

Howden market report

Solicitors' Professional Indemnity Insurance

July 2019



PII Premiums

Setting the scene

Market conditions have been favourable for buying PII for some years. This has been the case across all professions, not just solicitors. Capacity has been plentiful and renewing PII has been relatively straightforward, although engaging with a specialist PII broker to ensure you are paying a fair premium has still been important. This scenario was not expected to last and a turning point arrived in July 2018, when Lloyd's of London published their thematic review highlighting that PII was one of their worst performing lines of business. Rate increases have followed. This was a catalyst for company markets to adopt a similar position to Lloyd's syndicates, having also experienced poor performance on their PII books.

While that is the scenario in the wider market, the burning question is how this is translating into rate increases in relation to solicitors' PII.

1 April 2019 Renewal: What happened?

Rate

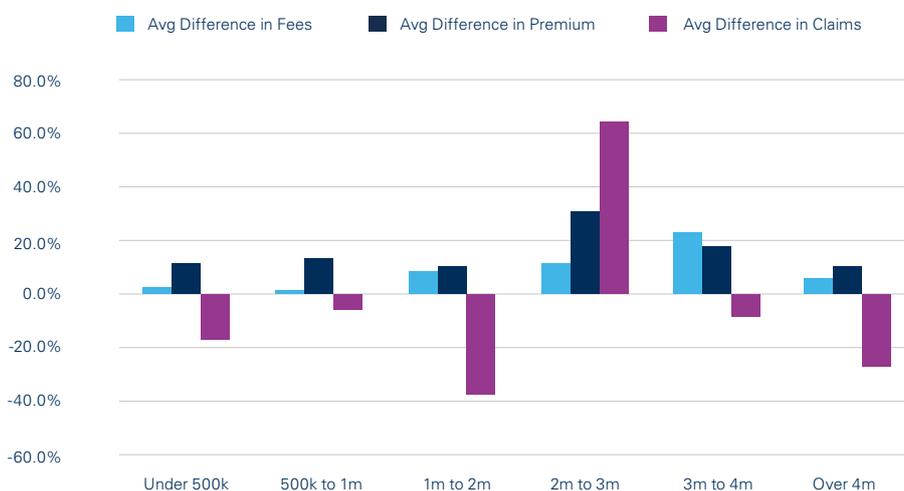
Leading up to 1 April 2019 there was a great deal in the legal press warning that there would be a significant hardening of rates. There are two stories to tell, as there was a marked difference between the primary (compulsory) £2m or £3m limit and the excess layer market.

The primary £2m or £3m coverage is where most of the premium is always focused, being the layer that is the most vulnerable to claims. This is a real area of concern for firms, as any increase can be significant in money terms. There was a variation between insurers as to the level of increase they were proposing at the start of the renewal period, and any increases suggested were rarely applied "across the board". That was expected as some insurers will apply increases more heavily towards certain areas of practice and/or to those firms with a more challenged claims experience. Insurers will always be keen to retain more profitable risks and accordingly the rate increase for a firm with a good claims history will invariably be at a more modest level than other more challenged firms, despite them having the same insurer.

In previous years, a firm's growth in fee income would sometimes be absorbed and the expiring premium maintained – thereby achieving a rate decrease. That changed this year. If gross fees had increased then it was factored into the calculation, with the increased rate applying across the total gross fee income.

The graph below shows our April renewal book grouped into gross fee bands. The graph records the average change in gross fees, premium and claims with reference to each band. Claims activity has been measured with reference to both claims payments and reserves over the last 5 years.

Fees, Claims and Premium changes by size of firm



The graph shows:

- a. There was an average increase in gross fees for each band with the largest average increase being for those firms earning £3m to £4m gross fees per annum.
- b. With the exception of firms in the £2m to £3m band, there has been a decrease in claims activity.
- c. As expected, average premiums have increased beyond the increase in gross fees and notwithstanding decreases in claims activity.
- d. Again as expected, the most significant increase in premium has occurred in the sector where claims activity has increased. This confirms that, generally, underwriters are adopting a granular approach with a greater share of the increase being directed at those firms that are more challenged from a claims perspective.

