

Will Going Bare Become Fashionable?

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Historically, a substantial majority of Texas lawyers engaged in private practice purchase legal malpractice insurance. They do so for a variety of reasons, ranging from trying to protect the client to trying to protect their own assets. However, lawyers, tend to be very price sensitive when purchasing malpractice insurance. Frequently, price alone is the factor that determines whether a firm purchases insurance, and if so, what policy is purchased.

During the year 2002, four events occurred that had dramatic consequences on the cost of malpractice insurance. The four events were: 1) the erosion of the investment markets; 2) the tightening of reinsurance; 3) the effects of the September 11, 2001 terrorist attack on the World Trade Center; and 4) the retreat from the Texas market by several carriers.

The first event that affected the price of malpractice insurance was the decline of Wall Street. As many of us have noticed in our 401K statements, our investments have been decimated. The investments of insurance carriers have suffered similar fates. In the 1990's, insurance companies used investment income to help cover any shortfalls between income from premiums and the cost of operating the company and paying claims. As investment income has decreased, many carriers now have net losses. The decrease in an insurance company's investments means many carriers may have less capacity to insure lawyers in the not too distant future. Many carriers in 2002 had fewer available resources than they had in 1998. The likely consequence of smaller capacity was that the cost of legal malpractice insurance went up.

A second recent event that affected the cost of legal malpractice insurance in Texas in 2002 was the tightening of the reinsurance market. Reinsurance agreements allow an insurance company to share the risk of their insurance policies with other companies. During 2002, reinsurers were able to command higher fees and require the originating insurance company to take on more risk. As a result, many malpractice insurance carriers had to expend substantial efforts to try to renew their re-insurance agreements. This increase of cost and risk for in-

surance companies meant that many of them must restrict the amount of policies that they sold. The tightening of reinsurance was a factor that caused the cost of malpractice insurance to increase.

The events of September 11, 2001 also had an affect on the cost of malpractice insurance in Texas. Although the losses from the World Trade Center are still being calculated, some early projections suggest several of the largest reinsurers will lose in excess of a billion dollars on that event alone. This loss alone caused further contraction in the availability of reinsurance resources. Such a contraction a factor in increasing the price of malpractice insurance.

Finally, malpractice insurance rates in Texas will likely increase when fewer carriers who had been selling malpractice insurance pull out of the market. In late 2002, a handful of carriers left Texas. Their departure left a number of law firms scrambling to try to replace their present policy with a new carrier, if it was replaced at all.

The cumulative affect of these four events did lead to substantial increase, in the cost of malpractice insurance for lawyers in Texas over the next couple of years. Some carriers endeavored to increase their price in 2002 by more than 25%. For lawyers that had claims or grievances, in the last five years, the impact could be even more substantial. The cost of malpractice insurance, if it was available to these lawyers at all, could be substantially more than 25% of the cost in 2001. Some would say that on the bright side, premium increases may create an atmosphere for more insurers to return to Texas to take advantage of what is perceived as actuarially-sound pricing. It will remain to be seen whether any return of carriers to the state will be a short-lived opportunity.

Lawyers or firms that have had claims or grievances will likely also have restricted coverage. And, there is a substantial possibility that some firms will be entirely uninsurable if they have a history of frequent or severe claims. So the question remains: Will going bare become fashionable? Hopefully not, but we will have to wait and see what the market brings.