



Solicitors' Professional Indemnity Insurance Market Update

Miller's Review of the April 2021
Renewal Season

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Hard market conditions were an apparent feature of the Solicitors' 1 April Professional Indemnity Insurance (PII) renewal season with a significant number of law firms receiving increased premiums.

Insurers were very particular on the allocation of insurance capacity due to the limited appetite for PII within Lloyd's of London and were extremely cautious about which law firms they quoted, particularly those with high levels of conveyancing exposure, not to mention their concerns regarding financial viability following COVID-19.

Miller has been alert to these trends for some time and has been working with a variety of law firms, both well-run with good claims records and problematic practices, to guide them through their renewals.



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Market update – what have we seen from insurers?

COVID-19

The pandemic continues to cause insurers concerns with large losses expected across the insurance industry due to COVID-19 business interruption claims. The situation has unnerved insurers leading to them asking specific COVID-19 related questions and requesting the completion of Covid Questionnaires to drill down into technical aspects of how firms are managing during these unprecedented times, specifically in relation to financial robustness and the management of risk throughout this period and beyond.

Insurers have focused their attention to questions relating to how business operations have been impacted by the pandemic; asking law firms to provide detailed information on their ability to continue to operate while staff work remotely, risk management, supervision arrangements and the financial implications of the pandemic on firms.

Such questions include:

- Do staff have remote access to company systems?
- Are your risk management procedures still effective? For example: are peer reviews still taking place? Are audits/file reviews still possible? Do and how are 'Know Your Client' (KYC) procedures continuing to operate?
- With the pandemic resulting in reduced cash flow and delays in fee payments, insurers are keen to understand whether law firms have the ability to continue trading effectively, with particular focus on financial viability of firms and the potential exposure to unfunded run-off premiums.

Risk specific questions

In some cases insurers have been examining in detail the individual contracts that law firms are handling, specifically when it comes to high-risk work, most notably firms with commercial and/or conveyancing exposure. Insurers were not only analysing the percentage figure of this work, but also asking in-depth questions and reviewing the monetary transaction values involved.

Where there was a high percentage figure, or high monetary value, insurers requested further information relating to:

- Where the contract is based.
- The level of experience of the individual(s) carrying out this work.
- What the sign-off procedures are for such transactions.
- The average residential/commercial transaction value over a five year period.



Market trends

We have seen limited appetite from insurers to write new business and stricter underwriting criteria, particularly in relation to the percentage of conveyancing work that firms undertake, with many insurers (but not all) reducing their maximum conveyancing capacity to 25%.

Primary Compulsory Layer (GBP2m/3m):

This solicitors renewal season illustrated insurers applying 'standard' rate increases between 15% - 20% for both small-medium sized and larger law firms. This was consistent with the October 2020 renewal season. Some firms saw less than 20% increases and those firms with commercial and conveyancing exposure witnessed more than 20% due to the nature of this work being deemed high risk. On average, the 'standard' rate increase applied to law firms was 20%.

Excess Layers:

Excess layer insurance is a 'top-up' liability cover which provides increased limits of insurance over the primary insurance cover. Higher rate increases were applied on excess layers than primary layers, for the following reasons:

First Excess Layers:

The first excess layer from the Solicitors Regulation Authority's (SRA) Minimum Terms and Conditions (MTC) of GBP2m/3m up to GBP10m – has its own microcosms of hardness. Supply issues are exacerbated as there are only a few insurers that will participate at this level, and because of this, pricing has increased significantly above market standard, with some increases as much as 50-60%.

1 Due to reduced capacity in the PII market, premiums have increased - it's the simple law of supply and demand. As demand increases and supply to write this type of insurance decreases, price increases. The Lloyd's Thematic Review in 2018 identified that professional indemnity had the largest losses across all books of business. In order for insurers to correct their books following the review, premiums increased to ensure that minimum monetary premiums are still achieved per risk, in spite of the insurer's participation on the risk reducing. An additional effect of insurers reducing their capacity is the need to obtain additional capacity on to a programme – new insurers by definition tend to require a higher premium than holding insurers (as these new insurers have not been competitive in the past).

2 Insurers are seeing claims on excess layers, in particular the first excess layer stretch. This layer is now being seen and referred to as a 'working layer' and insurers are seeking to correct their pricing due to the number of claims hitting that layer.

Above GBP10m:

There is more capacity at this level in terms of insurers, therefore rate increases on these layers have been between 15% to 20% or minimum premium, which is now GBP2,000 per GBP1m. Historically, these layers were unpriced, but due to the number of claims hitting these layers, insurers have had to correct their pricing as above. This is similar to what we witnessed in the October 2020 renewal season, so there has not been much change in terms of how insurers are pricing since then.

