SOLICITORS' PROFESSIONAL INDEMNITY INSURANCE

An overview of the 2014 PII market and what to expect in 2015

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Next

SOLICITORS FACED INCREASED SCRUTINY IN 2014

The number of High Court cases against solicitors tripled in 2014[1]

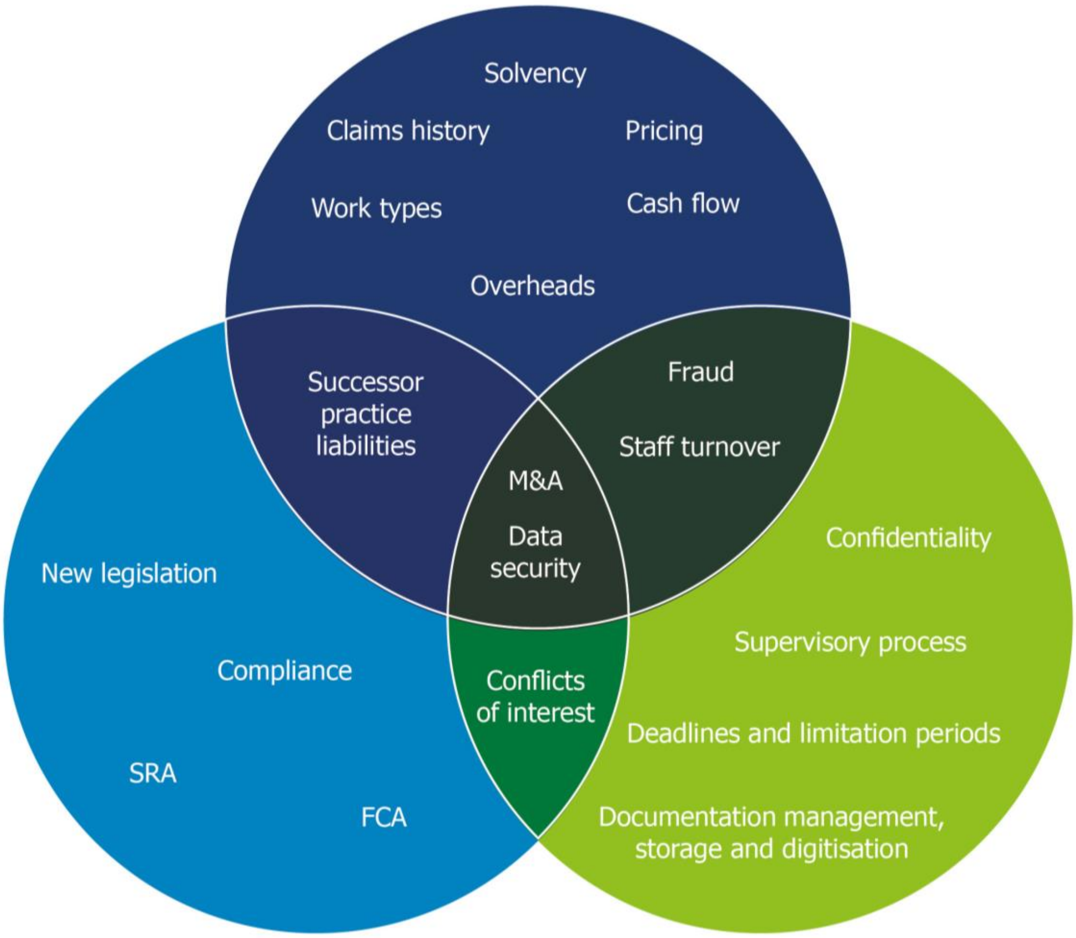
[1] *Number of High Court cases against law firms for professional negligence almost triples*, www.rpc.co.uk, http://www.rpc.co.uk/index.php?option=com_flexicontent&view=items&cid=56:latest-news&id=20609:number-of-high-court-cases-against-law-firms-for-professional-negligence-almost-triples-in-a-year-&Itemid=27, 4 December 2014.

CONTENTS

THE RISK LANDSCAPE

In our experience, the main risks to your PII renewal fall into one or more the following categories.

Financial
Risks associated with your firm's balance sheet. Insurers are concerned by the increase in firms going into insolvency.



Regulatory
Risks associated with the implementation or interpretation of regulation.

Operational
These are familiar risks that stem from the routine operation of your business.

RISK REDUCTION

Professional indemnity insurance (PII) premiums are high and insurers would like them to keep going up.

