Welcome
Happy New Year! We start 2011 with a special edition of @risk, focusing solely on the important issue of the future of solicitors’ professional indemnity insurance. Both insurers and solicitors firms have a vested interest in a viable sustainable insurance market and to this end changes must be made to the current regime. The SRA has published a Consultation on Future Client Protection Arrangements proposing changes for 2011 and beyond. This follows a ‘root and branch’ review by Charles River Associates of the problems arising out of the current insurance regime – the increasing incidence and cost of claims, the huge shortfall in funding for the Assigned Risks Pool (ARP), increasingly higher premiums for most firms, and the fact that some firms still struggle to get obtain market insurance at all. In this @risk, we set out our own views on the proposals.

The future of solicitors’ PI insurance: time to have your say

The consultation paper (available at: www.sra.org.uk/sra/consultations/client-financial-protection-arrangements.page) sets out a number of proposals for change, some of which are non-contentious, whilst others are more radical. We encourage you to make your views known to the SRA by 28 February 2011, the deadline for responses.

The SRA are suggesting a two stage approach. The first four proposals, if adopted, would take effect from 1 October 2011. Further changes are up for debate and any implemented would come into force on 1 October 2012 or later.

October 2011 proposals

Proposal 1 – Removal of the single renewal date

The requirement for firms to renew their compulsory PII cover on 1 October each year would cease. After renewal this year firms would be free to renew their PII cover on any date convenient to them, subject to the requirement that they hold qualifying insurance at all times.

The single renewal date is an accident of history. It exists only because the master policy scheme and its successor, the Solicitors Indemnity Fund (SIF), had a single renewal date and this feature of the insurance regime continued with the move to the open market.

Currently, insurers receive a huge volume of applications in the run up to 1 October, and as a result, insurers do not always have sufficient time to engage with firms as fully as both insurers and firms might prefer and to investigate fully any aspects of firms’ practices that may concern insurers. The scrapping of the single renewal date will ultimately lead to renewal applications being spread throughout the year, many firms could benefit from insurers having more time to look in-depth at their systems and procedures and at how their practices are managed. On the other hand, for some firms, such in-depth scrutiny could well be to their disadvantage!

For the last 10 years, insurers have set their rates once a year to take account of the 1 October renewal date. With the proposed move to an all year round business, insurers would have greater flexibility to review their rates throughout the year. For example, if there were a spate of claims or a number of large claims emanating from a particular area of practice, the rates for the relevant practice area could be reviewed immediately and premiums levels adjusted accordingly. Similarly, if rates had been increased in anticipation of a market event which did not occur, rates could be decreased during the course of the year.

One problem that a scrapping of the single renewal date won’t change is that of firms seeking to renew their insurance at the last minute or late, or submitting applications which are illegible or incomplete. The current press attention given to the October renewal date will wane in time leaving such disorganised firms even further exposed to the possibility of forgetting to renew at all.
There is a danger of focussing on this proposal as a solution to all the problems that currently exist in the market. Many commentators seem to view the removal of the single renewal date as a panacea that will automatically lead to cheaper insurance premiums. This is a popular but naive view. The proposal is in fact non-contentious and creates choice for practitioners, and for that reason, Zurich supports the proposal.

Proposal 2 – Removing financial institutions from the scope of compulsory cover
Proposal 2 will permit insurers to exclude from cover claims by financial institutions arising out of work conducted on or after 1 October 2011. Claims from work undertaken for financial institutions prior to that date will continue to be covered.

The draft definition of Financial Institutions is:

‘any undertaking or unincorporated association which carries on a business of lending money (which may include mortgage lending) or otherwise providing or issuing credit including, without limitation, any bank or building society’.

The proposal is clearly directed at excluding cover for claims by lenders in the context of residential and commercial conveyancing but in practice the exclusion will be more widespread and will extend to all claims arising out of, for example, corporate work, employment advice, debt collection, repossession proceedings or even professional negligence litigation, conducted for financial institutions.

