Clyde&Co

London Market Professional Indemnity Report

July 2022

LONDON PI MARKET OPTIMISTIC DESPITE ECONOMIC HEADWINDS

Contents

London PI market remains optimistic, but sees challenges ahead

Professional indemnity insurers, brokers and claims professionals remain optimistic about market conditions - at least for the coming year.

While survey respondents were acutely aware of the distressed geopolitical and economic climate, it seems likely there will continue to be specific pockets of distress in the professional indemnity market rather than the widespread challenges seen in the aftermath of the Global Financial Crisis.

In this, our second annual London Market Professional Indemnity survey, we were interested to gauge how the market is reacting to these challenges and other evolving issues, such as increasing cyber threats, as well as to gain a clearer picture of any changes to appetite, wordings, coverage and capacity.

We surveyed a targeted range of insurance professionals across underwriting, broking and claims for their take on developments in the PI market.

Twelve months on from our last survey, the mood in the PI market can be described as upbeat, despite various headwinds. Respondents reported that rates across most lines continue to rise, albeit at a slower pace than last year. Most believe that the market will maintain discipline, though the market continues to attract capacity and competition is increasing for certain lines. Survey respondents highlighted the likelihood that economic conditions will prompt an uptick in claims - though the impact of this may not be fully felt in the next 12 months.

The role played by Managing General Agents in the PI marketplace is predicted to increase, which may prompt more flexibility and the development of more specialist products - good news, perhaps, for buyers of coverage. Meanwhile, many survey respondents reported a contraction and a narrowing of coverage for specific perils such as fire safety-related cover and cyber.

The vast majority of respondents noted that buyers will be able to maintain existing aggregate limits of cover for the next 12 months at least.

We were also interested to hear the market's views on how the increased focus on Environmental, Social and Governance (ESG) policies and the potential impact of Artificial Intelligence might affect the risk profile of the PI market. The reaction here was a mixed bag, but both issues will be ones to watch for future years.

The impact of changing ways of working on the London market is also provoking some discussion. While many experts we talked to praised the market's ability to continue functioning during the COVID-19 lockdowns, we sense some concern that networking - a hallmark of the London market - and training and development may suffer as a result of less face-to-face contact. This will be something for the market and its key service providers to address in the coming 12 months.

All in all, these are interesting times for the PI market with confidence and optimism set against a series of potential challenges, unknowns and an unprecedented economic and geopolitical backdrop. We hope you find the survey findings of interest. I would like to thank the industry leaders who took part in the survey, some of whom are quoted in this report. I would also like to thank Rob Crossingham and the Clyde & Co professional liability team who assisted in the preparation and production of this report.

Please contact me or your usual partner should you require further insight or wish to expand on any of the issues highlighted in this report.

Simon Konsta,
Partner and Head of Clients & Markets, Clyde & Co LLP

Top level findings

61% of insurers believe broad economic trends will affect the volume of PI business written in the London Market

86% of respondents say buyers will be able to maintain existing aggregate limits

81% of insurers expect more new entrants, exits and consolidation

53% of insurers say their appetite for PI business will increase

64% say new post-COVID working practices will create challenges in building and maintaining networks

88% say rates will increase

58% say recessionary pressures will materially influence claims

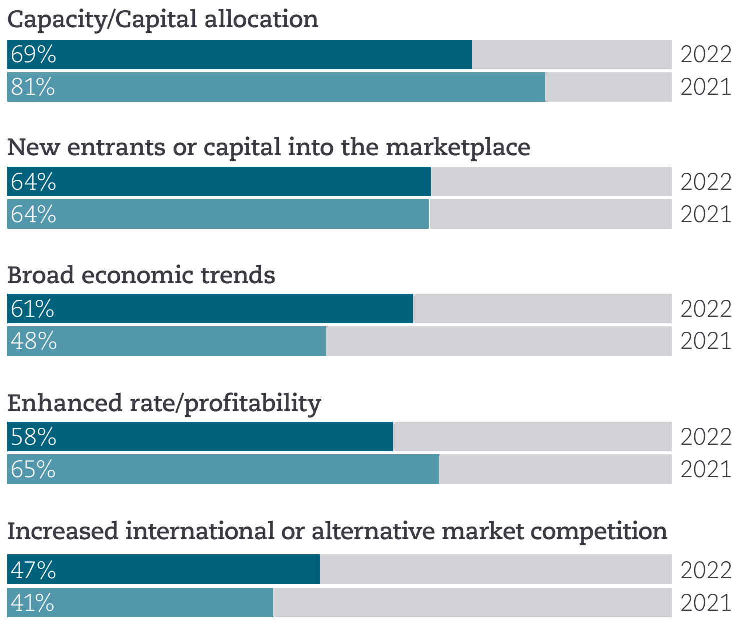
83% expect the frequency of claims to increase in the next 24 months

56% say economic uncertainty will materially influence claims

68% expect the severity of claims to increase in the next 24 months

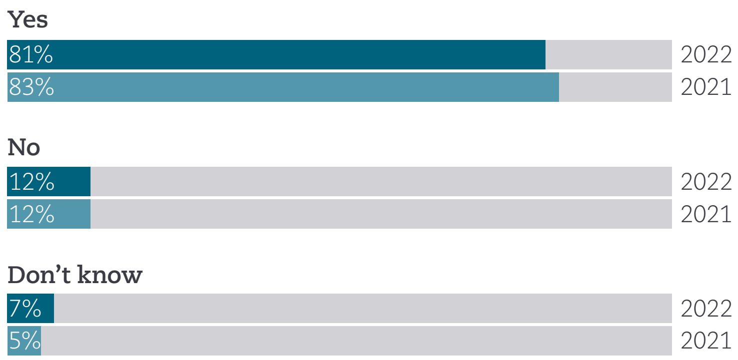
Market influences are constant but economic concerns are increasing

WHAT WILL BE THE MOST IMPORTANT STRUCTURAL INFLUENCE ON THE VOLUME OF PI BUSINESS WRITTEN IN THE LONDON MARKET IN THE NEXT 12 MONTHS?



