# Professional indemnity insurance: key trends

*Frank Maher*

**Most of the profession – probably about 90 per cent of firms – will be renewing their professional indemnity insurance (PII) on 1 October 2015. What should they expect from the process and what should they bear in mind? Plus, the next step in the Solicitors Regulation Authority (SRA) consultation process is expected soon in the form of a discussion paper. This article also covers some of the issues that may arise**

## Claims experience

Most insurers are reporting a reduction in claims numbers, as might be expected with the passing of the sixth anniversary of the collapse of Lehman Brothers and the ensuing global financial crisis. While there were press reports of a spike in the number of High Court proceedings issued last year, that does not necessarily translate into an increase in claims because many of the proceedings will probably have related to claims already made and notified to insurers.

However, there are two points of particular concern to note. These are the increase in large claims and bank scams. Insurers are seeing increasing numbers of seven and eight-figure claims. The 2014 accounts for top-up insurer SIMIA (the Solicitors Indemnity Mutual Insurance Association, now in run-off) note that: 'The Company's more recent claims experience however suggests that the layers of insurance above £2m or £3m have become working layers.' There are also more claims from international firms' foreign offices, where in years gone by they were few and far between. As well as being large, these can cause challenges in claims handling due to the lower numbers of suitably experienced defence firms and expert witnesses and language difficulties.

Secondly, the increasing numbers of bank scams and cybercrime incidents are becoming a significant concern for insurers. There are reports of claims amounting to several million pounds and, with the total premiums for compulsory primary cover paid by the profession last year across all insurers amounting to a little over £250 million, it is easy to see how this could start to have a severe impact on one or more of them.

As a consequence of the last point, some insurers will be asking more questions about the training that firms are giving to staff to prevent such claims. There are two aspects here. Firms should be ensuring their staff have all done the online course on Cyber Security for Legal and Accountancy Professionals, provided free by HM Government, the Law Society and the Institute of Chartered Accountants in England and Wales **http://cpdcentre.lawsociety.org.uk/course/6707/cyber-security-for-legal-and-accountancy-professionals**.

This deals with cybercrime, but still leaves the risk of bank fraud: several cases, involving millions of pounds, have involved 'vishing' where a fraudster makes a phone call posing as a bank representative and persuades law firm staff to reveal account information or use their card readers to authorise online payments. In other cases, hacked emails have purported to change the clients' instructions on the account details to which they want their money sent. So firms need to train their staff on this risk as well, whether online or face to face.

In the course of a year, we review many firms' claims records. It is a significant concern to see how many conveyancing firms are still facing lender claims from the same causes which plagued the profession in the 1990s. Allowances, direct deposits, identity theft and, particularly, failure to report transactions in the previous six months are recurrent. The underlying causes of claims are the same as they always were, with lack of supervision high on the list. Engagement letters are still an issue – do you define the scope of the retainer? – and, perhaps even more importantly, do you know who you are acting for?

We have seen several firms caught up in unauthorised collective investment schemes. These come in many shapes and sizes. Examples have included land banking, hotel rooms, student lets, wine and ostrich farms. Schemes that would require authorisation by the Financial Conduct Authority, as most do, are unlawful and give rise to a host of issues. Firms which have been involved in such schemes need to consider most carefully how they proceed, particularly on the issue of block notification, of which more anon.

Undervalue settlement issues are beginning to emerge, with firms deprived of their livelihood from personal injury work turning to cannibalism and pursuing claims against other firms for settling claims too cheaply. In some cases, there may be merit in these claims, perhaps because they were settled by inexperienced and unqualified paralegals working under financial pressures, but we have been hearing of many where the claimants are making low Part 36 offers at the outset, at such a level as suggests there cannot have been any negligence in the first place. They are no doubt hoping to appeal to solicitors' desires for a quiet life.

Some nightmare claims scenarios have arisen where firms have unintentionally become successor practices to other firms which had disastrous claims histories. We have seen firms with multimillion pound exposures arising from acquisitions which, had they taken advice beforehand, could have been structured differently to avoid the risk. Successor practice planning is a bit like tax – if you address it beforehand, you may be able to do something about it (in fact almost invariably in the writer's experience), but leave it until after the event and there may be little you can do by way of damage limitation.

## Levels of cover

Following on from the increase in larger claims, firms should consider the level of primary cover. Life is far easier when fewer insurers are involved in the handling of a claim. So a primary layer of £5 million or even £10 million for larger firms may make claims handling easier.

