October 2021

Solicitors Season Review

Lockton Review

It is not lost on any of the Lockton team just how challenging the recent Professional Indemnity insurance (PII) season was for our clients, and the legal sector as a whole. While we gave as much advance warning as possible, the insurance market was generally even harder than many expected during the October renewal period.

Matters were not helped by the SRA, and their consultation in respect of the cyber coverage afforded inadvertently under the Minimum Terms and Conditions (MTC) wording, which created an avoidable bottleneck to proceedings. Had the SRA made a decision sooner, we expect that this may have improved the outcome for a number of practices.

After each peak renewal season, we produce this report, summarising what went on leading up to the October renewal, capturing the numerous aspects that may have influenced the market conditions, proceedings and the thoughts of practices, brokers and insurers, such as the pandemic, SRA's consultation, PSYROC and claims to name just a few. We will provide analysis on what actually happened during the season and make predictions on what to expect in 2022 along with providing some key points for consideration too.

The Market Conditions

Despite some views to the contrary, PII is not car insurance, it is a much more complex class of insurance, especially for the legal profession of England and Wales. Ignoring the breadth of coverage afforded under the Minimum Terms and Conditions (MTC), its long tail nature means that most or certainly many losses are not realised for several years past the expiry of a policy and there are so many factors that influence an insurers proposed pricing. Hopefully this review will provide some insight into its mechanics along with some rationale as to why things occurred.

As highlighted in the opening paragraph, the prevailing insurance market conditions were tough, with rates and premiums generally rising. Insurers were adopting greater caution, more forms were required and questions being posed which in turn made the process more time protracted and time consuming too. A number of insurers would not consider new business enquiries unless there was confirmation of a valid renewal quote on the table. The cynic in me suggests that one or two insurers may have had their fingers burned whereby claims or notifications had not been appropriately reserved or documented on claims summaries in order to help the risk appear to be more attractive to another insurer.

While opinions differ on the reason for these challenging conditions, the overarching consensus is that this was largely due to significant claims activity in the profession. Given that the frequency and severity of claims show no sign of slowing, insurers appetites are understandably suppressed.

If we can cut out or significantly change the deteriorating claims picture, the cost of insurance will absolutely reduce and the MTC wording perhaps would stop being called into question? However, insurers appetites were supressed further which we expect was largely due to a fear or expectation of future claims.

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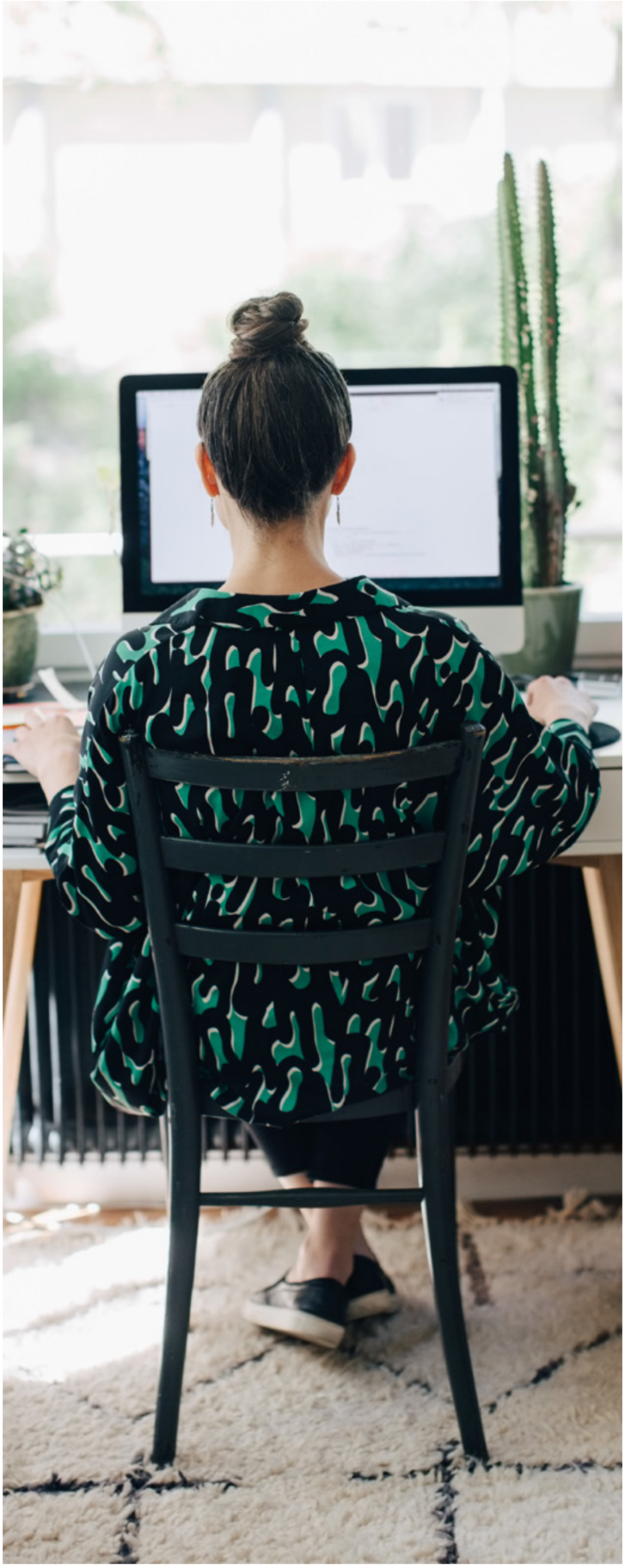

