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Please Reply to: Dennis Lam

Our Ref 本行編號: DL/OFFICE

Date 日期: 27<sup>th</sup> September 2001**BY FAX (2845 0387)**

Mr. Herbert Tsoi  
The President  
The Law Society of Hong Kong  
3/F, Wing On House, Central  
Hong Kong

Dear Mr. Tsoi,

**Re: Professional Indemnity Insurance**

I refer to the meeting of the Panel on Administration of Justice and Legal Services ("Panel") held in the Legislative Council on 18<sup>th</sup> September 2001 at which I was present as an audience.

At that meeting, Ms. Margaret Ng confirmed that several members expressed concern about the significant increase of professional insurance premium. She proposed that The Law Society and the insurer provide more information about the operational mechanism and claims details of the Professional Insurance Indemnity Scheme ("Scheme").

Following the Panel meeting, I reviewed the response of The Law Society to the report submitted to the Panel by Messrs. Horvath & Giles and Erving Brettell ("Response") and exchanged views with Mr. Lawrence Lee of Aon Risk Services Hong Kong Ltd.

To assure the members that escalation of the premium is not due to mismanagement of the Scheme and to avoid causing conflict among firms of difference sizes, I suggest that The Law Society clarify the following issues to its members:

**1) Fundamental Reasons for the Poor Claims**

The members have been provided with a comprehensive history of the disastrous claims development since the indemnity year 1995/96 by The Law Society and the insurer.

However, no reason has been given about the cause of such losses. As you correctly stated in your letter of 7<sup>th</sup> September 2001, it is unrealistic to expect commercial insurers to underwrite at a loss and the cost of insurance is ultimately determined by the amount of claims. Changing re-insurance companies or taking advantage of the insurance cycle by signing an insurance contract with a longer tenure as proposed by the insurer would not reduce negligence claims as such solutions do not deal with the fundamental problems which appear to exist.

Unless The Law Society or the insurer reviews the fundamental reasons of the poor claims records of our profession and improves the risk-control measures, the standard of legal services in Hong Kong would not improve.

2) **High Management Fee**

According to the Income & Expenditure Account of Hong Kong Solicitors Indemnity Fund Ltd. ("SIF") for the year ended 30<sup>th</sup> September 2000, contributions from the members were HK\$94,551,739 while a management fee of HK\$9,485,551, equivalent to 10.03% of the contributions, was charged against SIF. There is no breakdown of such high management fee in the Annual Report of SIF.

Please clarify the calculation formula of such management fee and its services provided therefrom. In this connection, I repeat my earlier request that copies of the contracts between The Law Society and the insurer be provided to the members for reference.

3) **Low Efficiency of Claims Handling**

As advised by Mr. Lawrence Lee in the Forum, the purpose of having claims reserves is to cover claims payments in future. Therefore, if the claims handling system is managed efficiently, the total claims reserves in any particular year should be close to the total claims payments in the following indemnity year.

I attach Tables 2 and 5 of SIF's Annual Report incorporated with my claims analysis in the Schedule of this letter. The figures shown in Table 5 indicate an alarming deterioration of efficiency on handling of claims from around indemnity year 1996/97 and the amount of reserves has increased significantly while little progress has been made to process claims, in particular for indemnity year 1999/2000 when it dropped to HK\$1,692,647.00.

If the members are charged with management fees worth more than 10% of the contributions made each year but, as is evident from the example of 1998/99 and 1999/2000 when only 5 cases were settled in the former and only 1 case in the latter year as shown in Table 2 of SIF's Annual Report, the efficiency of claims management is in great doubt, bearing in mind there are over 500 outstanding claims which remain unresolved over these 2 indemnity years. Please comment.

4) Reserves Criteria

Since the members are not provided with copies of the insurance contracts with the insurer, it is impossible to ascertain whether the contributions made by the members or the reserves amount proposed would have any bearing on the management fee payable to Essar, as the Manager of the Scheme. Please advise.

Furthermore, please also confirm the actuarial guidelines for setting claims reserves and clarify why no reserve has been made on a large number of outstanding claims in the last few years as stated in Table 5.

5) Conflict of Interest

According to page 7 of SIF's Annual Report, Aon was appointed as the Broker of the Scheme while Essar, a subsidiary of Aon, was appointed as the Manager. As mentioned in the Annual Report, the Manager has responsibilities to monitor the claims and to advise SIF on the options provided by the Broker.

I am concerned whether the members are being provided with arm's length independent advice from the Manager in respect of the proposal made by its parent company, Aon. There appears to be a conflict of interest. Please comment.

6) Collapse of HIH

The insurer is of the view that the repositioning of the Scheme in 2000 by entering a new 5-year contract would have been a success if it were not disrupted by the failure of HIH.

