



M E M O R A N D U M

TO: CLLAS Advisory Board
Copy: Patrick Mahoney
FROM: Joe Tontini
RE: Renewal Strategy and Other Business
DATE: February 23, 2016

The purpose of this memorandum is to provide the CLLAS Advisory Board with some information on renewal issues and solicit feedback that may assist us with our reinsurance negotiation strategy for the July 1, 2016 renewal.

Limit Benchmarking

CLLAS has offered limits of up to \$250,000,000 since 2011. There is significant insurance limit capacity available in the market today and CLLAS firms could buy additional limits at a relatively low cost. We asked Mark Popple at Miller Insurance Services and Bob Wilson at Hub International to help us benchmark law firm limits in Canada, US and UK.

We could not obtain specific data from Canadian law firms but we believe that Canadian law firms with no international presence would not purchase more than \$250,000,000. There are, however a number of law firms in Canada that are now affiliated with international law firms, including Dentons, Norton Rose, Gowlings, DLA Piper and Clyde & Co. We therefore gathered information on US and UK firms to determine what limits they might carry.

In the UK, we understand that the majority of “Magic Circle” firms purchase above £400,000,000. The next tier of about 50 firms (300 to 2,500 lawyers) purchase £100,000,000 to £200,000,000. The next tier of 50 firms (70 to 300 lawyers) purchase £50,000,000 to £200,000,000. Anecdotally, Miller heard that one UK law firm purchases £1 billion of professional indemnity (PI) coverage.

In the US, we understand that firms with greater than 250 lawyers purchase average limits of US\$100,000,000 with a high of US\$600,000,000.

In the UK, limits are typically on an each and every claim basis while in the US, limits can have a double or triple aggregate or reinstatement. Canada typically offers a single aggregate relying on higher limits to cover multiple losses.

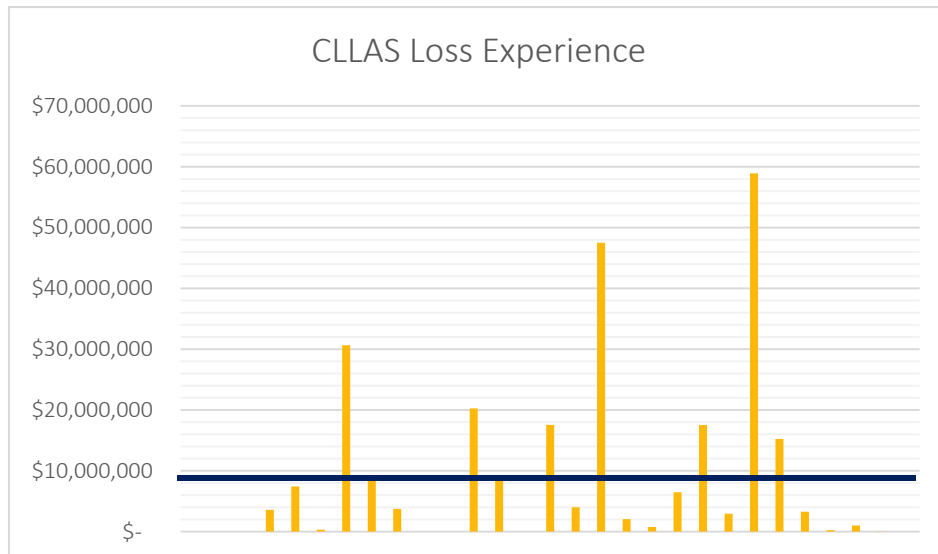
According to a recent survey conducted by Ames and Gough of nine insurers who specialize in lawyers PI claims, six either paid or participated in paying a claim of \$20 million or greater, including three payments between \$50 million to \$100 million and one involving a claim exceeding \$100 million. See article attached.

Should CLLAS firms be interested in higher limits, we would suggest that additional limits of \$50,000,000 or \$100,000,000 be made available in the Optional Excess layer to bring the total limit to \$300,000,000 or \$350,000,000. The rate per lawyer per \$10,000,000 of additional limit should be less than \$30.

