HONG KONG SOLICITORS INDEMNITY SCHEME

REVIEW OF INSURANCE ARRANGEMENTS

Review Report

28th November 2003

Willis

User Guide

We have organised this Report in five sections. Each section being more detailed than the one before it. The purpose of the structure is to allow the reader to delve into as much or as little information as they may require. The sections can be read sequentially and provide greater detail as the reader progresses from Section 1 through to Section 5.

From a top level approach, **Section 1** outlines the parameters needed to fully appreciate the other Sections in the Report.

Section 2 sets out conclusions, followed by supporting information on the grounds for these conclusions.

Section 3 provides a detailed analysis of the current scheme arrangements and the key issues behind our conclusions.

Section 4 details the different types of insurance arrangements that form the subject of this review.

Section 5 provides a comparison with the insurance arrangements in other common law jurisdictions.

A **general index** is provided, along with an **index of the tables** that are contained within this Report.

The appendices are also separately indexed at the front of that part of the Report for ease of reference for the reader.

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SECTION 1

1.1 OUR BRIEF

The brief to Willis is: -

To review the current insurance arrangements and to report on what insurance arrangements are in the best interests of the Legal profession and of the Public.

To consider and advise The Society and its Members **on whether at the expiration of the current insurance arrangements on 30th September 2005** The Society should **maintain** the **existing mutual scheme** with or without amendment, or **demutualise** the Scheme and put in place **other options** including a qualifying insurer scheme "QIS", freedom for all solicitors to purchase cover in the open market from an insurer of their choice or other combinations or methods likely to be available in the insurance market.

To review and consider other aspects (which are not exhaustive): -

- The appropriate **limit of indemnity** for cover
- The **geographical extent of cover** and any jurisdictional limitation on places or sovereign law for which Indemnity is best provided
- The desirability of a form of **no claim discount** or bonus operating differently from the existing claims loading on contributions for firms with paid claims
- The desirability of **risk banding** based on the type of practice activity or legal services provided by a firm
- The likely impact and desirability of adjustments to the existing
  - **Claims experience loading** formula
  - Insureds **deductible**
  - **Penalty deductibles** on defined criteria according to circumstances of a claim
- The appropriate **level of risk management** and the likely impact of risk management on the amount of premium demanded by insurers obtainable from the insurance market.

"QIS"

With respect to a **qualifying insurers' scheme** specific matters referred to be addressed are:-

- What criteria would best be used for an insurer to qualify.
- What protection for an insured or claimant might be available against a qualified insurer becoming insolvent and unable to pay claims.
- What minimum terms of cover could the members of the Profession and the Public realistically expect to obtain from the insurance market, for what period and in what circumstances.
- Is the creation and maintenance of an ARP catering for solicitors unable to obtain cover from the commercial insurance market feasible in Hong Kong.
- If an assigned risks pool is viable in Hong Kong, how is it best structured.

- What options are likely to be available to a firm and to the solicitors in it, if they cannot obtain cover at an affordable price either from a qualified insurer or an ARP. Are small Hong Kong firms likely to be exposed to being uninsurable and to what extent.

- If a QIS was adopted, what expectations of or requirements for risk management by solicitors are likely to result.

- If a QIS was operating, could the Law Society influence the manner in which claims were managed and/or exercise with insurers any role as an advocate or decision maker if decisions on the resolution of any claim were likely to affect either the public interest or the interest of the Profession.

Condition of Appointment

To eliminate any conflict of interest and to ensure independence with respect to this review, Willis has undertaken that for a period of five years it shall not, without the prior written consent of the Law Society, participate in the solicitors' primary professional indemnity market in Hong Kong.

1.2 KEY TERMS

ASSIGNED RISKS POOL (ARP)	A scheme established by a number of professional institutes where they recognise that sometimes members suffer claims which result in their insurance arrangements not being renewed on terms that may, in effect, put the Firm out of business. In some cases Firms suffer insurance problems through no direct fault of their own, perhaps as a result of the activities of a former partner or employee. In this event the member or members may not be able to comply in full with the professional indemnity insurance requirement. An ARP facility enables members to comply with the insurance regulations whilst they take action to rectify such problems that have led to them being declined insurance, see Appendix 2 (page 159).
AON	Aon Hong Kong Limited (formerly Aon Risk Services Hong Kong Limited)
CAPTIVE	A captive is similar to a mutual scheme, but it is conducted through the medium of a licensed insurer that is subject to similar regulation, but lower capital requirements as any licensed insurer. The Captive insures only the profession that owns it and operates for the benefit of its owner. Its management can be retained by representatives of the professional body or outsourced to a professional captive manager.
CHINA	The People's Republic of China, excluding the Special Administrative Region of Hong Kong
CLAIMS	Includes circumstances notified that might give rise to claims
CLAIMS COMMITTEE	The committee established by the Council of the Law Society for the purpose of and with power to, adjust, settle submit to arbitration, compromise, initiate, prosecute or defend all claims in favour of or against any members of the Law Society arising pursuant to the terms of the Rules.
CONTRIBUTION	The amount paid by solicitors as the price of indemnity. The equivalent of "premium".
ESSAR	Essar Insurance Services Ltd a wholly owned subsidiary of Aon and the manager of the Indemnity scheme
HK SIF	The Hong Kong Solicitors Indemnity Fund established under Rules 3-5 0f the Rules.

HK SIF Ltd	Hong Kong Solicitors Indemnity Fund Limited, a company limited by guarantee, and appointed to manage the Scheme by Rule 5 of the Rules according to the powers set out in Schedule 2 to the Rules.
HONG KONG	The Special Administrative Region of Hong Kong.
INDEMNITY/INSURANCE	It was decided in HONG KONG & SHANGHAI BANKING CORPORATION v HONG KONG SOLICITORS INDEMNITY FUND LTD (HCMP 411 of 1994) that the Hong Kong Solicitors Fund was not an "insurer" offering "insurance". The term insurance is sometimes used to describe the indemnity offered by the Fund for consistency and comparison with other insurance arrangements.
LOSS RATIO	The ratio of premium to claims losses incurred. 100% loss ratio means that premium equals incurred losses. Loss ratio of 200% means amount of claims losses is double the premium.
MASTER POLICY SCHEME	A master policy arrangement is one where a single insurance policy is issued by commercial insurers to a body representing the members of a profession and covers every member of the profession within limits and terms and for a premium that is predetermined by agreement between the master policy holder [The Society] and insurers.
MUTUAL FUND	This is an arrangement under which members of a group decide and agree to pool the risks of all of them and to contribute to the losses that might be incurred by all or any of them. The mutual sets the terms of indemnity to its members which are the same for all; the mutual sets the contribution each member must make and establishes the administrative arrangements for managing the mutual, appointing persons to manage, and the rules for calculating and collecting each members contribution, the management of claims, compliance with statutory requirements, investment of funds, control mechanisms such as voting rights and ultimately for winding up of the mutual and distribution of any of its remaining assets.
PIAC	The Professional Indemnity Advisory Committee that considers matters related to the Scheme referred to it by HKSIF, the Claims Committee, or the Council.
PANEL SOLICITORS	The Panel of solicitor's firms in Hong Kong appointed by the Society to handle claims against the members of the Society pursuant to the Rules
THE COUNCIL	The Council of the Hong Kong Law Society
THE DD	Discussion Document dated 30th October 2003 "Hong Kong Solicitors Indemnity Scheme Review of Insurance Arrangements" published by Willis (wherever reference is

	made to the discussion document by page number the page number will be prefaced by the letters DD)
THE HIH GROUP	FAI (HK) Limited FAI (Australia) Pty Ltd C E Heath Underwriting Agencies Limited HIH Management Limited HIH Management (Asia) Limited HIH Casualty & General Insurance Limited FAI First Pacific Limited
THE ORDINANCE	The Legal Practitioners Ordinance
THE SOCIETY	The Hong Kong Law Society
THE RULES	The Solicitors (Professional Indemnity) Rules
THE SCHEME	The Law Society Professional Indemnity Scheme established pursuant to section 73A of the Ordinance by the Solicitors Professional Indemnity Rules.
THE PROFESSION	All of the Solicitors of Hong Kong required to take out and maintain indemnity under the Rules as a precondition of legal practice.
QIS	Qualifying Insurer Scheme. An arrangement under which an insured professional qualifies to carry on business by purchasing cover from an insurer who has previously agreed to comply with qualifying pre-conditions set by the profession's representative body. [Presupposes that the insurer is otherwise authorised by law to trade as an insurer].

1.3 OUR APPROACH

Suitability, feasibility, sustainability and acceptability are the attributes we have used for our assessment. We have also considered three interests:

- The interests of the public,
- The interests of the profession as a whole,
- The interests of individual practices.

We consider that whatever structure of funding indemnity against claims is suitable needs to:

- Be fair to all three interests,
- Fully recognise the public interests,
- Provide the most effective environment to implement effective risk management.