Reflecting on the final result across our April renewal book, while some rates did increase across the primary layer, it was not to the levels many had feared. The average increase (based on rate on fees) was 7.1%, obviously with some firms above and others below this. This was a good result and our extensive range of "A" rated insurers helped us keep any increases to a minimum for our clients.

Excess layers were more challenged. The excess layer market has been "cheap" for years. In recent years the solicitors' market has experienced a decline in the number of claims notified compared to the heady days post-recession, however there has been an increase in the value of claims. More claims have been hitting the excess layers, resulting in some significant losses to the market. It was therefore no surprise that we saw rate increases ranging up to 100% in this area. While that is high as a percentage figure, when applied to what is a very modest starting point, it is manageable in "money" terms. It still represents value for money and is an important aspect of your insurance programme as discussed further below.

Appetite

We did see some insurers revisit and limit their appetite. This was mainly with reference to the level of conveyancing as an area of practice, which as we all know continues to generate a concerning level of claims activity. While that did not generally affect firms already on an insurer's existing book, it was applied to new business cases. Otherwise, there was a good appetite for new business and the competition this generated helped to keep rate increases in check.

Capacity

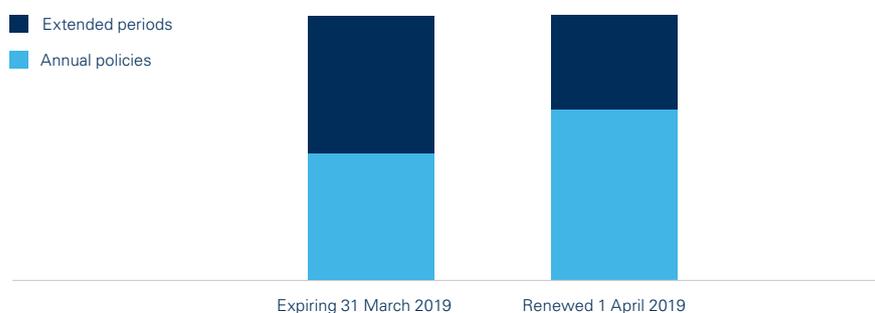
There have been some departures from the solicitors' PII market over the last 12 months. Large firm specialist Libra left in late August last year and some of the insurer capacity behind Managing General Agents such as Omnyy and Maven has also been withdrawn and replaced. However, there is no need for panic. There are still plenty of "A rated" insurers willing to write solicitors' PII. We are not aware that any of the long-term, solid players are considering an exit from the market, although we do need to monitor this as we approach 1 October. The position could change given the pressure on profitability that insurers are facing.

18-month deals

Long-term deals have been popular in recent years and they are a useful tool for firms to maintain their premium rate in a hardening market. On our own book, 52% of the firms renewing on 1 April 2018 took an 18 month deal. Predictably, there were fewer 18-month deals being offered by insurers at 1 April 2019 and the percentage of our renewal book that was able to secure such a deal dropped to 37%. Where they were offered, some insurers applied a rate increase for the final six-month period for the privilege. This contrasted with previous years, where the additional premium was calculated on a straight pro rata basis.

The following table has been compiled from our April 2019 result:

Number of Firms for each policy length option



1 October 2019 Renewal: What to expect?

At the time of writing it is our expectation that 1 October will be similar to the 1 April position outlined above. There could be some further hardening of rates, but again this will differ between insurers, and for any one insurer the rate they apply to each individual firm will also be dependent upon the unique characteristics of each firm in terms of size, areas of practice and claims history.

Rather than worrying about the headlines in the legal press, we urge firms to pick up the phone and talk to us. We do not consider it helpful or useful to simply state a vague range such as 5% to 20% or quote our 1 April average of 7.1% referred to above. Knowing your insurer and your risk, we will be able to give you an idea of what you can expect. We can also discuss an appropriate timeline, whether a full market exercise would be desirable and what you can do to ensure that you submit the best possible presentation of your firm.