The Covid-19 Pandemic

The pandemic brought some enforced change to business and the way in which it is conducted. Within a few weeks of the first national lockdown everyone adapted to new technologies; Teams, Zoom, Web Ex, FaceTime, WhatsApp calls quickly became the norm, replacing that face to face engagement with both clients and colleagues. Businesses had to become more flexible with their associates overnight, especially when the schools closed. Lines became blurred between home and work and when the outside world was cut off, barring even trips to the supermarket, people tended to work longer hours or had to adopt a very different working pattern to juggle home schooling whilst still adhering to billing targets. As this review is about Solicitors PII, we will now focus purely on the impact this had on the way in which legal professionals work.

Initially, there was a considerable pause in activity given the closure of the courts. Many commercial deals were put on hold and conveyance instructions dried up. With the legal professionals soon classified as a key workers, things gradually changed and activity increased. This was particularly significant for property teams during the stamp duty holiday.

With practices forced to adopt a fragmented, home-based workforce, governance, supervision and oversight became more challenging too. Video conferencing systems helped firms stay connected, but these were not as conducive to learning or interaction as the office environment. Basic, crucial processes like sense-checking with peers were generally lost with employees working at home.

The introduction of the furlough scheme and various financial schemes to safe guard the future of the British economy were introduced. Understandably, many legal practices took advantage of these, although from what we have seen, many practices took out the loans purely as a precaution and left the money untouched. Having benefited from some of the initiatives that were introduced, a large proportion of the profession had a positive year financially.

As a result of the pandemic, insurers are now far more inquisitive around the financial health of each practice. Detailed questions are being asked about the impact of the pandemic on the firm, its clients, its associates, and its ways of working.