In 2014 insurance rates were stable but premiums are increasing as revenues grow.

Despite established insurers pushing for higher rate rises, increases were curbed by competition in the market and new entrants.

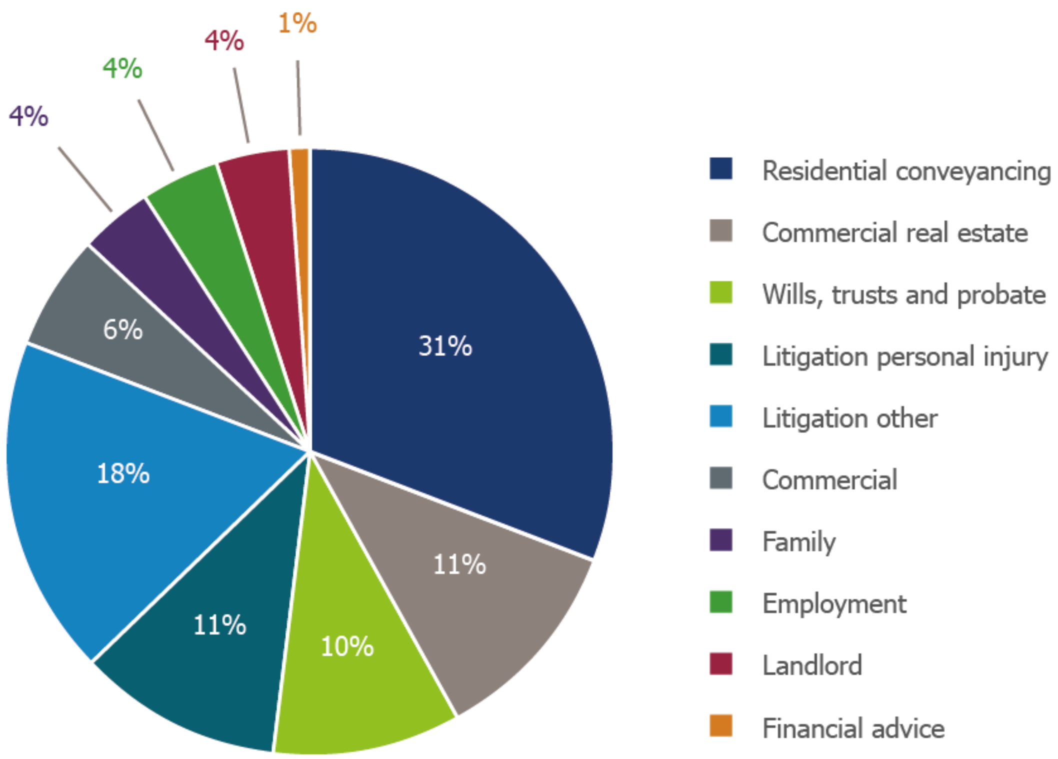
In this report we look at the risks, often intrinsic to your business, and outline some of the steps you can take to prepare yourself before your next PII renewal. Using claims data, we look at the trends in claims against solicitors since 2010. These are the issues that concern the insurers and could drive up the cost of your insurance:

1. Your claims history.
2. Legacy liabilities you may have inherited when you acquired or merged with other practices.
3. The quality of work and advice you give your clients.
4. Your balance sheet and future financial stability.

It is easier to address the right risks when you know what underwriters are focused on. Our recommendations for 2015 include:

- regularly audit a percentage of matter files pre and post-closure, as part of your supervisory process and to identify historical liabilities caused by new legislation;
- include Lockton in your due diligence processes;
- ensure you have a robust supervisory process in place; and
- show the strength of your balance sheet.

Top 10 work types by % of claims 2010 – 2014



Data security a cause for concern

Our client purchased litigation software to enable them to store and share their clients' files, via an online portal. Documents were marked as privileged, partly privileged or open for inspection. Via the portal, the opposing side were given access to the disclosed documentation, with the privileged documents hidden from view. Due to a failure in the software, the opposing counsel gained access to all the documentation, including privileged material. Even though the software failure was identified quickly and an electronic audit revealed that the other side had not viewed any privileged documents, our client was required to inform its client of the data breach.

Any loss in relation to the litigation case, caused by the data breach, was covered by their PII policy. However, the damage to the firm's client relationships, loss of earnings and reputation were not covered.

The number of claims against solicitors has dropped but the severity of claims has grown.