Starting early is key. Completing proposal forms always takes longer than you expect and this is certainly the year to pay close attention to the quality of what you are submitting. For more advice on this, we recommend you read the "Top Tips" article we prepared for April renewals, available here:

www.howdengroup.co.uk/solicitors-top-tips-renewal-2019

Another discussion that arose during the April renewal period was whether firms should reduce their limit of indemnity, or increase their self-insured excess, as a way of controlling their premium spend. We advise firms to be cautious about this. While the cost of excess layer insurance has increased it is still good value and gives "peace of mind". You also have a regulatory obligation to ensure you are purchasing cover that is at "an appropriate level for your current and past practice, taking into account potential levels of claim by your clients and others and any alternative arrangements you or your client make"¹.

¹ Outcome 7.13 SRA Code of Conduct

Likewise there are regulatory consequences if you increase your self-insured excess and find you are unable to pay it in the event of a claim. We have published articles on both of these issues, which we recommend you read if you are considering these options. They are available here:

www.howdengroup.co.uk/tempted-reduce-your-limit-indemnity-save-money-your-professional-indemnity-insurance-beware

<http://www.howdengroup.co.uk/beware-increasing-your-self-insured-excess-save-money-your-professional-indemnity-insurance-pii>

A further note of caution on excess layers is to ensure you understand the terms of the cover you are buying. Excess layer policies do not follow the SRA Minimum Terms and Conditions. It is important to understand if your broker has access to markets that offer excess layers with the widest wording available. Howden can assist you with this.

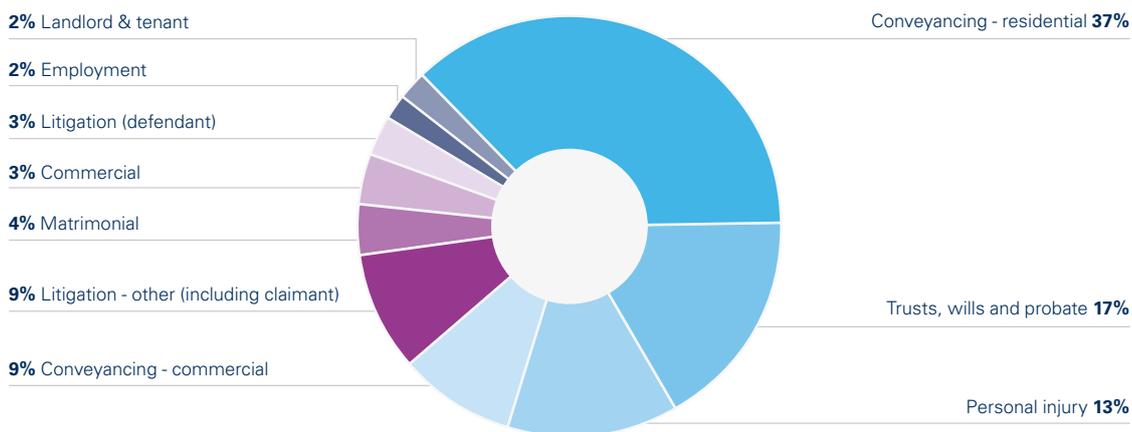
As a final word on the 1 October renewal, we remind you that Howden have access to a great number of "A rated" markets for solicitors PII. As a result we are able to test the market for those firms where the initial quote involves a significant increase. We will always use our position as a specialist and substantial player in the legal professions market to achieve an excellent outcome for our clients.

Claims against solicitors – What are the current areas of concern?

Regrettably solicitors continue to attract a high incidence of claims. Insurers look closely at claims to determine what additional questions they need to ask in proposal forms. In the same way, you can use the claims experience both in your own firm and others to inform changes you need to make, or procedures you need to introduce, from a risk management perspective.

In terms of areas of practice, conveyancing continues to attract the highest incidence of claims as demonstrated by the graph below which is based on the number of notifications in each area of practice from 1 January 2018 to 31 December 2018 on the Howden solicitors' book:

Top 10 loss types



In the discussion below we highlight some areas and issues that are a point of focus at the present time.

Onerous ground rent clauses

For several months now, the media has reported on onerous ground rent clauses in relation to new-build, leasehold homes. Solicitors who advised on the purchase of these properties have been identified as being in the firing line for professional negligence claims for alleged poor advice at the time of purchase. The issue is not confined to leasehold houses and onerous ground rent clauses have also become a concern in relation to many new-build flats.

