~~This article was first published in the August 2014 edition of Managing for~~ Success, the magazine of the Law Society's Law Management Section (www.lawsociety.org.uk/lawmanagement)

Insure enough

The decision by the Solicitors Regulation Authority to reduce the minimum compulsory cover for professional indemnity insurance has sent shockwaves through the profession. ***Frank Maher*** *explains the change and what firms need to do*

Frank Maher *is a partner in Legal Risk LLP, solicitors. He has defended solicitors' professional indemnity claims and advised firms and insurers on coverage issues since 1983, and has also provided expert evidence on compulsory schemes*

On 2 July 2014, the Solicitors Regulation Authority (SRA) announced its decision following its consultation on professional indemnity insurance (PII), entitled 'Proportionate regulation: changes to minimum compulsory professional indemnity cover'. The key decision was to reduce the minimum compulsory cover to £500,000, from the present £2m for partnerships and sole practitioners and £3m for incorporated practices. Firms that conduct insurance mediation activities must have cover of at least €1,120,200 for any one claim under the terms of the Insurance Mediation Directive.

The decision is a bad one in the writer's view, and goes against the weight of responses to the consultation: 92 (including the Law Society and the City of London Law Society) were against, and 34 in favour, with 16 unclear or not responding on the point. The decision represents a rare example of an attempt at cutting red tape actually increasing the burden on firms – perhaps a product of an over-hasty consultation process. It is also a surprising decision, as the reduction in risk transfer will put some firms' financial stability at greater risk, at a time when financial stability remains on the SRA's agenda. There is no doubt that something needed to be done about professional indemnity, but not this.

At the time of writing, the changes still require the approval of the Legal Services Board (LSB) before they can take effect. The Law Society has asked the LSB not to approve the changes, but does not expect a decision from the board before August.

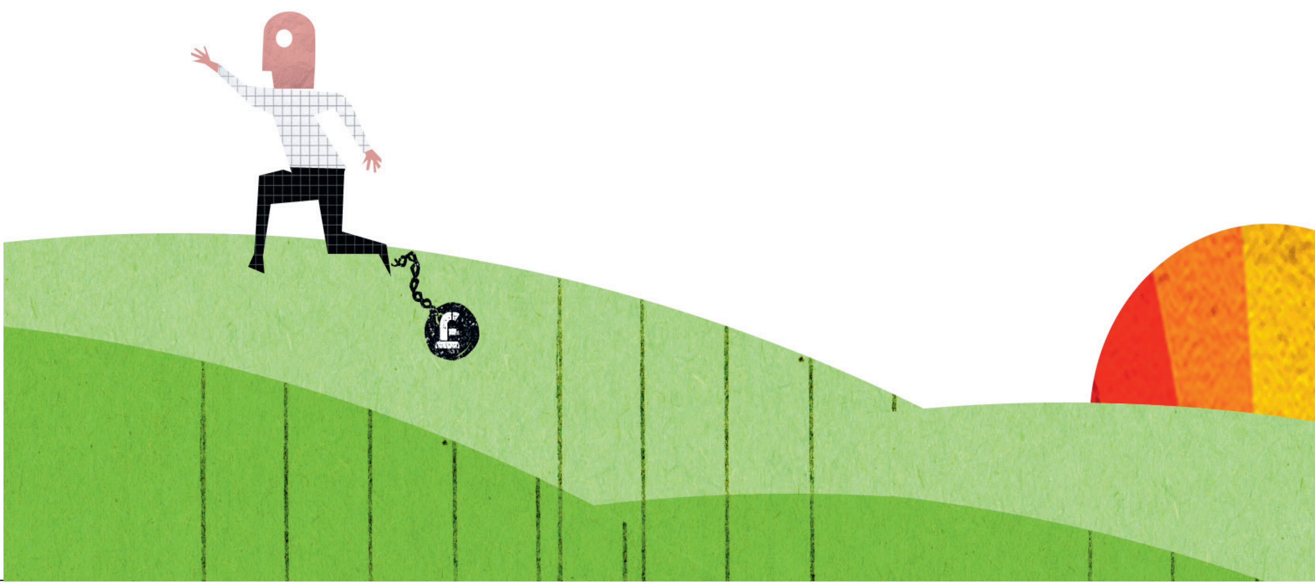
However, firms cannot rest on their laurels; some may have obtained renewal terms already, but many will not, as insurers have waited for the SRA's decision in order to know what cover they are required to provide under the SRA's Minimum Terms and Conditions (MTC). This article looks at what firms need to consider following the decision.

THE COSTS OF INSURANCE

The decision was made on the premise that there would be a reduction in premiums of 5-15%. However, any saving, if indeed there is one (which the writer doubts, as most claims are below £100,000), will most likely be eclipsed by the cost of top-up cover. Smaller firms are least likely to make savings, as they may be affected by insurers' minimum premiums.