Small-medium law firms

(1 to 10 partners/directors)



There were average increases of 15% to 20% for firms presenting unchanged risks and clean claims records.

Conveyancing firms in particular saw some insurers limit their capacity percentage from circa 25%-30% of their income down to 15% due to the high-risk nature of the work and number of related claims such as Buyer Funded Developments.

Larger law firms

(11+ partners/directors)



For larger law firms, the lack of competitive offering on excess layers showed no signs of abating. With the severity of claims increasing i.e. claims potentially breaking through the GBP2m and GBP3m layers, this has led to several insurers who previously offered excess layer cover also pulling out of the market in previous years. Premiums for some firms have doubled due to claims exposures, but those firms with a clean claims record and effective risk management processes saw the standard rate increases applied.



Cyber risks

With staff operating remotely across many sectors, it is also worth noting that cyber crime has become a focus for insurers due to the increased activity of cyber criminals targeting businesses in sophisticated ransomware attacks. The disruption these attacks can cause to daily working practices and the implications on law firms can be catastrophic, especially if businesses haven't purchase cyber insurance, more on this later in the report and in our debrief on **silent cyber – what does this mean for insureds?**

Silent cyber

You may have heard of 'silent cyber' in recent months - the impact that this is having on law firms is more evident now than ever before.

What is silent cyber?

In the past, the uptake of bespoke, standalone cyber policies has been relatively low (when compared with the risks faced by businesses). This meant that as businesses continued to place increased reliance on their IT systems, in the event that they suffered a breach or cyber event, they looked to their more 'traditional' policies to seek coverage. Some levels of cover were offered under these policies, often inadvertently, thus the name 'silent cyber', or more specifically, non-affirmative cyber.

Use of Lloyd's Market Association (LMA) and International Underwriting Association (IUA) clauses and affirmative language

Following on from an extensive survey of the PII and Cyber markets, taking into account views on claims scenarios and how coverage within both Cyber and PI policies was intended to respond, the LMA and IUA developed two model endorsements – the **IUA04-017** and the **LMA 5531** (note that there is also an IUA04-014 endorsement in addition which addresses technology professional services but we will focus on the 017 for the purposes of this piece). In addition, the IUA have produced an explanatory note outlining the approach and the intentions behind the endorsement and provided explanatory claims scenarios to show the intended coverages.

How are the IUA and LMA clauses affecting PI renewals this year?

Following this April renewal season, the use of IUA and LMA clauses has increased. We have seen insurers applying such clauses on PII policies to all professions across all layers where minimum terms permit.

This is definitely a shift in the market in comparison to prior years and echoes the serious threat that cyber crime poses to all businesses.

SRA Cyber Clause Consultation

The SRA are considering changing their minimum terms and conditions for PII in response to the increased risk and scale of cyber attacks. The SRA are proposing, which is subject to **consultation** and open until 25 May 2021, to add in a clause to include that client losses caused by a cyber attack, which could result in a claim against a firm, **must be covered**.

Click here to read our full debrief on silent cyber: what does this mean for insureds?





What does this tell us?

It is not just a matter of factoring in the potential increase in cost, but also the time required to present the risk to the market, a potentially time-consuming exercise that means starting early is crucial. We have seen several insurers asking existing clients for complete proposal forms where historically a short proposal form, asking a few key questions would have sufficed, before offering renewal terms.

Firms have had to be prepared to go into in-depth information relating to risk management, cyber hacking prevention as well as complete full risk assessments, including an analysis of a firm's prior claims history. Firms have also been required to explain any open claims and detail lessons learnt from past claims, as well as any compliance and training controls and systems. With the likelihood that a growing number of firms will be forced into creating competitive tension with a new insurer, having this information ready and well-presented has assisted and been an advantage to many law firms through this renewal season.

Paying attention to the overall quality of the presentation has been important. Insurers' time is precious, therefore a poorly presented and badly written proposal form full of minor errors can lead insurers to liaise with other law firms, even if the practice itself is sound and relatively low risk. First impressions of your proposal form are a focal point for insurers, the need to ensure all applicable questions are answered and in an eligible format, with supporting/supplementary information is key to ensuring your firm stands out from the rest.

Claims trends

This renewal season insurers have raised more questions than prior years about a firm's claims history, focusing on the number of claims, quantum paid, reserves held and lessons learnt from such claims.