Insurers began to focus on this issue at the time of the October 2017 renewal after it was reported that a law firm had been established to bring group litigation against solicitor firms, with a suggestion that the total losses could be as high as £500 million². As yet the jury is out on the extent to which this figure is overstated; however the issues of onerous ground rent clauses and leasehold property generally have continued to receive a great deal of attention. The Government has now undertaken a consultation on leasehold property and reform is expected. Some house-builders have also taken remedial action. In particular Taylor Wimpey have set aside £130m as a redress fund and established a claims process for original purchasers who still own properties affected by onerous ground rent clauses.

Claims against solicitors have progressed slowly, but there has been more activity in the last six months and it remains a significant issue for PII insurers. In March 2019 one firm confirmed to the legal press that it had sent 750 pre-action notification letters and another reported that it had been contacted by “several hundred” people³.

Please also remember that this issue is no longer confined to “new-build” purchases. Many affected properties are now back on the market as owners move on – some of them still not realising that their property is the subject of an onerous ground rent clause or turning a blind eye to it. Insurers will want to know that your conveyancing teams focus on this issue when instructed on the purchase of leasehold properties and ensure that any onerous clauses are very clearly brought to the attention of clients and lenders. Be clear about this when completing your PII proposal form.

² Legal Futures 25 April 2017

³ Law Gazette 19 February 2019

Investment schemes – including buyer-funded developments

The SRA issued a warning notice regarding concerns about dubious investment schemes back in June 2017⁴. At this time there were particular concerns regarding buyer-funded developments and leases of assets such as hotel rooms, storage facilities and parking spaces.

Buyer-funded developments involve the construction of a development funded by significant deposits received from buyers purchasing “off plan”, as opposed to the developer using finance obtained from a commercial lender. The deposits paid by buyers can be as high as 80% and funds are released to the developer prior to completion to enable the construction to take place. A number of developments where this model has been adopted have failed. Predictably many buyers have pointed the finger at their solicitors for failing to give adequate advice or for releasing funds when they should not have done so. This has led to some very significant claims.

Leasing of assets such as a hotel rooms, parking spaces or storage units have involved buyers paying a substantial amount for the asset with the promise of high returns. Many think that taking out a lease means that their investment is protected because they have an interest in land or property. The reality is that their investment is dependent upon the business being well managed. Many solicitors have failed to properly advise their clients of the risk, and claims have followed.

Most underwriters now include questions on their proposal forms to understand whether firms have been engaged in transactions such as those discussed above. These cases also highlight the importance of firms remaining alert and on the lookout for the next dubious scheme. What procedures do you have in place in your firm to address this? Can you reassure your underwriter that you have good controls and that they are adhered to? Remember, no matter how much you caveat your advice and warn of dangers associated with “get rich quick” schemes, there will always be a claimant solicitor ready to pull apart the advice given when it all goes wrong.

⁴ [https://www.sra.org.uk/solicitors/code-of-conduct/guidance/warning-notices/Investment-schemes-\(including-conveyancing\)-Warning-notice.page](https://www.sra.org.uk/solicitors/code-of-conduct/guidance/warning-notices/Investment-schemes-(including-conveyancing)-Warning-notice.page)

Client account and cyber fraud

Client account and cyber fraud continues to be a problem for law firms. Given you will have significant amounts of money in the client account at any one time, you will always be a target. There is no doubt that firms take this issue seriously and insurers report that there have been fewer of the traditional “Friday afternoon frauds” in recent months.

The difficulty is that fraudsters are continually adjusting their modus operandi and finding new ways to successfully target your client account – or the funds that your clients intend to transfer to you. The issue requires relentless attention on your part, with on-going review and updating of systems and procedures, and monitoring of SRA and other warnings. Insurers will continue to focus their attention on this area in their proposal forms and we advise you to respond as comprehensively as you can.

Separate cyber cover is also advisable and we encourage you to talk to us about this.

Wills, probate and estate administration

We mention this as it is an area where insurers report an increase in both the number of notifications and the quantum of claims. We expect there are various reasons for this. Property values are high and estates invariably involve at least one residential property. Families are also more complicated these days. There are more second and third marriages/relationships, step-children and half-siblings, resulting in more opportunity for conflict. People are also living longer, and with age comes a greater risk of disappointed beneficiaries raising the issue of mental capacity.