Desirable principles in any future indemnity insurance arrangements include:

- Firms should have as much freedom of choice from competing sources if feasible,
- Cover should be provided at as low an overall long term cost to the profession as possible and ensure protection in all insurance market cycles,
- Contributions should be closely related to risk so that there is not excessive systematic cross-subsidy between identifiable firms or groups of firms, whether based on size of firm, type of work undertaken or previous claims records,
- The risk of substantial unforeseen claims on the profession should be minimised,
- The arrangement should encourage the avoidance of risk and the prompt reporting of claims.

Any solutions adopted in Hong Kong in 2005 when the present arrangements expire must be sustainable in all insurance market conditions. What is sustainable in 2005 can be reviewed as and when market conditions change. Presently the insurance market is in a hard cycle. In August 2000 and April 2001 when the current 5 year arrangement was negotiated, the market was in a softer cycle. Allowing for these significant variations in market forces is critical to an opinion on the feasibility and sustainability of any insurance arrangements.

1.4 BASIC INSURANCE BUSINESS BACKGROUND

To appreciate the observations, statistics and views, set out in this report it is essential to understand the concepts and ramifications of the underlying product it discusses which is a claims made "insurance" policy. If, or when, the current indemnity arrangements through HK SIF are stopped **there will be the cost of already notified claims to be funded in addition to whatever new arrangements are put in place from 2005 because of the nature of liabilities under a claims made cover.**

1.4.1 Event based cover - Claims made cover - Differences

The typical event based policy, such as a fire policy, provides for a period of indemnity and if during that period a loss event happens, that is damage to the insured property by fire, the insurer must pay the insured loss, subject to the terms of the policy.

Advantages to the insurer are that within a relatively short time the total amount of the **net loss** is known, and premiums can be adjusted to reflect the losses fairly quickly.

Assessment of all the costs of all loss events usually can be reliably estimated within a few months. This enables the insurer to estimate the **outstanding claims liabilities** on the fire insurance portfolio and to make accurate **outstanding claims provision.** At any period the insurer can estimate the **loss ratio**[1] fairly accurately. Profit can be distributed [if there was one] for a financial year free of the risk that the losses from fires in that year may increase in future years. Thus the insurer on a fire risks portfolio is able to evaluate the **underwriting result** for an **underwriting year** relatively quickly. This is called **short tail business.**

The typical professional indemnity cover is written on a claims made basis, as is the cover provided by HKSIF. The **indemnity** provided is for a **claim made** against the insured during the period of cover. The event that caused the loss (i.e. the delivery of the legal service) may have occurred at any time and is typically years before the **policy year** for which a premium is paid. The insurer's potential liability to pay the contracted indemnity to the insured crystallizes into an actual liability by the act of a **claimant** occurring during the period of cover.

Under the HKSIF the **claimant** who can activate the insurer's obligation to indemnify is both the insured solicitor who notifies insurers of circumstances that might give rise to a claim and any **third party** who makes or threatens a claim against, and to the insured solicitor. The indemnity given by HKSIF is called "claims made" **OR** "claims notified".

In the example of a fire policy, when a fire occurs an adjuster, builder, engineer, architect or some expert can examine the damage and quantify the cost of either repairing or replacing the insured property. This can be done relatively quickly.

Under HKSIF if a claimant alleges negligence against an insured solicitor the ability to quantify the net **loss,** not only takes a considerable time, but is not an accurate or scientific process.

Typically, a solicitor receives a letter of demand from a former client. To assess whether there is likely to be any loss and the quantum of that loss there must be an examination of the event from which the claim arises. The insured's file must be located, examined, explained or supplemented by the insured. Evidence of and particulars of the claimants alleged loss must be obtained. Once the information is available it must be evaluated to determine if the insured might be liable to the claimant and, if so, for how much. That evaluation process is itself a

[1] Loss Ratio - the ratio of premium to claims costs.

matter of opinion from solicitors and Counsel. In Hong Kong it is evaluated by the legal officers of Essar, without reference to the Claims Committee. Once proceedings are issued, and occasionally before that, panel solicitors advise and Essar establishes the reserves.

At annual intervals [minimally] an insurer must

- establish **loss ratios and the ultimate loss ratio** for the policy year
- determine premiums for the next policy year
- determine the **underwriting result**
- **make provision** for the payment of claims outstanding and which will be paid in future years from premium received in the current year, in other words set that money aside
- determine the **solvency** position of the insurer in light of the underwriting results
- report to the shareholders and the regulatory authority on the solvency of the insurer
- determine how much capacity the insurer has to renew existing business and to write new business in light of its total assets, liabilities outstanding claims liabilities, and administrative expenses while still maintaining a prudent **solvency margin**.

At any point in time, these determinations depend for their reliability on a reasonable prediction of the potential liability of insured solicitors to claimants, for amounts, that under the principles of the assessment of damages, are not precise.

The nature of the judicial process and of investigating the evidence is such that the average time that it takes for claims against solicitors to develop to the point where the **reserves** and provisions for the claims can accurately reflect the final underwriting result for all claims made in a year is typically 4-6 years. That period is called **"the development period"**. Finalisation of all of the claims for a policy year usually takes 10 to 12 years. Professional indemnity insurance is therefore referred to as being, **long tail** business.

The cover is for claims made during a specified period. The premium is paid to cover claims made in that period. Once that **period of indemnity** or **policy year** is finished, the time it takes to resolve, or close, all claims made, (or deemed to be made), within the indemnity period is called, **the Run-Off period**.

Accordingly, when considering any statistics about the claim losses in this paper, any "total incurred", or claims losses after 2000 are not yet developed enough to make direct comparisons with earlier years. When considering changing the arrangements the run-off must be managed.

At the point in time an insurer has to make the determinations set out above, many claims may be at different stages in their development. To establish a central estimate of outstanding claims liabilities, a prudent insurer uses the services of actuaries to evaluate the present value of future liabilities that have been reported in a policy year.

At the end of a **policy year** a loss has been made if the **paid claims** and **the outstanding claims liabilities** compare unfavourably to the premium from all insureds in the portfolio. For example: If a total gross premium for insuring 5,000 properties against loss or damage by fire for 12 months was $500,000, and the total claims from fires occurring during that same 12 months was $450,000 the **loss ratio** is 90%. The insurer has made a gross "profit" of 10%. To obtain the **underwriting result**, operating expenses, **underwriting expenses, brokerage** and past and future **claims handling costs** also need to be taken into account to give the **combined ratio**.

If the combined ratio for an indemnity period shows a loss, the insurer will most likely increase the premium for the next period or withdraw from that business. It is obvious from this that to set the following year's premiums for solicitors' professional indemnity insurance and not make a loss, accurate up-to-date reserves, or estimates of a solicitor's potential liability is crucial.

A prudent commercial insurer will expect a return on the **exposure** being insured. **Exposure** is the total risk. In the above example the exposure is 5000 properties. If the **limit of liability** under each of the 5000 policies is $1,000,000 the insurer's maximum exposure is $5 billion.

HK SIF has to operate in the same manner as a commercial insurer. Every six months ESSAR has reported to Hong Kong Solicitors Fund Limited of the paid and outstanding claims liabilities and the loss ratios for each policy year. The solvency margin of HK SIF has been determined in each year, audited by an independent auditor and the results published in an annual report to the profession.

1.4.2 Winding Up HKSIF

During our review consultations a number of solicitors have written or told us that they favour HK SIF being "wound up " rather than paying calls that are the equivalent of amounts that will not be recoverable from the HIH Group . That opinion was also agreed to by 78% of the 670 solicitors who responded to a survey conducted by Margaret Ng, Member of The Legislative Council, in October 2003.

Our terms of reference do not extend to considering how the consequences of the insolvency of the HIH Group for the Profession is best managed. We raise for consideration of those who must deliberate on winding up HK SIF the existence of the long tail and the number of claims outstanding. HK SIF is not an insurer under Hong Kong law.

That fact and the law of privity of contract may prevent any insured and any member of the public with a right to compensation from accessing the re-insurance that HK SIF has from other reinsurers. In the absence of legislation (such as Section 562A of the Australian Corporations Law) re-insurers have an obligation to indemnify the original assured and the ultimate insured in Hong Kong, the solicitor against whom a claim is made, cannot cut through to the re-insurers. The consequences of that for Hong Kong may be that in order to access the re-insurers who are not part of the HIH Group, HK SIF would need to remain until the last of the existing claims was finalised.

HK SIF is a statutory fund. We do not believe that it can be wound up according to normal insolvency procedures. The power to wind it up is laid down in the Rules, clause 14. That clause seems to require that HK SIF be maintained to provide indemnity until all the claims notified while HK SIF was the sole provider of indemnity are finalised.

We do not purport to offer a legal opinion on whether it is legally permissible to wind up HK SIF if a QIS or other arrangement is adopted from 2005. We raise the practicalities involved because HK SIF will need to continue until all claims are closed unless the run-off is out sourced. When any decision is made it must take account of the fact that if HK SIF is no longer the provider of indemnity from September 2005 going forward, other functions will need to be managed and will continue with respect to its operations extant from 1989.

The terms of indemnity provide run-off cover for retired or former solicitors. A solicitor who retired before 1st October 2005, if arrangements are changed then, could have a claim made against him or her after 2005. HKSIF would need to have funds to cover such claims or else leave the solicitor and the public unprotected. The only source of that funding would be the profession.