The claims trends that we have identified are:

- 1 Multiple Dwelling Relief (MDR)** - claims against solicitors usually allege failure to properly advise of the potential to claim MDR savings on Stamp Duty Land Tax (SDLT). There is evidence to suggest a decline in the number of new claims relating to multiple dwelling relief for SDLT purposes.
- 2 Buyer-funded developments/investment schemes** - conflict, failure to advise fully and independently on the ramifications of investment and/or breach of trust. Insurers are asking more questions on this area in their proposal forms, specifically in relation to the percentage deposit taken - anything higher than 10% is deemed to be a greater risk.
- 3 An increase in the number of General Data Protection Regulation (GDPR) related claims** arising from minor breaches such as emails sent to the wrong address.
- 4 An increase in the number of will drafting issues** (some arising from family breakdowns but others are simply ambiguous drafting and apparent non-compliance with instructions). Family structures tend to be more complex now with second marriages and extended families which can lead to more disputes.
- 5 Increasing number of matters where claimants write directly to a firm's insurers seeking a prompt settlement** - although the claimant is entitled to insurance details, it is designed to put pressure on a law firm and to bypass the normal claims process.

Law firm risk: keeping ahead of the curve

In this section Frank Maher, partner at Legal Risk LLP, identifies some current key issues on client risk, business risk and insurance risk.

Client risk

When law firms started addressing risk management issues in the days of the Solicitors Indemnity Fund (SIF), one of the largest risk areas was missed time limits. While time limits are still missed, the profession has largely moved on, assisted in part by computerised case management systems, of which more later.

Many areas of concern have been highlighted in recent times including ground rent and exposure to identity fraud on conveyancing. Perhaps the largest single area of concern in terms of claims exposure, however, is investment schemes.

Exposure to investment scheme claims is not new. The types of schemes have changed, moving through prime bank instruments, ostrich farms, wine and crypto assets could potentially be next. Buyer-funded developments – hotels, student lets and buy-to-lets – have been the most serious problem.

While many have completed successfully, an extraordinarily high number have failed, resulting in multiple claims against law firms. The maximum potential loss on claims on which the writer is advising firms, on coverage and regulatory issues, probably equals a year's premiums for the profession's compulsory GBP2m to GBP3m cover.

Many firms which have acted on such schemes have found it difficult to obtain insurance. They have also faced investigation by the SRA, which has issued warning notices and become embroiled in a variety of coverage issues with insurers, more detail referred to later. Firms that are still acting on investment schemes, however confident on the scope of their retainer, their advice and risk warnings should be alert to the fact that insurers are sceptical of such schemes due to the claims currently hitting the market, and may look askance.

Business risk

Law firms have been resilient in dealing with COVID-19 and remote working, even those that were heavily paper-based a little over a year ago. Cyber attacks are rarely out of the news and have increased during the pandemic. Any comfort which solicitors had in the past that attackers have bigger fish to fry and would not bother attacking small firms has long since evaporated. Nor is the risk confined to losing all your data in a ransomware attack: criminals are now not only threatening to publish confidential client data but are carrying through with the threats. This happened to a large global firm and a small US personal injury practice.

We are at an early stage of a journey in addressing the risk. **Cyber Essentials Plus** accreditation, backed by the National Cyber Security Centre (NCSC), is a must for all firms. So too is cyber insurance (and crime cover) – think of it like AA or RAC cover for your car, emergency assistance from specialists when you have a problem. Staff awareness is critical, as human error is a significant issue – with so many phishing emails every day, a moment of inattention, clicking on a link without thinking is all that is required. **Free training is available** from the NCSC. Recovery plans are also key, knowing what to do in the moment of chaos when your business is attacked.

Law firms' suppliers are a potential source of risk: the NotPetya attack on DLA Piper originated in what purported to be an update to the accounts software used in the firm's Ukraine office and resulted in 1,500 servers and 6,500 PCs needing to be rebuilt. The recent SolarWinds attack has affected Microsoft Exchange servers globally.

Attacks such as this raise the spectre of case management and document management software used by multiple firms being attacked; that in turn may highlight the difficulty in implementing a recovery plan when key parts of critical infrastructure are outside a firm's control, and limitations on liability in the software providers' terms of business may be problematic.

Insurance

Coverage issues were rare in the early days of the open market, post-SIF, but are now far more common. At least in part, that is down to solicitors failing to protect their own interests.