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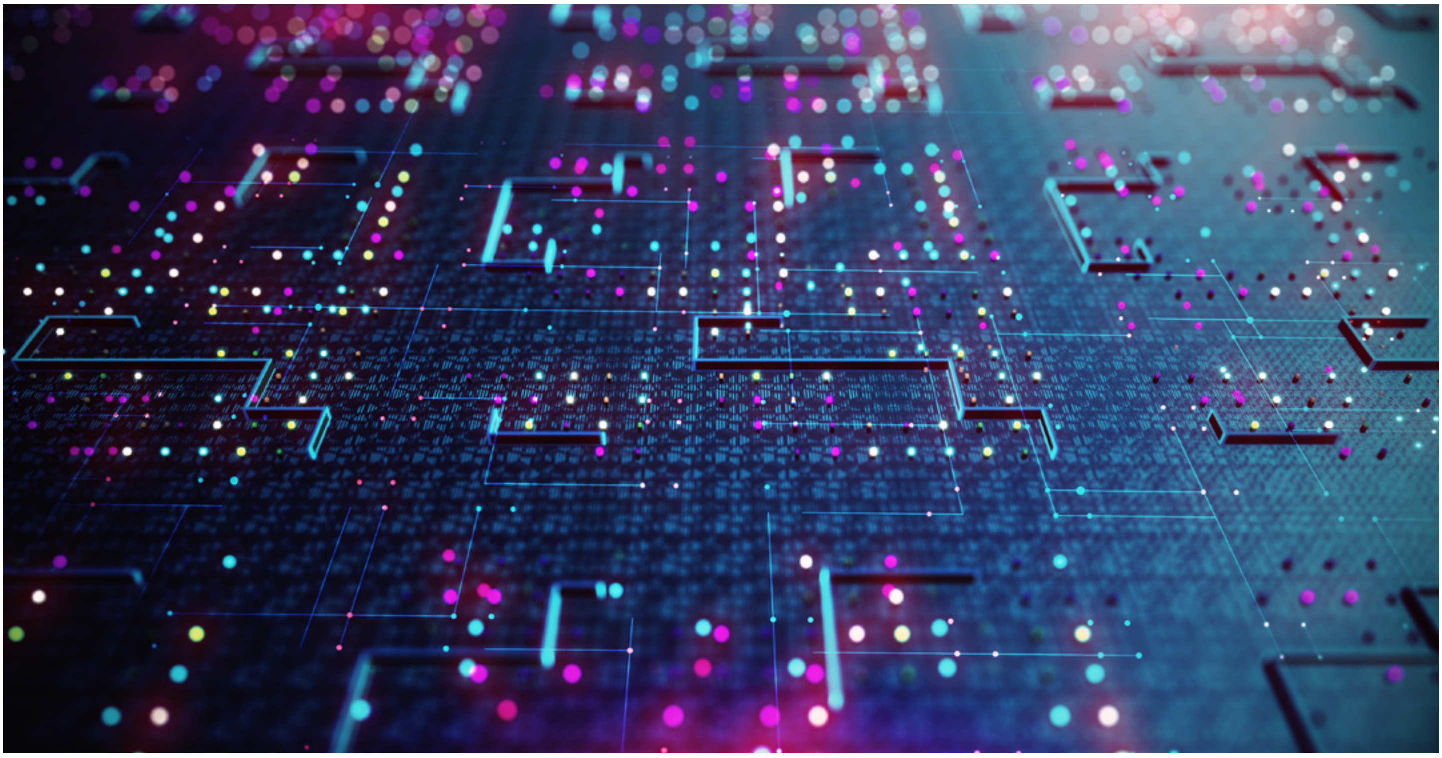


SRA Consultation – Silent Cyber

Throughout 2021 the SRA undertook a consultation on the MTC wording. This consultation intensified in the summer months leading up to the October renewal, causing both delays and confusion among some insurers.

The backdrop to this is that via new regulation, insurers were tasked to provide clarity on all insurance lines in respect of cyber exposures inadvertently covered by non-cyber policies. Insurers were asked to state clearly whether certain cyber perils were included within a policy.

Cyber exposure linked to professional service advice remains a challenging exposure for a PI insurer to underwrite; no-one wants to be hacked, that is acknowledged and appreciated. As such, there is naturally an expectation from insurers that practices will have robust defences in place, just as they would expect there to be a lock on the front of doors to act as a deterrent from intruders entering your premise.

Given that the SRA consultation launched in early 2021, a resolution should have been reached early in the summer. Sadly, this didn't happen and the result of the delays meant that a bottleneck was created in the market place.

Understandably, insurers wanted to know the extent of the coverage that they were agreeing to abide by before signing up to the participating insurers' agreement. These delays made trading with insurers even harder as some underwriters struggled with the increasing volume of enquiries presented to them in a short space of time. This, in turn, impacted their barrier to entry on enquiries that they would consider.

Moving forward, some consideration from the regulator is required to appreciate that running a consultation with no conclusion so close to a key renewal date for the profession may have some negative repercussions.

The SRA was able to reach agreement to extend the decision until the end of 2021, meaning October renewals would not be impacted but this only became clear at the start of September. Despite this, an increasing number of insurers took matters into their own hands, specifying that firms would need to have a cyber-policy in place before they would consider underwriting their PII. This direction was driven by the fact that law firms continue to be a very attractive target for criminals, given the extent of client data and money passing through accounts.

The SRA has now finalised a suggested drafting that supposedly meets the requirements of the insurance community while still providing protection to the general public. This draft is now with the Legal Services Board for ratification. Once the changes do come into effect, we will advise and articulate on any expected impact.