For firms which are closing, additional run-off cover is likely to be costly, may be hard to obtain, and will probably not be available for anything like the current six years. The profession's bulk-buying power has been sacrificed for a possible small cash saving that may prove illusory. Firms which have not incorporated should do so as a priority, and review their terms of business – these steps will not be a guarantee of individual immunity, but may help.

Note, too, that the £500,000 includes claimants' costs. If a claim exceeds the limit – and the trend seems to be towards larger claims – the defence costs paid by insurers will be reduced *pro rata*. Claims-handling conflicts for insurers' panel solicitors will increase, with more firms requiring separate representation.



Conveyancers will need to consider whether it is safe to accept undertakings from other firms on higher value transactions.

UNRATED INSURERS

The real issue which needed to be addressed was not premium levels, but the dependence of a large proportion of the profession on unrated insurance, against the background of so many unrated insurers such as Lemma, Balva and ERIC failing and leaving firms to their fate with the Financial Services Compensation Scheme, which provides 90 % cover to some firms, but not those with turnover in excess of £1m (in broad terms). We look further at unrated insurers below.

Insurers without a rating from one of the ratings agencies may remain on the scene for some time yet, following the SRA's previous consultation. A policy statement on 7 May 2014 indicated that the SRA was not proposing to introduce a rating requirement "at this stage".

Cost saving may have been one reason why firms have previously chosen unrated cover, but in very many cases, the main reason was lack of choice. This may be because of adverse claims history, or the profile of the particular practice. Those with insurance from unrated providers need to find out why they are in that position, and consider what they are going to do about it.

Even if firms are allowed to continue using unrated insurers in the longer term, the recent news of three lenders withdrawing instructions from firms with unrated cover may force solicitors to address the situation sooner rather than later. There are also suggestions that lenders will insist on firms maintaining current levels of cover, and those with only £500,000 may find themselves removed from panels.

ANOTHER OPTION?

Some, mainly in smaller firms, have called for the revival of the Solicitors Indemnity Fund (SIF). However, the writer is firmly of the view that this will not happen, much as SIF may have its attractions to many. If the profession was divided on SIF's merits in 2000, it is likely to be even more divided now. That makes it more likely that any new SIF would not be compulsory (though there may be ways of making it more palatable to larger firms than the SIF of old, for example, by allowing firms to place the SIF cover above their other policies, with a consequent reduction in premium).

If one assumes that any new SIF would not be compulsory, a number of problems start to emerge. Law firms have shown themselves to be fickle, against all advice to the contrary, even in some cases choosing insurers on the basis of a premium saving of £1 or less. Many firms renew their cover in the last week or two before renewal.

A new SIF would need commitment from firms. And it would require them to be committed even if they obtained a cheaper quote elsewhere, because it would be impossible to set it up without a clear picture of premium income. The SIF of old was not technically a mutual insurer (it was a statutory fund), and did not have to satisfy the capital adequacy requirements for an insurer. It is not certain that it could continue in such a form in future, and in any event, it would be undesirable to have an insurer which did not meet the best practice requirements of competing open market insurers – particularly against the backdrop of widespread dissatisfaction with the problems caused by unrated insurers following the collapse of Quinn, Lemma, Balva and ERIC.

COMPLIANCE

A new outcome (7.13) will be inserted into the SRA Code of Conduct requiring that "you assess and purchase the level of professional indemnity insurance cover that is appropriate for your current and past practice, taking into account potential levels of claim by your clients and others and any alternative arrangements you or your client may make".

Outcome (1.8) is unchanged. This requires that "clients have the benefit of your compulsory professional indemnity insurance and you do not exclude or attempt to exclude liability below the minimum level of cover required by the SRA Indemnity Insurance Rules", so firms may wish to review their terms limiting liability.

OTHER PROPOSALS

The other main proposals in the consultation were to:

- introduce an aggregate limit on claims (in place of the current position, where insurers may treat multiple claims arising from the

same or a series of related acts or omissions as one claim with one policy limit);
- require compulsory cover for claims by individuals, small and medium-sized enterprises, trusts and charities;
- reduce run-off cover to a minimum of three years; and
- require firms to assess the level of cover appropriate to their firm beyond the minimum.

These proposals will be the subject of further consultation, with a decision in 2015.

A change to the aggregate limit or excluding categories of claimants may leave lenders unprotected in part or in whole, and they may react by removing firms from panels, as we have seen recently when three lenders excluded firms with cover from unrated insurers. Lenders may, in any event, be expected to enquire as to firms' level of cover, and if there is any change in the MTC, that may impact on firms' assessment of what is appropriate.