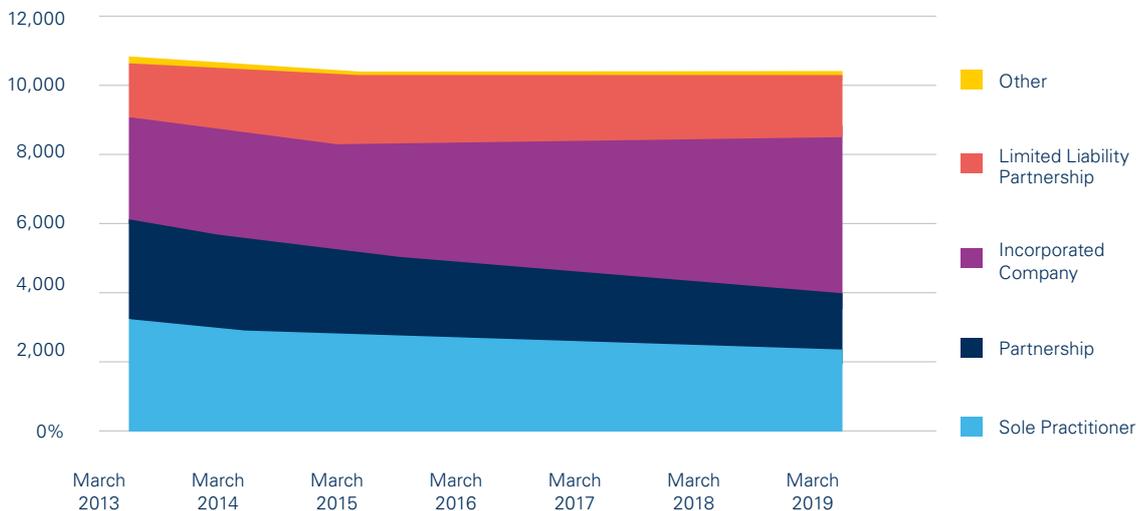
If you have not reviewed your risk management strategy in these areas recently, it would be advisable to do so – and let your insurers know you have done this when completing your proposal form.

Equity release schemes are also worth a mention at this point. While they do not fit within the area of practice heading above, they are generally targeted at the retired population including elderly and vulnerable individuals. This is an area that is ripe for claims activity prompted by disappointed adult children who realise they will not enjoy the inheritance they expected. Ensure you have a clear risk management framework for undertaking this work – it is an area where we see potential trouble on the horizon.

Changes to the way solicitors practise

Historically there have been limited options in terms of practice structures for solicitors to offer legal services to the public. The following table⁵ provides us with a snapshot of the way the profession has organised itself to deliver legal advice in more recent years.

Practice structure of solicitors firms 2013 to 2019



One point to note is the steady decline in sole practitioners and partnerships – albeit they still make up 38% of the profession. Undoubtedly some of these have changed to incorporated structures and will appear under that heading through this period, but over recent years it has become more and more difficult to operate as a sole practitioner or small partnership. The relentless increase in regulation and the burden of associated costs are clearly having an impact across the entire profession, but this is more keenly felt by sole practitioners and smaller practices.

⁵ Source: sra.org.uk/sra/how-we-work/reports/data/population_solicitors.page

Against this backdrop the SRA are pressing ahead with their plans to enable “solicitors” to:

- offer legal services to the public as “freelance solicitors”; and
- offer unreserved legal services to the public from entities that are not SRA-regulated

In neither scenario is there a requirement to carry solicitors’ PII that complies with the Minimum Terms and Conditions. Freelance solicitors will need “adequate and appropriate” insurance, although at the time of writing we await guidance from the SRA as to what “adequate and appropriate” insurance is. Of greater concern is the prospect of solicitors practising in unregulated entities offering unreserved legal services. They will not need to carry any insurance at all. It is suggested that the new arrangements might offer a viable alternative for some sole practitioners or small practices, but is that realistic given they would need to fund run-off premium when concluding their SRA-regulated practice?