When England & Wales converted to a QIS they entered into a joint venture with an insurer who is managing the run-off. That same insurer is the managing general agency for the QIS scheme.

HK SIF could continue to outsource the management of the run-off to its current manager, Essar, but the cost would have to be collected from the profession. This is a ramification of cover being provided on a claims made basis. As at 30th September 2003 there were 1875 claims open for which HK SIF may or may not have a potential liability.

The fact to be noted is that 362 are claims, are still open and notified prior to 30th November 1998, 5 years ago. 105 are over 10 years ago. This is typical of long tail insurance. As at 30th September 2003 there are 1898 open files. After release of our Discussion Document, Essar advised us that there were 353 files to be closed. We recommend that the Society and HKSIF Ltd arrange for Essar to prepare a year by year list giving an update of the data in table 10 (page 91) once the files have been closed.

1.5 CONSULTATION DURING THE REVIEW

Throughout the period of the review we received written expressions of views and information from solicitors. We met with twenty five firms of solicitors who availed themselves of an invitation to consult and discuss the issues.

Two surveys were conducted. The first in November 2002 and the second in October 2003.The first was distributed to all Principals [approximately 1800] of Hong Kong firms, with 73 being returned. The second was distributed to every solicitor in private practice of whatever status. Wider distribution of the second survey was in response to a request voiced by a number of solicitors who attended a Symposium on 18th September 2003. We received 419 responses.

We also were given copies of letters written to the Society, to the Legislative Council Panel on Administration of Justice and Legal Services, to Aon and to HKSIF Ltd in which solicitors had raised matters affecting the Scheme. A Principals' Forum relating to the levy for the deficit caused by the insolvency of the HIH Group was held on 11th April 2003 and we received a copy of the transcript. A Members Forum for open discussion on the review itself was held on 25th November 2002 at which we and the Members had an opportunity to discuss matters of mutual interest affecting the insurance arrangements for solicitors in Hong Kong. A further meeting with members was held at a Symposium on 18th September 2003. Another open forum was held on 6th November 2003.

We have listed in Appendix 3 (page 166) the people we have interviewed, in addition to the twenty five firms mentioned above.

We have met with the steering committee whose members have knowledge of HKSIF. We have had frequent communication with Vivien Lee, Assistant Director Professional Indemnity Scheme to obtain background information. We also conferred with Essar. No details of any actual claims, or firms with claims could be disclosed to us.

In formulating our recommendations we are required to consider the insurance arrangements that are in the best interests of the Profession as well as of the Public. It is our belief that any arrangements ought not to be unacceptable to the majority of the Members of the Profession. We have carefully considered all views made known to us. We have assumed in the absence of any other cogent evidence that the views expressed are representative of the opinions and concerns of many of the members of the Profession.

We have been given a paper dated 26th October 2003 prepared by John Ku which addresses the validity of the process by which HK SIFL has called for contributions of the contingent liabilities of HK SIF in 2003. For the purpose of our review we have accepted a presumption of regularity and applied normal accounting actuarial and insurance practices which deem that contingent liabilities for claims incurred, but not paid at an accounting date are quantified and provided for by claims provisions. We do not purport to express any opinion on the method of the recoverability of those contingent liabilities, nor are we qualified to do so. The normal practice for the treatment of unpaid claims liabilities we have adopted is succinctly described in a background paper published by the Royal Commission into HIH entitled "General Principles of establishing outstanding claims provisions" Background Paper No.14 which is posted on the web site of the Royal Commission www.royalcom.gov.au

1.5.1 Executive Summary of Discussion Document

We Released a Discussion Document to the profession at the end of October 2003. We reproduce the relevant parts of the Executive Summary for ease of reference.

Published October 2003

1. *The purpose of this paper is to provide conceptual information about professional indemnity insurance and some forms of insurance vehicles commonly used by groups of professionals to insure against liability for errors and omissions. The paper is intended for consideration by solicitors in private practice in the Special Administrative Region of Hong Kong and their representative, the Law Society of Hong Kong (The Society). It considers professional indemnity insurance for solicitors provided solely and compulsorily by the Hong Kong Solicitors Indemnity Fund (HKSIF).*

   This paper is being released at this time to publicise our preliminary observations because The Society and its members request an opportunity to provide their views on the specific conclusions that we are considering before we finally report. It is intended to make this paper available on The Society's web site and its format has allowed for that medium.

2. *.....(APPENDIX NOT INCLUDED).....*

3. *The current professional indemnity arrangements under section 73 A of the Legal Practitioners Ordinance (The Ordinance) consisting of The Hong Kong Solicitors Indemnity Fund (HK SIF) administered by The Hong Kong Solicitors Indemnity Fund Ltd (HKSIFL) and Essar Insurance Services Ltd (Essar) are suitable and provide adequate protection of the interests of the public and of the Legal Profession as a whole. The arrangements are potentially sustainable and potentially feasible for the future, subject to consideration of a number of improvements to make them more acceptable to individual legal practices.*

4. *The current arrangements are unacceptable to an undetermined number of practices mainly because losses from claims, particularly in 1997 and 1998, combined with the insolvency of a major re-insurer of the liabilities of HK SIF, have caused a sharp increase in contributions over a short period. This is contrary to the main purposes of a mutual insurance scheme, which are to level out steep fluctuations in contributions and to protect solicitors by capping or transferring risk to limit the total liability which the Profession retains. There is also a perception that the extent to which good risks are subsidising bad risks is not fair and that the allocation of contributions among all solicitors ought to be more equitable and transparent.*

5. *The need for increases in contributions which have led to discontent with the current arrangements have been caused by:*

   A. *depressed economic activity in Hong Kong, particularly in the property market, and a decline in income of some firms whose business is heavily dependent on the buoyancy of the property market*

   B. *unexpectedly high losses on claims in 1996, 1997, 1998 and 1999, causing re-insurers to incur liabilities amounting to more than double the premium paid and rendering the profession vulnerable to increases in reinsurance premiums of 300%-400% for future years*

C. *insolvency of the HIH Group rendering the Profession potentially liable for the losses on past claims of HIH*

D. *the onset of a hard cycle in the commercial insurance market as a result of the global decline in returns on capital and years of underwriting losses further exacerbated by losses from the attack on the World Trade Centre on September 11th 2001*

which was an untimely combination of events.

6. *The Profession in Hong Kong is likely to remain vulnerable to setbacks in its claims experience, commercial insurance market cycles and possible re-insurer insolvency in the future. It can attempt to minimise the risk of claims by risk management programmes, but Hong Kong has no generally available facility, such as the English Policyholders Protection Act to give a safety net in case of insurer insolvency. It cannot control market conditions and even though The Fund is capable of delivering a saving on premiums by retaining HK$1.5 million of each claim, the profession and HK SIF cannot safely operate without re-insurance to limit the total exposure. The current dissatisfaction is due to the Profession having to pay for some risks that have occurred in claims because the re-insurance of part of the liabilities has failed. The Profession and the premium pool associated with it are not large enough to absorb the risk without reinsurance. This means that the Profession will always be affected by commercial market conditions as it cannot, due to its lack of critical mass compared with its claims experience, retain sufficient risk to achieve the full potential benefits that a mutual fund arrangement offers.*

7. *To achieve the appropriate level of protection of the public interest with public confidence in that protection, as well as the protection of individual practices and the Profession as a whole, the insurance arrangements must have minimum uniform terms and conditions which are acceptable to the public and to the profession. Although some practices have the skills and knowledge to be discerning purchasers of cover and to negotiate acceptable protection direct with insurers, some are unlikely to be able to achieve appropriate cover without help and guidance from the Profession's representative body, The Hong Kong Law Society (The Society). It follows that The Society must set minimum terms of cover for the whole profession. Once minimum terms of cover are set it is preferable that solicitors have the freedom to choose any insurer to provide that cover. In the Hong Kong insurance market it is a concern that sufficient insurers would provide insurance to enough of the profession to ensure the availability of the cover on the set terms required for the minimum level of consumer protection.*

8. *A scheme offering choice to individual practices to purchase cover on minimum terms and conditions from a number of insurers qualified to offer that insurance by agreement with The Society that any insurance provided would be no less favourable than the minimum terms and conditions (a QIS) would provide a feasible option. However, it is unlikely to be feasible in Hong Kong by 2005 because of the current hard cycle in the insurance market and the comparatively small premium pool of the Hong Kong profession. Hong Kong has about 6,000 solicitors. An appropriate premium pool in 2005 could be $HK 200,000,000 – 300,000,000. If only two insurers qualified and had equal market share, the potential profit to each compared with the risk is unlikely to attract them in the current climate. The administrative costs of entering the market and establishing local claims handling facilities would increase the cost. It is likely that large international firms would be able to arrange cover offshore as an adjunct to their firms international insurance programme. This would further decrease the pool available to attract insurers to qualify to insure the remainder. At present 16 firms with 15 or more partners contribute 25% of the premium pool. If 16 firms out of nearly 600 reduced the pool by 25% those remaining would be less likely to attract new insurers.*

If a qualifying insurer had to contribute to an assigned risks pool (ARP) to pay losses from firms who could not obtain insurance, then the number of insurers who would consider

qualifying is likely to be even less. A commercial monopoly might emerge which would have no more (probably less), benefit than a master policy arrangement.

