Run-off Insurance Cover Explained

What is Run-off Cover?

Run-off is the insurance cover provided under certain policies when your practice ceases, whether voluntarily, as a result of retirement, merger or involuntarily, through insolvency or other closure event.

Why is Run-off Cover provided?

Professional Indemnity Insurance is provided on a 'claims made' basis – that is, the cover applies at the date the claim is made, not when the error or omission causing the claim occurred. Losses on a PII policy are therefore 'long tail liabilities', meaning it can often be several years after the work was done that a claim arises.

Solicitors in England & Wales must have PII that complies with Minimum Terms & Conditions (MTC) set by the SRA). This MTC wording requires insurers to provide a minimum 6 years run-off cover. This ensures that you and your clients continue to benefit from the very wide cover your PII policy offers (up to £2m for a Partnership, or £3m for LLPs and other incorporated entities) against any such 'long tail' liabilities.

This provides a significant degree of protection for both the public and for partners in law firms, who might otherwise face personal liability for claims that may arise after the firm in question has ceased.

Clearly, notwithstanding the 6-year limitation period, valid claims can arise even after the 6 year run-off period has expired. Currently, SIF (the Solicitors' Indemnity Fund) provides cover for claims arising after the run-off cover has expired, for no additional charge. This arrangement will cease in September 2020, and it seems more likely than not that (at the time of writing) after this time it will be down to the firm to make their own arrangements as this additional cover is unlikely to be provided through the Law Society/SRA in future.

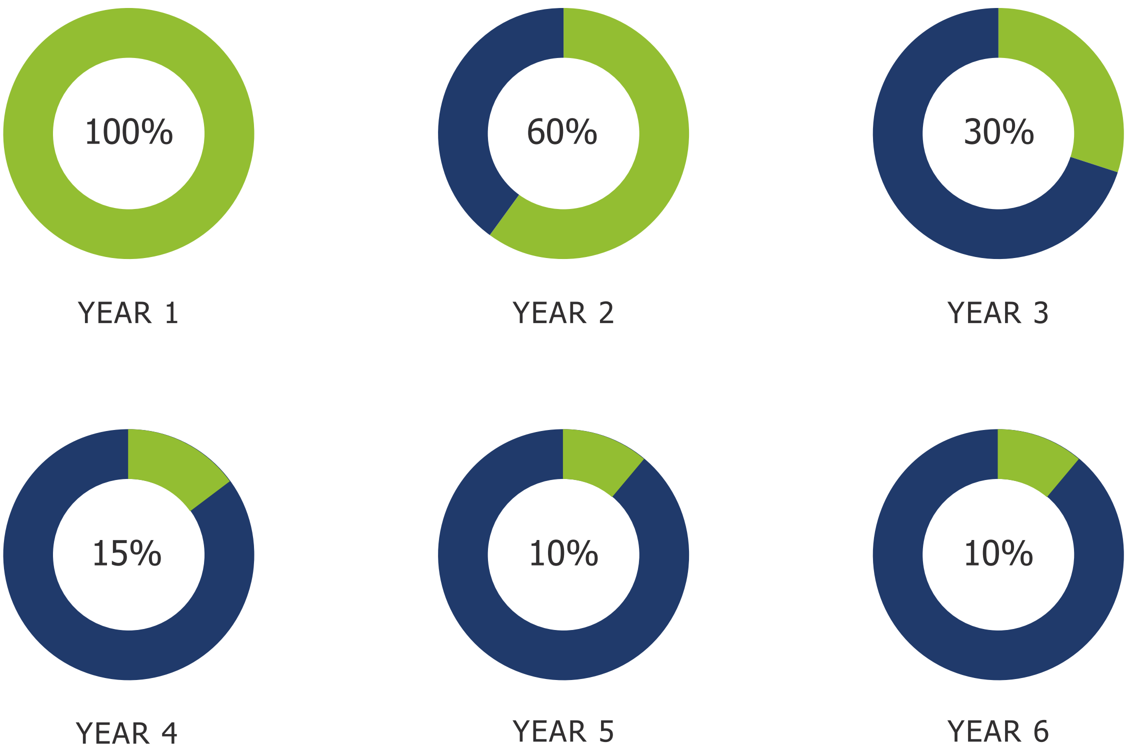
How much does Run-off Cover cost?

Run-off cover incurs a one-off premium. The cost of run-off generally varies by insurer and is set out in your policy wording, as a percentage of the annual premium you have paid. Most insurers charge between 225% to 400% of the preceding year's annual 'Primary layer' (the compulsory £2m/£3m) PII premium.

The variation in the cost of run-off between insurers is due to their own assessment of risk of claims over the six year period, but the likelihood of a claim emerging should naturally diminish as time moves on.