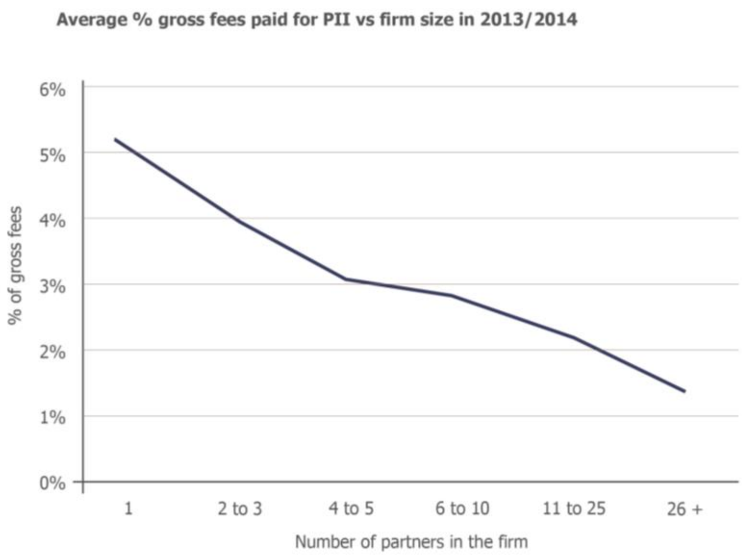
Increases in claims notifications prompted by the start of the financial crisis affected all practice areas. Overall claims peaked in 2011/2012, fuelled by a 300%+ increase in claims notifications since 2007 in the residential property sector.

Claims notifications are down for the first time since the start of the recession, thanks to the expiration of the six-year limitation. However, City of London law firm, RPC, reported that the number of High Court professional negligence cases against solicitors tripled in 2014, going from 143 in 2013 to 418 in 2014.[2]

Sole practitioners still pay more for PII

The average amount of primary premium paid as a proportion of income was 5.11% for a sole practitioner in 2013/2014. The rate reduces as gross fees increase. The largest law firms will pay less than 1% of gross fees for their primary policy, depending on their claims history.

Average % gross fees paid for PII vs firm size in 2013/14



Now is the time to plan your 2015 PII renewal, and these are the things you should be thinking about.

1. ______________

You get what you pay for
Assigning low-cost resource to low-value work? You may have a time bomb on your hands.

2. ______________

Dabble at your own risk
Lack of specialisation among lawyers has a direct correlation to the increase in claims notifications.

3. ______________

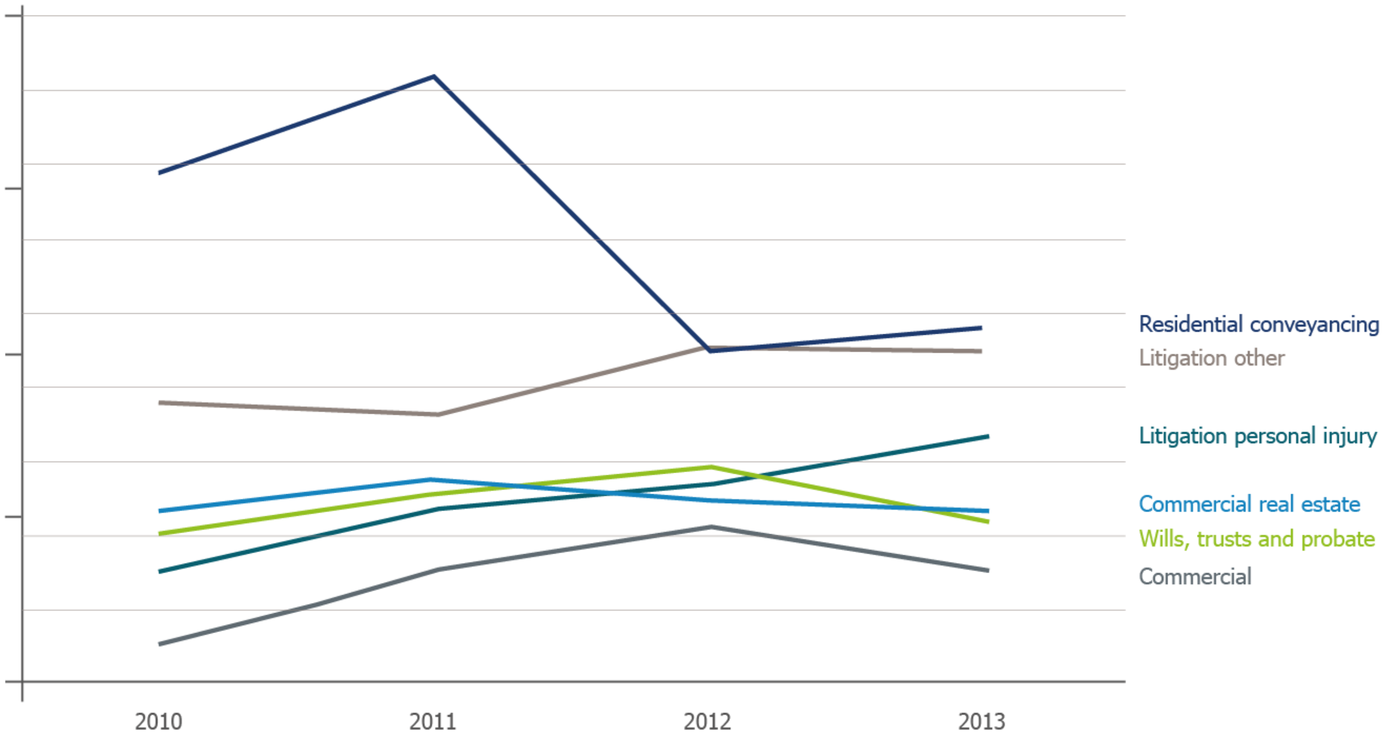
Look for the red flags when you merge
It's surprising what is missed in the due diligence process.

