

**Extract of draft minutes of meeting of Administration of Justice
and Legal Services Panel held on 18 September 2001**

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V. Solicitors (Professional Indemnity) (Amendment) Rules 2001

(LC Paper Nos. LS143/00-01 and LS158/00-01; CB(2)2270/00-01(01) to (03); CB(2)2294/00-01(01) to (05); CB(2)2312/00-01(01) and (02))

The Chairman drew members' attention to the subsidiary legislation relating to Solicitors (Professional Indemnity) (Amendment) Rules 2001 (the Amendment Rules) (L.N. 162 of 2001) which was gazetted on 6 July 2001. The main purpose of the Amendment Rules was to increase the contributions to the Solicitors Professional Indemnity Scheme (the Scheme), in terms of a net increase of 130% in insurance premium costs payable from 1 October 2001.

2. The Chairman pointed out that the increase in contribution to the Scheme would take effect on 1 October 2001. She sought advice from Assistant Legal Adviser (ALA) on the time-frame for LegCo to scrutinize the Amendment Rules and the implications in the event of amendment or repeal of the Amendment Rules.

3. ALA said that amendments, if any, to the Amendment Rules would have to be made at the second meeting of LegCo in the next session, i.e. 17 October 2001, or the third meeting if extended by resolution, i.e. 31 October 2001. He pointed out that by virtue of section 34(2) of the Interpretation and General Clauses Ordinance (Cap. 1), a repeal or amendment would be deemed to take effect from the date of the publication in the gazette of the resolution to repeal or amend the subsidiary legislation. The repeal or amendment would be without prejudice to anything done under the Amendment Rules before such repeal or amendment. However, whether there were other implications, such as the possibility of a pro-rata refund of the annual contribution, might need to

be further examined.

4. At the invitation of the Chairman, Mr Anthony CHOW brief members on the background to and the reasons for the increase in contribution to the Scheme. The details were set out in the papers provided by the Law Society (issued vide LC Paper Nos. CB(2)2294/00-01(02) to (05)), which were summarised as follows -

- (a) At present, the Scheme had a three-year reinsurance programme which was due to expire on 30 September 2001. Under the current arrangement, the Hong Kong Solicitors' Indemnity Fund Limited (SIF) provided coverage of \$10 million in each and every claim to its membership. Of this amount, SIF retained the first \$1 million of every claim and reinsured the remaining \$9 million. To further limit the aggregate impact of the \$1 million retention for each claim, SIF also purchased Stop Loss Reinsurance which provided coverage if the aggregation of retention was in excess of a predetermined amount.
- (b) In view of the substantial increase in claims payments in recent years, SIF commissioned the Scheme's brokers to conduct a benchmarking exercise in April 2000. The exercise predicted an enormous reinsurance premium increase after 30 September 2001. At a forum attended by members of the Law Society on 15 September 2000 to discuss the options available, the decision was taken to cancel the three-year programme and re-write a five-year programme which allowed an increase in reinsurance premium phased in over a period of five years on a progressive basis. The five-year programme had the effect of subsidising the Scheme in early years and capping the premium for the five years even if the claims situation was to deteriorate. The five-year programme

commenced on 1 October 2000.

- (c) However, the new reinsurance programme required SIF to increase its retention for the self-insured layer from \$1 million to \$1.5 million per claim from 1 October 2001 to 30 September 2005. Based on projections made by actuaries, the costs of the premium and SIF's retention over the five years were found to have exceeded the members' contributions based on the existing contribution assessment formula set out in paragraph 2 of Schedule 1 to the Rules. Therefore, the formula was amended as introduced under the Amendment Rules to raise the amount of contributions sufficient to administer the total coverage.

5. The Chairman referred member to a report submitted to the Panel by Horvath & Giles and Erving Brettell (Horvath & Giles), which raised issues and concerns about the proposed contribution increase under the new reinsurance programme (the report was circulated vide LC Paper No. CB(2)2270/00-01(03)).