Post Six Year Run Off Cover - PSYROC

For those of you that are not aware, currently for any claims that materialise after the six year run off cover has ended, the residue monies from The Solicitors Indemnity Fund (SIF) would be used to deal with these. The SRA now wish for SIF to be closed down, which could leave an exposure to individual practitioners (a number of whom may well be in retirement) but also could expose the reputation of the legal profession and dent public confidence if there is no resolution to this matter.

Whilst many claims may be dealt with within the limitation period, typically up to six years, this is not the case for all areas of practices and there is also long stop to consider too. What is the solution? This is currently being explored and debated, with a consultation starting imminently. Given the lack of data available in terms of the claims picture due to numerous insurers having exited the class, no longer being in existence, and no availability on the numbers of firms that have closed, it will be very difficult for the solution to come from the conventional insurance market. That is not to say it won't come up with a solution, but we suspect some further changes to the indemnity rules would be required for this to be a consideration.

For those of you that are unaware, under the current indemnity rules, even without consideration (payment), the last insurer must provide six years run off coverage. So, unless there is a change to this then it is highly unlikely that the current participating insurers would ever agree for run off to be extended beyond the current six year period.

SDLT Holiday

The SDLT holiday provided a much needed jump-start for the UK economy. Simultaneously, it also introduced new risks for practices, adding higher costs to their PII insurers' balance sheets. Despite a halt in conveyance work, the SDLT holiday introduced huge buyer demand, introducing a situation that was fraught with risk.

Conveyance is quite often a stressful area of practice. Fee earners not only have to manage several third parties, they also have to deal with clients expectations, all while juggling the numerous risks involved in the process. Clearly this is no mean feat, but when you add in the pressure of a client potentially missing out on the financial incentive of the SDLT holiday, the pressure is piled on the fee earning staff.

If the fee earner's workload is too high, they are more likely to make mistakes, which could result in financial losses and a negative impact on mental health.

Due to the increased volume of work, insurers and their underwriting teams will naturally be concerned about errors, as well as the potential for practices to take on unskilled practitioners to dabble in this specialist area.

The extension to the original SDLT holiday expiry date may have been good for the economy, but for fee earners it meant excessive workloads continued to grow. This may also have had a negative impact on insurers' appetites to take on more conveyance risk too due to increasing exposures.

If there is an increased likelihood of claims materialising due to fee earners being overworked or supervision being inadequate, it stands to reason why a prudent underwriter may well be a little reluctant to deploy his or her company's capital taking on additional business with this exposure. With the SDLT holidays now passed, we would hope in 2022 insurers will begin to have an increased appetite for firms with conveyance work, we suspect however that they will continue to be very selective regardless given the long tail nature of this class of business, meaning it may be some time before any mistakes are identified.

Claims

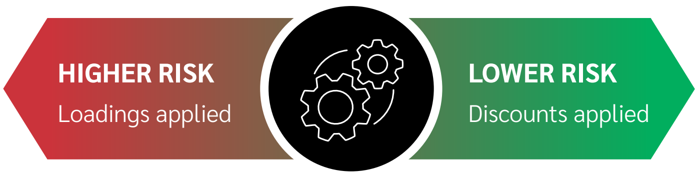
Claims often have a major impact on the cost of insurance. The premise of insurance is that the premiums of the many pay for the claims of the few, but when the claims of the few are outweighing these premiums, it will naturally mean changes in the costs for everyone.

This is sadly the position that the insurance market is in, especially when it comes to the legal profession. A prolonged period of soft market conditions has resulted in insufficient premium collection due to the amount of claims experienced.

No practice area is immune from claims activity, but some do have a much greater frequency of claims activity e.g. the property sector. Claims experienced are increasingly severe given that asset values continue to rise. If we look at house prices alone since the abolishment of the Solicitors Indemnity Fund and the commencement of the Open Market in September 2000, the average property value has risen by 209%.

As the severity of claims increase, this naturally impacts on the average cost of a claim, which means higher rates for that practice area. More severe claims have also resulted in insurers raising the minimum premium to deploy capital.

Minimum premium will also depend on the specifics of the work undertaken, such as the values involved or whom the work is being undertaken for. The more financial risk involved, the higher the premium.



Claims of Note

Dispute resolution has been identified as a growing area of claims in the last twelve months, with issues in the retainers equating to a significant number of these losses.

