

## What is the role of a specialist PI insurer in the face of predicted turbulent times for the insurance market?

# PI premiums and the current insurance market turmoil

■ **Northern Rock, Bear Stearns, Lehman Brothers and now AIG are a few examples of companies whose fortunes have collapsed as a result of the credit crunch and mounting mortgage debts.**

### the crisis at AIG

AIG is a diversified company whose structure is not typical of other global insurers. Their exposure to mortgage related credit derivatives and residential mortgage backed securities forced the company to reduce the value of those portfolios by \$18bn earlier in the year. A subsequent liquidity crisis brought AIG to the brink of what could have been the largest insurance holding company bankruptcy in history had the US Federal Reserve Bank not have stepped in with an \$85bn rescue package.

AIG's core insurance operations are, however, largely insulated from the losses in other segments of the company by insurance regulations which require the company to ring fence their insurance assets. Although the AIG parent company was in trouble, the insurance entities were profitable and their balance sheets remained strong.

### the end of the soft rating cycle?

The crisis at AIG coupled with write-downs of investments held by other insurers has prompted some market commentators to suggest that the current, consumer friendly, soft rating cycle is coming to an end. Their view is also strengthened by the losses generated by the global insurance market following hurricanes Gustav and Ike which could cost the industry as much as \$20bn.

Not all insurance industry practitioners and observers agree with this view. Other European insurers, backed by sound balance sheets, ample cash and comparatively healthy

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insurance markets, see themselves as potential winners of the US home-loan crisis. They have the financial means to grow organically and through takeovers and maintain a competitive rating environment.

Speaking before the AIG crisis reached its peak, Evan Greenberg, Chief Executive Officer of ACE Ltd, said: "I do believe we are going to have soft market conditions for the foreseeable future. I am prepared and my company is prepared for it to last for some time."

### the impact on premiums

Whether the soft insurance market cycle is coming to an end or not we will have to wait and see, but the cost of Professional Indemnity insurance (PI) for ACCA members shows no sign of a general hardening as competition for the business among insurers remains intense.

The widely respected business intelligence and market research service Datamonitor has predicted that the insurance market is expected to harden in 2008 or 2009 due to changes in competition and product penetration in the PI sector. If premiums begin to harden in 2009 it is forecast that Gross Written Premium (GWP) in the PI sector will grow to over £2.5bn by 2011. If the market hardens in 2009, however, the forecast is

GWP growth to 'only' £2.1bn – but still a 25% increase on the figures for 2006.

The PI insurance sector does look set to grow as many more companies become aware of the increasingly litigious society that is beginning to evolve in the UK. More professionals are being persuaded by the benefits of taking out cover as the UK's exposure to risk has grown enormously over the last 12 months. The sub-prime crisis, the credit crunch, emerging risks such as identity theft, Northern Rock, and not to forget the huge loss at Société Générale, will all lead us into a period of caution.

### the importance of a stable relationship with an insurer

It is certainly the case in PI insurance that it can sometimes pay dividends to build up a relationship with an insurer over time rather than enjoy the illicit thrill of a 'one night stand' with a new entrant to the market. Although new entrants offering the promise of lower premiums may be tempting during a soft market, they frequently prove to be less than accommodating when the market turns and the serious claims start to mount.

Stability should be the key to receiving a good service from your insurer. Stability in this sense means a specialist PI insurer will tend to see the market through the good and bad times whereas the new entrant will more typically withdraw when these types of risks become too hot to handle. ■

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