

28 JUL 2014

BOARD



Mr Chris Kenny
 Chief Executive
 Legal Services Board
 1 Kemble Street
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Your Reference

Date 24 July, 2014

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Dear Mr Kenny

**SRA Consultation: Professional Indemnity Insurance
 Proposed changes to minimum compulsory professional indemnity cover**

On 2 July 2014 the SRA Board met to consider the outcome of its consultation on proposed changes to the SRA's compulsory professional indemnity insurance arrangements for the 2014/15 indemnity period commencing on 1 October 2014.

Whilst the SRA agreed to defer the vast majority of the proposals set out in its consultation until at least the 2015/16 indemnity period, it voted in favour of one proposed change which is of particular cause of concern to Zurich and upon which we would like to make representations to the Legal Services Board (LSB) before the LSB meets to consider whether to approve the proposed changes in August. The proposed change in question is that of reducing the minimum level of compulsory cover per claim to £500,000.

Zurich submitted a response to the SRA's consultation confirming that it did not agree with the proposal to reduce the compulsory limit of cover to £500,000 per claim. We enclose a copy of Zurich's response to the SRA consultation for ease of reference but, to paraphrase, Zurich's principal objections were (and remain) as follows:

1. One of Zurich's principal concerns is that of public protection. Underinsurance will leave clients facing a shortfall on recovery of any claims. It is unclear whether any such shortfall would be met by the Compensation Fund (arguably not, particularly given that the Compensation Fund is a discretionary scheme) but, even if so, any shortfalls will fall to the profession by way of levy, thereby penalising those who make prudent and sensible arrangements for their own insurance cover.
2. Whilst Zurich accepts that the majority of claims against solicitors are below £100,000, there is an increasing volume of claims above this level. Further, for claims where aggregation may become an issue, a limit of indemnity of just £500,000 could quickly become exhausted, again potentially leaving both the firm and client(s) exposed and vulnerable.

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3. It is accepted that there are some areas of practice, such as criminal law, where the value of claims is consistently low. However, even these “safer” areas of practice are not immune from high-value claims. Zurich quoted in its response an example of a claim we had recently faced involving an aborted jury trial owing to a breach of confidentiality by an assistant solicitor during the course of the trial. Such a claim could easily exceed £500,000 if it involved a lengthy trial, multiple defendants (and representatives) etc.
4. Very few firms could justify a limit below the current minimum of £2,000,000 for a partnership or £3,000,000 for an incorporated practice. Given the current level of property prices, any firms undertaking conveyancing work should retain a higher level of cover. It is not only firms based in London that need to be concerned with this issue, given that many conveyancing firms routinely deal with transactions involving property all over England & Wales.
5. Even with the proposed introduction of a new compulsory Outcome in the SRA Code of Conduct to require firms to assess and purchase an appropriate level of insurance cover (to which Zurich has no objections), we anticipate that many firms will simply not appreciate the potential value of some claims which could be made against a firm, or the need to ensure a sufficient level of higher cover for claims arising from historic, higher value work. Due to solicitors professional indemnity insurance (PII) being “claims made” insurance, it is possible that a high-value claim could be made against a solicitor several years after they have reduced their level of PII cover to an amount insufficient to meet the claim.
6. As an insurer Zurich is concerned about the financial consequences of underinsurance. If a firm has inadequate cover and a shortfall arises in relation to a claim then that will almost inevitably lead to an insolvency situation. We could be forced to provide six years’ run-off cover for a firm in circumstances where there is likely to be no hope of receiving the run-off premium. This could adversely affect the appetite for new entrants (and healthy competition) to the solicitors PII market, as well as reduce the appetite of current participating insurers for remaining in the market.

Anticipated reduction in premiums

Zurich takes particular objection to the SRA’s consultation seemingly being based on the false premise that reducing the compulsory level of cover will result in a meaningful reduction in premiums for smaller firms. The SRA failed to engage at all with the insurance market before issuing its consultation. Whilst rating information is market sensitive, it is widely known and it is already the case that the different areas of practice, and likely values of claims, are already factored into the underwriting process and are priced accordingly.

It is entirely unrealistic to expect there to be any significant premium reduction if a firm were to lower its limit of indemnity. By way of example, when the compulsory limit of cover doubled from £1M to £2M (and £1.5M to £3M for incorporated practices) on 1 October 2005, total market premium for the 2005 – 2006 indemnity year increased by just 0.45%.