CLLAS Loss Experience

CLLAS has incurred (paid and reserved) approximately \$250,000,000 in claims since its inception in 1987. Four policy years have had claims incurred between \$5,000,000 and \$15,000,000; four years between \$15,000,000 and \$25,000,000; and three years have had claims exceeding \$30 million. The paid and reserved amount for the July 1, 2009/2010 policy year is currently just under \$60,000,000 most of which is the result of a significant reserve adjustment on one claim that was posted last year just after the reinsurance renewal was finalized.

Reinsurers currently collect under \$9 million annually (100% figures) for the \$50,000,000 primary CLLAS policy. The incurred claims do not reflect inflation, trending and loss development so based on the historical loss experience, it will continue to be a challenging renewal negotiation process as we attempt to justify low reinsurance costs relative to actuarial determinations. The chart below illustrates the point.



Reinsurance Rates Vs Actuarial Rates

The July 1, 2011/12 reinsurance structure was dramatically changed when we went from a multi-layered approach on \$49 million excess of \$1 million of coverage to a single layer of protection. This allowed CLLAS to take advantage of soft market conditions and pay for reinsurance protection that was substantially lower than the actuarial expected loss costs. The table below sets forth a comparison between the reinsurance rate and the expected loss costs per lawyer as determined by our actuary. The expected loss costs take into consideration inflation, loss trending and loss development.

Policy Year	Reinsurance Rate	Expected Loss Costs	% Difference
2011/2012	\$2,728	\$3,510	129%
2012/2013	\$2,288	\$3,774	165%
2013/2014	\$2,345	\$3,356	143%
2014/2015	\$2,195	\$3,484	159%
2015/2016	\$2,134	\$3,362	158%

While no one is predicting a hard market any time soon, it is interesting to note that AIG recently announced that they would no longer accept new lawyers PI business and renewal business would be priced 20% higher than expiring (see attached article).

The renewal negotiations will be challenging but CLLAS does have a couple of good arguments in favour of keeping reinsurance costs down. They are:

1. CLLAS has had excellent experience since the new \$50,000,000 structure was put in place in 2011. Many of the underwriters on this new structure were relatively new to CLLAS so if they solely concentrated on the last five years, underwriters should feel confident that they have a good chance of making a profit. Of course, nothing is certain and underwriters will argue that the last five years are still developing and it is always possible that claims experience will deteriorate unexpectedly.
2. Long term relationships matter. On all layers of coverage, we do have underwriters that have reinsured CLLAS for a very long time. Clearly, they have experienced good years and years that were not so good but they continue to support CLLAS. The lead underwriter on the \$50,000,000 layer is Nigel Dorning of Argo Syndicate and is relatively new but he has been especially flexible in establishing the initial terms and negotiating favourable renewal terms over the past several years. We will rely on his ongoing support to keep reinsurance costs down.

Renewal Strategy

Underwriters are fully aware that CLLAS is close to the end of its current five-year underwriting cycle. CLLAS is probably one of the top ten insurance buying groups in the world and underwriters appreciate the certainty that a five-year underwriting period brings to CLLAS. However, it is fair to say that every five years, underwriters become a little anxious about whether the next five-year underwriting period will have the same number of firms and lawyers as the expiring period. They would like nothing more than absolute certainty that the group will stay together for another five years.

We can expect a tough renewal process due to the significant reserve increase posted in 2015 and the wide discrepancy between the current reinsurance rates and the actuarially determined rates. We believe that underwriters may soften their rating approach if they were informed that CLLAS members made an early commitment to the next underwriting period. In effect, an early commitment would mean that CLLAS would maintain its current membership for the next six years. Underwriters understand that Dentons would only be obligated to stay for one year. We therefore have had some preliminary discussions with our lead underwriter about the possibility of a two-year guaranteed rate (subject to certain conditions to be agreed) with the quid quo pro CLLAS members would make an early commitment to the next underwriting period. If CLLAS members are interested in pursuing this approach, we will ask underwriters to provide more details about what a two-year policy might look like, including rates and policy terms and conditions. Underwriters would need some early and current claims statistics in order to make their determination. We believe we can provide them with this information and obtain their response within six weeks. This should hopefully give us enough time to inform CLLAS members of the underwriting proposal so that members can approach their management committees. The management committees would then have to decide whether they are prepared to make an early commitment to the next underwriting period.

