The Market for Lawyers’ Professional Liability Insurance for Large U.S. Firms*

* Defined as > 50 Attorneys

Aon Global Professions Practice
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The Fourth Quarter of 2007 signaled the first significant softening of the lawyers’ professional liability insurance market since premiums peaked in 2006. Rate reductions of 5-10% were common in late 2007 (for firms without specific claim issues) and some firms achieved even greater reductions on certain layers of coverage. In light of expected continued profitability and increased competition among insurers writing this line of business, law firms are seeing continued rate reductions in 2008, though the magnitude of such reductions depends upon the unique characteristics of the law firm and its program.

As in past cycles, the lawyers’ professional liability insurance market has lagged behind the D&O market, which softened several years ago. Law firm losses - and corresponding premium changes - tend to develop more slowly than D&O losses and premiums do, because a law firm frequently is not a party to initial litigation. Only after underlying litigation is resolved is it determined if the law firm will have any liability whatsoever.

Another factor that delayed the soft market for lawyers is the lag before new capital enters the market. The lawyers’ professional liability market is substantially smaller than the D&O market and law firm losses are not reported publicly, as D&O losses are. The larger size and transparency of the D&O market makes it more attractive (than the lawyers’ professional liability market) to opportunistic capital entering the insurance market. In addition, the perception of lawyers’ professional liability loss experience by insurers outside of that market (including insurers that exited the market without waiting for premiums to recover) often tends to be worse than reality.

The 2007 year was notable for the increase in insurer capacity flowing to the lawyers’ professional liability market. This created greater competition and accelerated the market softening in the fourth quarter.

Marketplace Conditions

Large law firm losses have been relatively benign for the last five years, after a four year period from 1999 to 2002 characterized by a greater frequency of severe losses, arising from financial failures of law firms’ clients due to corporate malfeasance and the economic downturn in the late 1990’s, as well as from tax shelter work performed by a few firms. Yet, even during the high loss period, law firm claim frequency remained well below the frequency of D&O losses. For example, many of the financial scandals that generated D&O claims did not result in law firms claims (and in several cases where law firms were sued, they were later dismissed based on Central Bank of Denver protections). Laddering and options back-dating are examples of loss “categories” that have generated few, if any, law firm professional liability claims, to our knowledge.

The credit market crisis is the latest issue to worry lawyers’ professional liability underwriters, triggered by indications that related suits have contributed to rising D&O notifications after a period of reduced frequency of securities filings. Law firms have not been targeted in these suits, to our knowledge. Meanwhile, the Stoneridge Investment Partners LLC v Scientific-Atlanta Inc. decision by the Supreme Court reaffirmed existing strong protections for professionals relative to federal aiding and abetting claims, making it even less likely than in the late 1990’s that law firms will be drawn into federal fraud cases where they are not deemed a primary violator.
Large law firm loss experience is expected to remain favorable for the near term, recognizing that adverse changes to the global economy might ultimately affect the law firm claim environment.

Loss severity today generally remains below the $50 million ceiling established in the lawyers’ professional liability cycle of the late 1980’s to early 1990’s, with a small number of claims approaching $100 million and one notable exception in which a law firm loss might potentially exceed $200 million.

Rates

Law firm liability rates peaked in 2005 and 2006, after a series of increases that began in late 2001. For large law firms, the dearth of primary layer capacity has allowed insurers to sustain primary layer rates for the last few years, despite the fact that several insurers writing this coverage entered the market after the adverse loss years and have therefore enjoyed very profitable underwriting results. In 2007, the number of credible Lead Underwriters on primary business remained fairly constant. However, available supporting capacity for primary layers increased, which allowed brokers to fill out placements led by alternative Leaders without using the incumbent Leader’s capacity. This created real competitive pressure on incumbent primary layer Leaders for the first time in many years and led to substantial rate reductions in the latter part of the year.

Excess layer rates started to become more competitive in 2005, but only for law firms that did not “buy the market” (i.e. they purchased per claim limits of less than $150-200 million). Excess layer rates declined for most firms by the Fourth Quarter of 2007, largely because of aggressive premium growth strategies of certain insurers who put up more/new capacity and priced their product competitively to deploy it.