The new outcome 7.13 in the SRA Code of Conduct, introduced on 1 April 2015, requires 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'.*

Firms should therefore review their level of cover and keep a record of having done so.

## Choice of insurer

When you buy insurance, you are buying two things – claims handling and security. Do you know which panel solicitors will be used? From our experience of reviewing claims files, both on behalf of firms and insurers, the writer can say that there is considerable variation in quality.

There have been examples of firms suffering client account losses through banking scams where the insurers have refused to pay, not realising, due to their inexperience, that such claims are generally covered under the wide provision in the SRA minimum terms and conditions (MTCs). In one case, it is said that this resulted in an intervention in the practice by the SRA. So it is important to be sure that your insurer and its panel solicitors have wide experience of solicitors' claims.

Financial strength of insurers is particularly important, as we have seen with the collapse of Quinn, Lemma, Eric and Balva (though fortunately those insured with Quinn are still being saved by the premium-paying public in Ireland). We have encountered firms who have suffered from more than one of these. It can be very stressful for a firm having a claim with no financial protection, a point which those who seek to reduce limits of cover should appreciate. Only the smaller firms are protected by the Financial Services Compensation Scheme, and then only for 90 per cent of the claim and a similar percentage of defence costs.

A combination of lender requirements, wider availability of rated cover and concern following previous insurer failures has led to a significant reduction in take-up of unrated insurance. It is also of note that only six firms failed to obtain insurance last October.

## Tackling a problem claims record

What do we mean by a problem claims record? The starting point is to identify the firm's 'burning cost' – comparing the sums paid by insurers with the premiums over a six-year period. Insurers are there to make profit and, if they did not do so overall, they would soon be out of business (as we have seen with the collapse of a number of unrated insurers in recent years). But in reality, when insurers pay a claim, in one sense they are only lending you the money – they will want it back in premiums. Changing insurers may offer a way round this, but it carries risks too.

A single large claim may have a disproportionate impact on a small firm's claims record, though it does not necessarily mean it is a bad firm. But, in many ways, what can be more concerning is the frequency of claims – and what firms have done to address them. Solicitors often delude themselves that a claim is a one-off event – in fact, it can be more of an indicator of being caught on a one-off basis than an indicator of the quality of the firm's processes and overall risk management.

Have you got a process for managing risk throughout the year – not just on the day you complete the proposal form? An underwriter at one major insurer commented recently that, while some firms say they are doing risk management, it may not actually be happening: file audit in particular is not searching enough. If firms with problems do undertake a formal review of their risk management, or commission one externally, they need to show they are following it up with regular, say quarterly, reviews, and document them.

Sometimes, a firm may identify particular issues which have given rise to a number of claims and may have cause to suspect that there may be more similar claims waiting to creep out of the woodwork. This can make renewal difficult, and they may need to consider submitting a block notification or 'laundry list' to their insurers. The reason for this is that, if you make a valid notification of circumstances to insurers during the policy year, a subsequent claim arising from the circumstances notified will be treated as falling under the policy year in which it was notified, and not the subsequent policy year when the claim is made, when you may have different insurers.

Care is needed here, for several reasons. First, there is a risk of fallout with your current insurer who may decline renewal. Often, the insurer will refuse to accept the notification as a valid notification.

Second, great care is needed in drafting the notification. We have seen DIY block notifications which have been rejected by insurers, meaning that the firm then has a dispute between its old and new insurers on whether a particular claim arises from the circumstances notified.

Third, some policies contain specific requirements for an effective notification to be made.

Fourth, in some cases there may be a judgement call on how far you should go in search of trouble – it is one thing notifying insurers about 'known knowns' and 'known unknowns', to quote Donald Rumsfeld, but quite another to go in search of 'unknown unknowns'.

So block notifications can be a valuable tool, but drafting them is not a good place to start learning about the finer points of professional indemnity policy wordings.

When firms do have a problem claims record, some panic, then contact as many brokers as they can. We have seen that in practice this can be very damaging and can seriously impede their prospects of obtaining any cover at all. What they do need is an insurance broker with real experience of dealing with difficult cases who can manage the process. Other measures may also assist, such as a review of claims experience or of the firm's risk management.

## Cyber cover

We have already looked at cyber risk. Increasingly, brokers are offering cyber policies. This is a developing area and, unlike the compulsory cover under the MTCs, there are no standard provisions.

