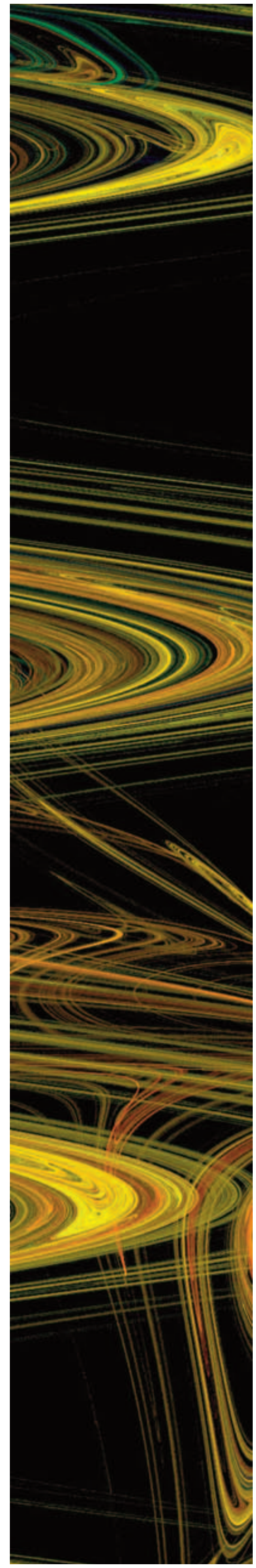
LAWYERS PROFESSIONAL LIABILITY

EASY STREET FACES A TURN IN THE ROAD

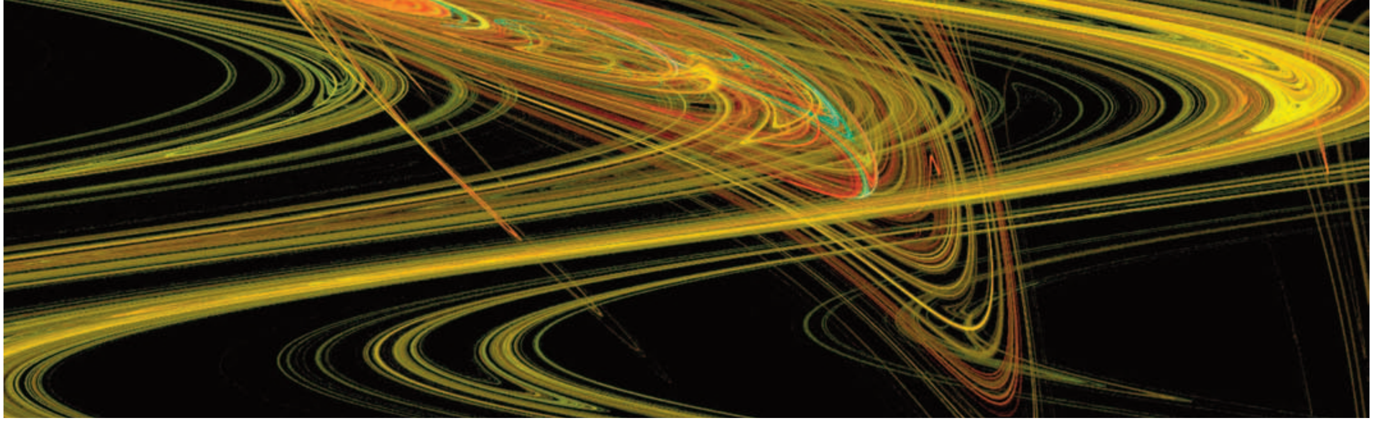
Law firms have enjoyed a soft, competitive market with declining rates and abundant capacity for the past five years. Will hard times in the world economy lead to a hardening of the law firm Professional Liability market?



Lawyers Professional Liability (LPL) underwriters have been talking about the need for a rate increase for the past year, citing deteriorating loss experience and litigation expected to result in several huge losses. Despite the dialogue, the market is still reasonably competitive, with rates flat or down 5% for firms with good loss experience and up 5-10%, or more, for those firms with noteworthy losses. However, the tone and process of underwriting in 2009 suggests that we are in the "bottoming phase" of the market cycle. The next logical question is: How long will it last and when might the market begin to harden?

Before we hazard a guess, it may be useful to consider the events that *could* usher in a hard LPL market:

- A catastrophic event or series of events such as a hurricane or terrorist attack that adversely impacts insurer surplus.
- An upsurge of claims related to the current financial crisis. Underwriters expected that the subprime/CDO/CDS problems which surfaced last summer would start a flow of claims, but this has not yet happened. Historically, criminal activity has increased during troubled economic times and law firms are not immune. (See the recent Willis *Executive Risks Alert*, "Law Firms in the Year of the Criminal" at www.willis.com.) There is also evidence that organizations in financial distress are more likely to sue their professional service providers, such as law firms, as a way to reduce costs, obstruct implementation of obligations or find financial scapegoats.
- A contraction of capacity due to insurer downgrades.
- Increased focus on insurer financial strength – a new factor this year. The LPL buyer has rarely had to concentrate on this issue. Today, many large law firm programs rely on insurers with an A- rating for 40% or more of their program capacity. Managing insurer credit risk will be a factor in determining target limits and attachment points. Consequently, demand for rating quality could harden the market by effectively diminishing supply.
- Hardening of reinsurance rates – although reinsurance has less impact on this line than on others.
- Departure from the market by one or more of the recent entrants into the LPL space. The impact would be limited to the higher excess layers, but could impact overall pricing.



Many large law firms renew October 1. The run up to this key date will provide insight into the direction of the market. Since it appears the market is bottoming now, October 1 will be the point at which a potentially new LPL supply and demand equation begins to take shape.

We expect rates to move upward in the second half of the year. Accordingly, firms should prepare to differentiate themselves *now*. Risk management continues to be a critical focus. Law firms should also discuss issues of financial stability and potential staff realignments. Finally, firms should articulate their business plans to address economic challenges facing the practice. Such efforts will be rewarded, especially as the market moves through the bottom of a long cycle – one that may turn quickly with little or no warning.

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