The Profession in Hong Kong does not compare with England and Wales in size and the transposition of the experience there with a QIS to Hong Kong and an expectation of a similar result is not realistic.

9. *The arrangement most likely to afford the public and the profession the necessary level of cover, that is sustainable in the long term and over various market conditions, is either a master policy scheme or the current arrangements. The current arrangements, if continued, have the potential to lower the cost of cover. The extent to which they will do so compared to a master policy scheme will vary according to prevailing returns on investments, claims losses and the period involved.*

   The saving on annual premium is, in our view, not equivalent to the risk being assumed by the profession if it continues to retain some risk. Cheaper premiums from the present arrangements would decrease as the market softened. In the long term the savings must be balanced against the risk retained. Many lawyers will practise for 20-30 years and the arrangements are best considered over a similar period. Other non-financial benefits of retaining risk such as claims management input, access to data for risk management and the like, although of value do not tip the scales when balancing the transfer of all risk against retaining some risk. The current expression by solicitors of the unacceptability of the current arrangements is a natural reaction to the consequences of having retained risk, taken reasonable care to limit that risk, but suffered financially from the exposure nonetheless.

10. *The co-existence of a mutual arrangement with a QIS is probably not financially feasible.*

11. *Whether in 2005 the current arrangements continue or a master policy or a QIS is adopted, the profession has a continuing liability for past liabilities as a result of the insolvency of a re-insurer, the HIH Group. Past insurance premiums have been paid by the profession to the HIH for the benefit of the public as well as for the solicitors. It is therefore reasonable to share the burden of HIH's insolvency between the profession and the public as neither is responsible. It might be said that it is unreasonable for the public not to share that burden. We have referred to Ontario and the levying of a charge payable by clients on all real estate and court transactions. We consider that such a levy would not be unreasonable for a period with a sunset clause to relieve solicitors of consequences from insolvency of HIH. There is a precedent in Hong Kong with the scheme to compensate people from the consequences of insolvency or default of tour and travel organisers.*

12. *Our final Report will examine in more detail all of the matters we have been commissioned to review, discuss all options as well as identify factors that solicitors, the public, and those who represent them, need to consider in deciding what form of insurance is best for both their interests going forward from 2005.*

After the Discussion Document was posted on the Society's website and made available in paper copy, an advertised open forum was held on 6th November 2003. We received 12 written submissions from solicitors and conferred with four other solicitors. We also met Margaret Ng, Legislative Councillor who provided us with the results of a survey of the profession that she conducted. Essar wrote to us with comments on the Discussion Document. The transcript of the November 6th Forum is posted on the Society's website.

1.5.2 Size of firms consulted with

We were asked to disclose the size of the 25 firms with whom we had met. Those details appear below.

Size of Firms who Accepted Invitation to consult by Partners	
Sole Principal	2
2-3	6
4-5	2
6-10	4
11-15	2
16 and over	9

1.5.3 Analysis of responses to questionnaires

Hong Kong Law Society Professional Indemnity November 2002 and October 2003 Questionnaire Responses

From about 1,800 Questionnaires sent for the November 2002 Survey, 73 were returned.
From about 4,500 questionnaires sent for the October 2003 Survey, 419 were returned.

The 2002 survey to partners asked for the number of solicitors in the firm. The 2003 survey is size of firm by partners only.
The Results are as follows:-

Q1. Professional Indemnity Insurance for solicitors in Hong Kong is currently compulsory for solicitors. Do you agree it should be?

November 2002

Yes	68 %	No	32%	
1 Sol	**Yes**	55%	**No**	45%
2 S	**Yes**	66%	**No**	34%
3-5 S	**Yes**	77%	**No**	23%
6-10 S	**Yes**	60%	**No**	40%
11-15S	**Yes**	66%	**No**	34%
16-25S	**Yes**	85%	**No**	15%
26-35S	**Yes**	60%	**No**	40%
36-50S	**Yes**	50%	**No**	50%
51-75S	**Yes**	100%	**No**	0%

October 2003

Yes	66%	No	34%	
SP	**Yes**	61%	**No**	39%
2-5 P's	**Yes**	59%	**No**	41%
6-10 P's	**Yes**	74%	**No**	26%
11-20 P's	**Yes**	75%	**No**	25%
20+P's	**Yes**	71%	**No**	29%

Comment:
Making professional indemnity insurance for solicitors non-compulsory has been ruled out by the Administration and it is interesting to note that two thirds of the respondents agree this should be so.

Q2. Is it necessary for all solicitors to have cover for all fields of practice?

November 2002						October 2003
Yes	35%	No	52%	No Opinion	13%	N/A

1 Sol	**Yes**	27%	**No** 54%	**N/O**	19%
2 S	**Yes**	33%	**No** 55%	**N/O**	12%
3-5 S	**Yes**	33%	**No** 55%	**N/O**	12%
6-10 S	**Yes**	60%	**No** 30%	**N/O**	10%
11-15 S	**Yes**	33%	**No** 55%	**N/O**	12%
16-25 S	**Yes**	29%	**No** 57%	**N/O**	14%
26-35 S	**Yes**	20%	**No** 60%	**N/O**	20%
36-50 S	**Yes**	50%	**No** 50%	**N/O**	0%
51-75 S	**Yes**	50%	**No** 50%	**N/O**	0%

Q3. Would your firm prefer to arrange its own Insurance?

November 2002						October 2003				
Yes	60%	No	24%	No Opinion	16%	Yes	78%	No	28%	

1 Sol	**Yes**	45%	**No** 36%	**N/O**	19%	**SP**	**Yes**	84%	**No** 16%
2 S	**Yes**	45%	**No** 33%	**N/O**	22%	**2-5 P's**	**Yes**	75%	**No** 25%
3-5 S	**Yes**	78%	**No** 11%	**N/O**	11%	**6-10 P's**	**Yes**	72%	**No** 28%
6-10 S	**Yes**	70%	**No** 20%	**N/O**	10%	**11-20P's**	**Yes**	78%	**No** 22%
11-15S	**Yes**	56%	**No** 22%	**N/O**	22%	**20+P's**	**Yes**	88%	**No** 12%
16-25S	**Yes**	70%	**No** 15%	**N/O**	15%				
26-35S	**Yes**	40%	**No** 40%	**N/O**	20%				
36-50S	**Yes**	50%	**No** 50%	**N/O**	0%				
51-75S	**Yes**	50%	**No** 50%	**N/O**	0%				

Comment:
This question was asked to inform us and ultimately the Law Society of Hong Kong whether or not the profession considered that freedom of choice is an important factor.

Q4. Should those who have justified claims pay more than those with no claims?

November 2002						October 2003				
Yes	60%	No	26%	No Opinion	14%	Yes	83%	No	17%	

1 Sol	**Yes**	45%	**No** 36%	**N/O**	19%	**SP**	**Yes**	85%	**No** 15%
2 S	**Yes**	55%	**No** 33%	**N/O**	12%	**2-5 P's**	**Yes**	80%	**No** 20%
3-5 S	**Yes**	72%	**No** 17%	**N/O**	11%	**6-10 P's**	**Yes**	74%	**No** 26%
6-10 S	**Yes**	70%	**No** 20%	**N/O**	10%	**11-20 P's**	**Yes**	80%	**No** 20%
11-15 S	**Yes**	55%	**No** 33%	**N/O**	12%	**20+P's**	**Yes**	89%	**No** 11%
16-25 S	**Yes**	57%	**No** 29%	**N/O**	14%				
26-35 S	**Yes**	40%	**No** 20%	**N/O**	40%				
36-50 S	**Yes**	50%	**No** 50%	**N/O**	0%				
51-75 S	**Yes**	100%	**No** 0%	**N/O**	0%				

Comment:
In virtually all other jurisdictions and as a matter of natural justice and human nature this response was not unexpected. The responses indicate to us that the "user pays" principle is acceptable and appropriate in any insurance arrangements in Hong Kong.

Q5. If a firm has a claim against it which is successfully defended but costs not recovered, should that firm pay higher premiums than those who have never had a claim?

November 2002

Yes 38% No 42% No Opinion 20%

1 Sol	**Yes**	45%	**No**	44%	**N/O**	11%
2 S	**Yes**	66%	**No**	22%	**N/O**	12%
3-5 S	**Yes**	22%	**No**	61%	**N/O**	17%
6-10 S	**Yes**	50%	**No**	30%	**N/O**	20%
11-15 S	**Yes**	22%	**No**	55%	**N/O**	23%
16-25 S	**Yes**	29%	**No**	57%	**N/O**	14%
26-35 S	**Yes**	20%	**No**	20%	**N/O**	60%
36-50 S	**Yes**	50%	**No**	50%	**N/O**	0%
71-75S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

Yes 64% No 36%

SP	**Yes**	61%	**No**	39%
2-5 P's	**Yes**	67%	**No**	33%
6-10 P's	**Yes**	53%	**No**	47%
11-20 P's	**Yes**	78%	**No**	22%
20+P's	**Yes**	66%	**No**	34%

Comment:
This comment tested whether or not financial considerations were more important than principles of fairness in the event that a firm was subject to an unjustified claim. What was interesting was that the first survey was equally divided between the two schools in that 16% either had not thought about it or were not prepared to commit to an opinion. In the period between November 2002 and October 2003 the financial ramifications of the collapse of the HIH Group and increasing premiums were felt. We speculate this may have had some influence in turning the weight of opinion towards the financial ramifications rather than any underlying empathy with firms that have unjustified claims made against them. The rule in Hong Kong is that a deductible is payable by an insured when defence costs exceed the deductible. There is also a provision for waiver of the deductable (see also Q.9.5).