The topic of aggregation is one of some concern to insurers generally. One case which is going to trial on the point in November 2014 is *Godiva v Travelers Insurance*. The claim arises from the case of Willmett Solicitors, which folded following the discovery of dishonesty by partner Jonathan Gilbert, who has since been struck off by the Solicitors Disciplinary Tribunal (SDT). The case is of such importance that the Law Society and the SRA have been given permission to intervene. The SDT judgment reported that losses were in the order of £50m. Even if no change is made by the SRA to the aggregation provision in the MTC following the further consultation, the case may have such impact on the insurance market as a whole that change is forced on it later.

COVERAGE AND CONFLICTS

Firms should be particularly cautious where insurers have not confirmed cover for a claim. They need to be aware of the position of panel solicitors appointed by insurers, and be alert to conflicts of interest, as in our experience, defendant insurance lawyers may not always be as astute to detecting conflicts as they should be. Even when insurers instruct separate firms to deal with coverage and the defence, solicitors should still be on the alert. We have encountered situations where the line adopted in the defence by supposedly independent panel solicitors may prejudice the coverage issue.

If insurers ask a member of the firm to attend a conference with counsel to explore coverage issues – be afraid! This is a hostile environment, and care is required. The purpose may be to establish whether the individual was dishonest and may therefore be denied cover. Occasions such as this are career-damaging, and advice should be sought first. Nor is it just the culprit who need fear such occasions. We are also seeing cases where insurers are looking closely at the position of uninvolved partners, on the basis that they 'must have known' what was going on but turned a blind eye.

Other areas of potential conflict between insurers and insured which crop up in practice are issues over late notification, claims over the policy limit, and whether two or more claims should be aggregated, which may mean that the firm has insufficient cover.

One factor to consider when selecting an insurer is the claims handling arrangements, including choice of panel solicitor. This is what you are buying. We see considerable variation in the quality of panel solicitors, including some with very little experience of solicitors' claims.

WHAT FIRMS NEED TO DO NOW

There will doubtless be many firms facing difficulty obtaining renewal this year, because of their own claims experience or that of firms to which they are successor practices, or simply because of the state of their finances – the MTC put a significant credit risk on insurers, both for unpaid excesses and because they have to provide run-off cover for six years, even if the premium is not paid. Below are some tips for this year's insurance cycle, whether you are in this position or not.

1 Review your claims record

The starting point for each firm is a review of its claims record for the past six years, compared against the premiums paid. This is an exercise insurers will do. Insurers are in business to make profit, and if they were not, they would fail.

It may also be an enlightening experience to compare the fee income from that work with the cost of claims it has generated. Can you really justify carrying on with conveyancing if the claims outweigh the fees? In reality, when insurers pay a claim, they are only lending you the money – they will want it back in premiums.

Many firms with problems have had either a long run of lender claims, or a smaller number of large claims. Either way, thought needs to be given not only to improving the firm's approach to risk – particularly supervision and file audit – but also whether there are any more potential problems lurking in the files.

While it is hoped that the worst of the lender claims are over, given the passage of nearly six years since the global economic crisis of 2008, there may be more recent cases, or those where limitation periods may have time yet to run. These need careful consideration, and thought should be given to block notifications of outstanding claims. Block notifications are a technical area, however, and require careful consideration and attention to detail. Insurers will often challenge their validity, so take specialist advice.

2 Notify promptly

It is always incumbent on firms to ensure that they notify insurers promptly of circumstances which may give rise to claims, and of claims, too, but this is an area where we see an increasing number of problems. It is becoming far more common to see firms with coverage disputes. I am currently representing a firm in such a case where the claim is in eight figures, and had the partner concerned notified insurers at the time, the firm would have had three times the cover it has now. The partner concerned also faces a potential claim by insurers for reimbursement. Situations such as this will only become more common when the level of compulsory cover drops.

It is not enough to rely on the renewal as a mechanism for extracting information from members of the firm. The policy will usually require notification 'promptly' (or similar such words), and an annual trawl is unlikely to be sufficient.

Many firms only ask partners, exposing the partner or other person who signs the form to significant personal liability, as the form will contain a warranty that they have asked all members of the firm, breach of which leaves the signatory exposed to personal liability. Support staff may hold critical information – they may know of problems caused by emails or letters sent to the wrong person (which has caused substantial claims in my experience), or they may know that a fee-earner is suffering from stress and concealing problems.

3 Consider your personal appointments

Solicitors may wish to consider whether they should continue to take personal appointments as trustees or executors. These involve the assumption of personal liability. If the firm closes, they may be dependent on the firm's run-off insurance for many years to come: I encountered a claim (not so many years ago) where the alleged act arose in 1932! At present, firms enjoy six years' run-off cover, and insurers have to provide it even if the premium is unpaid (though they may have various remedies open to them). Peace of mind could be affected by both the reduction in the level of compulsory cover, and the proposal to reduce compulsory run-off cover to three years.