PROFESSIONAL INDEMNITY FOCUS

This year will be the last in the past 40 years where firms will have to renew compulsory professional indemnity at a set date, but unease over unrated insurers and the general rise in risk in the market make it one of the most challenging, says **Frank Maher** (i - iii)
Solicitors Journal has put these and other issues to lawyers in firms big and small. The increase in lender claims and volatily in conveyancing and other high-risk areas are causing particular concerns, but financial instability in the insurance sector as a whole is making a lot of stakeholders uncomfortable (iv - x)

The big insurance renewal

Small firms reliant on unrated insurers will face a difficult task

For the last time in nearly 40 years, all solicitors in England & Wales will be renewing their compulsory professional indemnity insurance on the same date. In future years firms will have a choice of renewal date; some may change to avoid the annual post-holiday rush, which is still something of an improvement on the old 1 September renewal.

Having been involved in one way or another through most of those years – defending claims for insurers, arranging the firm's own cover and advising other firms on their arrangements – I can safely assert that, for the profession as a whole, though not every firm, this year will probably be the most complicated yet.

For some, the renewal on 1 October will be very easy – more of the same, buy the same as last year, pay roughly the same, or may be slightly more if fees have increased, and the job is done. But for others, there will be more to think about, and none more so than those forced to change insurer. Change may be enforced for several reasons: it may be down to bad claims experience and their insurer will not offer terms, or it may be because the insurer has ceased writing such insurance, as is the case with Aviva, or because the insurer has been banned by regulators from writing further business in the UK, as with Balva, insurer of approximately 1,300 firms.

Claims experience across the profession was particularly bad in 2009 but has improved since then. There has been an increase in the number of large claims, and a recent £50m settlement is believed to be the largest for very many years - but claims overall are generally in decline at the moment. Insurers of US law firms have fared rather worse with some horrific loss ratios, though the number of circumstances notified is generally down.

Whether there is a time bomb ticking in the UK with the approaching expiry of the primary limitation period for lender claims arising from the economic turmoil of 2008 will be known fairly soon, but probably not in time to influence this year's renewal. For the future, much may turn on it.

For now, the majority of large firms should be expecting a straightforward renewal. They may even see no or very little increase in premium, particularly once any increase in fee income is factored into the equation. Some may consider spending any savings in premium. They could buy more cover. Those who were members of SIMIA, the Solicitors Indemnity Mutual Insurance Association, which provided top-up cover for many larger firms, may have a weather eye to any possible need to provide for a future shortfall, much as one hopes there will be none. Some may spend it on management liability cover instead, or take it out if they do not already have it. Review the limit – recent claims experience demonstrates that some firms' cover may be inadequate – and consider the wording carefully, particularly any exclusion for insured v insured claims.

Smaller firms face more challenges. Many of the insurers available to them are only available through schemes tied to particular brokers. Some may appoint independent brokers to guide them through the mire.

The biggest problem, however, is the degree of reliance which small firms have on unrated insurers. Of course, a rating guarantees nothing: one only has to look at the trouble which faced the rating agencies in the global financial crisis. Ratings are paid for by the insurers themselves. However, some will recall the collapse of Independent, which insured many law firms and enjoyed an AA rating before its collapse in June 2001. At the time, I was defending a large City firm on a substantial claim where Independent was insurer of one of the excess layers, and the firm faced a real risk of having to contribute partners' money to the settlement.

Having noted the risks inherent in relying on ratings, firms have to form their own view, taking advice from their brokers – while noting that brokers' own professional indemnity insurance is unlikely to cover them for claims arising from collapse of an insurer. Insurance of law firm risk is a long term business – in my experience it may take 15 years or more for an insurer to close its claims after ceasing to write the business. This arises from multiple causes – compulsory six years' run-off cover for firms which close, standstill agreements where claimant and defendant hope that a problem may resolve itself, claims made after the policy year

> **"Whatever the reason for choosing an unrated insurer, for many the problems have come home to roost"**

which are covered because circumstances were notified before expiry, delays in litigation, *Jarndyce v Jarndyce*-like trust claims, and so on.

The Law Society has put out warnings about the risks of relying on unrated insurers, but although some have doubtless chosen them on cost grounds alone, to my knowledge, many did so because they had no choice. They may have had a toxic combination of claims experience – perhaps a rogue partner or employee – and exposure to high risk areas of practice such as conveyancing.

Some criticise the Solicitors Regulation Authority (SRA) for failing to insist on a rating for qualifying insurers (renamed 'participating insurers' for the coming year) – unfairly, as the SRA's legislative powers are prescribed by section 37 of the Solicitors Act 1974, which does not apply to other professions, and the question of insurer solvency is more properly the responsibility of financial services regulators in the various European (and EEA) jurisdictions where the insurers are based.

Whatever the reason for choosing an unrated insurer, for many the problems have come home to roost. In broad terms, the protection for firms whose insurers have collapsed is very limited, with only 90 per cent cover from the Financial Services Compensation Scheme, and that only for firms with turnover under £1m. I have one case involving a firm caught by the collapse of Lemma, a Gibraltarian subsidiary of a Ukrainian insurer, which faces a £400,000 claim with potentially no insurance at all.

Now we have the problem of Balva, whose Latvian regulator has banned from writing further business in the UK. Nobody says it is insolvent, but equally there is scant evidence in the unaudited 2012 accounts on which a firm can satisfy itself that it will be there for the long term – an important consideration, as explained above. The sheer scale of the problem, with one in eight firms now having to seek a new insurer as a result, means that many will struggle to find an alternative on renewal. Some may be forced to close; if they cannot find another firm to take on their insurance risk under the successor practice rules, they may have to face the uncertainty of six years' run-off cover with Balva.

Those offered alternatives should look very carefully at the substance of what is offered. There are significant concerns in this respect. While there may be new rated entrants to the market, and, it is understood, the possibility of a Law Society-backed MGA (managing general agency), it is doubtful whether they can satisfy the needs of the volume of small firms with issues.

Insurers may be increasingly concerned about the strength of law firms' balance sheets. If a firm collapses, they have to fund six years' run-off cover, even if the premium is not paid, and claims excesses. This may increase the number of firms who have difficulty obtaining cover. Personal guarantees may be required. One of my cases was for members of a substantial failed LLP facing seven-figure claims from insurers for excesses and run-off premiums, and there are other similar large claims. I am also seeing many more coverage disputes than in the past, not just with small firms.

A further complication for many hard-pressed firms will be funding the premium. Many borrow from secondary lenders who may have had their fingers burned in the high-profile collapse of large firms in the past year or so, as well as many smaller firms. Banks too, will be tightening their grip on law firms, no longer the safe bet for lending that they once were. So borrowing for the premium may be more difficult than in the past.

It should be an easy renewal for most large firms, but more stressful for many smaller ones.

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