Q6. Would you approve of professional indemnity insurance arrangements if there was a risk that insurance could be declined to your firm because of one or more claims against you?

November 2002

Yes 38% No 37% No Opinion 25%

1 Sol	**Yes**	27%	**No**	55%	**N/O**	18%
2 S	**Yes**	55%	**No**	11%	**N/O**	34%
3-5 S	**Yes**	28%	**No**	44%	**N/O**	28%
6-10 S	**Yes**	50%	**No**	30%	**N/O**	20%
11-15 S	**Yes**	33%	**No**	55%	**N/O**	12%
16-25 S	**Yes**	57%	**No**	14%	**N/O**	29%
26-35 S	**Yes**	20%	**No**	40%	**N/O**	40%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	0%	**No**	100%	**N/O**	0%

October 2003

Yes 66% No 34%

SP	**Yes**	77%	**No**	23%
2-5 P's	**Yes**	67%	**No**	33%
6-10 P's	**Yes**	61%	**No**	39%
11-20P's	**Yes**	85%	**No**	15%
20+P's	**Yes**	45%	**No**	55%

Comment:
This question was deliberately drafted using the words "your firm" to turn the minds of Principals, to whom the first questionnaire was sent, to their own personal circumstances if they were declined insurance. The results indicate that two thirds of the respondents would find it acceptable to lose their right to practise if they had claims against them and were unable to obtain insurance. The same question was asked again twice in different forms (see Q7 & Q9.9). The fundamental principle which underlies any mutual arrangement, whether it is a mutual fund, such as HKSIF, a captive insurer, a master policy or an assigned risk pool, is on the acceptance that, for some greater good, members of a group agree to subsidise each other for their mutual advantage. It is always argued in a number of jurisdictions that it is the Judicial system or the Law Society or other

regulatory body that should control whether a professional continues to practise, not insurance companies. The three questions were designed to test whether solicitors of Hong Kong ascribed to that approach, or whether they would find it acceptable to have firms driven out of practice and solicitors unable to exercise their earning capacity because of claims. Five responses said that it depended on the facts and size of the claims.

Q7. Is it preferable for a firm to be driven out of practice if it has large claims than for firms with no claims to subsidise the losses by higher premiums?

November 2002

Yes 56% No 27% No Opinion 17%

1 Sol	**Yes**	55%	**No**	36%	**N/O**	9%
2 S	**Yes**	55%	**No**	23%	**N/O**	22%
3-5 S	**Yes**	55%	**No**	23%	**N/O**	22%
6-10 S	**Yes**	70%	**No**	20%	**N/O**	10%
11-15S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25S	**Yes**	57%	**No**	29%	**N/O**	14%
26-35S	**Yes**	20%	**No**	40%	**N/O**	40%
36-50S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75S	**Yes**	50%	**No**	50%	**N/O**	0%

October 2003

Yes 70% No 30%

SP	**Yes**	75%	**No**	25%
2-5 P's	**Yes**	57%	**No**	43%
6-10 P's	**Yes**	74%	**No**	26%
11-20P's	**Yes**	85%	**No**	15%
20+P's	**Yes**	86%	**No**	14%

Q8. The preferred method of obtaining professional indemnity insurance is through:-

October 2003

N/A

November 2002

i A Mutual fund scheme 6%
ii Master policy for all solicitors through the insurance market 10%
iii Purchase in the open market from any insurer chosen 19%
iv Purchase from a number of insurers approved by the Law Society as they offer adequate cover 19%
Both i + iv 3%
Both ii + iii 4%
Both i + iii 3%
Both iii + iv 25%
Both i + ii + iv 1%
Both ii + iv 4%

Comment:
We have reproduced only the statistics here. The responses to this question included a great number of individual comments which were not possible to analyse to determine any consensus. We did not repeat this question in our second survey, both due to the difficulty of analysis and because we came to the conclusion that it is for the members of the profession, the Society, the Chief Justice and the Administration of Hong Kong to determine their **preferred** method, and because Margaret Ng of the Legislative Council had conducted a survey in September 2001, covering the same aspect the results of which were given to us.

Q9. Do you consider the following features of Professional Indemnity cover to be essential, regardless of their impact on premium?

Comment:
Each of the matters inquired about in this series of questions are generally considered in a number of jurisdictions to be the minimum essential terms to protect the public interest. All of these features of the cover (except one) exist under HK SIF. It was interesting to note that the majority, in some cases, the great majority, agreed that such features were essential. We invite comparison of the responses to Q.9 with responses from insurers set out later in Section 3.4 page.....

Q9.1 Insurer cannot deny agreed cover to claimant for any reason

November 2002

Yes 40% No 44% No Opinion 16%

1 Sol	**Yes**	55%	**No**	27%	**N/O**	18%
2 S	**Yes**	33%	**No**	55%	**N/O**	12%
3-5 S	**Yes**	55%	**No**	27%	**N/O**	18%
6-10 S	**Yes**	20%	**No**	60%	**N/O**	20%
11-15 S	**Yes**	33%	**No**	55%	**N/O**	12%
16-25 S	**Yes**	29%	**No**	58%	**N/O**	13%
26-35 S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50 S	**Yes**	0%	**No**	100%	**N/O**	0%
51-75 S	**Yes**	50%	**No**	50%	**N/O**	0%

October 2003

Yes 58% No 42%

SP	**Yes**	67%	**No**	33%
2-5 P's	**Yes**	49%	**No**	51%
6-10 P's	**Yes**	68%	**No**	32%
11-20P's	**Yes**	33%	**No**	67%
20+P's	**Yes**	71%	**No**	29%

Comment:
It is our opinion that a term such as this will be unavailable in the open insurance market at the present time and probably in 2005.

Q9.2 Continued Indemnity after death or retirement for prior work for no additional premium

November 2002

Yes 44% No 33% No Opinion 23%

1 Sol	**Yes**	55%	**No**	18 %	**N/O**	27%
2 S	**Yes**	22%	**No**	55%	**N/O**	23%
3-5 S	**Yes**	50%	**No**	27%	**N/O**	23%
6-10 S	**Yes**	50%	**No**	40%	**N/O**	10%
11-15S	**Yes**	22%	**No**	44%	**N/O**	34%
16-25S	**Yes**	43%	**No**	29%	**N/O**	28%
26-35S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50S	**Yes**	50%	**No**	50%	**N/O**	0%
51-75S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

Yes 64% No 36%

SP	**Yes**	69%	**No**	31%
2-5 P's	**Yes**	69%	**No**	31%
6-10 P's	**Yes**	66%	**No**	34%
11-20P's	**Yes**	28%	**No**	72%
20+P's	**Yes**	70%	**No**	30%

Comment:
We have some doubts about whether unlimited run-off in these terms will be available in the current insurance market. If a QIS is established with this as a term it is unlikely that the run-off period will be open-ended. It may be possible to obtain run-off cover either for a fixed period and/or on payment of a premium. (In England & Wales in a soft cycle of the insurance market with the promise of a premium pool considerably larger than in Hong Kong the Law Society of England & Wales were able to negotiate run-off cover for a period of 6 years. If this cover is available in the open market the cost of it will be passed on to solicitors insuring with commercial insurers) in their premium.

Q9.3.a Indemnity to innocent partners in the event of - fraud by an employee

November 2002

Yes 51% No 34% No Opinion 15%

1 Sol	**Yes**	45%	**No** 36%	**N/O**	19%
2 S	**Yes**	55%	**No** 33%	**N/O**	12%
3-5 S	**Yes**	44%	**No** 38%	**N/O**	18%
6-10 S	**Yes**	60%	**No** 30%	**N/O**	10%
11-15 S	**Yes**	33%	**No** 55%	**N/O**	12%
16-25 S	**Yes**	57%	**No** 29%	**N/O**	14%
26-35 S	**Yes**	40%	**No** 20%	**N/O**	40%
36-50 S	**Yes**	100%	**No** 0%	**N/O**	0%
51-75 S	**Yes**	100%	**No** 0%	**N/O**	0%

October 2003

Yes 68% No 32%

SP	**Yes**	80%	**No**	20%
2-5 P's	**Yes**	70%	**No**	30%
6-10 P's	**Yes**	71%	**No**	29%
11-20 P's	**Yes**	35%	**No**	65%
20+P's	**Yes**	66%	**No**	34%

Q9.3.b. fraud by a partner

November 2002

Yes 54% No 30% No Opinion 16%

1 Sol	**Yes**	55%	**No** 27%	**N/O**	18%
2 S	**Yes**	55%	**No** 33%	**N/O**	12%
3-5 S	**Yes**	55%	**No** 27%	**N/O**	18%
6-10 S	**Yes**	70%	**No** 20%	**N/O**	10%
11-15 S	**Yes**	22%	**No** 55%	**N/O**	23%
16-25 S	**Yes**	57%	**No** 29%	**N/O**	14%
26-35S	**Yes**	20%	**No** 40%	**N/O**	40%
36-50S	**Yes**	100%	**No** 0%	**N/O**	0%
51-75S	**Yes**	100%	**No** 0%	**N/O**	0%

October 2003

Yes 66% No 34%

SP	**Yes**	79%	**No**	21%
2-5 P's	**Yes**	70%	**No**	30%
6-10 P's	**Yes**	45%	**No**	55%
11-20P's	**Yes**	68%	**No**	32%
20+P's	**Yes**	71%	**No**	29%

Comment:
Cover for dishonesty/fraud by employees or Principals is most commonly the subject of additional premium in the commercial market and provided by way of an extension to basic cover. Sole Practitioners do not need innocent partner cover.

