Run-off insurance: the tail that wags the dog
Frank Maher

While solicitors are enjoying a sustained period of relatively low-cost insurance, they may not appreciate that there are some potential changes in the pipeline which could severely impact on their future prosperity. The issue is not confined to firms that are planning to close, nor is it confined to small firms, as the failure of some large firms, and London offices of US firms, shows.

Solicitors’ practices which close without a ‘successor practice’ (as defined rather tortuously in the SRA Glossary 2012) are required, under the SRA Indemnity Insurance Rules 2013, to have six years’ run-off insurance. The minimum terms and conditions 2013 (MTCs) provide for this to be included as an extension to firms’ compulsory cover and firms are required to pay any additional premium specified by the insurers in the policy – usually between two and four times the last premium paid. The cover is on the same terms as the existing policy with a limit of £2m (sole practitioners and partnerships) or £3m (incorporated practices and alternative business structures (ABSs)).

Insurers have to provide the cover, even if the premium is not paid. (Some policies provide that cover is conditional upon payment, but even if this is effective, insurers would still have to satisfy any claim subject to reimbursement from the insured.) Collapsing law firms have left substantial premiums unpaid.

After the six-year period, cover is provided by Solicitors Indemnity Fund Limited (SIF), but this will cease in 2020. The Solicitors Regulation Authority (SRA) has decided not to extend it.

For practices which closed without a successor practice before SIF went into run-off in 2000, run-off cover has been provided without payment of an additional premium, a benefit which, at the time, may have escaped the notice of those who voted to abolish SIF. Barristers insured through the Bar Mutual Indemnity Fund (as most in private practice are) still enjoy this benefit.

Other records that may be necessary include:
- money laundering (reg.19 of the Money Laundering Regulations 2007) for five years; and
- tax (including VAT) records.

Conclusion
All firms must consider the possibility of closure and plan for the consequences. A failure to do so can make an otherwise difficult time significantly more stressful and, in extreme cases, lead to regulatory penalties being imposed by the SRA.

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There have been reports in the press, largely unattributed, that the cost of run-off has prevented many practices from closing, causing practitioners who are past their prime to soldier on when this may not be in anyone’s interests.

It is easy to identify the premium as the problem, but the real problem is the claims. If the acts or omissions of a solicitor or the solicitor’s staff have caused a loss, someone has to bear that loss. That could be an insurer, the profession as a whole, an uninsured solicitor or staff member, or the claimant. The possible impact of the last of these outcomes on the reputation of the profession should not be ignored: it could easily be a brain-damaged child who is left uncompensated.

Nor can one assume, as some bloggers appear to do, that, because one is uninsured, a claimant will not sue. Solicitors and their staff may have houses and pensions, making a claim worthwhile. An illustration of the problems which can arise where there is no such protection can be found in the case of *Merrett v Babb* [2001] EWCA Civ 214. In that case, an employed valuer personally signed a mortgage valuation. In 1994 his employer became bankrupt and later that year the practice’s professional indemnity insurance (PII) was cancelled by the trustee in bankruptcy without run-off cover. In 1997 a claim was made against Mr Babb for negligence. He was found personally liable – and was uninsured.

Professional liability claims usually arise some time after the alleged act – typically three years or more. The judgment in *Merrett v Babb* does not say when the claim was made, but we do know that the valuation was undertaken in 1992 and the proceedings commenced in 1997. The Court of Appeal thought Mr Babb had been imprudent for failing to arrange his own insurance after his former employer’s trustee in bankruptcy cancelled the practice’s cover. It failed to appreciate, however, that such cover is all but unobtainable in practice.
As Oscar Wilde identified, a cynic is ‘a man who knows the price of everything, and the value of nothing’ and, unfortunately, this appears to be reflected in the thinking of the SRA and the Legal Services Board as they appear not to see beyond the cost of the premium. The writer has defended several thousand claims and advised solicitors and other professional people on claims that were uninsured – which provides some insight into the true value of insurance.

Both regulators seem also to be transfixed by their obligations to consumers under s.1 of the Legal Services Act 2007, yet their duties under s.37 of the Solicitors Act 1974 extend to solicitors and solicitors’ staff and were not limited to consumers; although Parliament expressly amended s.37 and many other provisions in the 2007 Act, it did not choose to restrict the breadth of the provision on PII. The SRA’s consultation in 2014 proposed a reduction in run-off cover to three years, a figure picked at random with scant regard to any facts. Yet the review which the SRA commissioned from Charles River Associates reported that 40 per cent of run-off claims were made after three years.