The proposal is not popular in some quarters. In an article in the Law Society Gazette, Paul Marsh, former Law Society president, described it as “potentially a disaster for high street conveyancers”. The current president, Linda Lee, has stated that the proposal could “hit conveyancing solicitors hard”. The Solicitors Journal has even opined that “in theory the proposal would allow conveyancers not to carry insurance at all”. This is simply not the case. The permitted exclusion refers to claims by financial institutions only; cover for claims by individual conveyancing clients would still be compulsory. Firms wishing to undertake lender work will simply have to ensure that they have the relevant additional cover in place.

Despite the scare stories, there should be no problem for firms obtaining cover for claims by financial institutions if they present themselves to insurers as a good risk, with competent, well trained staff, effective supervision, and comprehensive, robust risk management procedures. Furthermore, it is likely that, in practice, additional cover for financial institutions will be written on the same terms as the compulsory cover and included as an endorsement to the standard policy.

We acknowledge that firms which are seeking to do lender work but which are unable to present themselves as a good risk to insurers may be unlikely to secure the additional cover they will need. We have no concerns if, as a result of the proposal, a serially negligent conveyancing practice or a firm with little by way of professional expertise or demonstrable risk management procedures is no longer able to practise in the conveyancing field. If they were not generating claims this would have a positive impact on premiums generally. Furthermore, the public and the profession need to be protected from such firms.

Whilst Zurich supports the proposal to exclude claims by financial institutions we are disappointed that it will provide no relief at all for the market in 2011 from lender claims, particularly those against ARP firms, arising as a result of the recent recession and which will continue to be made for some years yet.

Proposal 3 – Less time in the Assigned Risks Pool
Proposal 3 reduces the time for which firms are eligible to be in the ARP from 12 months to 6 months. The proposal would also create the obligation for ARP firms to develop and implement effective plans to exit the ARP into the open insurance market or to undertake orderly closure within that six month period if they are unable to obtain market insurance. Zurich supports this proposal to the extent that it reflects, albeit to a lesser degree, our view that firms that are unable to secure market insurance should not be permitted to practise. [See ARP on the following page].

Proposal 4 – Requiring insurers to report to SRA
From 1 October 2011 insurers will be required to report to the SRA those firms that fail to pay their insurance premiums and those that insurers believe may have misrepresented information on their proposal forms. Currently these reporting obligations are permissive only, rather than compulsory. Zurich is in favour of this proposal but we are of the view that the reporting obligation should be extended to include circumstances where the premium has been paid to the insurer in full with borrowed funds, but the firm fails to make instalment payments to the credit provider. We would suggest that a mechanism for reporting to the SRA non-payment of instalments needs to be developed as often the default on instalment payments will be an indicator that a firm may no longer be financially viable.
Potential changes in October 2012 or beyond

Reform of the Assigned Risks Pool

The main issue affecting the stability of the market is the Assigned Risks Pool; reforming the ARP is crucial to placing the market on a more sustainable footing. The problem with the ARP is the cost, and in particular, the huge shortfall between the cost of claims made against firms in the ARP and the premiums collected from those firms. This shortfall is funded by insurers in proportion to their market share of premiums for the compulsory level of cover; in other words, insurers end up paying the claims made against the very firms they have chosen not to insure! This cost is passed on to the profession in the premiums individual firms pay. In this respect the complaint that was levelled against SIF continues: namely that the good firms are subsidizing the bad and they have no idea how much this is costing them.

Claims against ARP firms are significant; for the 2008 policy year, the indications are that insurers will be required to fund claims of £45.8 million, the equivalent of 20% of the total market premium for that year, and that’s before they start to pay the claims for the firms they selected to insure in that policy year. The indications are that the 2009 year will be every bit as bad. And with 293 firms in the ARP following the 2010 renewal, it is realistic to expect that the position will be little different for the current insurance year.

Another problem with the current funding of the ARP shortfall is that it is inefficient. This is due to the fact that firms pay broker commission and Insurance Premium Tax (IPT) on that part of their premium that insurers factor into their rating to meet their ARP exposure. The Consultation paper estimates that in the current insurance year between £5m and £6m of premiums paid were ‘lost’ in this way. And the problem will only get worse as IPT, previously 5%, increased to 6% on 4 January this year.