There are many concerns that have been well rehearsed in responses to the consultation⁶ on this issue and the legal press. In particular, many believe that the new regime will:

- create confusion for the public, particularly with reference to the issue of consumer protection
- leave some consumers (and possibly the most vulnerable) without redress when something goes wrong
- potentially lead to a two-tier profession, given the low barriers to entry for inexperienced solicitors or those with a “blemished” practice history

The Legal Services Board has now given its approval and the SRA are on track to deliver this change with the introduction of the new Codes of Conduct (for firms and individuals) in November this year. It may be that the take up will be modest. For example, we understand that to date only a small number of SRA-regulated firms have switched to CLC regulation since the “Switching Protocol” was introduced in October 2017 and you do not have the complication of needing to purchase run-off cover in that scenario.

It will be interesting to revisit a revised version of the above table in another five years to see how this change has unfolded – and to see the response when consumers are left out of pocket as a result of uninsured solicitors being unable to meet a successful claim against them.

⁶ Please contact us if you would like a copy of our response to the consultation.

Minimum Terms and Conditions for PII cover: Are they going to change? What happened to the consultation?

In our last report⁷ we discussed our concerns regarding SRA proposals to change the Minimum Terms and Conditions. By way of recap the proposals include the following:

- reducing the compulsory limit to £500,000, save for conveyancing services in respect of which solicitors would be required to purchase a limit of £1,000,000
- excluding cover for clients with a turnover greater than £2,000,000
- reducing run-off cover to an aggregated limit of £1,500,000 (or £3,000,000 for firms undertaking conveyancing work)
- allowing defence costs to be subject to an excess and a limit

Responses to the consultation closed in June 2018 and as yet there has been no further response from the SRA and no decisions have been announced. The legal press recently suggested that the issue had been “kicked into the long grass”⁸. To the contrary, we understand that the issue remains on the SRA agenda. This was confirmed by Chris Handford, SRA Director of Regulatory Policy, who advised during a presentation at the Legalex Conference in March that we could expect to hear further from the SRA on this issue later this year⁹. We await developments with interest and will keep you advised.

⁷ <https://hyperionprod.blob.core.windows.net/cmsmedia/10884/solicitors-market-report-august-2018-digital.pdf>

⁸ Law Gazette 12 December 2018

⁹ Noted in response to questions at the end of the attached presentation <https://www.youtube.com/watch?v=TVqPpweSeEA>

Spotlight on Conveyancing Practice

SRA thematic review on residential conveyancing

The SRA has recently published the results of a “Residential Conveyancing Thematic Review” undertaken during 2018. The prospect of a review was welcome news from the perspective of the solicitors’ PII insurers, given that conveyancing continues to be responsible for significant claims activity. By way of illustration, the data that the SRA collected from insurers in late 2015 confirmed that over the 10 year period from 2003/4 to 2014/15 conveyancing was responsible for 51% of the claims paid by the PII market. This amounted to some £766.8m, but even that figure is understated given that data was only collected from only 74% (by premium) of the Participating Insurers in the solicitors’ PII market and it also excluded reserves that insurers were holding against open notifications.

Losses at this level underline the need for a review of conveyancing practice to determine what measures can be introduced, or changes adopted, to reduce claims. If conveyancing related claims can be reduced, then that is a change that will support a reduction in solicitors’ PII premiums – in contrast to the proposed changes to the MTCs that the SRA has yet to make a final decision on.

Regrettably, the results of the review are disappointing. While the report notes a concern about the level of complaints to the Legal Ombudsman generated by residential conveyancing, it completely fails to mention the extent of the PII claims experience, let alone acknowledge that the level of PII losses support the need for reform of the conveyancing process.

The SRA visited forty law firms in the course of the review. Firms completed an online questionnaire and the SRA reviewed “documentation” and interviewed a manager and fee earner in each firm. However the SRA only reviewed two files per firm. Given that 60% of the firms the SRA regulate undertake residential conveyancing, there is a serious question as to whether eighty files provides any sort of meaningful sample for this exercise.

The report highlights a concern regarding inaccurate cost estimates. Was this a bid to justify the SRA’s introduction of the Transparency Rules last year, requiring firms to publish cost information on their websites? Lack of transparency in relation to telegraphic transfer fees was also a point of focus and this issue prompted the SRA to refer five firms involved in the review to their internal disciplinary process. Six firms were referred in total. Other areas of potential concern identified were:

- inefficient processing of paperwork
- failure to explain the difference between freehold and leasehold
- failure to ensure a client understands long term obligations, fees and charges in respect of leasehold property

We consider the above issues are the “tip of the iceberg” when it comes to those aspects of conveyancing practice that give rise to claims. In Howden’s view this is a missed opportunity from the perspective of consumers, the PII market and the profession, to properly identify areas of concern, so that constructive recommendations for change can be considered.