Other Business – Cyber Coverage Considerations

Cyber risks and cyber coverage continue to be the most talked about subject in the insurance industry. CLLAS introduced cyber language on the Primary Policy on July 1, 2012. We knew at the time that law societies were beginning to exclude cyber from the mandatory policies and CLLAS wanted to make sure that, notwithstanding these changes, whatever coverage existed on the CLLAS policy continued. Consequently, the CLLAS Policy Committee made some changes to the policy by introducing some additional definitions, i.e. “Personal Information” and “Confidential Information”, and modifying the definition of “Claim” and “Professional Services”.

LawPro introduced cyber language in 2014 by doing the following:

- 1) LawPro introduced a specific exclusion: (j) to any CLAIM in any way relating to or arising out of a CYBERCRIME(S)
- 2) LawPro added two new definitions:
 - a. CYBERCRIME(S) means an incursion, intrusion, penetration, impairment, use or attack of a COMPUTER SYSTEM(S) by electronic means by a third party, other than the INSURED or the INSURED’S LAW FIRM
 - b. COMPUTER SYSTEM means any electronic device, component, network or system, or any protocol, portal, storage device, media, or electronic document, or any computer software, firmware or microcode, or any associated technology which receives, processes, stores, transmits or retrieves data either locally or remotely, or any part thereof, whether stand-alone, interconnected or operating as part of an integrated system or process, for use by or on behalf of the INSURED and/or the INSURED’S LAW FIRM.
- 3) The Program then added a limited form of coverage as follows:

This POLICY, subject to all its terms and conditions not in conflict with this endorsement, shall include the following:

A. COVERAGE:

Notwithstanding Part III Exclusion (j), but subject to the SUBLIMIT OF LIABILITY, terms and conditions contained in this endorsement, coverage in accordance with Part I, Coverages A and B of the POLICY, is hereby provided for CLAIM(S) arising out of liability for a CYBERCRIME(S), provided such CYBERCRIME(S) results in:

- (i) the disclosure, destruction, modification, corruption, manipulation, damage, deletion, theft or misuse of any confidential client data which has been entrusted to, received by and held in trust by or on behalf of the INSURED as a direct consequence of the performance of PROFESSIONAL SERVICES; or*
- (ii) the misappropriation of money which was entrusted to, received by and held in trust by or on behalf of the INSURED as a direct consequence of the performance of PROFESSIONAL SERVICES.*

B. SUBLIMIT OF LIABILITY:

The amount of coverage provided with respect to this endorsement shall be subject to a SUBLIMIT OF LIABILITY of \$250,000 per CLAIM and in the aggregate per POLICY PERIOD for the INSURED. This SUBLIMIT OF LIABILITY is included within the LIMIT OF LIABILITY and AGGREGATE LIMIT OF LIABILITY of the INSURER, as set out in ITEMS 5 and 6 of the Declarations. The total limit of the INSURER'S liability pursuant to this endorsement, for each CLAIM, regardless of the number of INSUREDS who may be in a LAW FIRM, shall be \$250,000 per POLICY PERIOD for each LAW FIRM.

The LawPro approach is very specific in terms of what it intends to cover including being specific about "Cybercrime" which is not defined in the CLLAS policy. We would suggest that the CLLAS Policy Committee review the LawPro amendment (as well as the cyber language that may or may not exist in other relevant law societies) and compare it with the current cyber coverage that exists in the CLLAS policy. A report on cyber of the Policy Committee can be tabled in September or December of 2016. If there are any changes suggested by the Policy Committee, they could be implemented for the 2017 renewal.

Other Business – Associate Member Initiative

Lenczner Slaght Royce Smith Griffin LLP officially became a CLLAS Associate Member on January 1, 2016. The firm purchased an 18 month policy to coincide with the expiry of the CLLAS policy for \$95,000,000 in total limits. The Primary Excess Policy (\$50,000,000) was placed in Binding Authority arrangements that included underwriters who also participate on the CLLAS coverage. Specifically, the underwriter percentages were as follows: Lloyd's 72%; Allianz 8%; and CNA 20%. \$45,000,000 excess of \$50,000,000 was placed through Bob Wilson with the same markets that CLLAS members currently have.