Since then, SIF has reported an increase in claims – these are mainly claims after the compulsory six-year period. So how can a shorter period of cover be justified?

Other proposals, which would have had a knock-on impact on run-off cover, would have limited compulsory cover to £500,000 and excluded claims by all but individuals and certain other limited categories of client, thus excluding lender claims which are probably the greatest fear for solicitors in practice, particularly in smaller firms.

The SRA position appears to be that those who want the cover can buy it, yet the reality is that many who are exposed to claims are unable to buy run-off cover at all. The choice to buy such cover is, in practice, the exclusive preserve of the partners at the time the firm closes, not the partners who have left, not the employees, and certainly not the clients. Even if the firm does decide to buy run-off cover, it is unlikely to be for more than two years at a time and claims during that period may make it impossible to renew cover. It will be far more expensive, and claiming tax relief may not be straightforward.

It is also pertinent to note that, under outcome 1.8 of the SRA Code of Conduct 2011, solicitors are prohibited from limiting liability to less than the current minimum level of insurance (£2m/£3m as explained above). However, clients and solicitors may agree to limit liability to these sums now, yet face the risk of claims from past acts in future when the limit of cover is reduced. The effect of a reduction in cover is retrospective, and impacts on both client protection and the protection of solicitors’ right to property.

The real possibility of a reduction in cover is something that solicitors should factor into their retirement and succession planning. This is not confined to small firms, but a simple example illustrates the problem.

Case study

Bill and Joan are the only partners in a small practice. They have always limited liability to clients to £2m (including claimants’ costs).

Bill is retiring in six months’ time. But for the threat of changes, he could retire in the knowledge that the practice would have £2m cover for at least the next six years. However, after a few months after Bill’s retirement, Joan decides to become a consultant with Jones & Co. Jones & Co will take on all the clients and agrees to be successor practice. As Bill has left the practice, he has no say in any of these arrangements.

The following year, the SRA reduces the compulsory minimum cover to £500,000 and limits run-off cover to three years. It also restricts compulsory cover, broadly, to consumers.

Jones & Co hits hard times and reduces its insurance to the new minimum. It then goes into administration and run-off cover is triggered. Five years after Bill retired, he receives a claim from a former conveyancing client and her lender. The client had decided to sell her house and found there was a problem over access making the house all but worthless. The claim is for £1.5m.

After enquiry as to the insurance position, Bill notifies the claim to Jones & Co’s run-off insurer. It immediately warns him that there is only £500,000 cover, and that, if the claim concludes at a greater sum, it will only be responsible for a pro rata share of the costs of defending it. So, despite having limited his liability to the client to £2m, Bill is now seriously exposed financially. Once he had retired, there was little he could have done to protect himself retrospectively. He regrets not having addressed the situation with Joan before he retired.

Even if Jones & Co had continued in practice and taken out £2m cover, only £500,000 of this would have included the broad protection offered by the MTCs, so non-disclosure by Jones & Co could have resulted in no cover above that sum. Even then, there might be no cover at all for the lender’s claim.

The options

So, having identified the problem, what are the options? Run-off cover has also provided challenges elsewhere, hence the title of this article.

The Law Society of Ireland has MTCs which are broadly similar to our own, but encountered difficulty finding insurers willing to offer cover after the financial crisis, and reduced the period of run-off cover to two years, a period which leaves much to be desired because, as we shall see, claims can be made at any time. (Whether they are statute-barred is not the point – they still need to be defended.)

However, in 2011 the Law Society of Ireland established a run-off fund, paid for out of premiums charged by participating insurers, which provides almost indefinite cover for firms which close without a successor practice (a broadly similar definition to the provision in England and Wales, with minor differences), to continue as long as the current open market scheme or a master policy is in place. Certain conditions apply.

The Council for Licensed Conveyancers (CLC) recently reviewed its insurance requirements and licensed conveyancers now have an open market scheme similar to the SRA’s, albeit there were only two participating insurers for the renewal on 1 July 2016.

