CHANGES FOR PROFESSIONAL INDEMNITY INSURANCE

An article by Mark Aizlewood and Simon Thomas, featured in Legal Business, where they review developments in the last 12 months and assess how these, the introduction of the Insurance Act and regulatory changes could impact on the 2016 renewal season.

The professional indemnity renewal season promises to be favourable again for solicitors. Insurers' appetite to write PI remains strong, with new entrants expected. Insurers' general willingness to introduce capital, a lack of catastrophic events in the reinsurance sector and a benign claims' experience across the insurance field dictate that premiums should remain broadly static for the profession.

However, it may not be all plain sailing: conveyancing practices will undoubtedly encounter resistance from some insurers with increased premiums likely. Conveyancing (both residential and commercial) continues to give rise to the majority of claim payments and the increase in cyber crime / Friday afternoon fraud will only increase Insurers' wariness as to whether to offer terms

Aggregation.

2016 saw the Courts give guidance on the aggregation clause in the Minimum Terms and Conditions. Teare J at first instance held that Insurers needed to establish that claims arose from transactions which are "dependent on each other" if they were to be treated as aggregated claims. This approach was favourable to the profession as a whole since it restricted Insurers' ability to treat a number of "similar claims" as one for limit of indemnity purposes.

On appeal (by the Insurers), the Court of Appeal agreed the underlying transactions had to be inter-connected but rejected the concept of dependence. The Court held there needed to be an "*intrinsic relationship*" between transactions for them to be "related"; an extrinsic relationship was insufficient.

Whilst this broader test could result in more claims being aggregated, the Court declined to offer much guidance as to the factual matrix required for an intrinsic relationship to be established.

The profession and Insurers will need to wait and see how *"intrinsic relationship"* is interpreted. It is likely the Judgment will assist Insurers when dealing with claims involving multiple and repeated fraud - a constant source of irritation for Insurers that such are covered at all and which have given rise to significant claim payments. The Appeal Court's judgment may deter other lenders (aside from Godiva Mortgages Ltd in its claim against Willmett solicitors) challenging Insurers' decision to aggregate claims arising from the activities of one partner involved in a number of fraudulent property transactions.

Cyber

Cybercrime is a universal problem. Reports abound of attempts to divert conveyancing monies, the so-called 'Friday afternoon' fraud, or fraudsters simply seeking to exploit a weak link in a firm's compliance protocols to obtain security details to gain access to a firm's accounts. Larger firms, despite their more robust IT infrastructures, are not immune. The volume and sensitivity of deals make them a ripe target for hackers.

Whilst client money is protected by a firm's PI policy, office account losses are not. Firms must remain vigilant as increasingly sophisticated efforts are made to gain access to their systems. Whilst losses remain modest, insurers will look to firms to demonstrate what preventative measures, to include staff training, are being taken to combat fraud.

Regulation

The Law Society proposed the minimum level of PI cover should be reduced from £2/3m to £500,000. Despite suggestions of costs-saving for smaller firms, who are less likely to face a £2m+ exposure, insurers' response was unfavourable. Changes remain on hold whilst further data is obtained.

A further proposed change would see compulsory run-off reduced from six years to three. Presently SIF provides cover for any firm that has closed without a successor beyond its six year run-off. That protection ends in 2020, with no replacement yet determined. With run-off premiums rising from 250% to 300% of a firm's final year premium, cost is highlighted as a main bar to firms closing in an orderly manner. Insurers will be averse to reducing premiums if they are to meet post-closure claims in the absence of SIF's safety-net.

The Council for Licensed Conveyancers has moved to an open market and indicated that run-off for members will be provided 'at no cost'. The SRA is consulting whether firms should be able to move to an alternative regulator, without paying a run-off premium. The attraction, particularly for smaller firms, is clear.

The SRA is in the midst of a further consultation round as it assesses regulation in a changing legal landscape. The previous 'one size fits all' approach has not kept pace with the changing business models deployed across the legal sector. If the proposals are implemented, a revised Handbook and principles would be created together with codes of conduct for solicitors (as to standards of behaviour) and firms (obligations as a regulated business).

The Insurance Act 2015 came into effect on 12 August 2016, with the SRA adopting the non-consumer standard of disclosure - requiring firms to make a 'fair presentation' of a risk. The compulsory nature of cover supplied by the MTC means the change will have little material impact in practice.

In summary, the majority of firms should enjoy a relatively smooth renewal. With regulatory changes afoot, firms should use the time available to review their existing procedures. All firms need to demonstrate to Insurers they are seeking to minimise risk with particular reference to cyber risk, whether in preventing Friday afternoon fraud or more sophisticated cyber attacks. All members of staff from reception to partners should be both properly trained and fully engaged in recognising the danger signs and acting appropriately.

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