For depositor-funded developments, also known as buyer-funded developments, a number of claims are currently crystallising. While there has been some positive retention in many insurers' reserving positions, as these claims move from reserves to paid claims, the numbers are still significant. Importantly, while a number of additional claimants will be statute barred by limitation, there is still a significant exposure before the risk of additional claims/claimants has gone away completely.

In light of significant claims, insurers are asking more questions around development work. Some will refuse to provide coverage to practices that continue such work. If they are willing to insure practices, there will be an expectation to provide appropriate risk warnings and due diligence at the outset and throughout the engagement.

Cyber fraud is still prevalent, with many leading insurers still reporting large losses. The heightened reliance on IT due to remote and hybrid working, makes firms more vulnerable to cyber threats. The more access points to a system, the greater the risk – and this is a blend of both technological and human factors at play. The Simplify Group cyber hacking is a textbook example highlighting the risks and consequences of a cyber-attack.

A high number of claims have been claims arising out of the failure for firms to advise properly on stamp duty relief or to properly apply the stamp duty on a purchase, especially when it comes to Multiple Dwelling Relief (MDR).

Multiple claims have also arisen from the "ground rent scandal" where purchasers are trapped by vastly increasing ground rents in leases. This is a claim type that requires a close eye on developments – in particular as to the new build market itself and the statutory landscape.

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Status Changes and Partner Guarantees

Since the open market began on 1st September 2000, the Legal community has moved away from the traditional partner model with the majority of legal practices now being Limited or an LLP. With a small percentage of practices taking advantage of an ABS Structure, whether that is to secure some outside investment but more commonly to have a non-solicitor as part of the leadership team.

We have seen a recent trend of firms looking at converting to an Employee Ownership Trust. The rationales as to why naturally vary but culture and staff retention being common reasons as to why, along with succession planning for the business too.

In light of the status of most practices, select insurers require partner guarantees in order to deploy their capital. This is to ensure that in the event of run off or excess contribution being required the insurers receive consideration. Whilst only a modest number request this, a number of other insurers do so on a case by case basis.

Late Notifications

Several leading insurers have advised us of an upturn in the volume of late notifications, which can naturally be problematic. As stated by the MTC, if this were to prejudice an insurer's position or prove detrimental to the case, it could result in a greater contribution towards the indemnity payment made. It is always prudent to notify insurers of even remote circumstances that may give rise to a claim to avoid this potential exposure and avoid unnecessary problems.

Common Errors

A number of common errors that cause claims are linked to retainer management. This could be due to errors with the original drafting or scope creep during the instruction that was not appropriately communicated and addressed with an updated retainer. Missed time limits is a common cause of claim too, highlighting effective diary management remains essential.

When looking into the root cause of claims, overworked fee earners rushing the work or missing deadlines is also quite common. You could argue that this should fall into ineffective supervision or due to the absence or lack of peer reviews being undertaken.

Advice errors are far less likely, but they do occur. Far more widespread are errors relating to communication and the absence of a comprehensive file note. This ultimately means that in the event of an allegation, a PII policy may have to respond, despite the fee earner not actually doing anything wrong. If there is no evidence on file that the advice was given, sadly it is very difficult to argue that it happened.

Behaviour

Swift resolution is always the desired outcome when it comes to claims. There is an expectation of cooperation from insurers and insurer claims representatives, with the SRA's MTC stipulating this as a requirement, but unfortunately not all practices behave in this manner. This can have an adverse impact on the underwriter's opinion if an insured is uncooperative, unresponsive, or rude.

We acknowledge that if claims occur it can be an incredibly emotive time, especially for the fee earner involved in the matter. We think it is true to say that, nobody wants to experience a claim, but if or when a claim materialises, it is then that all parties interests should totally align, which, sadly on occasion is sometimes forgotten which can then have a negative impact on future PI renewal negotiations, regardless of the actual size of the claim.

Changing Insurer Appetites

In light of the commentary provided, many insurer appetites for new business were supressed, particularly toward practices more prone to claims activity. Some insurers reduced the cap or percentage ceilings to certain practice areas and the barrier to entry in getting an alternative quote was raised.

The logistical challenge created by the SRA wording consultation would have supressed insurers' appetites further or certainly lifted the barrier to entry even higher. With 50 to 60% of the profession renewing their insurances at this time, underwriters faced a logistical challenge, especially considering the extent of the due diligence undertaken by underwriters.