Capacity and capital allocation will be the most important structural influence on the volume of PI business written in the London market over the next 12 months, experts believe. More than two-thirds, 69% of respondents said that the volume of business underwritten would be affected by capacity and allocation of capital, while 64% said that new entrants and new capital would exert a structural effect.

DO YOU ANTICIPATE MARKET CHANGE IN THE FORM OF NEW ENTRANTS, EXITS AND CONSOLIDATION?



After a return to profitability in recent years, and with respondents reporting that rates will continue to rise - albeit at a slower pace than last year, it is perhaps unsurprising that the PI marketplace is attractive to new entrants and new capital.

Over the coming year, most respondents predict a continued market shift with 81% saying they expect new entrants, exits and consolidations, compared with 83% in 2021.

Overall, however, brokers and underwriters do not believe that new capital will have the effect of eroding rates to too great an extent in the next 12 months. And while there was an uptick in concern about increased competition from developed and emerging insurance centres around the world, more than half of respondents 54% said this was "not a significant factor."

The fact that an increased percentage of respondents 29% in 2022 compared with 7% in 2021 - believe that international competition is a concern makes this an issue to watch for future years.

Almost all underwriters and brokers said they believed that the volume of business written by MGAs, binders and delegated authority would increase in the coming two years. While many welcome the flexibility of this capacity and its ability to get closer to the customer, others caution that it is important new capacity acts with discipline in the coming months.

Economic headwinds

The broader macroeconomic trends are impossible to ignore, however. The unfolding crisis in Ukraine, the inflationary environment, supply-chain issues, and Britain's exit from the European Union, among other factors, are giving underwriters and brokers in this marketplace pause. Some 61% said these trends would have a structural influence on the PI market this year, compared with 48% in 2021, making this the biggest year-on-year shift of opinion. And given the long tail nature of the PI market, it seems undeniable that future years will be shaped by these economic headwinds too.

While most experts believe the direct impact on the PI market is likely to be less severe and widespread than in the wake of the Global Financial Crisis of 2008, they stress that underwriters should be pricing in the effect of inflation, in particular, as we move forwards although some expressed doubt that this was yet fully part of the underwriting decision.

The COVID-19 legacy and new ways of working

Many have praised the insurance market's adaptability in adopting new ways of working during the height of the COVID-19 pandemic and in putting into place hybrid or flexible working models as we begin to recover from the pandemic's effects.

But underwriters expressed concern - and indeed amazement - at the degree of reluctance they had witnessed in the market about getting back to face-to-face meetings.

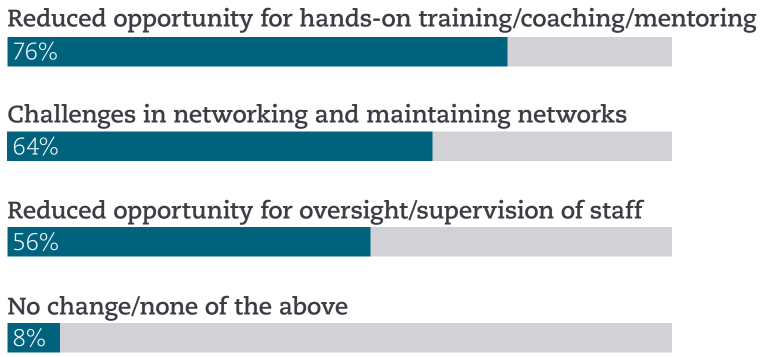
While most agreed that a hybrid model, with some remote working, was efficient and important both for work-life balance and for attracting and retaining talent to the market, they said the reduction in face-to-face contact would present challenges to building and maintaining networks - a crucial element of the PI marketplace.

Some underwriters highlighted a reduction in broker footfall at Lloyd's boxes noting that this may be to the detriment of the marketplace, which has built its reputation in no small part on the flexibility, nimbleness and intellectual capital of a face-to-face trading environment.

Claims professionals too expressed concern that a lack of in-person interaction could hold up the progression of claims.

More than three-quarters of respondents noted that a reduction in in-person interaction would reduce the opportunities for hands-on training, mentoring and coaching. And more than half of survey respondents said they believed new ways of working reduced the opportunity for oversight and supervision of staff.

HOW MIGHT NEW WORKING PRACTICES POST-COVID-19 CHANGE THE PI/LONDON MARKET?



> "The war in Ukraine, Brexit and the post-COVID environment are, in a way, wild cards. The three biggest risks to the (UK) economy* are at the moment pretty much unprecedented and we don't know how they are going to play out or how they are going to interact with each other.
>
> Charles Manchester, Chief Executive Officer, Manchester Underwriting Ltd.

*The survey was carried out before the July 7 resignation of Prime Minister Boris Johnson

> The London insurance market has traditionally been based on networks. The concerns expressed by respondents about the potential erosion of these networks, or an increased challenge in building and maintaining them post-COVID, are somewhat troubling. It remains to be seen if face-to-face meetings will gain more traction again as we move out of the pandemic, or whether the market will need to find new ways of networking - one of its undoubted strengths.
>
> Julian Smart, Partner, Clyde & Co.