4. ______________

Show the strength of your balance sheet
Insurers don't want to be left with a client that's gone bust.

[2] *Number of High Court cases against law firms for professional negligence almost triples*, www.rpc.co.uk, http://www.rpc.co.uk/index.php?option=com_flexicontent&view=items&cid=56:latest-news&id=20609:number-of-high-court-cases-against-law-firms-for-professional-negligence-almost-triples-in-a-year-&Itemid=27, 4 December 2014.

Claims notification trends 2010 – 2013



1. You get what you pay for

Claims vs overheads

Insurers suspect that some firms have undertaken an analysis of the revenue generated from low-salaried, high-volume work versus the value of any claims that may arise against them.
Assigning low-cost resources to matters without a robust supervisory process could prove costly, no matter how low margin that work may appear. Insurers are now taking a closer look at how solicitors run their businesses, and how they allocate and supervise work. (See Appendix 2 Solicitors Risk Management Best Practices).

Residential conveyancing

Insurers will often not provide cover to a practice that makes more than 25% of its gross fees from residential conveyancing. It remains the biggest source of claims against solicitors, and costs insurers more than any other practice area.

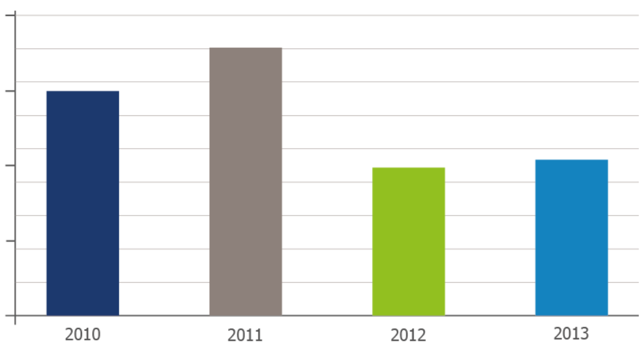
The expiry of the six-year limitation period following the financial crisis has not led to residential conveyancing claims dropping back to pre-recession levels.

Commercial real estate

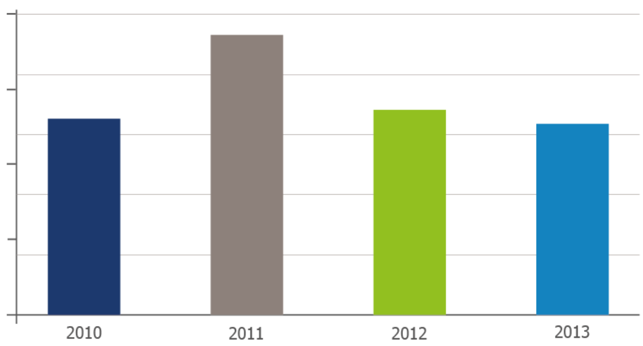
Commercial real estate claims peaked in 2011 and have been stable over the past couple of years. Although less frequent than residential property claims, they tend to be of higher value. Commercial real estate remains a high-risk area for insurers.