The SRA make a variety of suggestions for change from 2012 including:

- **Removing from the ARP the function as a provider of Qualifying Insurance.**
- **Controlling entry to the ARP by preventing firms from accepting new instructions and not permitting them to hold client funds.**
- **Changing the method of funding the ARP by a direct levy on the profession or a levy as a percentage of insurance premiums.**

At Zurich we are of the view that it should be a fundamental principle that firms that are unable to obtain professional indemnity insurance in the open market should not be permitted to practise. We do not accept the SRA’s proposal that firms without insurance on 1 October (or any other relevant renewal date) would have to close forthwith; it ignores the reality that firms which have been trying to obtain insurance up to the last possible moment will be unlikely to be able to close instantaneously if they haven’t obtained cover by their renewal date.

Our view is that a better option would be to give such firms 30 days after their renewal date to obtain backdated open market cover, close down, or to be intervened in forthwith by the SRA if they haven’t obtained insurance or closed within that 30 day period. We also believe that firms that close or are intervened in should pay a premium to the SRA to cover claims arising from work undertaken up to the closure/intervention. We would suggest that any shortfall between claims paid on behalf of such firms and the premiums collected from them should be funded by a levy on the profession as a whole in the same way that the Compensation Fund is funded.

Whilst many solicitors’ initial reaction is likely to be against the imposition of additional levies, the reality is that the profession is paying for ARP losses already. It’s just that what they are paying is hidden in insurance premiums. This lack of transparency means that firms have no idea how much they are contributing to support the losses incurred by competitor firms whose performance is so poor they cannot even get insurance! However the ARP is constituted in the future, one of the advantages of a levy would be that it would make the cost of its shortfall more transparent and would hopefully drive more effective and robust regulation of ARP firms by the SRA, to date a shortcoming identified in the Charles River Report. It could also encourage practitioners to report incidences of poor practice by others in the market enabling, where appropriate, earlier investigation and intervention by the SRA.

Another option set out by the Consultation paper is not one that we view as being workable. It is that the current role of the ARP is maintained but with new controls on entry preventing firms from accepting new instructions and also preventing them from holding client funds. Whilst at first sight this proposal may seem attractive, in reality it would effectively mean that the firms would have to close as they would be highly unlikely to be able to continue in practice whilst operating under such restrictions. We do not support the proposal.
Scope of Minimum Terms and Conditions (MTC): cover limited to individuals
A further change the SRA is considering is limiting compulsory MTC cover to claims by individual clients. The proposal, building on the exclusion of cover for financial institutions, is based on the premise that corporate clients do not need the same level of regulatory protection as individual clients as they are sufficiently sophisticated to make informed choices about the firms they instruct. It is suggested that the definition of ‘individual’, to whom the compulsory cover would continue to apply, could be that which is used by the Legal Ombudsman covering individuals, charities and SMEs. Zurich supports this proposal.

This change would facilitate flexibility in the use of exclusions such that insurers could tailor policies to the needs and services offered by individual firms. It’s possible that some insurers would continue to offer insurance for all work undertaken irrespective of the nature of the client. Other insurers may be more circumspect as to whom they offer extended cover; professional expertise, claims experience and risk management will play a major role in those underwriting decisions.

Cancelling policies for non-payment or fraud or misrepresentation on proposal forms
In the Consultation paper the SRA seeks views on whether changes should be made at a future date to enable insurers to cancel policies for non-payment of premiums or where there has been fraud or misrepresentation in proposal forms. Zurich would welcome such changes but there is a danger of insurers cancelling policies for non-payment or fraud or misrepresentation irrespective of the nature of the client. Other insurers may be more circumspect as to whom they offer extended cover; professional expertise, claims experience and risk management will play a major role in those underwriting decisions.

And finally
We are pleased that the SRA’s Consultation paper addresses many of the issues that are causing distortions in the solicitors’ PI market. However, we are disappointed that the changes that will make a real difference and will benefit firms and insurers alike are not on the horizon until 2012 at the earliest. The current pace of change means that it is still likely to be a difficult renewal this year.

We have made our views known to you in this publication and will be responding formally to the Consultation paper. We urge you to make your views known to the SRA before the 28th February deadline. You don’t have to respond in detail or at length to every proposal, just address those issues that you feel strongly about, whether by completing the consultation paper response form or by sending a brief email. Details of how to respond are available on the SRA website.