New ways of working change risks too

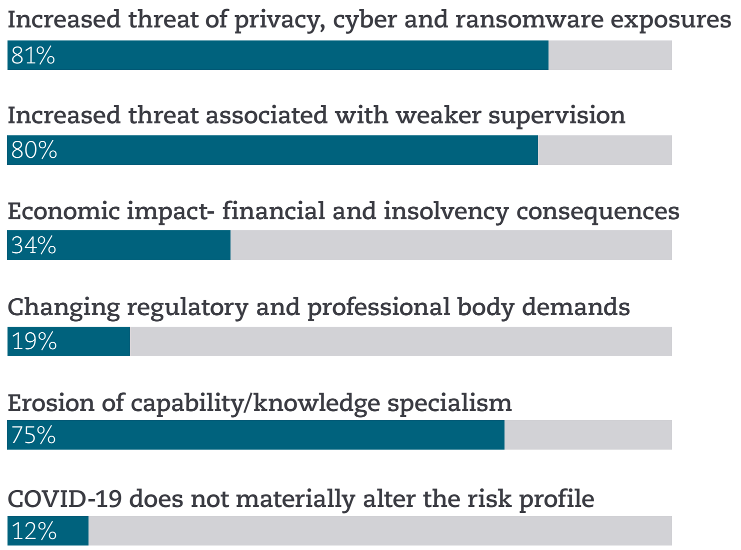
New ways of working post-pandemic will also alter the PI risk profiles of professional firms, according to survey respondents. They highlighted, in particular, an increased threat of privacy, cyber and ransomware exposures in a remote or hybrid working environment. Although experts acknowledge that firms across the professions have recognised this threat and increased their own controls and processes, it's also worth noting that more than half of underwriters predicted a restriction in coverage for cyber in PI programmes.

In recent years, both Lloyd's of London and the Prudential Regulation Authority have introduced mandates to require underwriters to make clear whether cyber coverage is expressly provided in policies, as an effort to reduce the effect of so-called 'silent cyber' exposures.

The increased threat associated with weaker supervision as a result of remote working is also expected to affect the risk profiles of professional firms.

Respondents also expressed concern that remote working would erode the knowledge, capability and specialisms of the professionals working within the firms that they insure. This is doubtless a worry given the nature of the risks being underwritten - arguably specialist capability is the core competence of the insureds. Whether this will manifest in claims remains to be seen, but an erosion in knowledge could be a dark cloud on the horizon, particularly if we do enter a recessionary period.

HOW MIGHT NEW WORKING PRACTICES POST-COVID-19 CHANGE PI RISK PROFILES OF PROFESSIONAL FIRMS?



Primary and excess capacity set to grow, appetite for PI remains strong

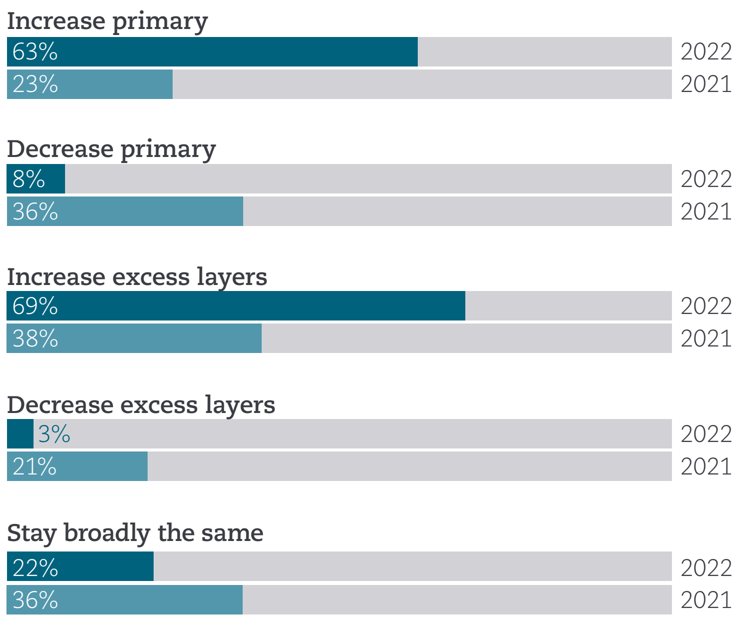
Our findings revealed that most respondents believe that capacity in the PI insurance market will increase over the next 12 months, for both primary and excess layers.

While 63% of respondents said they expected primary capacity to increase, almost 70% said there would be an increase in capacity for excess layers.

There may be some storm clouds gathering, however, experts noted, particularly if newer capacity acts naively. Primary insurers or reinsurers entering the market via fronting insurers will need to approach with particular caution, since they may lack the direct experience of more seasoned players.

Overall, however, much of the perceived 'new' capacity is stewarded by underwriters with great depth of experience in the market, meaning that a great degree of sophistication and experience is likely to be embedded into new entrants, and it may be unlikely that these new entrants will behave rashly in a bid for market share and top-line growth. The more challenging areas will continue to see sensible levels of capacity, respondents predicted.

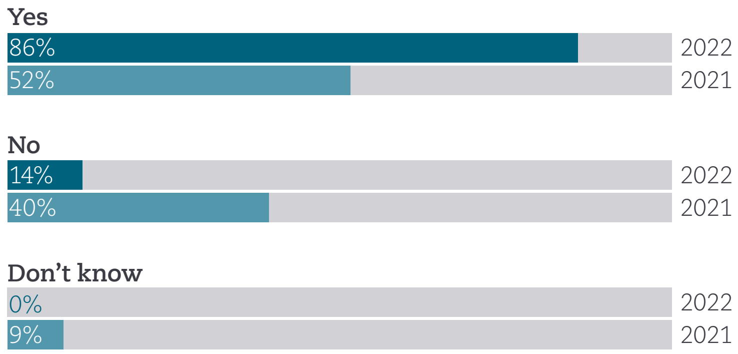
IN THE NEXT 12 MONTHS, HOW DO YOU EXPECT THE LEVEL OF CAPACITY IN THE PI INSURANCE MARKET TO CHANGE?