Risk over a six year Run-Off policy

We have provided an example on how an insurer may look at the risk over a six year run-off policy in terms of how they allocate premium and how they arrive at the figure they do:



TOTAL **225%**

What cover does Run-off cover provide?

- Run-off cover is normally an endorsement added to an existing policy. Run-Off cover typically therefore provides cover on the same terms and conditions, and at the same limit of indemnity, as applied in the last policy year before the firm went into Run-Off.
- It applies only to your Primary Layer insurance (normally £2m or £3m). If you need additional cover, you will have to buy excess layer policies each year.
- Policy excesses usually continue to apply, and the prinipals will be required to pay any applicable excesses on claims made during the Run-Off period (see below).

What are your liabilities, as a former Principal, for claims within the excess under Run-Off Cover?

The answer is very much dependant on the terms agreed with your insurers within your primary policy wording. Some insurers waive any excess payable during the Run Off period whereas others impose higher excesses without any cap.

Where an excess is payable, the responsibility for who is liable to pay the excess again depends on the terms agreed with your primary insurer. Under the MTC all principals whether they are in a partnership, LLP or limited company are liable to reimburse the insurer for any excess paid by an insurer on an insured's behalf. For large law firms it is possible to amend the MTC so that it is only the entity that is liable for payment of the excess rather than the principals. Lockton has successfully negotiated amendment of "Reimbursement of the Excess" clause for many of their larger clients. Please discuss this with your Lockton account executive for further clarification.

Why your choice of Insurer is important

When your firm closes and goes into Run-Off, you are obliged to purchase Run-Off cover from your existing PII insurer as at that date.

The majority of insurers follow the self-insured excess of the last "active" annual policy: this normally means a standard £x per claim excess, with an aggregate excess of three times £x.

Some insurers have more onerous arrangements with one insurer imposing a trebled standard excess per claim in Run-Off, with an un-capped aggregate. A number of other insurers imposes the original per claim excess with the annual aggregate excess of three times but reinstating each year of the run-off period.

case study 1

By way of example, a firm has wound down due to the Partners retiring. They pay their run-off premium and are now in their well-deserved retirement. Five years pass, and then one day they receive a letter from a solicitor saying that they were negligent in acting for a client eight years ago when completing on a conveyancing matter. The former partners manage to dig out the old and dusty PII file and send it to the broker who in turn dusts off his file and sends it on to the run-off insurer. Weeks pass by with relativity no contact, but then the Partners receive a demand from their insurers saying they have settled the claim and now require reimbursement for £10,000 excess. This is a complete shock as the firm thought that the huge premium they paid for run-off included everything!

case study 2

A firm (ABC Solicitors) have been approached by a larger firm (DEF Solicitors) to merge. One of the conditions of the merger is that ABC must activate run-off, as DEF do not want the uncertainty of an unknown claim emerging and tarnishing the new combined firm's (XYZ Solicitors) claims experience. Both firms agree, and settle into the new firm. A claim is notified under the run-off policy from work undertaken by ABC Solicitors. Again, the liability to pay the excess falls to ABC's Principals. Many former Principals of ABC are long retired and untraceable and the ones who are, don't have the funds to pay their share of the excess. It is therefore the responsibility of the remaining Principals at XYZ Solicitors who are the former Principals in ABC Solicitors to fund the whole excess.

Ensure you discuss the small print of your policy with your broker. If you are considering a change of insurer, run-off requirements could be a vital consideration - particularly if there is a merger, sale or closure of the practice on the horizon.

The recent experience of firms insured with unrated insurers that have subsequently become insolvent also highlights the reason that choice of insurer is important. Firms that purchased their Run-Off cover from the likes of Balva, Berliner and Enterprise are unlikely to have any claims arising under that cover paid – leaving uncertainty for any former Principals about what their future liabilities may be – and that may not be just the excess.

It is of paramount importance to be discerning and always consider the effect of run-off on your firm. Don't put yourself in the position where you have to deal with the consequences as and when they occur.

Alternative Options to Run-Off

The cost of Run-Off is such that many firms seek alternative arrangements. If you are a Sole Practioner considering retiring, or a Principal in a firm that is looking to sell to or merge with another practice, it is important to plan well in advance if you are to avoid incurring a Run-Off premium.

If another firm is prepared to buy your practice as a going concern, or merge and take on the past liabilities, there is no need to trigger Run-Off. However that does mean that the Successor Practice's own claims record could be adversely impacted by any future claims arising from work undertaken previously by your practice. They have to be confident that your practice is a 'good risk' before they are likely to agree to becoming a Successor Practice.

Succession Planning, Retirement, and Mergers are often complex matters that require careful advance consideration. Speak to us now for advice on how best to prepare your practice.

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