The biggest cause of claims is failure to register deeds.
Other common causes of claims include errors in rent review clauses, break clauses, options, and claims arising from dilapidation claims and assignment.

Residential conveyancing claims 2010 – 2013



Commercial real estate claims 2010 – 2013



2. Dabble at your own risk

When a law firm dabbles in practice areas outside its field of specialisation, there is an increase in the litigation claims against it.[3] Firms that diversified into fast-growing areas such as personal injury law during the financial downturn are now feeling the pain.

This was compounded in April 2013 by Lord Justice Jackson's civil litigation reforms placing new emphasis on enforcing compliance with court rules, practice directions and orders.

The Court of Appeal's decision on Denton v TH White Ltd has clarified earlier rulings based on the Lord Jackson reforms and Mitchell v News Group Newspaper Ltd, August 2013. Solicitors also have become accustomed to the changes. However, the focus of claimants has shifted, and the advisors have become their target.

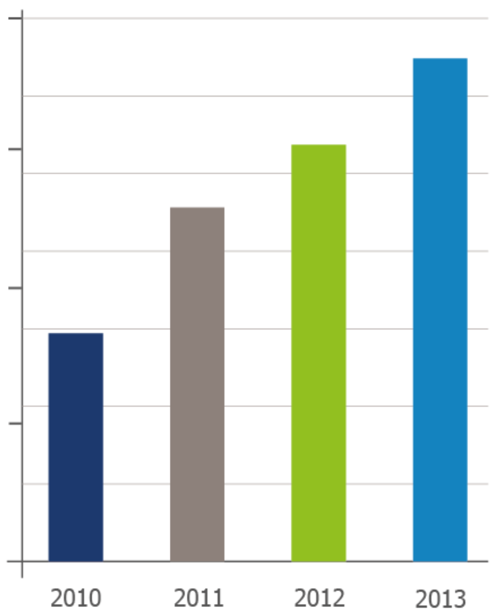
Personal injury

Personal injury claims went up in 2013/14 due to Lord Jackson's reforms and market disruption by claims management companies aggressively advertising to claimants who had settled their personal injury claims in the previous six years.
The targets are often solicitors that assigned inexperienced employees to cases, and arguably settled too quickly or for too little. This might have been due to the limited time firms spend on claims, the cap on fees that can be charged, or cases where critical deadlines were missed.

Claims trends suggest that the following areas of work will be similarly affected in the future:

- tax advice – on tax mitigation schemes; and
- divorce – failure of solicitors to challenge cash equivalent transfer values (CETV) provided by pension companies, which undervalued pensions by up to 30%.

Personal injury claims 2010 – 2013



[3] Source: Lockton's research into solicitors PII premiums, December 2014.

3. Look for the red flags when you merge

M&A activity among the top 100 UK law firms reached record levels in 2013, with 28 deals.[4] In 2014, 19 deals were reported. Dentons has already announced two mergers in January 2015.[5] The trend for consolidation looks set to continue as firms try to secure their place in an increasingly competitive legal market.

Reduce your risks

When law firms merge they sometimes miss red flags that turn out to be expensive risks. Talk to us as part of your due diligence process.

- The firm may have been flagged by the insurance market in some way.

We can use our benchmarking data to help you see how your target/acquirer compares to its peers.

We will be able to highlight any regulatory issues or claims liabilities that could affect the successor firm.

Coming back to haunt you

Areas of increased concern for insurers – which can relate to historical liabilities – are wills, trusts and probate. HMRC's successful court challenges to a number of tax minimisation schemes has meant that trustees can no longer set aside a trust on the grounds of a mistake, including unexpected tax consequences. Pitt v Holt, May 2013 held that the right to rectify the error is limited in scope. This led to an increase in the number of claims against solicitors, as clients are no longer able to escape the tax that is payable from the creation of a trust.

Corrective action was taken in 72% of complaints brought before the Legal Ombudsman in 2014 that related to wills and probate.[6]

An example of smart due diligence

Our client wanted to acquire another firm of solicitors. The firm included a number of predecessor practices, and we were asked to help with their due diligence.

We discovered that one of the predecessor practices purchased its run-off insurance from an unrated Latvian insurer called BALVA. BALVA had gone bust and there was no insurance in place for the predecessor practice, except a potential bailout by the Financial Services Compensation Scheme.