> Because limits reduced quite significantly over the past few years they are likely to be at a level which is sustainable, at least in the short term.
>
> Colette Finnieston,
> Legal Director, Clyde & Co.

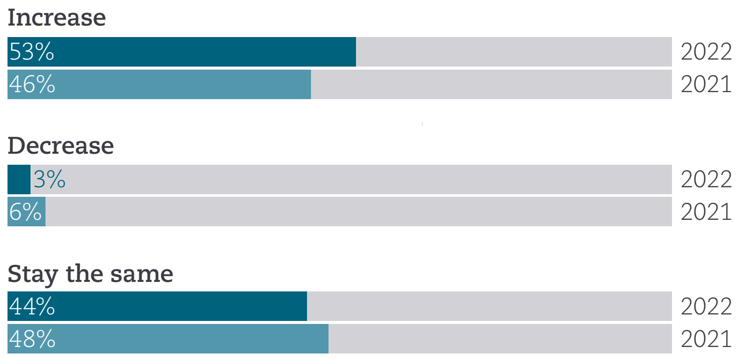
An overwhelming majority of survey respondents 86% said they believed insurance buyers would be able to maintain existing aggregate PI policy limits in the next year. While this may be more challenging for some stressed sectors, notably construction, the slowdown in the pace of rate increases for most professional indemnity lines means that, on the whole, buyers will be able to afford to maintain existing aggregate policy limits.

IN THE NEXT 12 MONTHS DO YOU ANTICIPATE THAT INSURANCE BUYERS WILL BE ABLE TO MAINTAIN EXISTING AGGREGATE PI POLICY LIMITS?



Insurers' desire to underwrite PI business remains strong, with 53% reporting that their organisation's appetite would increase in the coming 12 months, while 44% saying appetite would remain at current levels.

IN THE NEXT 12 MONTHS, HOW DO YOU EXPECT YOUR ORGANISATION'S APPETITE FOR PI BUSINESS TO EVOLVE?



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The professions that are less affected by an economic downturn will be more attractive in the coming months. Those that are affected, such as accountants, IFAs and surveyors among others, will become less attractive

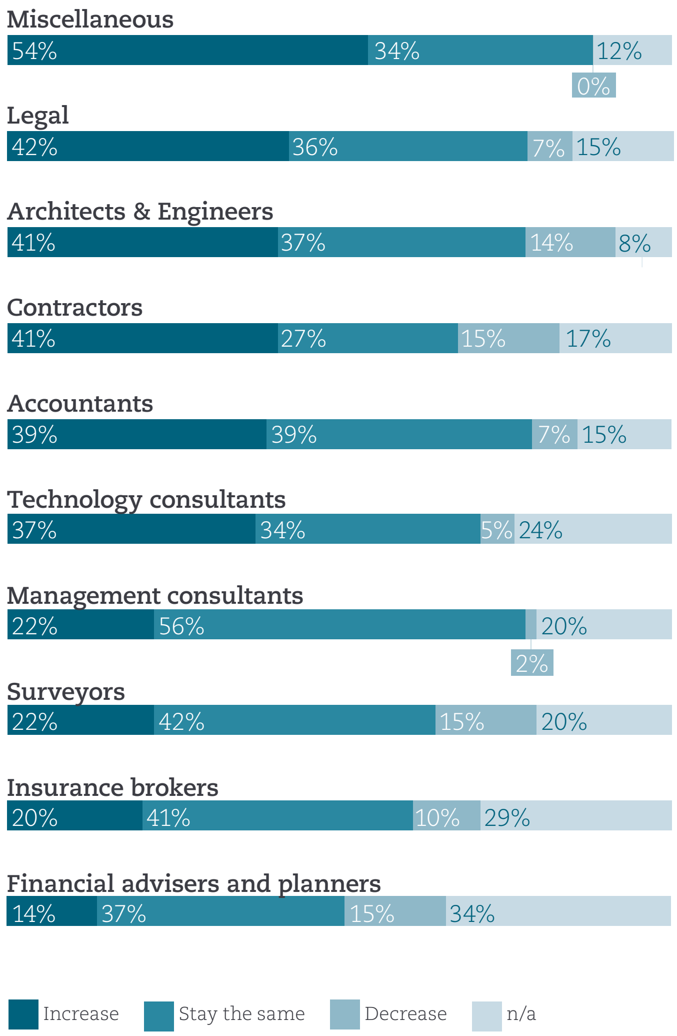
David Sawyer,
Divisional Managing Director, Professional and Financial Risks, Markel International

While underwriters expect to increase the volume of PI business written, there were some shifts in the volume of business respondents expect to underwrite for various professions in the next 12 months. The biggest rise in appetite was for the miscellaneous class, with more than 54% of respondents saying they expected to increase volume here in the coming year.

There was also a jump in appetite for the legal profession, with 42% reporting that they expected to underwrite more of that business in 2022, to the surprise of several of the respondents to the survey who suggested that this perhaps reflected a reduction in attractiveness of other lines.

There were sharp falls in appetite for some professions, however, with about 15% saying they would respectively reduce their appetite for financial advisors and planners and surveyors. Experts said that this likely reflected concerns about the potential exposures of those professions to claims in recessions; indeed the volume of business written for certain lines will doubtless change if economic conditions worsen further.