Further, the SRA’s consultation document relied upon out-of-date data in support of its position in this regard, as well as ignoring much more recent data in its possession (and indeed published on the SRA’s website).

Paragraph 9 of the SRA’s consultation document quotes from a report the SRA commissioned from Charles River Associates in 2010 (the CRA Report) which estimated that the average value of claims was between £40,000 and £60,000, except for conveyancing claims which

averaged between £60,000 and £180,000. It then quoted data from the Solicitors Indemnity Fund (SIF) from 1988 – 1999 stating that 98% of claims were below £500,000 and only 2% of claims above £500,000 (with the notable caveat contained in a footnote that, for whatever reason, these figures had not been restated to present-day values).

In fact, the CRA Report (using data obtained from the ABI) states (at page 147) that, between the 2005/06 & 2007/08 indemnity years, 33% of total value of claims were in fact in excess of £1,000,000; 23% over £1,000,000 and a further 10% above the primary layer limit. The CRA Report also includes the following notable statements:

- "...reducing the minimum level of cover to £1 million would result in 23% of the value of claims being at risk of not being paid to clients..."
- "...whether or not clients were compensated would depend on the commercial decisions by law firms which may, or may not, choose to top up their insurance cover..."
- "...if the firm did not choose to top up the insurance cover, the financial protection of its clients would be adversely affected compared with the status quo..."
- "...given the significant proportion of claims affected, this does not provide evidence that the minimum level of cover should be reduced to £1 million..."
- "...there is no evidence that the current level of cover is unreasonable – either that it is too high, or that it is too low..."

It should also be noted that the CRA Report uses figures from between 2005 & 2008. Inflation since 2008, together with factors such as increased claimant costs and higher property prices, would suggest that the figure of 33% of value of claims being in excess of £1,000,000 is still broadly accurate, if not too low.

The SRA's own commissioned report from just four years ago strongly recommends no reduction to the current minimum level of cover, stating client protection to be a paramount consideration for its conclusions. Why the SRA chose to prefer to rely on the out-of-date SIF data rather than the data from the CRA Report (despite quoting the CRA Report in the very same paragraph of the consultation document) is unclear and a concerning omission from the information they provided to their Board.

Finally, it is remarkable that, despite only 34 of the 142 respondents to the SRA consultation agreeing that the minimum level of cover should be reduced to £500,000 (i.e. less than 24% of those who responded), and almost 65% (92 respondents) disagreeing (there were 16 unsure, unclear or no responses), the SRA felt it appropriate to ignore the results of its own consultation and press ahead with this proposal in any event.

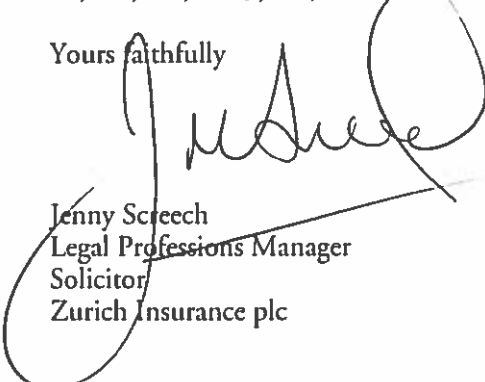
Conclusion

As demonstrated above, the SRA's proposal to reduce the minimum compulsory limit of cover to £500,000 per claim appears to be based on the false and misguided premise that such a change will lead to a meaningful reduction in premiums and that, in turn, that saving could be passed onto clients, thereby increasing access to justice. However, there is no credible evidence that this will be the case and, in fact, the reality is that this may well lead to (1) a reduction in consumer protection (which is the fundamental premise of compulsory PII cover for solicitors); (2) increased cost to the profession in having to cover uninsured elements of claims by way of levy for the Compensation Fund; and (3) increased risk of insolvency (both for firms and individual solicitors) in situations where solicitors are faced with claims over and above their level of cover.

This in turn could increase the regulatory burden faced by the SRA in dealing with insolvency events as and when they occur, both through potentially having to intervene in insolvent firms and taking disciplinary action against affected individuals.

It is therefore Zurich's firm recommendation to the Legal Services Board that it rejects the SRA's proposal to reduce the minimum compulsory limit of cover to £500,000 per claim and that it should insist upon the minimum compulsory limit remaining at its current level; namely £2,000,000, or £3,000,000 for an incorporated practice.

Yours faithfully



Jenny Screech
Legal Professions Manager
Solicitor
Zurich Insurance plc