Over the course of the next few months leading up to the January 1, 2017 renewals (for most Ontario firms), we will be approaching a number of other law firms about the prospect of joining CLLAS as Associate Members.

Other Business – Survey

We had asked CLLAS members to respond to a survey regarding additional coverages that may be structured through CLLAS and Colchester, including cyber coverage and cost of risk coverage among others. We received six responses the results of which are attached. We would encourage those that have not yet responded to take a few minutes to respond to the survey. We are not looking for a commitment at this stage, only an indication of general interest.

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Law Firms Face Large Malpractice Claims as Risks Grow: Study

As law firms adjust to the realities of the current business environment, they continue to fall victim to malpractice claims, which can be costly to defend and may result in enduring reputational damage. A new study by insurance broker Ames & Gough finds most legal malpractice insurers continue to see a steady flow of new claims, including those in excess of \$50 million.

In its fifth annual survey of lawyers' professional liability claims, Ames & Gough examined the trend by polling nine of the lawyers' professional liability insurance companies that on a combined basis provide insurance to approximately 80 percent of the AM Law 100 firms.

Claims frequency unchanged. Five of the insurers indicated the frequency of malpractice claims is similar in 2014 to the prior year, two reported seeing greater claim activity and two saw fewer claims. While the number of claims has been stable for the past two years, it is down from the highs of 2011 and 2012. Nonetheless, the current frequency of legal malpractice claims remains above pre-recession levels.

Meanwhile, six of the insurers surveyed either paid or participated in paying a claim of \$20 million or greater, including three with a payment between \$50 million – \$100 million and one involved in a claim exceeding \$100 million. Six of the nine insurers surveyed reported having more claims with reserves of \$500,000 or greater in 2014 than 2013.

“These are dynamic times for the legal profession in the U.S. as law firms drive for growth or stability in an environment marked by intensifying competition,” said Eileen Garczynski, partner and senior vice president of Ames & Gough. “As firms evolve, they need to keep a sharp focus on how their decisions might result in added risks, including those of malpractice claims.”

Trusts and estates practice now largest source of claims. Among specific practice areas, trusts, estates and probate law was viewed by two-thirds of the insurers as the most significant source of claims, followed by corporate and securities law, business transactions, and real estate. The latter dropping to fourth, after four consecutive years of being cited as the leading source of malpractice claims. According to the survey, it appears a large percentage of the real estate-related claims initiated during the recession have now worked their way through the system.

Conflicts are the leading cause of claims. Year over year, conflict of interest remains by far the single leading alleged legal malpractice error. This year, six of the nine insurers surveyed cited conflicts as the top driver of malpractice claims. When asked specifically about firm mergers or lateral hires, the same number of insurers cited an uptick in claims arising from the melding of staff at law firms.

“Conflicts are a growing concern today as increasing numbers of law firms seize opportunities for growth and expansion either through mergers and acquisitions or by bringing in lateral hires,” Garczynski noted. “Unfortunately, the potential conflicts arising from these initiatives often are not addressed early enough in the process. And when conflicts finally are realized, they are frequently either ignored or overlooked.”

Meanwhile, cyber exposures – at least on the surface – do not appear to be driving as many malpractice claims for law firms. Three of the insurers surveyed reported having a lawyers’ professional liability insurance claim arising from a cyber or network security event. Nonetheless, the finding may be misleading.

“There have been a number of reports along with a great deal of anecdotal information of law firms either being hacked and not yet aware of it or otherwise reluctant to make that information public,” said Garczynski. “What’s clear is that given how rapidly technology is evolving, it’s virtually impossible to be completely insulated from cyber and data security risks.

“As their business expands, law firms need to constantly assess how they exchange information and the type of client data they handle or maintain on their own systems,” she added. “Once they understand their risks, they need to act quickly and do what’s necessary to manage their exposures.”

The insurers participating in the Ames & Gough survey were: AIG/Lexington, AXIS, BRIT, CNA, Catlin, Huntersure, Ironshore, Markel, and Swiss Re Corporate Solutions.

Ames & Gough provides management liability, employment practices liability, kidnap & ransom and related insurances; as well as more typical property/casualty insurances. The firm has offices in Boston, Philadelphia and Washington, D.C.