IN THE NEXT 12 MONTHS WHAT CHANGE DO YOU EXPECT IN THE VOLUME OF PI BUSINESS YOUR ORGANISATION WILL WRITE FOR THE FOLLOWING GROUPS OF PROFESSIONAL



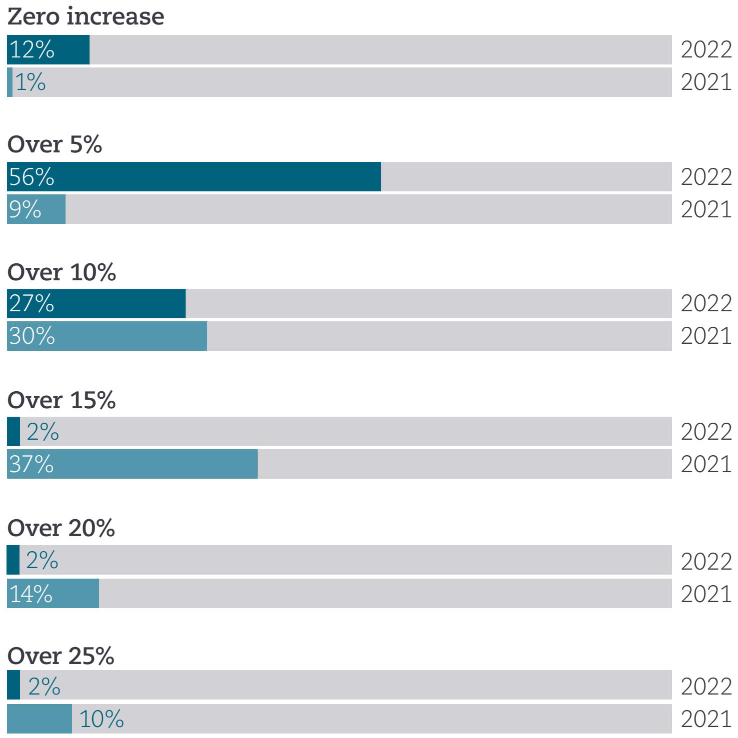
Rates starting to plateau?

While the vast majority of survey respondents expect rates for PI coverage to continue to rise over the next 12 months, the rate of hardening is slowing, they report.

More than half said they did not expect the market to harden further over a two-year period.

The majority, **56%**, predicted rate rises of 5% or more in the next 12 months, with more than a quarter of respondents, **27%**, expecting rate rises of 10% or more.

HOW MUCH DO YOU EXPECT RATES TO INCREASE IN 2022?



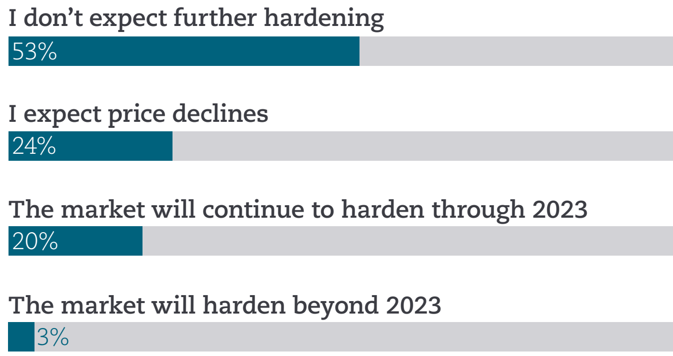
> After about five years of increases, rates are at an adequate level. But that's an adequate level for today. What's an adequate level in two years' time, or five years' time? With inflation nearing double-digit figures you have to ask what sort of impact that will have.

David Harries,
Executive Underwriter,
Berkshire Hathaway
Speciality Insurance

Over the next two years, however, more than half **53%** said they did not foresee further rate increases, while almost a quarter are expecting rates to fall.

A significant minority **20%** said they believed the market would continue to harden through 2023.

HOW DO YOU THINK THE PI MARKET WILL CHANGE OVER A TWO-YEAR HORIZON?



For some areas, there could still be significant movement on rates in the next one to two years. In the design and construction space, after a period of rate hikes and coverage restrictions in the wake of the Grenfell Tower tragedy and concern around cladding risks, experts reported a mixed picture. Some said they believed there was some room for rates to reduce here, but others noted that the extension of relevant limitation periods in the Building Safety Act 2022 could affect underwriters' appetite and/or the rates they wish to charge.

For insurance brokers, although claims emanating from disputes around business interruption coverage stemming from the COVID-19 pandemic have perhaps had less impact than might have been feared, there still remains the possibility of further actions. One respondent noted that brokers, who are required by the FCA to maintain adequate professional indemnity insurance, have a greater tendency than other professions to experience total limit losses, and the risk in this sector can be hard for underwriters to navigate with limit loss claims sometimes coming out of the blue. A "mini mega-hard market" still exists for this class.

While there is competition on some risks, overall the experts we spoke to said they believed the market was maintaining discipline - for now.

The claims picture is worsening

Despite the optimism displayed in the appetite to underwrite PI risks, the survey findings pointed to an expectation that the frequency and severity of claims may begin to increase, particularly if an economic downturn takes hold.

And while the number of directly COVID-related claims may have been less than some may have feared, the repercussions of the pandemic are also predicted to play a role in insolvencies over the medium-term.

More than half of respondents said they believed recessionary pressures and insolvencies post-COVID would be one of the top three external claims and liability factors that would materially affect the PI insurance market in the next five years.

While this is down from the **77%** of respondents who cited this as a concern last year, it's perhaps significant that **56%** this year said that economic uncertainty including wage and cost inflation would be one of the top three factors to materially influence claims; this was not a category voted on last year.

Past experience would suggest that PI claims increase in times of economic downturn as claimants seek redress for financial losses. Experts said that the likelihood of continued inflation could exacerbate the severity of claims and that economic predictions highlight the potential for inflation to increase further by the year's end.