6. At the invitation of the Chairman, Mr William GILES and Mr Chris ERVING presented their comments as follows -

- (a) Widespread concern had been expressed by lawyers over the new arrangements made on their behalf through SIF, in particular the insurance premium increases proposed. The views held by many small solicitors firms, which were already operating under a depressed business environment, were that the premium increases were simply untenable, and would have the effect of forcing them out of business.
- (b) The Law Society had not provided sufficient information on and

explanation of the commitments under the five-year scheme for the consideration of its members. Pending an immediate and independent review, it appeared that there were no sufficient justifications for the contribution to be increased so drastically at this stage. In fact, according to a recent survey on more than 600 law firms conducted by Horvath & Giles, of which about 55% had responded, 99% of the respondents demanded an immediate and independent review of the arrangements under the existing mutual scheme.

- (c) Under the existing compulsory mutual indemnity insurance scheme, all solicitors firms paid their contributions under a prescribed formula, irrespective of their claims experience and the degree of risks associated with their work. Some firms expressed dissatisfaction about the present arrangement under which firms with good claims records were effectively forced to subsidise others with poor claims records. Hence, it would be desirable to review and revise the formula in such a way that firms would be paying contributions commensurate with their claims records and nature of business. It would also be worthwhile to look at other options, such as a Qualified Insurer Plan (QIP) similar to that implemented by the Law Society of England and Wales, whereby individual members could buy coverage from any insurer that agreed to abide by contract terms.

7. The Chairman noted that in a letter sent to the Law Society from Li, Wong & Lam Solicitors (a copy of which was tabled at the meeting and subsequently circulated vide LC Paper No. CB(2)2312/00-01(01)), there was a table showing the value of claims by type of practice. She asked for an update on the figures for 1999/2000. In response, Mr Lawrence LEE provided the updated information as follows -

(Value of claims)

	Indemnity Year 1999/2000(\$)
Conveyancing	85,308,789
Commercial (reclassified)	0
Litigation	10,058,700
Probate	2,150,000
Miscellaneous	100,000
Total	97,617,489

8. Ms Emily LAU enquired about the implications of the huge amount of claims. Mr Vincent LIANG responded that the claims records in Hong Kong were not worse than that of comparable common law jurisdictions such as the United Kingdom. Mr Christopher HOWSE said that the problem, to a large extent, arose from conveyancing work. Historically, claims arising from conveyancing made up about 80% of the total value of claims in any year. The situation was exacerbated by the fall of the local property market, as many people looked for ways to get out of transactions they no longer wished to hold on to. Another contributing factor might be the change in conveyancing scale fees, i.e. the reduced fees charged by lawyers, which could possibly have affected the quality of work in certain cases. However, he said that he did not believe that the deterioration of the claims situation necessarily indicated that lawyers in Hong Kong were generally becoming more negligent.

9. Mr Albert HO asked whether it would be too late for a review as SIF had already signed the contract with the reinsurers as regards the new five-year plan. Referring to the option of QIP, he pointed out that the experience of some foreign jurisdictions was that it resulted in many small firms being driven out of practice because they could not afford to pay the high premium. Mr HO also asked whether the future enactment of the Land Titles Bill could help

alleviate the problems caused by conveyancing work.

10. Mr Vincent LIANG advised that a contract was signed with the reinsurers after the forum held in September 2000. If SIF were to break the contract on grounds other than that provided in the contract, SIF would be liable to pay damages. He said that if the Amendment Rules were repealed, there would be a danger that SIF would not be able to pay for the premiums, and hence the claims. He further pointed out that one of the major purposes of setting up a mutual professional indemnity fund, which was compulsory under the law, was to protect the interests of the general public against fraud and negligence by solicitors.

11. On the question of the Land Titles Bill, Mr Vincent LIANG said that he was not sure whether the enactment of the Bill could solve the problems with conveyancing. He pointed out that in England, where land titles statutes existed, there were still a lot of claims arising from conveyancing work.

12. Mr Anthony CHOW said that the Law Society was not at all opposed to the possible alternative of a QIP. However, there were substantial arguments about the advantages and disadvantages of a QIP. Also, there would be far-reaching consequences of conversion to such a scheme. All these would need to be fully evaluated before a decision could be taken. He pointed out that according to the experience elsewhere, one possible disadvantage of a QIP was that without a bulk-buying or bargaining power, individual firms, especially the small ones, would have to bear the burden of a much higher premium payment. Many were even forced out of business because of the inability to get insurance cover. Furthermore, there had been complaints that initial premium savings in the first year were negated by subsequent increases on renewal of the insurance policy.

