

Property Casualty 360

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The professional liability (PL) market in Florida, like most of the United States, remains soft for many industries. Generally, agents and brokers seeking this coverage on behalf of their customers are finding low rates, plenty of capacity, and an increasing number of insurance carriers willing to write it. Also, most agents and brokers are able to offer their customers proposals with higher limits at more competitive pricing and with broader coverage features than previously available.

Architects, engineers, lawyers, consultants, and other professionals are finding their PL policies, also called Errors & Omissions (E&O) coverage, at very affordable rates. In some cases, the nature of what would be considered covered -- protection against loss from a claim of alleged negligent acts, errors or omissions in the performance of professional services -- has expanded. For example, some Miscellaneous PL policy forms have added privacy cover and other features that in 2008-2009 would have been obtainable only through a stand-alone, specialty policy for most industries.

However, this capacity and largesse of terms does not apply to all risks or all industries. Two industries where capacity is tighter and terms are more restrictive are financial services and real estate; both were hit hard by the subprime mortgage crisis and market crash in 2008-2009.

In Florida, the housing and financial trends are particularly significant. According to the Mortgage Bankers Association, Florida had the highest number of bank failures in the first quarter of 2010 and was second only to California in home foreclosures. The state also ranks in the top five in mortgage fraud. And Floridians well remember that when Bernie Madoff turned his wealth management business into a massive Ponzi scheme that defrauded thousands of investors, Palm Beach was one of the hardest hit areas.

These facts, combined with the expected impact of the Dodd-Frank Financial Reform Bill, present significant challenges -- as well as opportunities -- for Florida agents and brokers. The PL market as it relates to real estate and financial services industries will become even more complex. However, if agents partner with someone who has expertise specific to these industries, then they can position themselves to serve a growing need for E&O coverage.

Claims, Rate Increases, and Exclusions Abound

Following the 2008-2009 market crash, there was a sharp increase in arbitration claims by investors, which subsequently pushed up PL rates and tightened capacity. In many cases, PL insurance is expected to rise 20 percent or more over the next 24 months. PL premiums at independent broker-dealers during the most recent 12 months range from about \$2,400 to \$4,200 a year per registered representative, a significant cost for firms with hundreds of representatives.

Also, these policies may be written with strict exclusionary language, including a "troubled investments" exclusion, which outlines an exclusion for actual or alleged transactions with people and companies like Bernie Madoff, LandAmerica Financial Group, Stanford Financial Group, Edward Okun, Medical Capital Holdings, Provident Royalties, LLC and others. In order to avoid the attachment of such an exclusion, insurance companies are requiring a signed statement that brokers and advisers did not do business with named entities.

Additional exclusions may involve commodities, commodity futures or option contracts except covered call options, real estate investment trusts, hedge funds, direct private placements, leveraged ETFs and auction rated securities, and securities issued that are unable to meet the minimum capitalization and other requirements for listing and maintenance on the NASDAQ SmallCap Market.

Growing Opportunity for Florida Agents in New RIAs

Another significant niche market is the increasing number of brokers and advisers who are abandoning their roles at bank trust departments, wirehouses, and other traditional financial services companies. These entrepreneurs are creating "breakaway" teams, establishing their own registered investment advisers (RIAs) firms, or joining other independent advisory firms. Fidelity Investments reported recently that 95 individual brokers or teams with nearly \$7 billion in assets either set up their own RIAs, joined existing RIAs, or affiliated with independent broker-dealers that clear through the company.

As Daniel Rojas, an agent at the Miami agency Kahn-Carlin points out, this trend also opens up new business opportunities. "With more financial services professionals splitting from their old institutions and starting their own firms, they will need professional liability coverage," he said. "While it can be tough for insurance agents to find new business in today's economic environment, tough times also bring new opportunities, and financial professionals are one of them."

PL coverage may become even more important in this market niche because there is a growing movement to scrutinize, analyze, and more heavily regulate these firms and their personnel.

Impact of the Financial Reform Bill

The real game changer in this arena is the Dodd-Frank Financial Reform Bill, which rewrites the fiduciary standard and constitutes the most sweeping financial reform package since the 1930s. It is anticipated that the biggest impact of the bill will be felt by broker-dealers, investment advisers, and RIAs. The following are among the bill's features that promise to affect PL coverage:

J It calls for study of additional information that should be made publicly available regarding a disciplinary disclosure system for both advisers and brokers.

J It puts larger broker-dealers in a group of non-bank financial companies that will be supervised, a provision that will have a trickle-down effect on independent broker-dealers and RIAs of all sizes.

J It calls for additional studies of hybrid capital instruments and whether such instruments should be excluded as components of Tier I capital for banking institutions and holding companies.

In addition to this bill, a new investment adviser public disclosure database creates an online system that tracks the disciplinary records of registered representatives (account executives at a broker-dealer) and includes allegations by customers against named investment advisers. Also, in July the SEC approved a rule change from FINRA, the largest independent securities regulator in the U.S. It increases the time period for public, online disclosure of unproven complaints, thus evening the playing field for the public availability of this information.

In short, a high threshold of compliance and transparency on the part of broker-dealers and advisers in Florida is on the horizon. When investors go online to check out the history of their investment adviser they will be able to see allegations, even if they are old and unproven.

Broker-dealers, independent advisers and RIAs who were not buying E&O insurance are increasingly required to buy it now -- and they need the help of their insurance agents. It is important that agents sit down with their clients, gather all the necessary information, and make sure the correct applications are filled out completely.

However, when it comes to placing insurance, agents may find that they need help. Markets are very limited and this is a tough line of business for agents to write unless they have experience and are connected to the right partners -- wholesalers, MGAs or carriers -- who can get these deals done.

Real Estate and Mortgages

The subprime fallout and increase in foreclosures also has had a significant impact on real estate finance professionals, most notably mortgage brokers and mortgage bankers.

"Financial service providers have taken a triple hit," said Rojas of Kahn-Carlin. "First was the housing market collapse, which resulted in no business for the mortgage industry. Then came claims from clients who said they were misled by their mortgage provider. Last, this period of very little new mortgage creation."

While PL premiums in this industry have leveled off after a spike in 2008-2009, exclusionary language has increased in these policies and most business is being written through London

markets.

Mortgage bankers are facing new challenges with the Real Estate Settlement Procedures Act (RESPA). Enacted by the federal government after the subprime crisis, RESPA establishes new criteria for mortgage bankers originating home loans and forces more transparency in their mortgage origination activities.

Looking ahead, it is expected that U.S. carriers will begin writing more PL coverage for mortgage bankers, providing additional opportunities for Florida insurance agents and brokers in this area. Those agents who can learn the market and find the right partners to help negotiate terms and conditions will see further opportunities and expanding capacity in years to come.

Mortgage brokers who walked away from the industry after the subprime experience are starting to return, and these professionals are facing different challenges than mortgage bankers. By January 2011 the federal government will mandate that all mortgage brokers be licensed and bonded, a requirement that has already been adopted by Florida and some other states. Obtaining a surety bond will require scrutiny of the mortgage broker's financials and if the financials are not strong, some form of collateral will be required.

Other real estate professionals such as appraisers, home inspectors and realtors can find ample markets for E&O coverage as long they stick to one line of business. Those who perform multiple roles -- especially those who also own or have owned property, or who delved into development -- will find somewhat limited capacity, higher rates and additional exclusions.

Like the financial services industry, the real estate industry is emerging from very difficult times, and markets for PL insurance are harder than other industries. However, for Florida insurance agents and brokers who take the time to learn about them and find the right partners, these markets can be an excellent source of growth in the years ahead.

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