THE LAW SOCIETY OF HONG KONG
香 港 律 師 會

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Executive Summary

(A) The appointment of the Broker/Manager to the Scheme had been subjected to tender prior to the 1 October 1998 renewal of the Scheme. Virtually all Hong Kong brokers were invited to tender and many did so, including Jardine Lloyd Thompson Ltd. (JLT), (the advisers on the Horvath & Giles ("H&G")Report)

Professional Indemnity Insurance is negotiated, not tendered.

(B) The current arrangement consists of Hong Kong Solicitors Indemnity Fund Limited ("HKSIF") providing cover to all Members up to a limit of $10 million per claim, and buying reinsurance for:

- $9 million excess of $1 million per claim (Excess of Loss reinsurance) – to become $8.5 million excess of $1.5 million at 1 October 2001.

- $100 million in the aggregate, excess of $90 million in the aggregate for 3 years, for the HKSIF retention of $1 million stop loss insurance.

(C) Since Scheme Year 1995/96 the claims experience has deteriorated badly and the last few years have been disastrous, The loss experience of the Scheme reinsurers has followed that of the Scheme itself with total premium from 1994/95 to 1998/99 of $229.4 million and losses of $546.3 million, and severe losses also on the stop loss insurance.

Neither reinsurers of a Fund nor insurers under a Qualified Insurer Plan (QIP) will absorb losses of this magnitude without drastic premium increases, and had a QIP been in effect it is quite likely that most insurers would have withdrawn from the market.

(D) It was apparent in the summer of 2000 that if the Scheme reinsurance was allowed to run to its natural expiry at 30 September 2001, the reinsurance costs would soar dramatically. The Law Society had instructed its Broker/Manager to investigate alternatives.

(E) Aon, the Broker/Manager, was able to persuade HIH and the other Excess of Loss reinsurers to agree, in consideration of them being released from the last year of a contract that was enormously disadvantageous to them, to issue if required a new 5 year non-cancellable programme with the essential premium increases phased in over the 5 years (and with premiums for the early years that were clearly inadequate to cover historic losses) in order that HKSIF might fund the increases over time rather than face the full brunt of the increase at renewal in 2001.

Three alternatives were examined. They were: a) do nothing, b) change the scheme to a QIP and c) cancel and rewrite. The Law Society in 2 separate circulars to members had informed members and also held a members forum before a final decision was made.

(F) Having reviewed the alternatives it was decided that to cancel and rewrite was the best choice in the circumstances.

(G) The Law Society decided that QIP though a programme worthy of further investigation could not be implemented immediately.

(H) At the same time consideration began to be given to a QIP similar to that being implemented at the time by the Law Society of England and Wales (LSE&W), whereby Members could buy coverage from any insurer that agreed to abide by contract terms and other provisions promulgated by the Society. Contrary to the inferences in the HoG Report, there can be strong disagreement about the appropriateness of such a plan. Along with the advantages, there are substantial disadvantages and serious issues which would need to be resolved, which would take a great deal of time and require legislative changes.

The principal advantages are:-

i) Competition among insurers for individual Members rather than just the Scheme as a whole.

ii) Removal of concern that some Members (particularly those who do not have substantial conveyancing practices) are subsidising others

iii) Sense of empowerment to Members who can negotiate their own terms.

The principal disadvantages are:-

i) No bulk-buying power nor bargaining power of the Law Society.

ii) Less guarantee of continuance of coverage.

(Both of these features were identified by JLT, the Advisor to H&G, in 1998 when they were arguing against a QIP as part of their Tender to be Broker/Manager).

iii) Less economic efficiency. The Scheme clearly costs less to operate than would a QIP which would pay brokerage and other costs.

iv) Lack of credit for investment income.

v) Commercial insurers may be influenced in their pricing by losses in other classes of business or parts of the world.

vi) Unless a Member is able to buy coverage from a Qualified Insurer, he would be unable to practise.

vii) Problem if an insurer becomes insolvent, as Members and the public are unprotected. This is not a problem for LSE&W as Policyholder Protection Board meets 90% of losses of Policyholders of an insolvent authorised UK insurance company.

viii) In hard markets, larger firms have more bargaining power, thus disadvantaging smaller ones.

ix) Difficulty providing cover for former Members who were not part of a current insured firm.

(I) The Society is not at all opposed to the concept of a QIP provided the advantages and disadvantages are fully considered, and the difficult issues resolved.

(J) The competitive open-market indications secured by JLT offer very attractive discounts. However, they are so low for a profession-wide basis (ranging from 36% to 73% of average Scheme losses for the last 5 years) that one has to question their viability and sustainability, particularly as the insurance market is starting to harden.

In England & Wales, after only 1 year, there are already documented complaints that first year premium savings have been almost negated by renewal increases, even in a no claim environment.

(K) Were it not for the insolvency of HIH, a major professional indemnity insurer writing around 50% of the Scheme reinsurance, the HKSIF would have been a success.

(L) The HIH insolvency is likely to eventually cause cash flow problems to HKSIF but it is hoped that annual contributions plus investment income will provide sufficient cash flow to cover losses until 2004/5.

(M) The Society has taken considerable steps following the HIH insolvency, including:-

i) replacing the HIH proportion with other reinsurers.

ii) commencing studies on cash-flow issues and exploring methods of ameliorating the situation such as loss portfolio transfer, alternative risk transfer, and loss deterioration patterns.

(N) Consequently it is the Society's plan to fully evaluate a conversion to a QIP in the light of the advantages, disadvantages, and issues to be resolved with a view to reporting to Members in 2004 and implementing such a Plan at 1 October 2005 if the Members so wish. This timetable will allow all aspects to be addressed including forLegCo to consider a Policyholder Protection Ordinance and Limitation of Liability for solicitors and other professionals and to learn from the experience of the LSE&W QIP after 5 years of existence.