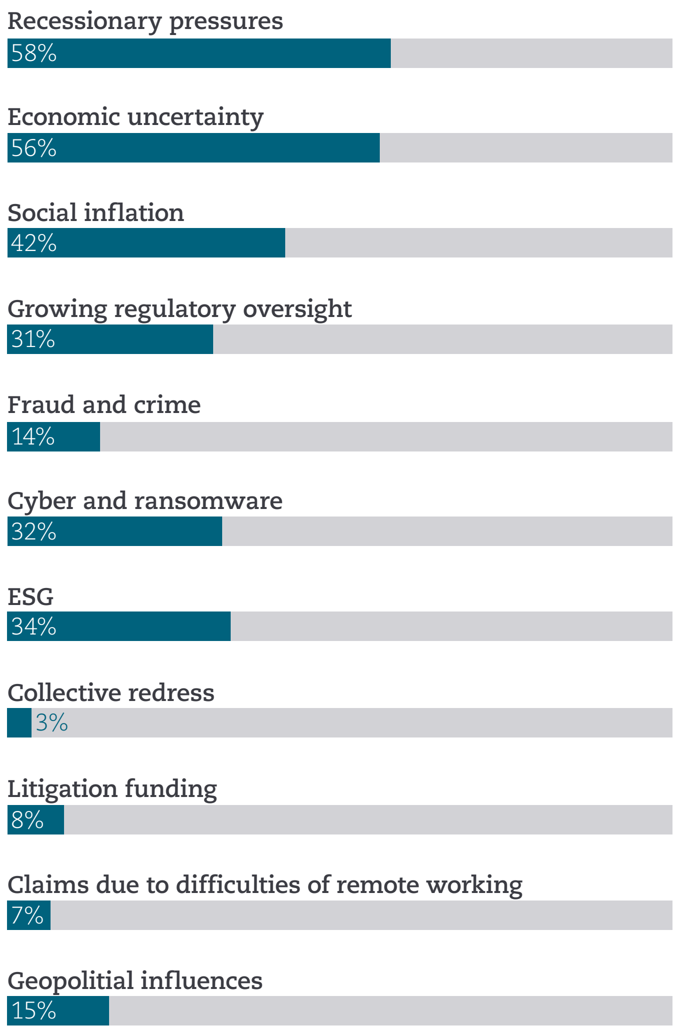
Social inflation is also a growing concern for many in the PI market. A large proportion **42%** of respondents cited this as one of the top three claims influencers for the next five years, up from **38%** last year.

Respondents largely expect the frequency of claims to increase over the coming two years, with almost **80%** predicting that claims frequency will increase.

And more than two-thirds of respondents said they expect the severity of claims to increase in the next 24 months, with **32%** predicting severity will remain broadly the same and no respondents predicting a decrease.

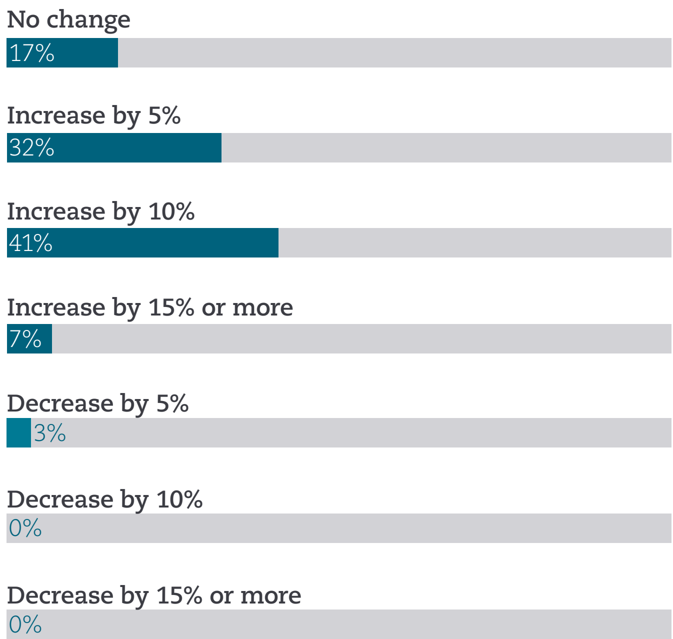
Some excess layers of coverage, which might still be substantially underpriced, may be drastically impacted by severity of claims. And while the market might be able to cope with an increased frequency, the combination of frequency and severity might cause problems for claims departments that have been hit by a lack of experienced and skilled talent in recent years.

WHICH OF THE FOLLOWING EXTERNAL CLAIMS AND LIABILITY FACTORS WILL MATERIALLY INFLUENCE THE PI INSURANCE MARKET MOST OVER THE NEXT FIVE YEARS?

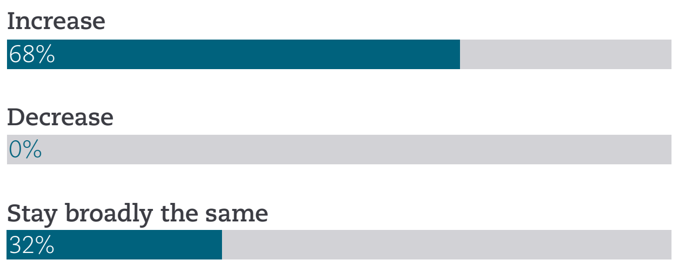


> We are all alive to social inflation and it's part of the daily underwrite. This is not a new issue. Social inflation takes different forms, including increased defence costs stemming from an evolving definition of wrongful activity. Those claims often do not find their way to an indemnity but nevertheless must be defended. Bodily injury claims on the US construction side continue to increase in severity. And asset price inflation will also probably come into focus a bit more as valuations fall and professional advice is scrutinised as out-of-pocket investors seek to recoup their gains.
>
> Jana Ratnajothy,
> Head of Professional Liability and Commercial E&O, Convex Insurance

IN THE NEXT 24 MONTHS, HOW DO YOU EXPECT THE FREQUENCY OF PI CLAIMS TO CHANGE?



IN THE NEXT 24 MONTHS, HOW DO YOU EXPECT THE SEVERITY OF PI CLAIMS TO CHANGE?



