure to protect client data as a result of a cyber incident. The introduction of the Notifiable Data Breaches scheme in Australia and GDPR in the EU has brought this risk exposure to the forefront with insurers. It is important clients understand what their PI policy will respond to and the gaps that can be covered via a standalone cyber policy. Most notably, PI policies generally do not provide any first party cover, notification costs or protection for employee data.

Renewals outcomes vary across professions

Expected renewal outcomes very much vary by profession. The construction and legal sectors have seen an exit of several insurers and average rate movements of 10-15%. Financial planners and mortgage brokers remain a challenging class with very little insurer appetite. Real estate agents, accountants, insolvency practitioners and corporate advisors are experiencing small rate increases. IT companies and management consultants are still sort after business for insurers.

Clients with claims can expect their risk management practices to come under question, deductibles increased and premiums pushed significantly. To date, outside of the industry specific exclusions we haven't seen a retraction of policy coverage from Australian insurers but it is anticipated this is likely to occur as the market develops.

London market conditions

The London market continues to be at the forefront of multinational risk transfer placements for global clients. However, for Australian PI business, the market is showing signs of hardening particularly for those insureds who have had losses.

Looking ahead

Over the last year underwriters have seen a slight rate increase on their total book. This is set to continue into the second half of 2018. Most insurers are forecasting that their PI rates will increase by a further 5-10% and disproportionately more for those accounts with losses.

The situation is changing monthly with a number of large loss reserves being posted. Experience to date is that PI losses have been both large in number and quantum which has made some portfolios now unsustainable. This has been despite insurance being established on the premise of a portfolio approach where a single loss can be absorbed by the insurer's portfolio. These market conditions have driven some insurers to withdraw from writing PI insurances altogether, while others have made the strategic decision to reduce their exposure to PI risks.

Despite all these challenges, there continues to be capacity available in London for Australian PI risks. Insurers are simply much more selective in how they deploy their capacity. The merger of several dominant players - combined with four markets withdrawing from writing Australian PI - has had an impact on the competitive tension. In contrast to the Australian marketplace, London insurers are focussed on policy coverage, contractual liability, multiple reinstatements of the sum insured and multi-year run-off are all becoming harder to obtain.

Tips for success

- Engage the market early and where possible meet with your insurer. A proposal form can only differentiate your business so far. Face-to-face interaction with your insurer provides a forum to talk through your risk management practices, approach to business and general company culture.
- Ensure your risk management practices are well documented and embedded in the business. How do you approach contracts management? Do you have a peer review process in place? What does a project life cycle look like to you; and how do you ensure compliance throughout?
- Review your policy wording with a specific focus on coverage relevant to your sector – investigations, loss mitigation, contractual liability, return of fees, cyber.
- Notify any circumstances prior to expiry of your current policy and look to take advantage of the loss mitigation cover where available to rectify the identified issue as oppose to waiting for the customer claim.

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