Presentation is important but so too is the timing of delivery. A proposal form that is signed close to the renewal date reflects badly and it will result in a number of insurers not being interested in providing alternative terms.

Co-Insurance

Co-insurance continued to be an increasingly popular way for a number of insurers to deploy their capital. This is where an insurer shares the reward of premium with the risk of claims with one or more other insurers. As severity of claims continue to rise, this is a trend that we expect to continue amongst the participating insurers.

Excess / Retention Changes

In order to minimise PII premiums we saw many law firms elect increased excess structures. This allowed practices to share more of the risk with the insurer and manage proposed increases. A common excess change was increasing the amount of excess payable if they were to have their first claim but keeping the overall aggregate exposure the same.

E.g. £5,000 capped at £15,000 in the aggregate, changed to £7,500 capped at £15,000 in the aggregate.

We also saw an introduction of an aggregate buffer excess. This allowed some practices to take on a significantly higher exposure usually £100,000 as an additional excess, which would kick in when the claim payable in over their usual each and every claim excess until exhaustion of the buffer.

Season Analysis

At each peak renewal period we look to analyse what actually went on during this period and provide some statistics based on our own data. It is incredibly important to put these statistics into context, given that each legal practice is unique and PII is a complex class of insurance.

Factors to Consider:

- Risk profiles change, which is something that we have seen during this renewal period perhaps more than in any recent peak season
- There have been a lot of changes within practices, such as fee fluctuations, claims, staff changes along with the focus on the work undertaken
- Certain practice areas have been reclassified with insurers, with minimum premiums increased.
- We have also restructured a number of our insurance programmes

Statistics:

During the October season, we introduced in excess of £81m in to the insurance market, placed across 14 insurers. When looking at the various permutations for primary coverage delivered to our clients through co-insurance, this involved 35 unique solutions up from 28 that we delivered in April.

We are delighted to welcome 106 new clients during this period and these clients were placed with 12 insurers – the same number as was achieved in April. This provides some evidence that the market is still active. These will not be used within our data set below as we do not have all of the comparable data. The sampling used for the analysis is taken from 827 clients.

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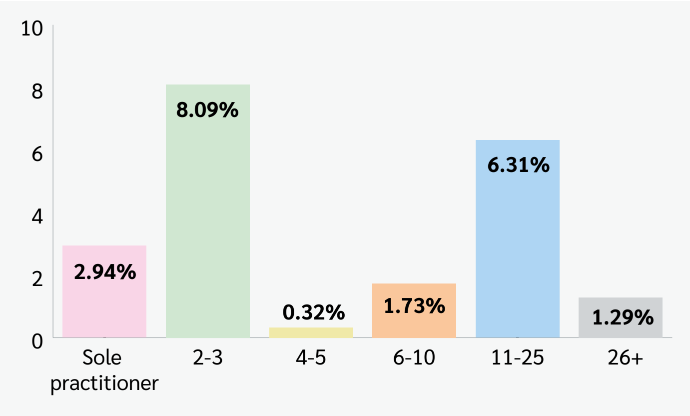
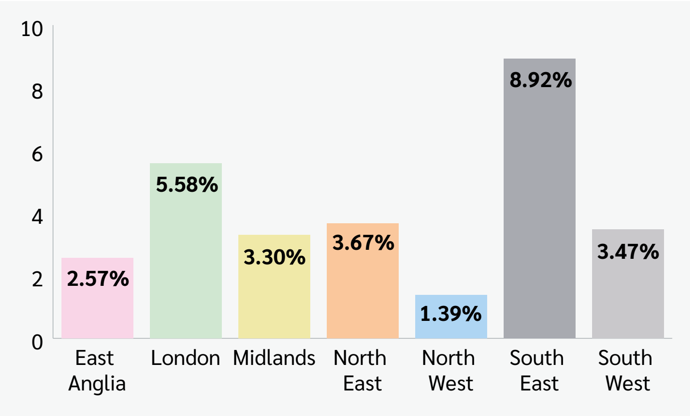
Fee Income

A larger majority of firms experienced an increase in their fee income, with the fees variance increasing on average 4.35%. Despite the economic uncertainty and pause in activity most firms across all regions were not negatively impacted. Most interestingly 2-3 partner firms were the best performers in terms of fee growth, however there was not a large amount of fluctuation between the partner groupings as per our previous reports. A potential reason for the lack of fluctuation is due to the pandemic, as for insurance purposes most accounts provided are one year behind, meaning these gross fees do not correspond to the positive effect of the SDLT holiday and the courts now open. We anticipate further growth next year in light of these factors.