Although our client, the acquiring firm, would not be liable to pay claims against the predecessor practice, the former partners of the predecessor practice were without insurance cover, and personally liable for any claims made against their former firm. We advised our client not to admit the former partners to the partnership on the grounds that it might expose their interest in the joint partnership's assets to a claim.

Under the Legal Ombudsman's scheme rules, the successor practice would remain liable for an unlimited number of awards of up to £50,000.

[4] MergerLineUK, http://jomati.com/jomatimergerline_jan2012.html, 22 January 2015.

[5] Ibid.

[6] Andrea Rasmussen, *Will-writing and negligence*, The Law Gazette, http://www.lawgazette.co.uk/analysis/comment-and-opinion/will-writing-and-negligence/5046174.article, 21 January 2015.

4. Show the strength of your balance sheet

Insurers are concerned by the rapidly evolving legal market, and the increasingly competitive environment, resulting in more firms becoming insolvent. When this happens, insurers are left with liabilities for up to six years, with no premiums paid, and the practical issue of losing the information they need to deal with any claims that might be brought against the firm. It's expensive, and the insurers' worst case scenario.

Help allay insurers' fears

Insurers look at a number of key indicators to alert them to a firm's financial position:

- your annual report;
- net worth of your business;
- increased complaints about overbilling; and
- non-payment of your excess on claims (this will lead to an increase in your premiums or your policy not being renewed).

LOOKING AHEAD TO YOUR 2015 RENEWAL

The rapidly evolving challenges and opportunities facing insurers worldwide continue to drive change in the industry.
Whilst the PII market remains competitive for 'good' firms, there is a noticeable change in attitude for firms that are considered too keenly priced, or unprofitable.

In order to help mitigate the risk of future catastrophic losses, insurers are focusing on risk management, and higher levels of self-insured excess.

A competitive market

In 2015 strong competition amongst insurers will shape the PII market. This will be due to new entrants creating ample capacity. Insurers see increased opportunity for growth, with the expiration of the six-year limitation period following the financial crisis and the perception that we are past the peak of claims against solicitors. Also the demise of the Assigned Risk Pool means insurers retain a greater proportion of the premiums.

Engage with Lockton at the earliest opportunity

Engaging with us early will give you time to build relationships with insurers and help to differentiate your business. You will have more renewal options available to you and the likelihood is you will benefit from a better deal. If you leave it to the last minute you may not get the same level of service from the insurers and their capacity may dry up.

The process

There's nothing you can do about historical advice your firm gave to clients. But there are some very practical things you can do to show your insurers you understand where your risks lie, and to demonstrate that you're in a strong position to respond to claims.

Two tips:

- audit your files – particularly residential conveyancing, personal injury, tax or trusts work – as these are areas that have caused insurers the most pain; and
- submit your proposal form early.

Your online resources

Available on locktonsolicitors.co.uk

- Guidance on your insurance cover
- Renewal guidance and documents
- Your claims process explained
- Risk register templates and guidance notes
- M&A guidance notes
- Information security planner
- Cloud computing advice

For more detailed information on the available resources and services, please contact Calum MacLean, calum.maclean@uk.lockton.com, or speak to your dedicated account executive.

RISK SOLUTIONS FOR YOUR BUSINESS

You have specific risk exposures that require tailored solutions. Through our knowledge and experience of working with the legal profession we have been able to design a range of services to suit your business needs. We would be delighted to discuss your requirements and explain the benefits available to you for the following insurances:

Asset protection insurance for partners and their families

The first product of its kind to offer dual protection depending upon the outcome of claims settlement negotiations. When a claim threatens the future of your LLP, you can call on funds to top up a settlement offer. However, if the claimant refuses to settle and the LLP becomes insolvent as a result, then the policy limit can be distributed to the LLP members. Having the additional funds available can help prevent insolvency should you be faced with a catastrophic negligence claim.

Cyber

Preserving client confidentiality is at the heart of your business – and fundamental to your firm's reputation and ongoing success. Not all third party cyber risks are covered by the PII. To talk to the team about our gap analysis and advice on a cyber policy, please contact a member of the Lockton Cyber team.

COLP and COFA

Regulatory Response Insurance protects against fines and defence costs arising from proceedings brought by any regulatory body against a practice or individual.