Source: Ames & Gough

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AIG exits LPL and targets other casualty withdrawals

David Bull

American International Group (AIG) is exiting lawyers' professional liability (LPL) business and conducting full or partial withdrawals from the environmental and construction casualty sectors, ***The Insurance Insider*** can reveal.

In its strategy update late last month the US insurance giant said it had "aggressively accelerated" the pace of remediation of and exits from underperforming sub-segments in the casualty arena.

And according to sources, that included an LPL book of business that is currently underwritten by AIG across three platforms.

The insurer's excess and surplus lines platform Lexington typically writes the business on an excess basis in the US.

AIG Cat Excess in Bermuda also has an LPL book, while Lexington's London market operation writes the business as a primary quota share player.

AIG, through Lexington, is understood to have told brokers that it will not accept any new LPL business and will look for a minimum of a 20 percent rate increase on its existing renewal book.

It is thought that last year AIG wrote around \$100mn of LPL premium across the three platforms.

The business is believed to have been loss making, with sources suggesting it may have registered losses paid and incurred in excess of \$160mn.

Most of the damage is likely to have been done in the US, where the insurer has typically written "big stretches at very thin margins", according to sources.

In a competitive marketplace it is unlikely that buyers will accept a 20 percent rate increase on renewing business.

As a result, broker sources believe that the strategy is effectively an attempt to manage a "constructive non-renewal and exit the business".

Beneficiaries of the move are likely to include Berkshire Hathaway Specialty Insurance and other carriers such as Ironshore, which are staffed by former AIG executives that know the business.

Meanwhile, it is thought that AIG is also targeting a full or partial retreat from other lines of casualty business including environmental and construction.

Full details are not yet known, but a partial environmental pull-out was referenced by Navigators' CEO Stan Galanski in his company's earnings call this week, as well as by market sources.

The executive noted that AIG would be withdrawing from certain segments of the US and Canadian environmental market, including site pollution policies, as he highlighted the opportunity for his company to capitalise on the opportunity to pick up the business.

In AIG's call with analysts following its strategy update in late January, commercial insurance CEO Rob Schimek pinpointed US casualty as an area that required improvement.

The business was the cause of a significant chunk of the \$3.6bn pre-tax reserve strengthening announced by the insurer, with \$1.2bn added to excess casualty reserves alone.

"There are some troublesome lines of business that despite the great efforts that we've gone through since Peter [Hancock, AIG president and CEO] arrived... the truth is we should actually just exit the line," Schimek suggested.

The executive said that in some cases the insurer would exit by pulling out of a line of business, while in others it would cut back via the way it prices itself in the marketplace.

After reducing US casualty writings by 30 percent from 2011 to 2015, AIG pointed to further cutbacks in the next two years.

The insurer said its strategy to improve the underwriting performance of its commercial insurance business will drive a further reduction in net written premiums of around \$1.5bn by the end of 2017.

AIG did not immediately respond to a request for comment.

The Insurance Insider February 12, 2016

SurveyMonkey Analyze Colchester Cell Captive Discussion

	I need to know more	Not at all interested	Somewhat interested	Very interested	Total	Weighted Average
— Cost of risk (i.e. stabilizing the cost of your current insurance program including fluctuations in premium and deductible expenses)	50.00% 3	16.67% 1	16.67% 1	16.67% 1	6	2.00
— Cyber risks (Including uninsured or under insured exposures such as business interruption or reputation risk)	33.33% 2	16.67% 1	33.33% 2	16.67% 1	6	2.33
— Difference in policy conditions (i.e. insuring exposures currently excluded such as "topping up" defense counsel fees and claims for return of legal fees)	50.00% 3	16.67% 1	16.67% 1	16.67% 1	6	2.00
— Management liability including outside directorship liability and employment practices liability	33.33% 2	66.67% 4	0.00% 0	0.00% 0	6	1.67
— Partners equity protection in the event of dissolution of the firm	33.33% 2	50.00% 3	16.67% 1	0.00% 0	6	1.83
— Protection against bad debts and extraordinary write-offs	50.00% 3	33.33% 2	16.67% 1	0.00% 0	6	1.67
— Extra expense coverage related to a failed merger and loss of income coverage caused by partners and clients leaving the firm	50.00% 3	50.00% 3	0.00% 0	0.00% 0	6	1.50