Q9.4 A deductible that is limited to a reasonable percentage of the sum insured

November 2002

Yes 60% No 23% No Opinion 17%

1 Sol	**Yes**	55%	**No** 27%	**N/O**	18%
2 S	**Yes**	66%	**No** 22%	**N/O**	12%
3-5 S	**Yes**	61%	**No** 22%	**N/O**	17%
6-10 S	**Yes**	70%	**No** 20%	**N/O**	10%
11-15S	**Yes**	55%	**No** 33%	**N/O**	12%
16-25S	**Yes**	57%	**No** 14%	**N/O**	29%
26-35S	**Yes**	40%	**No** 20%	**N/O**	40%
36-50S	**Yes**	100%	**No** 0%	**N/O**	0%
51-75S	**Yes**	50%	**No** 50%	**N/O**	0%

October 2003

Yes 64% No 36%

SP	**Yes**	82%	**No**	18%
2-5 P's	**Yes**	63%	**No**	37%
6-10 P's	**Yes**	39%	**No**	61%
11-20 P's	**Yes**	88%	**No**	12%
20+ P's	**Yes**	73%	**No**	27%

Comment:
Since a QIS was established in England &Wales, qualifying insurers who are bound to provide the minimum terms set by the Law Society have increased deductibles as an alternative to increasing the premium. Once a deductible becomes too high the public cannot be assured of compensation for the amount of the deductible. If the deductible becomes unreasonably high compared with the overall limit of indemnity, public protection is reduced. Under the terms and conditions that are set by the Law Society in England & Wales regardless of the size of the deductible/excess, the qualifying insurer must still remain liable for the full amount of the limit of indemnity.

Q9.5 No payment of the deductible due to incurred defence costs, if the claim is successfully defended

November 2002

Yes 58% No 23% No Opinion 19%

1 Sol	**Yes**	64%	**No**	18%	**N/O**	18%
2 S	**Yes**	55%	**No**	33%	**N/O**	12%
3-5 S	**Yes**	55%	**No**	23%	**N/O**	22%
6-10 S	**Yes**	70%	**No**	20%	**N/O**	10%
11-15 S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25 S	**Yes**	57%	**No**	14%	**N/O**	29%
26-35 S	**Yes**	20%	**No**	20%	**N/O**	60%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	50%	**No**	50%	**N/O**	0%

October 2003

Yes 59% No 41%

SP	**Yes**	77%	**No**	23%
2-5 P's	**Yes**	64%	**No**	36%
6-10 P's	**Yes**	43%	**No**	57%
11-20 P's	**Yes**	38%	**No**	62%
20+ P's	**Yes**	68%	**No**	32%

Comment:
This question asked the same question asked by question 5, but reversed the order. We infer that the difference in the results is because question 5 asked about who should pay, firms with claims or firms with no claims. Question 9.6 asks the same question in a more impartial way. To be logically consistent the "yes" response to Question 5 and the "no" response to this question ought to be the same.

Q9.6 A dispute resolution mechanism if the insurer wishes to settle a claim against the Insured's wishes

November 2002

Yes 61% No 26% No Opinion 13%

1 Sol	**Yes**	64%	**No**	27%	**N/O**	9%
2 S	**Yes**	44%	**No**	33%	**N/O**	23%
3-5 S	**Yes**	72%	**No**	16%	**N/O**	12%
6-10S	**Yes**	80%	**No**	10%	**N/O**	10%
11-15 S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25 S	**Yes**	57%	**No**	29%	**N/O**	14%
26-35 S	**Yes**	20%	**No**	20%	**N/O**	60%
36-50S	**Yes**	0%	**No**	100%	**N/O**	0%
51-75S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

Yes 74% No 26%

SP	**Yes**	82%	**No**	18%
2-5 P's	**Yes**	66%	**No**	34%
10P's	**Yes**	77%	**No**	23%
11-20 P's	**Yes**	88%	**No**	12%
20+P's	**Yes**	70%	**No**	30%

Q9.7 No policy exclusions that leaves a solicitor unprotected for the usual activities of legal practice

November 2002

Yes 60% No 23% No Opinion 17%

1 Sol	**Yes**	55%	**No**	18%	**N/O**	27%
2 S	**Yes**	44%	**No**	33%	**N/O**	23%
3-5 S	**Yes**	72%	**No**	22%	**N/O**	6%
6-10 S	**Yes**	70%	**No**	20%	**N/O**	10%
11-15 S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25 S	**Yes**	57%	**No**	14%	**N/O**	29%
26-35 S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50 S	**Yes**	50%	**No**	50%	**N/O**	0%
51-75 S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

Yes 75% No 25%

SP	**Yes**	82%	**No**	18%
2-5 P's	**Yes**	73%	**No**	27%
6-10 P's	**Yes**	78%	**No**	22%
11-20 P's	**Yes**	85%	**No**	15%
20+ P's	**Yes**	64%	**No**	36%

Q9.8 No firm/solicitor can be denied insurance

November 2002

Yes 34% No 41% No Opinion 25%

1 Sol	**Yes**	64%	**No**	27%	**N/O**	9%
2 S	**Yes**	22%	**No**	55%	**N/O**	23%
3-5 S	**Yes**	27%	**No**	55%	**N/O**	18%
6-10 S	**Yes**	20%	**No**	60%	**N/O**	20%
11-15 S	**Yes**	34%	**No**	33%	**N/O**	33%
16-25 S	**Yes**	71%	**No**	14%	**N/O**	15%
26-35 S	**Yes**	20%	**No**	20%	**N/O**	60%
36-50 S	**Yes**	50%	**No**	0%	**N/O**	50%
51-75 S	**Yes**	50%	**No**	50%	**N/O**	0%

October 2003

Yes 53% No 47%

SP	**Yes**	59%	**No**	41%
2-5 P's	**Yes**	42%	**No**	58%
6-10 P's	**Yes**	73%	**No**	27%
11-20 P's	**Yes**	75%	**No**	25%
20+ P's	**Yes**	27%	**No**	73%

Comment:
The response to this question is to be compared with the response to questions 6 and 7. Question 7 shows a large majority accepting that a firm ought to be driven out of practice rather than be subsidised by firms with no claims. The response to question 6 shows the same acceptance of firms being driven out of practice because of claims. The responses to 9.9 however have roughly half the profession indicating that they think it is essential that no firm or solicitor be denied insurance.

Q9.9 Indemnity limit to be for each and every claim rather than a total limit for all claims in a year.

November 2002

N/A

October 2003

Yes 76% No 24%

SP	**Yes**	77%	**No**	23%
2-5 P's	**Yes**	78%	**No**	22%
6-10 P's	**Yes**	75%	**No**	25%
11-20 P's	**Yes**	75%	**No**	25%
20+ P's	**Yes**	71%	**No**	29%

Q9.10 Insurer cannot deny agreed cover to insured except in case of fraud

November 2002 | **October 2003**

Yes 58% No 26% No Opinion 16% N/A

1 Sol	**Yes**	55%	**No**	27%	**N/O**	18%
2 S	**Yes**	55%	**No**	33%	**N/O**	12%
3-5 S	**Yes**	66%	**No**	16%	**N/O**	18%
6-10 S	**Yes**	50%	**No**	40%	**N/O**	10%
11-15 S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25 S	**Yes**	71%	**No**	14%	**N/O**	15%
26-35 S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50 S	**Yes**	50%	**No**	0%	**N/O**	50%
51-75 S	**Yes**	50%	**No**	50%	**N/O**	0%

Q9.11 No right of set off by insurer of amount due from insured but full payment of insurer's liability to claimant even if breach of conditions by insured solicitors

November 2002 | **October 2003**

Yes 45% No 30% No Opinion 25% N/A

1 Sol	**Yes**	45%	**No**	36%	**N/O**	19%
2 S	**Yes**	44%	**No**	33%	**N/O**	23%
3-5 S	**Yes**	38%	**No**	33%	**N/O**	29%
6-10 S	**Yes**	60%	**No**	20%	**N/O**	20%
11-15 S	**Yes**	44%	**No**	33%	**N/O**	23%
16-25 S	**Yes**	43%	**No**	14%	**N/O**	43%
26-35 S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	0%	**No**	100%	**N/O**	0%

Comment:
A term such as this in any indemnity policy ensures that a member of the public who is entitled to compensation will receive it and, leaving the insurers to recover from the insured solicitor if there is any breach of the terms and conditions of the policy. The same guarantee to a member of the public is contained in the Rules (Schedule 3 paragraph 7(2)). We do not think it feasible for such a term to be available in the commercial insurance market during a hard cycle such as is being experienced at the present time and which is likely to continue in 2005 when the current insurance arrangements for Hong Kong Solicitors expire. We consider a term such as this to be fundamental for the minimum level of protection for the public.

