

PI and D&O

- Conflicts
- Why would actuaries be interested?
- What is PI?
- What is D&O?
- Topical issues
- Market statistics
- Pricing issues and conclusion

PI and D&O: Conflicts

- Disclaimer
- People who know about Professional Indemnity and Directors & Officers are often unable or unwilling to talk publicly
- Frequently settled out of court
- Classes of business that cause trouble
- Actuaries are also at risk of claims

PI and D&O: Why should actuaries care?

- Important lines of insurance
- Losses
- Difficult to price and to reserve
- Actuaries like other professionals can suffer claims
- Underpricing: "PI is the red light district of the London Market" (Reg Brown)

PI and D&O: What is PI?

- Professional Indemnity
- Claims against professionals for negligence
- Must be a duty of care
- Normally only clients can claim
- Duty of care has been well-defined but definitions always at risk of being extended
- Time limited to six years - also at risk?

Topical issues: PI

- New professions eg IT
 - failure to deliver what was expected
 - may come under contract law rather than tort
- Time limit of six years attacked
 - Several recent Appeal Court decisions have gone beyond six years
- Woolf: fewer court cases, but more pre-litigation cases

Topical issues: PI

- Barristers no longer immune (since 2000)
- Duty of care extended to non-clients?
 - Dean vs Allin & Watts
- Not just partners: Babb case

Babb Case

- Mr Babb was employed as a surveyor
- He carried out a standard house mortgage survey in 1992 (fee to his employer was £70), never having met the client
- Babb changed jobs in 1993
- In 1994 his former employer went out of business
- When cracks were found in the house, the owner successfully sued Babb; no PI cover in force
- Babb forced to pay £40,000 from his own pocket

PI and D&O: What is D&O

- Directors and Officers liability
- Claims against Directors and Officers for negligence in carrying out their duties
- Third parties can claim - shareholders, employees, customers
- Less clearly defined and coverage keeps expanding

Topical issues: D&O

- Losses increasing especially on older years
- Typical soft market factors: package policies, entity covers, outside entity covers, long term deals
- High stock market increased exposure
- “Ambulance chasing”
- Security Litigation Reform Act 1995
- Not always clear what is covered especially outside US and UK

Topical issues: D&O

- Package policies
 - Include Employment Practices Liability etc
- Entity covers
 - Cover the Company as well as the Directors so claims which would have been split both hit the insurance
- Outside entity covers
 - Directorships of other entities, trusteeships, etc
 - No underwriting of these is possible
 - Extra exposure taken for no extra premium

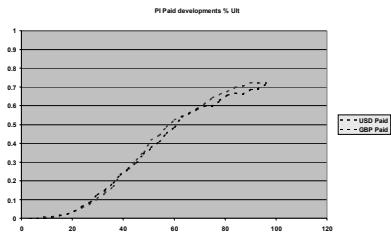
Topical issues: D&O

- Security Litigation Reform Act 1995
 - Intended to prevent nuisance claims
 - Has had some success, but...
 - New style of claim is to say that accounts were misleading, eg if targets not met could say reserves were too low

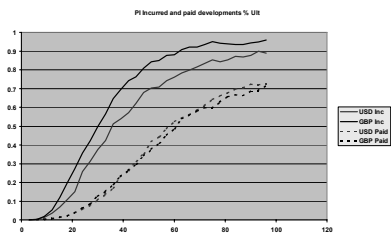
PI and D&O: Figures and graphs

- Lloyd's data projected using standard methods
- Usual disclaimers apply
- Also premium rate indices

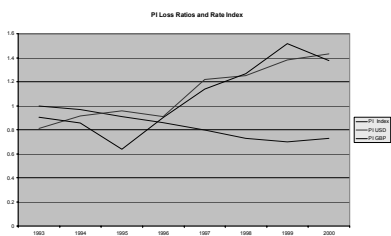
PI Paid Development



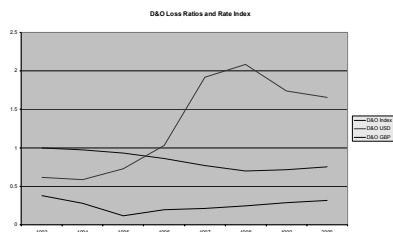
PI Incurred Development



PI LR's and Premium Rate Index



D&O LR and Premium Rate Index



PI and D&O: Why standard pricing methods might fail

- Small number of large claims
- Very heterogenous exposures and claims
- Overall average development is slow (IBNR and IBNER)
- Development pattern varies for different claims
- No good exposure measure
- Cycles and secular change

PI and D&O: One possible pricing approach

- Mack 1997 paper
- Individual claim projections
- “Types” of claim at each development (Estimate only, Estimate + Paid, Settled)
- Distance measure: $\sqrt{\text{squared difference in estimate} + \text{squared difference in paid}}$
- Choose a more developed claim of same type with smallest distance when at same development
- Still has problems with heterogenous data, but can be developed - eg operational time?
- No IBNR - need separate frequency analysis

PI and D&O: Conclusions

- Important and dangerous classes of business
- “Red Light District” - attract unwary punters
- Standard actuarial techniques must be adapted but can be
- Essential to work with underwriters and claims staff to understand complexities
- International risks - each country different
- Demand is real: people need this cover