The essence of entering insurance and re-insurance policies is to spread out the risk as much as possible and therefore reduce the financial impact to the insured. I understand that HIH underwrote 50% of the re-insurance policy and therefore the collapse of this one single re-insurance company is the main cause of the major impact on the members, who have to cover the short-fall of over HK\$370 million.

Please provide the members with the procedure and standards applied by Essar, as the Manager, to assess the financial viability of the underwriter recommended by Aon. As the insured who are now being asked to bear the cost of HIH's failure, it would appear that we have the right to receive such information.

7) Conclusion

There is no doubt that the legal industry in Hong Kong, as with all other business sectors, is presently undergoing a period of transition, and that a major consolidation of the industry is inevitable, following, inter alia, the Asian financial crisis and the abolition of conveyancing scaled fee system and, from a macro perspective, Hong Kong's continuing search for a position/identity as a part of Greater China.

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This is likely to result in the rationalisation of some member firms which are unable to face the new level of competition we are all forced to face and cannot continue to operate as viable businesses. Competitive as this may be, I believe that it is an inevitable and necessary development for our industry and would contribute towards maintaining the standard/quality of service produced by our profession in the long term.

Clarification by The Law Society on the points raised above and the issues mentioned in my letter of 17<sup>th</sup> September 2001 would help towards increasing our knowledge on how our insurance works and identifying the problems that we currently have in the industry so that the sector as a whole is better equipped to face the new business environment and can continue to offer a high standard of service to the public.

I very much look forward to receiving your reply.

Yours faithfully,



Dennis Lam  
Encl.

DL/kw

c.c. Ms. Margaret Ng- LegCo Member (Legal Profession Constituency)  
The Council Members  
Mr. Patrick Moss- Secretary General  
All Members

**SCHEDULE**

**Table 2**  
Progress of Claims by Claims Paid and Reserved as at 30<sup>th</sup> September 2000

Indemnity Year	Total Claim Payment		Total Claim Reserves		Total Paid and Reserved Claims
1987/88	13,890,880	100%	--	0%	13,890,880
1988/89	28,915,179	94.14%	1,801,372	5.86%	30,716,551
1989/90	12,470,291	90.61%	1,291,791	9.39%	13,762,082
1990/91	7,581,520	88.59%	976,672	11.41%	8,558,192
1991/92	8,630,877	86.27%	1,373,538	13.73%	10,004,415
1992/93	40,184,913	71.66%	15,892,123	28.33%	56,077,036
1993/94	27,289,336	56.61%	20,917,532	43.39%	48,206,868
1994/95	45,529,098	69.40%	20,072,124	30.59%	65,601,222
1995/96	56,098,656	45.30%	67,750,783	54.70%	123,849,439
1996/97	60,801,034	<b>56.46%</b>	46,890,019	<b>43.54%</b>	107,700,053
1997/98	74,354,257	<b>33.97%</b>	144,555,546	<b>66.03%</b>	218,909,803
1998/99	87,569,360	<b>24.99%</b>	262,906,942	<b>75.01%</b>	350,476,302
1999/00	1,692,647	<b>4.33%</b>	37,367,865	<b>95.67%</b>	39,060,512

**Table 5**  
Development of Settled and Unsettled Claims as at 30<sup>th</sup> September 2000

Indemnity Year	Claims Settled				Claims Outstanding			
	With Payment		Without Payment		With Reserve		Without Reserve	
87/88	24	45.28%	28	52.83%	0	0%	1	1.89%
88/89	22	20.56%	77	71.96%	6	5.61%	2	1.87%
89/90	25	29.76%	54	64.29%	2	2.38%	3	3.57%
90/91	13	19.12%	48	70.59%	2	2.94%	5	7.35%
91/92	12	13.33%	48	53.33%	9	10%	21	23.33%
92/93	29	25.66%	35	30.97%	16	14.16%	33	29.20%
93/94	16	15.68%	68	66.66%	6	5.88%	12	11.76%
94/95	20	13.51%	82	55.41%	14	9.46%	32	21.62%
95/96	19	12.58%	69	45.70%	41	27.15%	22	14.57%
96/97	16	<b>9.30%</b>	52	<b>30.23%</b>	39	<b>22.67%</b>	65	<b>37.79%</b>
97/98	17	<b>5.50%</b>	22	<b>7.10%</b>	77	<b>24.92%</b>	193	<b>62.46%</b>
98/99	5	<b>1.71%</b>	23	<b>7.88%</b>	108	<b>39.99%</b>	156	<b>53.42%</b>
99/00	1	<b>0.38%</b>	11	<b>4.18%</b>	40	<b>15.21%</b>	211	<b>80.23%</b>