Employment benefits

Employee benefits help firms to retain and attract the best talent within their businesses. Our Benefits team has in-depth market knowledge that enables us to provide benchmarks for clients, and to provide financial projections to evaluate insured and self-insured solutions.

Employment practices liability

Robust human resources practices and procedures can help to mitigate the risks of employment disputes, but will not eliminate them. Employment practices liability cover ensures you are prepared, and provides protection for the awards and defence costs arising from claims against the organisation and its partners and staff.

Management liability

Whether you are a two-partner practice or a multinational firm, business is becoming more litigious. The raft of regulation and legislation puts managers of firms under increased scrutiny. Without the protection of a management liability policy, those individuals are financially vulnerable to any wrongful acts in the course of their daily duties.

Office Guardian

Lockton's office insurance provides cover to protect your premises and assets, and can be tailored to your business's specific needs. Our dedicated team offers a 24/7 claims service, with your own claims handler.

Partners' personal insurance

We make it our business to understand your needs and the needs of your family. Whatever the asset, wherever the location and whether it is fixed or mobile, our personal and flexible service will provide a tailored solution.

How can we help you?

If you would like to discuss any of the services further, please contact your account executive or visit Lockton's dedicated solicitors' website:

www.locktonsolicitors.co.uk

APPENDICES

APPENDIX 1: PRIMARY PREMIUM INCOME 1999 – 2014

The introduction of variable PII renewal dates means the premiums declared on 1 October no longer capture all market activity. 10% of solicitors now renew at different times of the year. If you have any queries about moving your renewal date, please contact us.

Based on our market intelligence, the total premium renewed at 1 October is approximately £255,900,000 – a small increase on the previous year. The year-on-year comparison for total primary premium will be more than the 1% increase shown in the table below.

Year	Solicitors' Primary PI Premiums	Change on Previous Year
1999 final year of SIF	£256,000,000[1]	N/A
2000	£154,000,000	-39.84%
2001	£163,000,000	5.84%
2002	£225,000,000	38.04%
2003	£226,000,000[2]	0.44%
2004	£242,000,000	7.08%
2005	£243,811,851[3]	0.75%
2006	£211,374,653	-13.30%
2007	£204,607,718	-3.20%
2008	£226,001,774	10.46%
2009	£245,647,271	8.69%
2010	£220,886,756[4]	-10.08%
2011	£248,702,497	12.59%
2012	£239,300,522	-3.78%
2013	253,521,285	5.94
2014	£246,707,225[5]	-2.69%

1. Includes Y2K loading and an allowance for laundry listing of claims.
2. Annual premium based on actual 13-month premium of £245,000,000.
3. Compulsory limit of indemnity increased to £2M for partnerships and £3M for LLPs.
4. More likely £260,000,000 due to ARP mitigation strategies (see below).
5. Premium excludes firms renewing at other times in the year.

APPENDIX 2: SOLICITORS RISK MANAGEMENT BEST PRACTICES

Residential conveyancing

Claim type	Common causes	Preventative actions
Lender CML handbook claim	• Lack of supervision • Failure to obtain written consent to proceed from lender • Failure to make/note relevant enquiries of client • Failure to flag changes to the deal	• Use a CML reporting checklist that fee earners must sign per file • Use practice management • Audit a percentage of files pre-closure • Provide/attend regular update training on CML issues
Registration of deeds	• Failure to submit deeds for registration in a timely manner • Where deeds are 'bounced' by the land registry, failure to address outstanding issues and resubmit • Failure to submit security deeds to the Registrar of Companies separately	• Check account balances weekly for unexpected credit balances on completed matters • Audit checks on closed residential conveyancing files • Workflow timelines and diary reminders copied to matter supervisors • Pre-file-close supervision checks
Fraud	• Identity fraud by client • Mortgage fraud • Fake law firms	• Transaction vetting undertaken throughout the transaction life cycle • Transaction-specific vetting process (e.g. an existing client who has previously instructed the firm re drafting of a will is likely to require more detailed vetting for a conveyancing instruction) • Use electronic AML checks