Fee Income – Partner Brand



Fee Income – Regions



Primary Rate and Premium

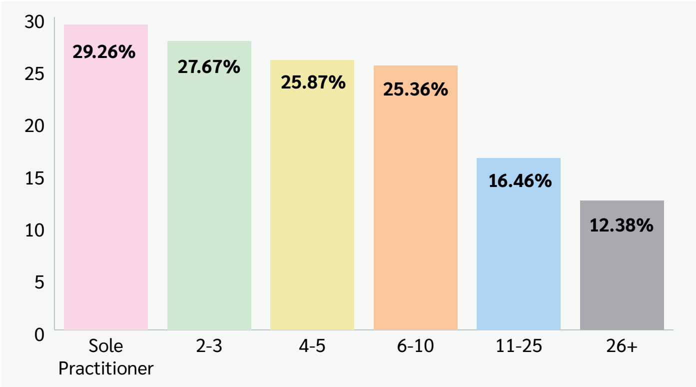
From our analysis on the primary rate, there was an increase of 27.08% resulting in an average increase on premium of 19% across all practices in England. We saw that practices based in the North, (East and West) saw the highest increases across all regions and a reason for this is largely due to the conveyance exposure, most namely the buyer funded claims now crystallising from their reserves to paid claims.

Primary Rate Change

Beyond rate and premium adjustments, many insurers imposed higher or different excesses to minimise the financial impact which the graphs do not highlight.

When we look closer, breaking this down by fee income you can see that there was almost a 53% rate variance year on year for firms with under £100k of gross income – an indicator that minimum premiums and adjustment in pricing was evident traditionally for those who conducted medium-high risk work and demonstrating a higher barrier of entry to legal insurance as insurers are most particular about how they deploy their capital and to who. The is also an offset of the pandemic where insurers wanted to back financially stable practices.

Primary Rate Change – Partner Brand



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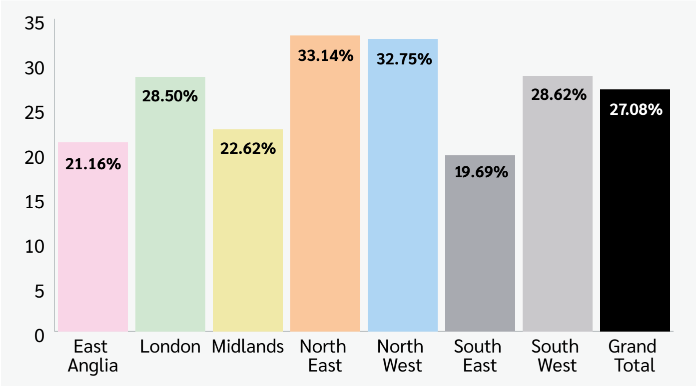
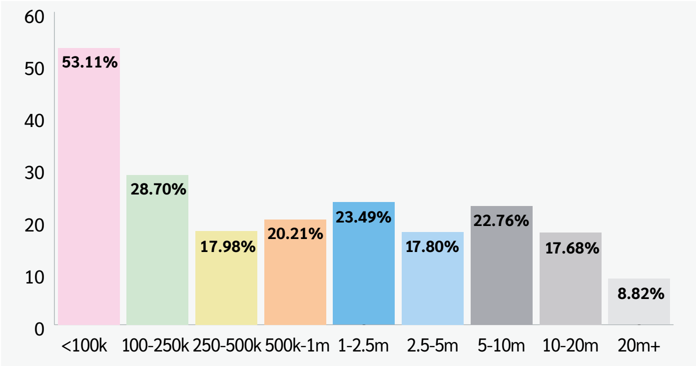
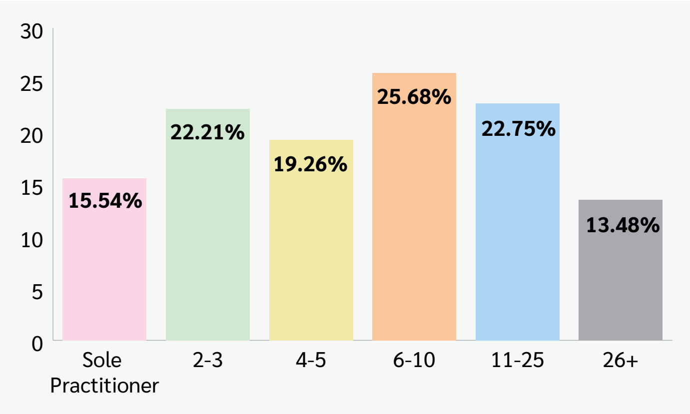


