LEGAL RISK LLP
SOLICITORS

Risk Update

NO.64 JULY 2015

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Slash and Burn: SRA Proposals for PII Reform

A toxic cocktail of reform is contained in the latest discussion paper from the Solicitors Regulation Authority (SRA) on professional indemnity insurance. It has serious implications for clients and for law firms large and small.

Proposals for cutting the cover required by the SRA Minimum Terms and Conditions under consideration include –

- Consumer claims only to be covered;
- £500,000 limit on cover – including claimants' costs – down from £3m (£2m for sole practitioners and partnerships);
- An aggregate limit on cover, rather than any one claim;
- Defence costs cover, except for consumer claims;
- Run-off cover down to three years (from six);
- Dropping protection for non-disclosure and other policy breaches;
- Partner fraud cover to be removed;
- Extended Indemnity Period, which currently provides temporary cover for firms unable to obtain renewal terms.

The profession's quarter-billion pound annual spend on compulsory cover has brought valuable benefits to both clients and to solicitors and their staff. Even large firms benefit because the breadth of cover benefits them too, both in primary and, by extension, excess layers. The paper suggests that change may encourage innovation – but the innovation is already there in the breadth of cover we have now, and the only foreseeable change from reform is more exclusions from cover.

The question is – why? Why would it be a good idea to sacrifice the broadest cover of any profession in the world on the altar of reform for its own sake? These changes will have retrospective effect, because cover is provided on a claims made basis, and applies to work already done. Solicitors may prudently have agreed with clients to limit liability to £3 million, and been prohibited by law from agreeing any lower sum. Each side agreed to that in the belief that the insurance would be there to cover it if something went wrong. Yet now they may wake up to find that the cover is not there at all. (See case studies on page 2.)

To take an analogy, we need a building to house our Parliament. If we were starting with a clean sheet of paper, we would probably not come up with the Palace of Westminster as the answer. But nobody suggests we should demolish it.

Most of the premiums go on claims: otherwise, we would not have seen four lower-cost unrated insurers fail and dozens exit the market over the past 15 years. So while insurance may be expensive, it follows that reform will result in clients' claims not being satisfied, loss of reputation to the profession, and solicitors and their staff finding themselves uninsured when claims come in, as surely they will. If you think insurance is expensive, try a claim.

The SRA Code of Conduct was amended in 2014 to include a mandatory Outcome 7.13 which requires firms to assess and purchase an appropriate level of insurance, but this is little more than a conjurer's trick creating an illusion of client protection. It presupposes that those making the decisions understand the likely exposure to claims. In many cases that is unlikely.

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Do they appreciate that claimants are entitled to interest at 8 per cent? Or that claims can far exceed the value of a matter? Or that the indemnity limit includes claimants' costs? (That was a point which appeared to be unknown to the SRA last year, and there is little evidence they have heeded the point this time.) It also ignores the fact that the people charged with its compliance will rarely be the people most affected by the decision made. Disciplinary action years later will not protect clients.

Those charged with regulation of the profession bear a heavy burden of responsibility. We need clear evidence that they understand the implications of what they are proposing, because there is scant evidence of this in the consultation papers we have seen so far. Reform for the mere sake of reform puts the reputation of the profession at risk, and with little consequence to its proponents.

At present, market conditions are benign. Against the background that premiums are largely spent on claims, and claims are unlikely to go away just because of insurance changes, we question whether substantial reform is warranted. However, the ability to react if market conditions were to change dramatically would be useful for the future, and this might include more flexibility for the SRA to grant waivers varying cover in specific cases of difficulty so as to provide a more proportionate response and would not necessarily result in loss of consumer protection. This approach was used for surveyors in the 1990s. It might also involve occasional reductions in cover, reinstated when market conditions permit, as happened in one Australian scheme.

The proposals do not, we suggest, satisfy the regulatory objectives in the Legal Services Act of protecting and promoting the public interest or protecting and promoting the interests of consumers. Nor is there any evidence that regard has been paid to the statutory requirement in the Solicitors Act 1974 of protecting the interests of solicitors and their staff as well.

Recent articles

The PII countdown begins (Pt 1)
Professional indemnity insurance: Frank Maher casts an expert eye over what to expect. First published in New Law Journal, 20 June 2014.

Could cuts in cover put your neck on the line?

For further information on any of the above, please contact info@legalrisk.co.uk

Case study 1

Ellen acts for Widget Engines plc on the acquisition of Big End Bearings Limited. They agree to limit the firm's liability to £3m. Meanwhile, Ellen's partner George, who works in a branch office and whom she has never met, misses a time limit in a large piece of litigation.

It is 2016 and the SRA has introduced most of its proposed changes to the insurance regime. The firm's insurance renewal is pending, and the usual round robin asks everyone in the firm for anything to be disclosed on the proposal form. George does not disclose his problem, rather naively thinking that it was a minor breach which he can put right on the forthcoming case management conference. The policy is renewed. Later on, George's application for relief from sanctions falls foul of the *Mitchell* decision and fails. The firm now faces a massive claim.

Ellen's Widget matter has also gone sour, and she has had a letter claiming her due diligence was inadequate. Widget's claim is large, but Ellen derives some, albeit minimal, comfort from the belief that the £3m limit of liability will keep the damage in check to some extent at least. The directors of Widget also relied on the assumption that the firm would have £3m insurance in place.

However, the firm's insurers have now picked up on George's failure to disclose his missed time limit, and they are refusing to meet not only George's claim, but Ellen's claim too. The firm now faces catastrophic losses without the benefit of insurance. Had the SRA's changes not taken place, Ellen's claim would have been covered. So too would George's; insurers may have had a right of reimbursement, but only against George, who concealed the material information.

Case study 2

Edward retired in 2014 and sold his practice to Local Law. He made sure that the buyers would be the successor practice, and settled in to his new life confident in the knowledge that any claims were someone else's problem. Or so he thought.

It was 2016, and new, reduced policy coverage was in place for Local Law. Unfortunately, when the pre-renewal round robin email came round, the firm had only asked the partners and not the rest of the staff. A monumental mistake went undisclosed – the new assistant, Steve knew about it but had been too embarrassed to mention it.

A claim then came in against Edward from one of his former business clients. Local Law passed it to their insurers. Having recently learned about Steve's mistake, they refused to cover any claims (other than consumer claims, which they were bound to cover under the new Minimum Terms and Conditions).

Edward was now without insurance. He had obtained an indemnity from Local Law, but as they were faced with the consequences of Steve's claim, it was worthless. Edward had to raid his pension to pay for the costs of defending the claim. What he thought was going to be a peaceful retirement was turning out to be anything but.

Online training

Anti-money laundering (including the FATF Red Flags), Data Protection, and Phishing for Trouble (on avoiding fraud). Please ask for details.

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