> There will be an increase in the number of claims, but they will not necessarily come out of the woodwork in the next 12 months. There's always a lag in PI claims. The inflationary impact will likely increase between now and the year end. Our experience of acting across the traditional and emerging professions has shown us that strategies for managing books of claims cost-effectively while meeting stakeholder expectations are key.

Louisa Robbins,
Partner and Head of Clyde & Co's National Professional Indemnity Practice

Coverage and wordings a mixed bag

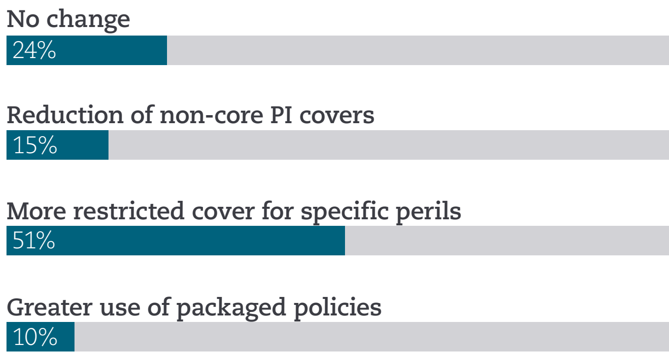
A majority of carriers said they expected to reduce or restrict coverage in the next 12 months. More than half said they would restrict cover for specific perils, while the offering for standalone, affirmative coverages is set to increase.

This is particularly true of cyber, for which **54%** of respondents said they are offering, or will offer, standalone coverage in the next 12 months. The Lloyd's and PRA mandates for clarity on silent cyber have served to create a greater market for standalone coverage.

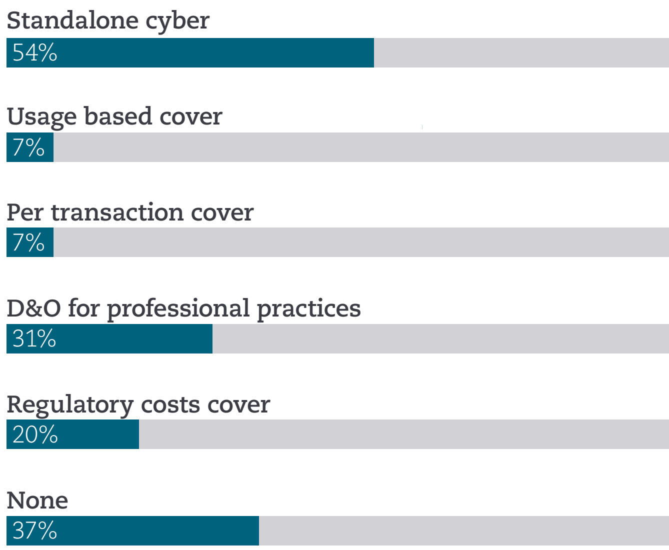
Experts noted that, particularly given the claims picture and the regulatory focus on silent cyber, buyers on the whole cannot expect cyber coverage to be given as part of a package any longer. They pointed to the expertise in underwriting standalone cyber coverage in the London market. While not all professional firms will need cyber coverage, a great many will, they pointed out and experience has shown that affirmative, standalone coverage will be of greater value, though is unlikely to come cheap.

There is a marked lack of enthusiasm to underwrite packaged coverage, with only **10%** saying they would increase their underwriting of combined policies in 2022. Commentators said that this demonstrates underwriters exhibiting greater caution and that non-packaged policies are by and large 'safer' from an underwriting standpoint.

HOW DO YOU EXPECT PI PROGRAMMES WILL CHANGE IN 2022?



ASSUMING THE EROSION IN SCOPE OF TRADITIONAL PI COVERS, WHAT ALTERNATIVE/STANDALONE ELEMENTS OF COVER ARE YOU CURRENTLY OFFERING/LIKELY TO OFFER PROFESSIONAL BUSINESSES WITHIN THE NEXT 12 MONTHS?



> Specialist underwriters in the Lloyd's market should, where practicable, be reviewing their wordings every year.
>
> James Sterling, Technical and Strategic Claims Consultant
> Aspen Insurance Group

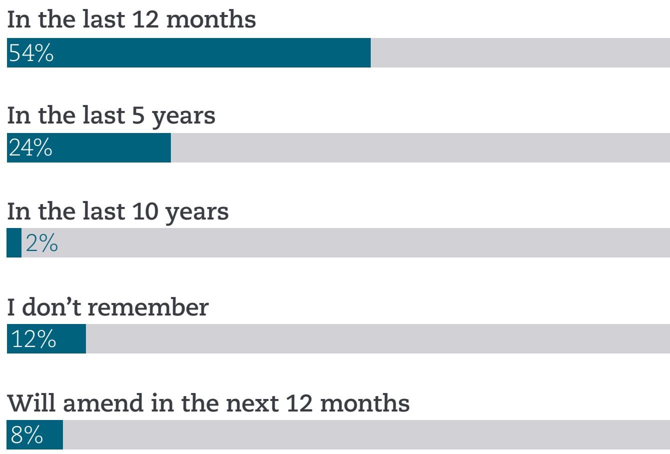
Wordings may be due a revisit

Only just over half, 55%, of respondents said they had substantively revisited PI insurance wordings within the past 12 months, and strikingly some 12% said they did not remember when wordings were last substantively amended.

Experts suggested that perhaps many underwriters believed they had done a lot of work on wordings, notably for design and construction business in the wake of the Grenfell Tower disaster, as well as more recently as the market hardened. Others noted that following markets are unable to exert changes to wordings.

It was noted, however, that as economic conditions start to bite, a review of wordings could help to ready insurers for the coming years.

WHEN DID YOU LAST SUBSTANTIVELY REVISIT YOUR PI WORDINGS AND PROPOSAL FORMS??