Q10. If a scheme of PI Insurance exists which is mandatory for all, risk management procedures are essential and should be compulsory for all?

November 2002

Yes 53% No 26% No opinion 21%

1 Sol	**Yes**	55%	**No**	27%	**N/O**	18%
2 S	**Yes**	55%	**No**	33%	**N/O**	12%
3-5 S	**Yes**	66%	**No**	22%	**N/O**	12%
6-10 S	**Yes**	50%	**No**	10%	**N/O**	40%
11-15 S	**Yes**	44%	**No**	22%	**N/O**	34%
16-25 S	**Yes**	29%	**No**	57%	**N/O**	14%
26-35 S	**Yes**	40%	**No**	20%	**N/O**	40%
36-50 S	**Yes**	50%	**No**	50%	**N/O**	0%
51-75 S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

N/A

Comment:
We did not repeat this question in the October 2003 survey as in the interim the Legal Practitioners (Risk Management Education) Rules and incidental amendments to the Admission and Registration (Amendment (NO.2)) Rules 2002 and other incidental amendments came into force, whereby risk management education has become compulsory for solicitors in Hong Kong

Q11. The appropriate level of indemnity should be HK$10m?

November 2002

Yes 56% No 27% No Opinion 17%

1 Sol	**Yes**	55%	**No**	27%	**N/O**	18%
2 S	**Yes**	55%	**No**	33%	**N/O**	22%
3-5 S	**Yes**	50%	**No**	33%	**N/O**	17%
6-10 S	**Yes**	60%	**No**	30%	**N/O**	10%
11-15 S	**Yes**	66%	**No**	11%	**N/O**	23%
16-25 S	**Yes**	57%	**No**	29%	**N/O**	24%
26-35 S	**Yes**	20%	**No**	40%	**N/O**	40%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	100%	**No**	0%	**N/O**	0%

October 2003

Yes 48% No 52%

SP	**Yes**	66%	**No**	34%
2-5 P's	**Yes**	39%	**No**	61%
6-10 P's	**Yes**	71%	**No**	29%
11-20 P's	**Yes**	28%	**No**	72%
20+ P's	**Yes**	32%	**No**	68%

Q12. Are you satisfied with the current professional indemnity arrangements for solicitors in Hong Kong?

November 2002

Yes 25% No 59% No Opinion 16%

1 Sol	**Yes**	18%	**No**	64%	**N/O**	18%
2 S	**Yes**	22%	**No**	55%	**N/O**	23%
3-5 S	**Yes**	22%	**No**	61%	**N/O**	17%
6-10 S	**Yes**	30%	**No**	60%	**N/O**	10%
11-15 S	**Yes**	33%	**No**	44%	**N/O**	23%
16-25 S	**Yes**	0%	**No**	86%	**N/O**	14%
26-35 S	**Yes**	40%	**No**	40%	**N/O**	20%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	0%	**No**	100%	**N/O**	0%

October 2003

Yes 34% No 66%

SP	**Yes**	39%	**No**	61%
2-5 P's	**Yes**	30%	**No**	70%
6-10 P's	**Yes**	40%	**No**	60%
11-20 P's	**Yes**	43%	**No**	57%
20+ P's	**Yes**	25%	**No**	75%

Comment:
We believe that any indemnity arrangements for a group which is to be on a mutual basis ought to be acceptable to that group as far as possible allowing for the public interest only. In asking that question we were looking for some indication of what was acceptable. What was most interesting was that in November 2002, 80% of respondents said that they were not satisfied and that percentage dropped to 66% over 2003. Given that during the interim two calls had been made which were additional to the normal contributions we would have expected the opposite result, namely, more dissatisfaction in October 2003 than a year earlier. The size of the sample is probably significant to explain that.

Q13. Do you consider that where the only choice for a firm is to pay an increased premium or reduce the breadth of their insurance cover, it is better to reduce the cover?

November 2002

Yes 56% No 27% No Opinion 17%

1 Sol	**Yes**	55%	**No**	27%	**N/O**	18%
2 S	**Yes**	55%	**No**	33%	**N/O**	12%
3-5 S	**Yes**	44%	**No**	33%	**N/O**	23%
6-10 S	**Yes**	70%	**No**	10%	**N/O**	20%
11-15 S	**Yes**	55%	**No**	33%	**N/O**	12%
16-25 S	**Yes**	57%	**No**	29%	**N/O**	14%
26-35 S	**Yes**	60%	**No**	20%	**N/O**	20%
36-50 S	**Yes**	100%	**No**	0%	**N/O**	0%
51-75 S	**Yes**	50%	**No**	50%	**N/O**	0%

October 2003

Yes 68% No 32%

SP	**Yes**	72%	**No**	28%
2-5 P's	**Yes**	64%	**No**	36%
6-10 P's	**Yes**	80%	**No**	20%
11-20 P's	**Yes**	78%	**No**	22%
20+ P's	**Yes**	45%	**No**	55%

Comment:
In asking this question we were testing how important price was compared to protection. We took the responses to be solicitors' perception of their needs for protection not that of the public.

Q14. Do you consider that the good standing, reputation and public confidence in the whole of the Hong Kong legal profession is an appropriate factor to take into account when considering the professional indemnity arrangements, even if it effects the level of premium paid?

November 2002

Yes 26% No 64% No Opinion 10%

1 Sol	**Yes**	27%	**No**	64%	**N/O**	9%
2 S	**Yes**	22%	**No**	66%	**N/O**	12%
3-5 S	**Yes**	27%	**No**	55%	**N/O**	18%
6-10 S	**Yes**	20%	**No**	70%	**N/O**	10%
11-15 S	**Yes**	34%	**No**	66%	**N/O**	0%
16-25 S	**Yes**	29%	**No**	71%	**N/O**	0%
26-35 S	**Yes**	40%	**No**	40%	**N/O**	20%
36-50 S	**Yes**	0%	**No**	100%	**N/O**	0%
51-75 S	**Yes**	0%	**No**	100%	**N/O**	0%

October 2003

Yes 58% No 42%

SP	**Yes**	41%	**No**	59%
2-5 P's	**Yes**	45%	**No**	55%
6-10 P's	**Yes**	77%	**No**	23%
11-20 P's	**Yes**	78%	**No**	22%
20+ P's	**Yes**	68%	**No**	32%

Q15. This firm's professional indemnity contribution for the period 1 Oct 2002 to 30 Sept 2003 as a percentage of gross fees was

November 2002	October 2003
N/A	**As a whole** **a) 0 to 2.5%** - 29% **b) 2.5% to 5%** - 21% **c) 5% to 7.5%** - 8% **d) 7.5% to 10%** - 2% **e) 10% to 15%** - 1% **f) above 15%** - 1% **No Answer given** – 38%

Q16. This firm's call (including March and August payment) for the HIH deficit as a percentage of gross fees was

November 2002	October 2003
N/A	**As a whole** **a) 0 to 2.5%** - 34% **b) 2.5% to 5%** - 13% **c) 5% to 7.5%** - 6% **d) 7.5% to 10%** - 2% **e) 10% to 15%** - 1% **f) above 15%** - 2% **No Answer given** – 42%

Q17. This firm's gross fees (adjusted according to any change in the number of Fee earners) in the period from 1 Oct 2001 to 30 Sept 2003 has

November 2002	October 2003
N/A	**Increased** – 26% **Decreased** – 25% **Not Altered** – 22% **No Answer given** – 27%

Comment:
During our research we were informed by several sources that the level of contributions and the call for the HIH Group liabilities was causing severe financial hardship to firms and a great number were at risk of going out of business. This had not been an issue that was so prominent a year earlier. We therefore sought information to try and gauge the extent of this burden on individual firms. We had received statistics from Essar across the profession and these questions were intended to supplement that information. A certain percentage gave no answer to questions 15, 16 & 17. Some indicated that the information was confidential. Others, we speculate, are employed solicitors who may not necessarily know the information requested.

November 2002 Breakdown of returned questionnaires by number of solicitors

These can be broken down into:-

- 1 Solicitor – **11 (15%)**
- 2 Solicitors – **9 (12%)**
- 3-5 Solicitors – **18 (25%)**
- 6-10 Solicitors – **10 (14%)**
- 11-15 Solicitors – **9 (12%)**
- 16-25 Solicitors – **7 (10%)**
- 26-35 Solicitors – **5 (8%)**

- 36-50 Solicitors – **2 (2%)**
- 51-75 Solicitors – **2 (2%)**

October 2003 Breakdown of returned questionnaires by number of partners

These can be broken down into:-

- Sole Proprietor **61 (14%)**
- 2-5 Partners **166 (40%)**
- 6-10 Partners **96 (23%)**
- 11-20 Partners **40 (10%)**
- 20 or more Partners **56 (13%)**

1.5.4 General Comments On Questionnaires

The responses from firms of 15 partners or more constitute approximately 10% of all responses. Firms in that band of the profession are about 1% the total number of firms in the profession. They contribute about 25% of the premium pool and account for about 28% of the liabilities. Firms in that band are also the most likely to have the resources and skills to manage their own insurance arrangements provided they do not have significant claims.