Commercial real estate

Claim type	Common causes	Preventative actions
Registration of deeds	• Failure to submit deeds for registration in a timely manner • Failure to address outstanding issues with deeds and resubmit • Failure to submit security deeds to the Registrar of Companies separately	• Check account balances weekly for unexpected credit balances on completed matters • Audit checks on closed commercial conveyancing files • Workflow timelines and diary reminders copied to matter supervisors • Pre-file-close supervision checks
Drafting errors & omissions	• Incorrect/out of date/inappropriate precedent documents • Failure to document negotiated position correctly • Failure to anticipate/identify risk issues • Incorrect conversion of formulae (e.g. payment mechanisms, rent reviews) into legal drafting • Incorrect party/property details/dates	• Regular review of precedents • Use of annotated precedents to reduce likelihood of inappropriate use • Staff training • Transaction aide-mémoires • Supervision • Email confirmation of agreed drafting changes with client • Consider retention of file beyond normal destruction date for high-value matters
Break notices	• Wrong break date • Service of notice too late • Inaccuracies in the notice • Incorrect service of notice	• Vet the transaction carefully before accepting it • Include a provision both in your terms of engagement and your precedent report on lease stating that you are not responsible for reminders to the client regarding dates that fall after the conclusion of a matter • Use a checklist (signed and dated by the fee earner per transaction) to ensure the notice is complete and correct • If in doubt, serve the notice earlier and in more ways than required. Obtain confirmation of receipt

Litigation

Claim type	Common causes	Preventative actions
Time bar & missed critical dates	• Failure to identify unusual time bar periods • Failure to establish the correct date from which the prescriptive period runs (e.g. in an unfair dismissal case) • Poor diary systems • Lack of supervision • Failure to diarise (and act on) court procedural dates properly • Handovers • Poor communication from client	• Default to shortest limitation period • Workflow systems • Diary systems with reminders and back-up • Review of identification and diarising of critical dates in high-value cases • Supervision • Client vetting • Explaining to client in advance the relevance and importance of accurate and timely responses
Under settlement	• Post-settlement remorse • Failure to document advice to clients • Failure to identify quantum accurately • Failure to explain issues to client effectively	• Where client settling against your advice, obtain signed acknowledgement from client to that effect. Retain on file • Retain clear record of advice to client on file, plus any information that has an impact on advice (e.g. client made redundant and needing quick settlement), along with evidence of quantum calculations

Wills, trust and probate

Claim type	Common causes	Preventative actions
Estate administration errors and delays	• Failure to manage client expectations • Failure to identify legal rights claims • Incorrect distribution of funds • Failure to identify vesting dates correctly in trusts • Workflow management	• Provide meaningful time estimates in engagement letter • Provide plain English guidance notes to clients when first instructed • Set up regular update calls with clients • Regular refresher training on key issues • File audits and regular supervisor file reviews/peer review
Will drafting	• Wrong beneficiaries • Version control (wrong version of the will) • Failure to follow client instructions • Failure to ask client right questions • Capacity of client • Tax liabilities	• Use Charity Commission Register to identify charity beneficiaries • Get client to double-check details of all other beneficiaries • Get testamentary intentions confirmed in writing • Ensure that scope is very clear regarding what tax implication issues you are advising on • Use a checklist of questions for clients • Check capacity of client if any doubt

Commercial

Claim type	Common causes	Preventative actions
Drafting errors & omissions	• Last-minute commercial negotiations • Failure to pass down risk in subsidiary contracts • Lack of clarity/overlap in role of different advisors • Changes from Heads of Terms • 'Execution only' basis of instruction • Multiple versions circulating/wrong version executed • Risks not identified and advised on	• Obtain client sign-off for all drafting changes • Retain [electronic] copies of interim drafts/annotations • Use trainee to take notes in meetings • Scope very clearly where multiple advisors involved and/or where scope excludes key areas of advice • Use of issue tracker to ensure key items addressed in drafting • Effective version control in document management system
Due diligence failures	• Poor handover • Lack of supervision • Pressure on fees • Client pressure to 'get the deal done'	• Regular file review meetings with supervising partner • Effective use of issue trackers
Costs dispute & delay	• Scope creep not identified and flagged to client (updated letter of engagement, separate matter, updated fee estimate not sent) • Client not managed properly • New issues arising • Unrealistic scope initially • Under-bid with many exclusions to win tender	• Interim billing/information bills • System flags when [70]% of fee estimate is reached • Establish clear pattern for update meetings – and stick to them • Report progress and lack of progress equally
Conflict of interest	• Failure of/challenge to information barrier • Complex group structures in client companies not identified • Lack of effective communication between offices within firm • Merger activity/lateral hires undertaken without adequate update of conflict database/systems	• Ensure conflict registers are complete and regularly updated

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OUR GOAL

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