Primary Rate Change – Turnover



Premium Percentage Increase

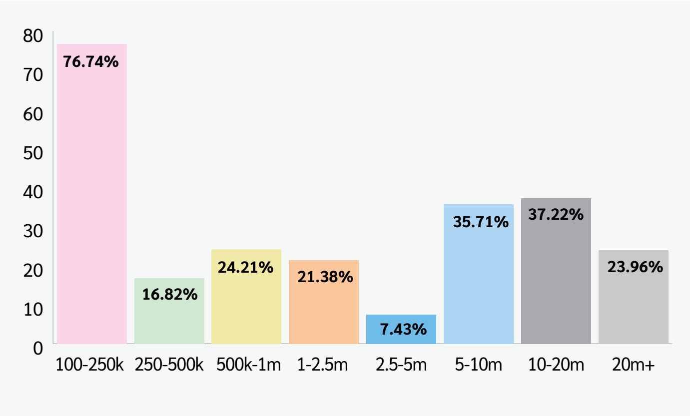


Working Layer

The working layer (the insurance layer directly above the compulsory limit of indemnity) continued to experience further pricing adjustments with the average rate applied increasing by around 23%.

These increases were largely due to the cost of claims now increasing in severity and now being more commonly utilised, hence the term 'working layer'.

Working Layer Rate Change

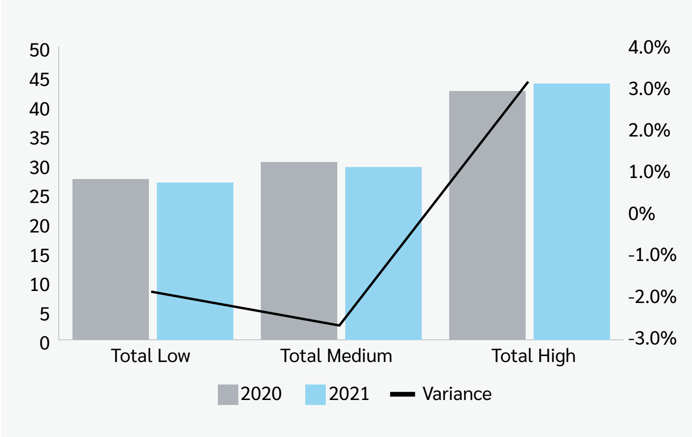


We also analysed work-split changers across the profession.

As a whole we saw higher risk practice areas increasing whilst lower risk practice areas reducing

Whilst the percentages may seem small the total value of gross fees used amount to £4,237,468,240, attributing £1,134,437,525 to low risk, £1,250,924,724 to medium risk and £1,852,105,991 to high risk areas of work. A key example for the catalyst in this change would be the change in personal injury work as many deviate away from RTA work following the recent reforms and moving into other high risk areas of work.

Working Layer – Variance in Risk Category for Area of Work



Expectation

As mentioned, the catalyst for these prevailing market conditions has been high claims activity in the sector. Due to the long tail nature of PII, insurers will not know for certain whether their approach and actions have been appropriate. While we would hope that the landscape will significantly improve, we do not believe that we are out of the hard market just yet, but we would like to think that rates will not be adjusted anywhere near as steeply as they were during 2021. Our expectation is that there will be much more stable pricing adopted by insurers in 2022.

Despite this projection, it is important not to be complacent. The market could be further impacted by claims, so all practices should make and take the time to review, reflect and refine their approach to risk with some regularity. Risks evolve and if you are not adjusting your risk mitigation strategies then the consequences could be severe. Escalating costs and failure to source viable insurance could be catastrophic.

Our team will be providing increased guidance with the support of specialist industry experts throughout 2022 to add greater value to your business.

We will be alerting you to further enhancements to the your client portal and specifically the Tool Kit but please do regularly log in, it currently houses documents that could truly be of value to your business. Should you wish for wider access please do advise your account executive, whom will be very happy to arrange for this.

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