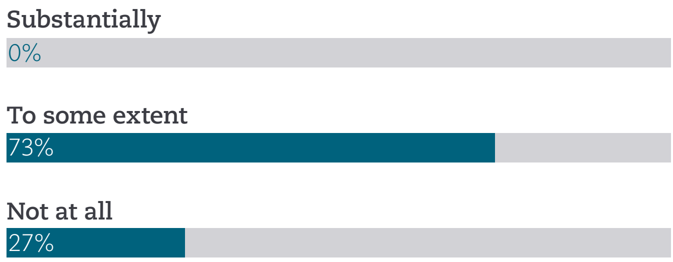


> Wordings need regular review as times change. A perfect example of that is silent cyber; a few years ago this was not an issue, now it is a focus for claimants and regulators alike.
>
> Ivor Edwards, Partner, Clyde & Co.

ESG rising up the agenda

None of the respondents to the survey said that Environmental, Social and Governance (ESG) considerations were having a substantial impact on the underwriting of PI risks. But almost three quarters 73% said ESG considerations were being factored into underwriting to some extent, with the (significant) remainder reporting ESG currently had no impact at all.

HOW ARE ESG CONSIDERATIONS IMPACTING UNDERWRITING OF PI RISKS?



> Professionals are still a long way behind the claims that are being brought against directors & officers for instance. That is, in good part, due to activist groups targeting boards of directors to achieve corporate changes. ESG is a significant issue for professional firms in that they need to understand what their client base is responding to. But exposure to liability claims will be a rather slower burn.
>
> Simon Konsta, Partner and Head of Clients & Markets, Clyde & Co

Market seems neutral on Artificial Intelligence

While just under a third of respondents thought that the greater use of artificial intelligence (AI) in the delivery of professional services would increase risk, 21% thought it would decrease the risk of practice, while 46% thought it would make no difference.

With the use of AI on the rise in all professions, insurance included, it would seem worth monitoring this in future years to see how risk perceptions change.

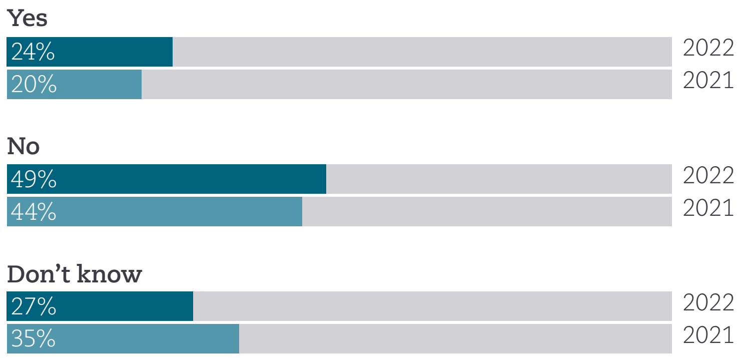
> It is interesting that the market remains broadly ambivalent about the impact of AI use in professional services. It is probably true to say that the implications of AI are not yet widely understood in the sector, and the survey results suggest that there is still a greater concern as to the risks of AI than an appreciation of its benefits. As AI gains traction in the professional services sector, and among insurers themselves, the market will need to keep ahead of the curve in its understanding of its use, risks and benefits.
>
> Rob Crossingham, Partner, Clyde & Co.

Investing in the future

Views on the London PI insurance market's investment in Diversity and Social Mobility remained broadly the same as last year, with **49%** saying they did not believe the market invested adequately - an even worse score than the **44%** reported last year.

While commentators noted that the insurance market has always included a good mix of individuals with and without degrees, for example, continuing to encourage and nurture young talent with a diversity of experience and background would be vital for the market to modernise and remain relevant.

DOES THE LONDON PI MARKET INVEST ADEQUATELY IN DIVERSITY AND SOCIAL MOBILITY?

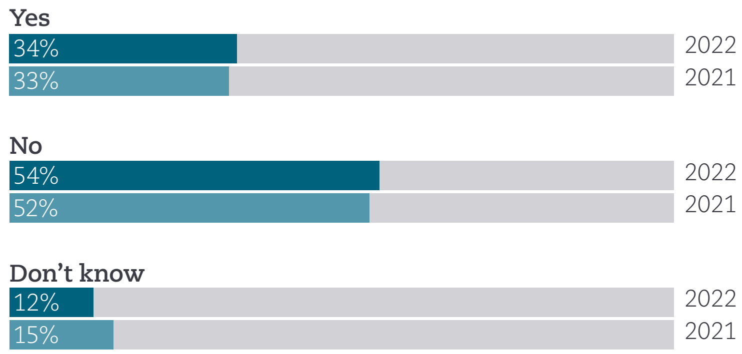


While the emergence of various company and market-sponsored schemes and development programmes is encouraging, it's clear that the London Market has a long way to go to improve D&I.

More than half of respondents also said that the London PI market does not invest enough in attracting and retaining talent, training and career development.

Though representatives of individual insurers and brokers were keen to mention the strides their companies are making to improve diversity and social mobility and to attract, train, develop and retain talent, it's clear there is still a lot of work to be done market-wide.

DOES THE PI MARKET INVEST ADEQUATELY IN ATTRACTING AND RETAINING TALENT, TRAINING AND CAREER DEVELOPMENT?



Methodology
Clyde & Co conducted an online survey of 89 targeted London market insurance professionals during May 2022. The findings were then discussed and analysed by Clyde & Co partners and used as the basis for interviews with David Harries, Berkshire Hathaway Specialty Insurance; Charles Manchester, Manchester Underwriting Ltd.; Jana Ratnajothy, Convex Insurance; David Sawyer, Markel International; James Sterling, Aspen; and Rob Turner, Howden UK.

480

Partners

2,400

Lawyers

3,200

Legal professionals

5,000

Total staff

60+

Offices worldwide*

www.clydeco.com

*Includes associated offices

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