State of the Lawyers' Professional Liability (LPL) Market

In 2021, the hardening Lawyers' Professional Liability (LPL) market began to show signs of stabilization. As we start the new year, underwriters are still pursuing rate, retention, and capacity initiatives. New entrants to the LPL market have provided the additional capacity needed to temper the challenging market endured in 2020 and early 2021. New insurers competing for business, especially in the small to midsized LPL market, have caused incumbent insurers to rethink rate goals and mandates. In addition, the continued absence of COVID-related E&O litigation has resulted in some additional confidence in long-term LPL profitability.

The following is our year-end 2021 review and 2022 forecast of the LPL marketplace.

Rate Adequacy

As was the case in 2021, our annual survey of select LPL underwriters revealed continued general concern over frequency of severe LPL claims in large, mid-size, and small law firm segments. The survey also revealed that underwriters are still pursuing rate initiatives across all portfolios.

At this time last year, we reported rate increases in the range of 10% to 20% for large law firms (200 lawyers and up). Our polled markets reported realized rate increases for 2021 of between 5% and 15% in the large law space. While rate increases are less than they were in 2020, underwriters reported that because of current uncertainty surrounding the economy, pricing initiatives are not expected to end "any time soon." Many of the markets we polled again noted high-severity losses developing for recent accident years of 2015, 2017, 2018, 2019, and 2020. Underwriters also expressed concerns over mounting defense costs, which have increased exponentially over the past 10 years.

To address these concerns over rising defense costs, underwriters have increased self-insured retentions to offset the cost of resolving claims and restricted capacity to reduce exposure to severe losses. This holds true especially for larger firms that control defense strategy by maintaining coverage on an indemnity form, and which tend to have greater potential to experience severe losses.

In the mid-sized and small law space (1 - 199 lawyers), more abundant capacity and new entrants to the marketplace have allowed such firms to manage proposed rate increases. Nevertheless, underwriters have successfully achieved 2.5% to 7.5% rate increases in this segment. While rate increases in the mid-sized space are more manageable, excess capacity has become relatively more expensive due to a spike in severe claims increasingly exceeding primary limits.

Through Q1 2022, LPL insurers will not change course. Rate increase initiatives and underwriting discipline will continue, though the overall rate need should wane slightly as 2022 wears on.

Claim Sources

Corporate, Securities, Tax, Commercial Transactions, and Litigation practice areas maintain their status as leading generators of severe losses for large and mid-size firms, according to underwriters surveyed. Claim frequency is down, but older claims are starting to develop, particularly as courts are reopening. As noted above, the increased severity of claims has renewed underwriters' focus on retention adequacy. Multiple insurers reported experiencing losses that fully eroded large insurance towers, including high excess layers.

The severe claims stem from quality control issues and basic lawyering mistakes. Underwriters noted a recent resurgence of transactional and real estate Ponzi scheme cases, which tend to draw multiple law firms into a single, complex malpractice claim. These matters tend to drag on for years and are expensive to defend, driving up any costs of a defense settlement number.

Trusts & Estates (T&E) practices also generated an expectedly frequent level of severe claims. T&E claims have been more troublesome among small and mid-size firms and are expected to occur more frequently as the "baby boomer wealth transfer" continues to produce disputes. Underwriters in the U.S. and the UK are also monitoring a growing trend of Special Purpose Acquisition Company (SPAC) transactions. Concern regarding risks associated with SPAC transactions is rational at this juncture. This form of investment vehicle, with unique risks, has moved into the mainstream, and underwriters appreciate the potential for malpractice or fraud allegations against lawyers in the event of a failed deal. Emerging opportunities that are not well developed or regulated yet, such as cryptocurrency and NFTs, are viewed by underwriters as additional exposure for law firms.

- Client acceptance issues – unworthy clients, conflicts of interest, poor or incomplete documentation of engagement scope
- Simple drafting errors
- Failure to understand the law
- Failure to accurately document advice given
- Technology related errors, such as court-generated notices caught in spam filters, errors in information input or IP maintenance payment notice caught in spam filter
- Errors calculating deadlines, such as jurisdictional differences of key dates or failure to discover the correct date of final decision
- Suing clients to collect fees
- Failure to supervise, such as young associates preparing and filing documents without requirement of quality review by a partner
- Poor client communication resulting in misunderstanding of scope of engagement and expectations
- Failure to properly counsel a litigation client about the risk of going to trial, in writing
- Defense errors, such as trial strategy error, failure to call an expert, failure to make appropriate argument regarding damages, or failure to settle case

Underwriters continue to attribute these causes to an erosion of disciplined execution of basic risk management practices due to the pressure on lawyers to generate new clients and more revenue and a lack of oversight on work product.