Market rates are expected to continue to decline through 2008, for accounts without specific claim issues, because of a number of factors:

- law firm loss experience remains benign relative to current premium levels and to losses from the 1999-2002 years;
- insurers that participated in the adverse loss cycle appear to have recovered from years with poor results;
- insurers that did not participate in adverse historical losses have enjoyed steady profits;
- incumbent insurers have increased capacity and/or targeted premium growth in the class, which has led to greater competition for the finite pool of insured firms; and
- new insurers have recently entered/re-entered the class.
  - other lines of business are less attractive because rates have been softening for some time; and
  - long-tail business is attractive as a counter balance to short-tail catastrophe business.
ALAS Rates as Directional Benchmarks

As ALAS firms know, ALAS is a mutual insurer (and a direct writer) that was formed in the late 1970’s by a group of law firms that were unable to obtain adequate insurance capacity in the hard commercial insurance market at that time. ALAS grew substantially in the mid-1980’s and continues to play a significant role in the lawyers’ professional liability marketplace today (supported by substantial amounts of reinsurance). ALAS charges unitary premium rates for firms at comparable limits and retentions. ALAS’s rates are published annually and have become a directional benchmark for the commercial market that competes with ALAS.

The chart below illustrates the change in ALAS’s benchmark rate over the period 1999 to 2008. We note that ALAS has earned profits in the past few years, which has allowed the company to return profits in the form of premium credits to member firms and led to rate reductions effective January 1, 2008.

### ALAS Rates

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<tr>
<td>Rate per Attorney</td>
<td>$2,984</td>
<td>$2,984</td>
<td>$2,984</td>
<td>$4,028</td>
<td>$5,220</td>
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<td>100</td>
<td>100</td>
<td>135</td>
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<td>227</td>
<td>195</td>
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<td>177</td>
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<td>Year over year change</td>
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<td>0%</td>
<td>35%</td>
<td>30%</td>
<td>30%</td>
<td>-14%</td>
<td>0%</td>
<td>0%</td>
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* Retention structure is $500,000 each claim up to an annual aggregate retention of $1,000,000 and $100,000 each claim thereafter.

A law firm with an excellent risk/loss profile can expect to pay substantially less than the ALAS rate for commercial insurance. This is because ALAS’s rate is an average rate for the group, comprised of firms with excellent loss experience and firms with poor loss experience. Commercial rates are based on the individual firm’s experience and risk profile. A reduction in the ALAS rate would presumably lead to reductions in commercial rates for “good” firms to allow insurers to maintain a competitive advantage over ALAS.

### Emerging Trends - Wordings and Self-Insured Retention Levels

Large law firms maintain broad wordings that afford comprehensive coverage and allow buyers to retain control of the defense of claims, including choice of counsel.

Many large law firms increased their self-insured retention levels (by two to three times in some cases) and took on co-insurance during the early 2000’s. Some firms might...
seek to lower those retention levels again as premium rates decline. Many law firms continue to prefer low retentions as a mechanism to protect partner earnings from volatile claim costs.

Certain insurers are now open to consideration of multi-year policies (for the first time since these were discontinued - for most firms - in 2002). Multi-year policies can provide a competitive edge to insurers that are willing to offer these policies, assuming they are also priced competitively. Buyers, of course, may be less interested in a multi-year form if it does not offer the flexibility to benefit from future softening in the marketplace.

Limits and Capacity

For large U.S. law firms, the maximum capacity in the commercial lawyers’ professional liability insurance market currently is approximately $350-400 million per claim. ALAS’s total capacity of $75 million per claim (which includes some different insurers/reinsurers than commercial placements) functions effectively as parallel primary capacity and does not substantially increase the total limits available to ALAS member firms, many of whom purchase excess commercial limits above ALAS.

Coverage is typically placed on a subscription basis for large firms. The Beazley Syndicate and the Brit Syndicate at Lloyd’s and CNA in the U.S. lead a substantial portion of the large firm primary placements. Swiss Re and Fireman’s Fund are substantial supporting insurers. Axis, Arch (US), Lexington UK, Travelers (St. Paul), Hartford, W.R. Berkeley, Hiscox (Lloyd’s) and Chubb are also involved on a more limited basis. Law firms between 50 and 200 attorneys have primary layer capacity options that are not presently available to larger firms, including One Beacon, Navigators, Liberty International and Catlin (U.S.).

Excess capacity migrated from London and the U.S. to Bermuda after 2002. Ten Bermuda insurers now provide capacity. Lexington and Liberty International have been consistent providers of excess capacity as well. New players who joined the excess layer marketplace for law firms in 2007 include Scor Re and National Union.

Success Strategies

Law firms that are most successful in the professional liability marketplace provide insurers with a comprehensive picture of the firm’s risk profile and loss history in their written submissions and in underwriting meetings with key underwriters. Insurers expect law firms to acknowledge the importance of risk management and to have state-of-the-art programs in place. Insurers want a chance to meet senior partners and managers in the firm to understand how the firm manages risk on a day-to-day basis, particularly the key risks associated with client intake and conflicts of interest.

Conclusion

Premium rates for lawyers’ professional liability are moving downward toward what will hopefully be a more realistic pricing level relative to insurers’ actual recent loss experience. As competition increases, buyers should find that incumbent insurers are more willing to enhance program pricing and structure to maintain client relationships.