Insurers under the CLC scheme are required to provide six years’ run-off without payment of an additional premium. However, there are some significant caveats. Cover is limited to £2m in aggregate over the entire period, including defence costs, and, critically, excludes fraud, which is a common allegation in lender claims. While one may therefore expect claimants to be cautious about alleging fraud, the manner in which a claimant pleads its case does not determine the issue of cover.
Nothing is free in this world and, although insurers cannot charge an additional premium, it is factored into the pricing and carries the risk that an insurer will decline to offer cover to a practice that it fears may be on the brink of closure and hopes to buy seven years’ cover for the price of one. Although this did not happen this year, it is understood that a small number of practices encountered initial difficulty on renewal.

It is also questionable whether either the Irish or CLC options would prove to be sustainable in a more difficult insurance market. The market is benign at present, with many firms seeing a reduction in cost and plenty of choice of insurers. But the insurance market is cyclical and a volume of recession-related claims post-Brexit could change all that. The CLC scheme in particular is very small indeed and it would be dangerous to draw too many conclusions from it.

The Institute of Chartered Accountants requires firms to take out two years’ run-off cover, but recommends that they take six years. As it now regulates providers of probate services, a practice area known for complex, high-value claims – with some made years after the event – it will be interesting to see how this unfolds.

In conclusion, solicitors should plan the insurance aspects of succession and retirement and mergers well in advance of any changes. They should also be refining their strategy on limitation of liability, though this can only be an imperfect solution.

Finally, they should consider responding to the SRA’s proposals for change when they are published next year. The possible changes could put small firms at a particular disadvantage.

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**PII renewal: top tips**

**Rebecca Atkinson**

Yes, it really is that time again. It’s time to renew your professional indemnity insurance (PII). ‘Oh joy,’ you might think, but actually, with a well-planned renewal, it can be smooth and... even fun

You may recall an article in the November 2015 issue of the Legal Compliance Bulletin ‘Want to lower your PII premium? Then renewal for 2016 starts now!’ ([2015] November, issue 40, pp.13–14) which explained that, in order to achieve a reduction in premium, firms should analyse why their premiums are so high, take stock of what systems, processes and policies they have, create a plan of action to change and improve and then carry out that plan and watch insurers’ confidence grow.

This article is more about how to approach your renewal this year when it comes down to the act of engaging with brokers and insurers. For this, I have taken the advice of Brian Balkin (senior vice president for global professional and financial risks) at insurance broker Lockton. Lockton is one of the leading brokers for the solicitor market and in previous years has placed over £85m of solicitors’ premium in a sole year.

So, what is Brian’s advice on this year’s PII renewal?

**Seek help from your broker**

If you haven’t done so already, seek help from your broker when preparing for this year’s renewal. Ask brokers what you should be providing, if there is a specific way to approach renewal and how to approach each insurer. Also speak to your broker about meeting insurers for a renewal chat. Your brokers are there to help you and to achieve the best renewal terms on your behalf.

**Give a good impression**

First impressions count. It is important to be ready and have all paperwork in order. A good but short presentation on the firm goes down well.

It’s all about you.

Clearly explain to prospective insurers what your firm is all about. Who are your clients? What is the work you do? Is it niche? Is it unique in any way? Are you an all-services firm? What is the vision? What is the strategy? Do you plan on merging? Do you plan on growing organically? Do you plan on staying the same size? What is the culture of the firm? What is changing? The key here is to not to hold back.

**Face your issues**

As echoed in the November article, be honest about the issues you have, not only within the firm but also with insurers. Be ready to explain what has happened in the past and what steps have been taken to rectify and prevent further occurrences.

If you have a particularly bad claim on record, speak about it with insurers and explain what happened. They will spot the bad claim anyway and ask about it, so why not get in there first? If necessary, write a short report explaining what happened. The worst thing you can do is be a ‘politician’ and try to be clever with the truth. Be honest and be ready to talk.

You also need to be ready to talk about any regulatory issues that you have. If you have reported material breaches to the Solicitors Regulation Authority (SRA), tell your insurer at renewal time and be up front about what has happened. What is important here is that you explain what you have done to improve the situation to ensure that it doesn’t happen again. If the firm is currently being investigated by the SRA, explain why and what stage the investigation is at. Likewise, if an investigation has been undertaken and concluded, explain the outcome.

**Go beyond the renewal form**

The renewal form, as large as it may be, does not always reflect the entire picture. Don’t be afraid to put together a pack of