When we wrote our 'State of the Market' report for 2021, underwriters still had some concerns regarding the impact of COVID-19. However, COVID-related claims have not materialized. The largest impact of COVID has been a reduction in support staff and the "war for talent." Law firms are not immune from the Great Resignation and are finding it difficult to recruit mid-level professionals, which has impacted how law firms do business. Caseloads have steadily increased, and underwriters are beginning to ask questions regarding matter count per attorney and staffing and talent retention initiatives. Despite wise use of technology and innovative training methods, it is evident that developing culturally aligned, competent associates remotely is very challenging. Additionally, due to understaffing issues, lawyer burn-out is also a concern for underwriters.

Cyber

Although LPL underwriters are not primarily focused on cyber-related risk controls, certain LPL insurers are asking for cyber-security-related information to evaluate their professional liability policy's potential exposure to cyber losses. In addition to discovering risk controls, some underwriters seek to confirm that firms are buying standalone cyber. Insurers affirmatively exclude first party cyber coverage from LPL policies and are removing modest cyber coverage from products in general.

A word of caution for cyber insurance renewal: In advance of the renewal, it is wise to invest in state-of-the-art IT infrastructure in order to promote insurability, maintain capacity and promote cyber-security readiness. Law firms also should prepare for significant increases in both retention and premiums. Given the volatility of the marketplace, it is difficult to accurately state or predict the level of increases we will see in 2022. Additionally, the underwriting process is taking longer and is more involved, which means firms should expect to start the process earlier.

Conclusion

Overall, the U.S. P&C industry is financially strong and well positioned to endure any economic turmoil caused by the COVID-19 pandemic. Similar to last year, the U.S. P&C industry is financially stable, and adverse results on individual books are largely offset by overall underwriting results and strong performance of investment income.

Law firms renewing in 2022 will experience another cycle of rate increases, the extent of which will depend on the size of firm. Primary rate increase strategies will vary from one insurer to the next and depend on individual firm risk profile. Except for a handful of primary markets, insurers are only offering $5,000,000 in primary limits, which has increased demand for excess capacity and resulted in upward rate pressure on excess layers. Efforts to manage limits exposed will continue through 2022, as will resulting upward rate pressure on excess layers.

Moving forward, more attention will be dedicated to factors such as adequacy of current rate per attorney, loss history, recent growth and size of firm, exposure to higher risk practice areas, staffing adequacy, and risk management practices. Due to the limited number of insurers willing and able to compete for large firm primary placements, and the more abundant number of competitors for mid-size law firm business, what law firms should anticipate at renewal will depend largely on the size of firm.

Large Law Firm Segment: Large firms should prepare for rate increases in the 5% to 10% range on primary layers. Since fewer insurers are willing to deploy capital on large firm primary layers, less competition for such positions has emboldened insurers in this space to push rate. Insurers in this segment will likely seek to increase self-insured retentions perceived to be inadequate. Firms in this segment with adverse claims experience will struggle to avoid rate increases above the range noted above. Insurers will likely continue to deploy capacity more conservatively, which will likely increase the cost of excess insurance and may challenge large towers of insurance to meet limit objectives.

Small to Mid-sized Law Firms: Law firms in this segment should anticipate rate increases in the 2.5% to 7.5% range and prepare to challenge any increase by leveraging more abundant capacity willing to compete for primary and excess layers. Despite more abundant capacity, firms in this segment with adverse claims development will also face difficulty avoiding significant rate increases as insurers seek to minimize exposure to severe losses. Coverage in this segment remains broad and competitive. Excess capacity is also abundant, but firms can no longer expect flat renewals on excess layers.

In preparation of this report, we surveyed key LPL insurers regarding their portfolios, claims experience, rate initiatives and their views of emerging trends. We would like to thank the following insurers for their time, insights, and contributions: CNA, Everest, Certain Underwriters at Lloyd's, Huntersure, MunichRe, ProSight, Sompo, and SwissRe.

Let's Start a Conversation!

Contact our Law Firm Team at **lawfirmserviceteam@lemme.com**