Remember that the MTC cover already protects you against most client claims arising from loss of data, so you need to check carefully what additional benefits the cyber policy will provide. There may be support, covering IT and crisis management, but you need to consider whether the claims process will help or hinder you. If you want to use your own IT support, for example, it may not suit you to be forced to use someone who does not know your system.

## Reform

In the past six years, solicitors have bought approximately 4,500 insurance policies from insurers who have subsequently become insolvent, but at present the market is quite benign and, as noted above, the appetite for unrated insurance has diminished significantly due to the availability of rated cover. Most firms are obtaining cover without too many problems and, although some insurers are trying to talk up premiums, it is doubtful there will be significant premium hikes in the foreseeable future.

At the time of writing, the next stage in the SRA's process for reform of professional indemnity is expected to be the release of a discussion paper. It is likely that some topics from the previous consultation will crop up again.

**Reducing the policy limit**

Reducing the limit from £3 million for recognised bodies and alternative business structures and £2 million for sole practitioners and partnerships was previously proposed. In support of this, other regulators of legal practices, such as the Bar Standards Board and CILEX, only require £500,000. A reduction in policy limit might result in a modest saving in premiums, but it would only be modest because the 'action area' is at the bottom of the policy limit, not the top.

Set against that, the problems are formidable.

1. The policy limit includes claimants' costs, which can be substantial on a claim contested to trial in particular. This point, remarkably, was missed by the SRA in last year's consultation and it is fundamental.
2. Once account is taken of claimants' costs, the sum insured is too low for most firms doing transactional work.
3. Even volume personal injury litigators can be at risk – an undervalue settlement which has failed to take account of minor brain injury (perhaps a cyclist's claim) or post-traumatic stress disorder can easily exceed that level. There has been a claim over £1 million arising from a £2,000 settlement.
4. Aggregation, under which multiple related claims may be subject to one single policy limit, can mean claims are more likely to exceed the policy limit; there is a case pending on the application of the aggregation clause, which could increase the incidence of this.
5. The writer has acted for firms which faced claims over their limit of insurance, and the stress and worry for those concerned is unimaginable for those who have not faced such a situation.
6. The broad cover minimises risks of disputes on coverage: other professions experience more coverage disputes. If cover were reduced, the wider coverage, which minimises disputes, would expose firms to more disputes. We have seen the difference when advising other professions who do not have such beneficial terms and are exposed to personal liability.
7. The cost of buying back the cover, if it can even be bought, would be far higher than the perceived savings.
8. What is not compulsory may not be obtainable at any price – particularly if a firm has ceased practice.
9. Law firms have been prohibited from limiting liability below the compulsory insurance limit. Firms may have limited liability to £2 million or £3 million, only to find that, when the claim comes in, they only have £500,000 cover. This may be detrimental to consumers, lawyers and their staff.
10. Solicitors may have retired and be unable to buy additional run-off cover at the level they believed would be in place when they did so.
11. Solicitors' staff may be exposed to personal liability, and it is simply not possible for employees to buy cover at any price.
12. In the face of competition, we currently provide the gold standard of client protection. Why try and sink to the lowest common denominator?

Unlike other branches of the legal profession, solicitors have huge buying power with annual premiums of over £250 million for primary cover. That in turn has brought us unrivalled breadth of cover. To throw that away for minimal savings would be foolhardy.

**Reducing run-off cover to three years**

At present, firms which close without a successor practice have six years' cover. Claims can come in even beyond that, with extended limitation periods, claims by minors, claims by beneficiaries under wills or whose interests have not vested, and more. Many of the arguments set out above in relation to the policy limit apply equally here.

Savings would be minimal, as most claims do fall within three years of firm closure, but the risks would still be massive. Obtaining run-off cover beyond three years may be well-nigh impossible. Consumers, solicitors and their staff would be unprotected. Solicitors and their staff risk losing homes.

**Limiting compulsory cover to individuals, small enterprises, charities and trusts**

This was raised in the consultation in 2014. Client protection is a feature of a mature and robust profession. To limit cover in this way would be arbitrary, remove protection even for many comparatively small business, and remove protection for solicitors and their staff.

## Conclusion

The writer expects that most firms renewing in October 2015 will not have great difficulty obtaining cover and will probably not see any large increases in premiums. However, all firms need to be ready to tackle the questions on what they have done about managing both the cyber risks and the banking scam risk.

Firms with problem claims records need to seek appropriate advice, not merely trawl round all the brokers they can find.

Take great care and seek appropriate advice if you are taking over another firm.

When the next round of consultation on compulsory cover starts, make sure you express your views.

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