13. The Chairman asked how the increase in premium would affect solicitors

firms of different businesses, and how it would impact on the legal services provided to the public. She said that she had received feedback opinion that many small solicitors firms operating with marginal profits would be forced out of business because of the increase in contribution which they could not afford to pay. Many of them were firms with good claims records and not engaging in conveyancing work. She also opined that the Law Society should do a research to analyse the effect of different professional liability insurance schemes on solicitors firms.

14. Mr Vincent LIANG said that the majority of small solicitors firms in Hong Kong in fact undertook conveyancing work. Under a scheme which was not a mutual liability scheme, small firms with previous claims records would find difficulty in getting insurance at a low premium. He added that the SIF was exploring ways to help its members in meeting the increased contribution, such as acquiring bank loans at prime interest rate. It was also looking into the feasibility of setting up a Premium Financing Programme to provide a more structured means of financing for its members.

15. Mr Chris ERVING opined that the Law Society had failed to consult its members fully on the situation and the problems created by the increase in contributions. He said that the forum in September 2000 was held at very short notice, and only about 65 members had attended. He added that as far as he understood, the idea of a Premium Financing Programme had never been mentioned to solicitors firms before.

16. Sharing the Chairman's views, Ms Miriam LAU opined that in view of the substantial increase in contribution introduced by the Amendment Rules, the Law Society should carrying out an in-depth analysis of the impact of the increase on different solicitors firms offering different types of legal services. She said that she well appreciated the demise of the small firms which were saddled with the increased contribution, as many of them were operating even

at negative profit under the current depressed business environment. She said that the law required that a solicitor must hold insurance before he could obtain a practising certificate. She had heard of some members of the profession saying that they would reconsider whether to apply for a practising certificate in view of the hefty increase in contribution.

17. Mr Vincent LIANG and Mr Christopher HOWSE advised that calculation of contribution to the Fund was based on a formula laid down in the Rules. The formula took into account a number of factors, including the number of principals of a firm, the number of assistant solicitors and consultants, and the gross fee income etc. Hence, it would be difficult for the Law Society to assess accurately the impact on individual firms without detailed knowledge of how the firms ran their business.

18. Ms Eudrey EU asked whether it was feasible to readjust the contribution payable by individual firms depending on their previous claims records so that, for example, those with good claims experience would be awarded a reduced rate in the form of a no-claim discount.

19. Mr Patrick MOSS said that the major problem with this proposal was that the shortfall in contributions would still have to be made up elsewhere, i.e. by the rest of the firms. Mr Christopher HOWSE added that a mutual indemnity scheme meant inevitably that there were cross-subsidisation between its members. In the context of the Scheme in Hong Kong, anecdotal evidence showed that firms which were heavily subsidising others in terms of contributions were the international big law firms, which did relatively little conveyancing or other high-risk work, as compared to the smaller firms. A consequence of switching to a non-mutual scheme, or a scheme with no-claims discount, would be that the big firms could pay for their insurance cover much cheaply, leaving the smaller firms in the situation of having to pay much higher premium than at present.

20. The Chairman said that this involved the question of who deserved to bear the blunt of higher premium. Some of the views she received were that it was unfair that the good should be subsidising the bad.

The way forward

21. In concluding the discussion, the Chairman said that the Amendment Rules had far-reaching impact and should therefore be considered by all parties in detail. She suggested and members agreed that the Panel should make a report to the House Committee on 5 October 2001 when the new legislative session commenced and recommend that a subcommittee be set up to scrutinise the Amendment Rules.

22. The Chairman added that some pertinent issues had been raised at this meeting which might warrant further discussion, e.g. how the proposed increase in contribution would affect law firms differently and the provision of legal services to the public, whether the amount of contribution should be based on the claims records and the nature of business of the firms, and whether other alternative schemes should be explored. She requested the Law Society and Horvath & Giles to do some fact-finding research on these issues to facilitate the deliberation of the subcommittee if formed.

Law Society /
Horvath &
Giles

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Legislative Council Secretariat

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