CQS 2019

On a more positive note there have been some changes to the Law Society CQS scheme that will enhance the management of conveyancing risk. The re-launched CQS scheme will focus on the delivery of three core values, which are:

- members will proactively and effectively manage risk and demonstrate behaviours that support and promote the integrity of CQS and the community
- members will demonstrate best practice and excellence in client care through robust practice management of residential conveyancing
- members will demonstrate thorough knowledge and skill in handling conveyancing transactions

The new Core Practice Management Standards were published in February 2019 with members expected to demonstrate compliance from 1 May 2019. The new requirements are in line with Lexcel V6.1, but also go beyond this. Firms will need to carry out a gap analysis (or engage a third party provider to assist with this) and undertake some work to ensure compliance. CQS are also introducing some on-site visits each year and increasing the number of desk-based assessments.

Hopefully these changes will result in more robust risk management processes and procedures for CQS related firms that will, in turn, prevent claims.

New Practice Note: Mortgage Fraud

The Law Society also published a new Practice Note on mortgage fraud on 11 February 2019. Historically mortgage fraud is an issue that has generated a great deal of claims activity and a number of PII proposal forms have questions in relation to this issue. When updating your insurer on recent risk management activities within your firm as part of your renewal process, it would be useful if you were to include detail regarding training that has been completed within the firm to ensure that all fee earners undertaking conveyancing are familiar with the content of this new Practice Note.

Why Howden?

Size, scope and insurer relationships

Howden is a specialist PII broker. We place £45m+ premium on behalf of firms that practise in the legal sector. Our client base comprises over 650 legal services firms from sole practitioners to Top 100 firms. We have a strong client retention rate, which we attribute to our focus on customer service. Given our size in the market we also have a strong negotiating position with insurers, which we use to the best advantage of our clients.

We have direct access to the majority of Participating Insurers with either exclusive or enhanced access to 5 "A" rated insurers.

Superior market access



AmTrust International



CHINA REINSURANCE



CV STARR & CO



+ many more

Claims

At Howden we also have a team of over 30 PII claims specialists with over 300 years' combined PII experience. Part of this team, comprising six full-time members, is dedicated to handling solicitor claims. The team provides a valuable interface between our clients and insurers. They have good relationships with panel firms and insurers' in-house claims-handling teams.

Our team monitors the development of cases including reserve movements and settlement proposals. They also "fight the corner" for our clients in the unfortunate event of a policy dispute.

Cyber and D&O solutions

Insurance protection does not stop with PII. Cyber Insurance is becoming increasingly important and we have access to market-leading cover. This includes:

- urgent access to a panel of industry experts to restore systems and business critical data
- cover for the cost of notifying affected third parties, cyber extortion and fines to the extent insurable at law

We can also provide quotes for D&O cover. We believe that this is becoming an increasingly important purchase for law firms. It is also critical to ensure that the D&O cover you purchase will respond specifically to the needs of a law firm. Issues include:

- specific cover for COLPS, COFAs and MLROs
- defence costs for both SRA investigations and SDT proceedings

We invite you to contact us if you have any queries in relation to this report or would like to discuss PII and related insurance products for your firm.

The Howden difference



Knowledge

We understand what you do and what insurers want. You will get appropriate cover, from the right insurer, at the right price.



Strength

Our size and reputation helps us consistently negotiate better premiums with insurers.



Sector specialisation

We take time to understand the sector you operate in. We understand the risks law firms are exposed to.



Size

Large enough to make a difference with insurers but still small enough to offer great service based on strong relationships.



Claims service

Over 30 claims advocates to guide, manage and advise on notifications and claims.



Integrity

We tell it how it is, providing honest and informed advice and guidance.



Expertise

We have over 150 PI specialists. We know what we're doing.



Keeping you informed

Gathering intelligence and sharing it via newsletters, magazines and events to benefit you.

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