Professional indemnity insurance: proceed with care

Frank Maher considers what firms can learn from October's PII renewal

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Ninety per cent of law firms in England and Wales renewed their professional indemnity insurance (PII) on 1 October 2014. By and large, they did so without difficulty, with limited premium increases, if any, and many moved away from using unrated insurers. New entrants to the insurance market helped provide a little extra capacity, which oiled the wheels.

Unexpected quarters

But a small proportion of firms had problems and, if anything, those problems were more acute than they have been in the past. With the passage of six years since the collapse of Lehman Brothers, and the global financial crisis which ensued, multiple conveyancing claims are on the wane, but new problem areas have begun to surface, many from unexpected quarters.

Many of the problems centred around large numbers of multiple potential claims from causes which were previously rare, others hit firms with some unusually large claims. Some had problems, for example, over unauthorised collective investment schemes which were in breach of financial services legislation, while others related to multiple personal injury claims.

Many of these firms were anxious to block notify the cases to their then current insurers, so the problem could be parked and they could move on. This is a procedure which needs great care, not only because of the risk of missing some cases off the notification.

It needs thought as to where the claims might come from and how they might be formulated, and it needs careful consideration of the particular policy wording. At worst, it may show the firm had knowledge at a particular time, but for one reason or another, had failed to make an effective notification – a potentially toxic combination.

A key question in relation to multiple claims is whether they will be caught by the 'aggregation clause', under which insurers may treat multiple claims as one, with one excess and one policy limit. This can mean that the basic compulsory cover of £3m for incorporated practices, and £2m for others, is not enough.

It can therefore cause significant issues in relation to low-value work, and is one of a number of reasons to challenge the wisdom of the proposal by the Solicitors Regulation Authority (SRA) earlier this year to reduce compulsory cover to £500,000, which the Legal Services Board has thankfully rejected. There is also real doubt that those involved in the decision-making appreciated that the limit of indemnity includes claimants' costs, so the real limit is far lower.

Firms taking on volume business should consider their exposure to an aggregate insurance limit applying and ask whether they have sufficient cover. It is an issue which may increase with pressure on the profession to commoditise services. An error in a system can be replicated across a book of business. With financial and other pressures on personal injury work, many firms are moving into industrial deafness, with reports of a five-fold increase in claims, and other disease work: we have already seen multiple claims against law firms arising from undervalue settlement of coal health claims.

The circumstances in which the aggregation clause may operate are sometimes less clear than one would hope, leaving a firm under a cloud of uncertainty as to the adequacy of cover. There was an expectation that some of the uncertainty may >>

>> have been resolved by the case of Godiva Mortgages Ltd v Travelers Insurance Company Ltd, the trial of which was expected to take place in November 2014, but the proceedings have been stayed.

Coverage disputes

Meanwhile there are more large claims around and my firm is retained by an increasing number of firms with coverage disputes. A recent example, happily now resolved, involved an eight-figure claim against a firm with £2m cover, its top-up insurers having declined cover.

Other examples include late notification, questions over whether a claim falls within a prior year notification and aggregation, not to mention sometimes misconceived allegations of dishonesty against upstanding members of the profession. As for the future, most of the remaining ten per cent of firms will renew around March. There may be some changes in the line-up of insurers by then and, although that may impact some firms directly, there will probably not be a significant problem overall.

When you buy insurance, you buy two things: peace of mind and the claims service. Peace of mind is heavily dependent on the financial security of insurers, a point which the profession at large is gradually coming to terms with after the collapse of Quinn, Lemma, Balva and Eric: 4,500 policies were sold to solicitors in the past six years by insurers who then became insolvent.

The standard of claims service varies considerably between insurers and there have been a number of cases where firms were unhappy with the service provided. A recent example involved a substantial claim where the firm has a six-figure exposure. The claim was being defended by a trainee at the insurer's appointed firm, and thousands of pounds had been billed without a vestige of legal advice or strategy in sight. The moral is: find out about the claims service and which panel solicitors will be used before you buy.

Ambitious programme

The SRA has embarked on an ambitious programme of regulatory reform, none more so than in the area of PII. A hasty consultation shortly before the October renewal caused more than a measure of disruption, although, as mentioned above, its proposal to reduce the level of cover to £500,000 was rejected by the Legal Services Board. However, the door is open for the SRA to reapply.

The reasons for every solicitor to be concerned by such a dramatic reduction in cover were explained in a previous article in Solicitors Journal (see www.solicitorsjournal.com/news/regulation/indemnity/sra%E2%80%99s-regulatory-arrangements-pii-cover-should-be-refused-lsb).

A slash-and-burn policy appears unwise, at a time when there are more large claims and unresolved aggregation issues, and particularly when any savings are likely to be minimal. The cost of buying back the 'lost' cover may be far more than any saving, due to the impact of minimum premiums. Mortgage lenders are likely to insist on current levels of cover being maintained in any event.

The SRA's other proposals for reform of PII remain on the table and may be expected to resurface in coming months. These include the introduction of an aggregate limit on claims, restricting compulsory cover to claims by individuals, small and medium-sized enterprises, trusts and charities, and reducing run off cover to a minimum of three years.

Again, if revived, these risk throwing out the baby with the bathwater. The current arrangements are not perfect, but perfection may not exist, and there are doubtless winners and losers under any scheme; they do merit a comprehensive review, but what must be avoided is knee-jerk reactions and significant change without carefully thinking through the implications that may only appear further down the line.

The issue is this: the solicitors' profession in England and Wales currently enjoys the widest cover of any profession in the world. That can have adverse consequences, because it can put it out of reach of some firms, and they are not always 'bad' firms, but they are often small firms; a small firm's claims are far more likely to make it uninsurable economically.

But the positive is that the bulk buying power of the profession has obtained valuable benefits for the profession at large. Such changes would cause uncertainty as to what was covered, and significant extra cost buying back the 'lost' cover, even if it could be bought at any price. So the near-inevitable next round of consultation should be considered carefully by all solicitors.

Any small saving in cost may be false economy and cause untold harm. **SJ**

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