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THE STRUCTURE OF THE PROFESSIONAL INDEMNITY SCHEME

HISTORICAL BACKGROUND

Introduction

The Law Society believes that it is in the best interests of the profession and the public to maintain a compulsory insurance scheme ("the Scheme") which indemnifies solicitors, including those who have ceased practice by reason of death or retirement, against negligence. The Scheme thus provides protection to both members of the profession and the public.

Prior to 1980 a large number of firms were not insured. This was because professional indemnity underwriters were scarce in the insurance market and those that existed were able to demand high premiums for the cover they offered. The underwriters could "pick and choose" their clients and were less inclined to underwrite firms without a proven "track record".

The Scheme resulting from a requirement for mandatory insurance for solicitors and their staff commenced operation in 1980 as a straightforward insurance arrangement. From 1980 to 1986, premiums increased substantially. By 1987, the Law Society replaced the commercial insurance arrangement with a partly self-insured scheme. The current arrangements are known as the Professional Indemnity Scheme and are run by the Law Society. The Scheme operates effectively by containing premiums and administrative costs.

Management

The Scheme is managed by the Hong Kong Solicitors Indemnity Fund Ltd. ("the Company") which was incorporated with limited liability by the Law Society in 1989. Its sole function is to manage and administer the Scheme. The Company has the power to delegate any aspect of the management and administration of the Scheme to a third party. All claims under the Scheme are handled by its Manager, Essar Insurance Services Ltd., which was appointed in 1988. An agreement exists between the Company and Essar wherein Essar is required to observe the confidentiality clause which precludes them from passing any confidential information, e.g. member firms' gross fee income and details of claims, to any third party. Essar negotiates with underwriters worldwide through its parent company, Aon, to obtain the best available cover at market rates.

COVER OFFERED BY THE SCHEME

From 1986 to 30 September 1994 the limit of liability for each and every claim was $5m (inclusive of costs). On 1 October, 1994 the amount of cover was increased by the Company to $10m (inclusive of costs). This increase was based on such factors as inflation and the substantial increase in the value of the property market.

The first $1m of each claim is paid from the self-insured fund. Every claim in excess of $1m but not more than $10m is met from the cover provided by "excess of loss" reinsurance. Some firms arrange their own "top-up" cover to meet claims in excess of $10m but this additional cover is a matter for each firm to determine and depends upon the type of work done and the risk attendant upon it.

The Scheme's previous 3-year "excess of loss" reinsurance programme which was due to expire on 30 September, 2001 was cancelled and replaced by a 5-year programme on 1 October, 2000. The 5-year programme provides the benefits of a longer term commitment from insurers which was difficult to secure because of the hard insurance market and the substantial increase in the value of claims over the past four years; a premium which was much lower than those quoted by other insurers; and a premium reduction in the following year if claims reduce in any one year during the 5-year contract.

The Scheme currently has a 3-year "stop loss" reinsurance arrangement which expires on 30 September, 2001. This means that once the Fund has exhausted its aggregate liability of $90 million at any time within the 3 year period stop loss insurers will pay up to $100 million to cover the Fund's liability of $1 million per claim. The purpose of "stop loss" insurance is to protect the Fund against a multiplicity of claims.

The Fund is further protected with a "drop down" arrangement whereby excess of loss underwriters will pay for all claims up to the Scheme's limit of liability of HK$10m per claim as soon as both the Fund's retention of HK$90m and "stop loss" insurance of HK$100m have been exhausted during the 3-year contract from 1 October, 1998 to 30 September, 2001.

BASIS OF CONTRIBUTION

The basic contribution payable by each member firm is calculated in accordance with the contribution assessment formula contained in the Solicitors (Professional Indemnity) Rules ("the rules") which govern the Scheme (see appendix 1). The formula was designed to take into account that every firm carries an element of risk but the element of risk attached to a firm with 10 solicitors and a small volume of business is not the same element of risk attached to a firm with 100 solicitors and a greater volume of business. Elements of the assessment are:-

1. firm's gross fee income; and

2. the number of solicitors it employs, whether they be partners, assistant solicitors or consultants.

Partners are assessed with a higher rate of premium based on the assumption that their responsibilities expose them to greater risks.

Claims-Loading

Claims-loading will be applied once the Scheme has made a payment on the Insured's behalf i.e. the firm will be claims-loaded for a period of 4 consecutive indemnity years. The loading is calculated in accordance with the factors established in the basic contribution assessment formula.

Deductible

Members firms are also required to pay a deductible or excess loading on each claim made. (Excess loading is a common practice in the insurance industry.) The deductible payable by sole-practitioners is $30,000 per claim. In the case of partnerships, the deductible is the first $20,000 of a claim multiplied by the number of partners and an additional $15,000 multiplied by the number of assistant solicitors and consultants with a cap being set at $200,000 for the very large firms.

The rules adopt the standard commercial insurance policy that the insurer reserves the right to repudiate indemnity on grounds of non-disclosure, misrepresentation or the perpetration of fraud by solicitors.

Investments

After payment of all expenses incurred by the Company on behalf of the Scheme the balance of contributions paid by each firm is invested with fund managers in order to maintain a prudent reserve.

Compulsory Cover

A major criticism of the Scheme is that members are deprived of the right to choose their own insurer, however, this is an illusory "right" given the reality of the market place. The benefits outweigh the "disadvantages" e.g. cover is guaranteed for all practising solicitors regardless of their claims experience, the cost of claims administration and premiums is minimised and the handling of claims is within the control of the profession.

The Law Society of Hong Kong
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