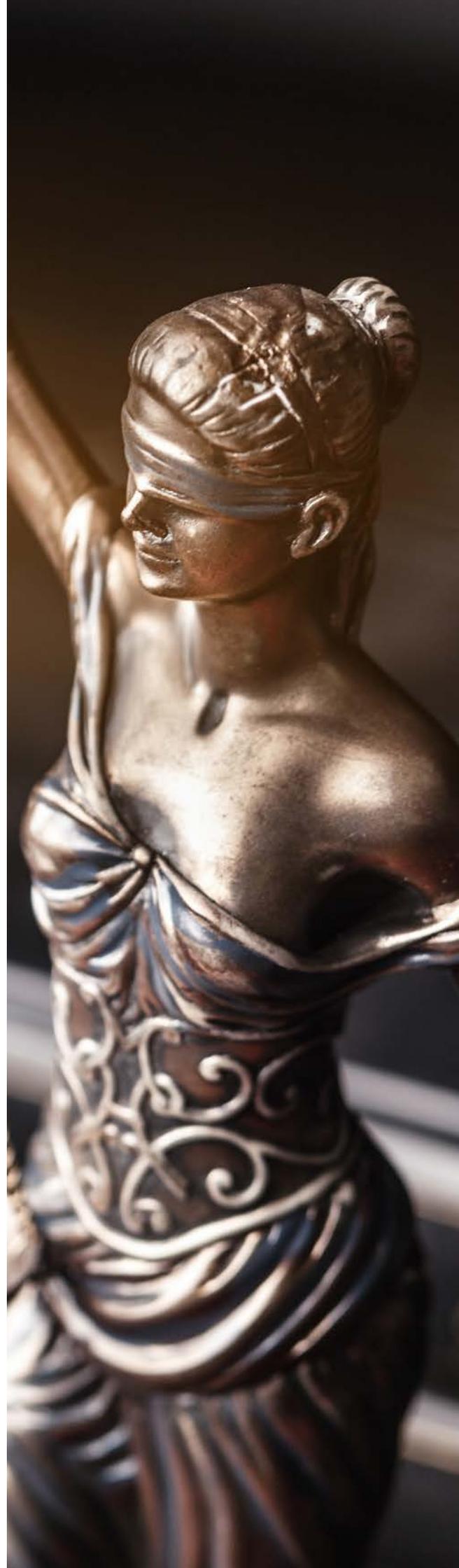
Many problems arise from the aggregation clause, which appears in all policies, by which insurers can, in broad terms, apply a single policy limit to multiple claims arising from similar causes. Although this issue has been prevalent in the development scheme claims referred to above, they are not confined to that. Claims arising from volume work, or a failed or undervalue settlement of a group action, or fraud could trigger the aggregation clause, as might claims from failure of IT systems caused by a cyber attack.

Compulsory cover under the SRA's MTC does not cover the firm's own losses in restoring systems following cyber attacks but does extend, in broad terms, to client claims from cyber and data breaches. The precise extent of the MTC cover is under review with the intention of giving clarity on the extent of cover; watch out for developments.

The risks which law firms face and the steps they must take to protect themselves through risk management, mitigation and insurance, are constantly evolving. Law firms need someone to keep abreast of developments, but be mindful that they are the responsibility of all.

Frank Maher is a partner at Legal Risk LLP, solicitors specialising in advice to law firms and other professional practices on professional indemnity insurance law and professional regulation.

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Outlook for October 2021 and beyond

More than ever firms need the support of a proactive broker to help law firms navigate the hardening PII market.

Just how much further the hard market has to run and how long it may last, both in terms of impact on the availability of cover and its cost, is difficult to predict with any certainty. There is no let up within Lloyd's of London on the need to squeeze loss-making classes of business out of underwriting portfolios and widespread caution across the rest of the market anxious to ensure it does not pick up poor quality, loss-making risks.

Starting the renewal process early is key for every firm but especially for those with claims against their name. Insurers will be looking for greater detail on the claims, and for information on actions taken to prevent similar claims arising in the future. They will look for complete honesty about other claims that might be in the pipeline, even if they are at a preliminary stage with an expectation that they are unlikely to develop further. Insurers will focus on financial viability and risk management controls and systems to understand your firm and how it sails in these chopping waters that we are in at this time.

Miller continues to assist firms by highlighting aspects of their business that might set off alarm bells with insurers. Working with firms to improve their risk management and claims position in order to present such risks in the best possible light to insurers with a view to obtaining the most accurate terms in this current market.

The expertise of a leading broker is going to be essential in order to navigate the hardening market, and the sooner solicitors start conversations with a broker the better. There are 10,000 law firms looking for cover. To get the best deal you need to stand out from the crowd. Let Miller help you do that.

Miller has a reputation of presenting profitable business to the market, enabling us to leverage relationships with the best insurers to the benefit of our clients.

Key message is:

- ✓ Begin your renewal process in plenty of time before your deadline
- ✓ Agree a timeline with your broker
- ✓ Proposal forms – make sure you have everything covered
- ✓ Budgeting – manage expectations and premium increases
- ✓ Consider all finance options available to you



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