At about the same time as we conducted our November 2003 survey, Margaret Ng Legislative Councillor, conducted a survey of the profession. The responses to Margaret Ng's survey also showed a response rate of about 10% from the top firms.

We received a number of criticisms about the form of the questionnaires. It was not our intention to, nor do we believe, it is appropriate for us to conduct a poll which will have any persuasive effect on the choice of insurance arrangements for the future. Our questionnaire was designed to encourage practitioners to think about the issues ; to give us some indication of the degree of understanding of insurance principles held by the Profession ; and to give an indication of underlying attitudes to the importance of public interest and professional standing in the minds of the profession. We anticipate that once practitioners have absorbed the information we are providing in our review, they and the Society will be more informed when they decide what is best. It would have been premature to conduct a survey of the profession's choice, until that choice was informed of the consequences of the options.

Comment on Question 14
The Profession serves the Public, not only as individual clients, but also as a group. The Public are entitled to have access to Justice and the benefit of the skills of those trained in the law to enable them to order their business and personal affairs with advice ; to avail themselves of their rights, enforce and protect them, if necessary, and to ensure liberty and equality before the law. Members of the Profession have a monopoly on the practice of the law and the sole right of access to the Judicial system as advocates for others. This privileged position of Members of the Profession imposes an obligation on solicitors individually and the Profession as a whole to maintain standards of conduct and skill commensurate with this Profession's uniqueness and because failure to live up to the prevailing standards could result not only in loss to individuals, but denigration of the whole of the Profession and ultimately of the rule of law. **This is one view of the character of the legal profession.**

Another view is that The Profession is a business like to any other business. So long as the Members of the Profession maintain appropriate technical skills and provide to their clients legal services with the appropriate level of skill, no wider obligation exists and no justification exists for imposing on the Legal Profession any standards or benchmark that does not apply to dentists, engineers, doctors, accountants, architects, or any other profession.

Any opinion about whether the Public is entitled to expect that solicitors maintain appropriate levels of professional indemnity insurance, about whether protection of the Public is paramount to cost to the solicitors, or about whether protection of the reputation of the whole of the Profession justifies compulsory insurance, will vary according to the degree to which one ascribes to one or other of the philosophical categorizations of the legal profession set out above. We asked Question 14 to turn the minds of solicitors to consideration of the nature of the legal profession, which is the starting point of decisions about professional indemnity insurance.

SECTION 2

2.1 OUTLINE

2.1.1. Relevant Decision – Maintain the Fund?
Maintain the existing Scheme, demutualise, or other option

Review Conclusion

Option One

If sustainable lower cost of insurance is the paramount factor consistent with appropriate public protection – then maintain the Solicitors Indemnity Fund from 2005 **on condition** that, claims loadings and deductibles are increased, firms deriving a significant portion of fees from conveyancing work pay higher contributions, the decision making process and management structures are modernised and the reinsurance arrangements and the Fund are restructured so that the Fund no longer has primary liability for any limit above its retained level, so as to protect the Fund, and Profession from any future insolvency of a commercial insurer. What we are proposing is a single commercial policy for a limit of HK$10,000,000 supported by an HKSIF component of HK$1,500,000 – HK$2,000,000 in excess of the Insured's deductible.

Option Two

If freedom of choice for individual firms and lower short term cost for some firms despite adverse consequences to other firms are paramount factors, a Qualifying Insurer Scheme will provide adequate public protection and be in the best interest of the majority of firms, although unfavourable to firms who have had claims.

Our recommendation for 2005 is Option One. The major matter that has persuaded us to recommend Option One rather than Option Two is our opinion that if a QIS is established, it will not be possible to obtain cover that prohibits Insurers from denying claims or indemnity because of non-disclosure, late notification, or breach of condition or duty of utmost good faith. If the Society's insurance brokers, or others, can confidently assure the Profession and the public that the commercial insurance market would make indemnity available with that prohibition, the two options would be finely balanced.

2.1.2. Relevant Decision – Limit of Indemnity
Is the existing limit of indemnity of HK$10 million appropriate

Review Conclusion
The limit of indemnity of HK$10 million is appropriate. Any reduction would be inappropriate.

2.1.3. Relevant Decision – Geographical Extent of Cover
Should the Hong Kong Solicitors Indemnity Fund, or the minimum terms appropriate in the public interest as a condition of practice, limit either the geographical extent of indemnity or liability arising under foreign law or from legal services with respect to foreign jurisdictions.

Review Conclusion
Indemnity ought to be for all services in whatever jurisdiction or according to whatever system of laws Hong Kong solicitors are qualified and permitted by regulatory authorities to offer and provide. The commercial insurance market will limit indemnity to a geographic area or system of law for which a solicitor is qualified. Any extension of

indemnity for practice geographically outside Hong Kong, is likely to cost additional premium. As Hong Kong is an international centre and part of the People's Republic of China the absence of compulsory insurance for all prospective clients would not be in the public interest. Special considerations apply to damages awards in a court of the United States of America and indemnity for those awards ought to be excluded from compulsory terms.

As it is reasonably foreseeable that legal services provided by Hong Kong solicitors, both in and out of the mainland, on Chinese law, on the client choice between a Hong Kong and mainland legal framework potentially carry a higher risk, if the Solicitors Indemnity Fund continues to provide indemnity after September 2005, higher contributions ought to be made by Hong Kong firms with offices in mainland China, or who employ Chinese qualified lawyers. Those higher contributions ought to be removed if claims as foreseen do not come about. If insurance is being purchased from commercial insurers the cost of extraterritorial cover or foreign law services cover will be a matter of negotiation between the firm and the insurer.

We are recommending that liabilities from a branch office outside of the Special Administrative Region of Hong Kong are excluded from compulsory cover.

2.1.4. Relevant Decision – No Claims Bonus

Would a form of "no claim" bonus be preferable to the existing collection of a loading on the contribution of firms with claims.

Review Conclusion

This only has relevance if the Hong Kong Solicitors Indemnity Fund remains after September 2005 as a provider of indemnity. The current system of loadings is fairer to the firms with claims as it does not impose any penalty until a payment has been made. The amount so far paid as an overall percentage of contributions is small compared with the claims losses and could be said to be unfair to the remainder of the Profession. The amount of loadings ought to be increased generally; the time at which it is first levied ought to be shortened and the loading ought to be increased differentially for claims related to frequently occurring risks, or practices such as conveyancing, a conflict of interest or missing a deadline. The latter changes would act as risk management incentives and help the firms with no claims perceive that penalties are being paid by solicitors claiming from the Fund. The Annual Report of the Professional Indemnity Scheme ought to inform the Profession of how many firms pay loadings and what proportion of additional contributions as claims loadings are paid.

If commercial insurers are providing indemnity after September 2005 the premium and the factor charged to a firm as a result of a claim will be a matter for negotiation between them. Usually a claim that is not finalised will attract an additional premium.

2.1.5. Relevant Decision – Risk Banding

Should risk banding be introduced and, if so, on what categories of work and how will it be applied and policed.

Review Conclusion

Risk banding ought to be introduced by Hong Kong Solicitors Indemnity Fund if it remains as a provider of indemnity after September 2005.

Initially, all firms would be required to declare the percentage of fees from particular areas of work. We suggest that initial extra contributions on a sliding scale be collected from firms whose fees constitute 25% or more of the following work: -

- Residential conveyancing, excluding associated loan securities
- Civil litigation
- Conveyancing associated with financing, loan, mortgage or other securities involving real property

After collection of the first year of data, each firm's fee data ought to be compared with any claim against that practice to determine if there is any correlation between the amount of fees derived from an area of practice, the size and staff composition of a firm and the circumstances of a claim. The profiles of firms with claims can then be compared against those of other firms with similar characteristics. The object of the exercise is to accurately and fairly define the"band". For instance, if claims are from firms that do only 10% of their work in conveyancing, while those that do 70% conveyancing rarely have claims, a higher contribution ought to be paid by those with the lower proportion of conveyancing work. The data is not available to us to do other than suggest that risk banding be initially based on frequency of claims in the general statistics. If the management of Hong Kong Solicitors Indemnity Fund and the decision making processes surrounding it are streamlined by 2005, the data ought to be available to implement risk banding.

The collection of appropriate contributions from firms relies on the firm's declaration of accurate information. If the accuracy is to be policed, the current Rules, 8 and 9 can be amended appropriately.

2.1.6. Relevant Decision – Adjustment of loading and deductibles

Could the existing Scheme be improved by adjustments to the apportionment among the Profession of losses through claims loadings and deductibles. Could that satisfy complaints from a number of members of the Law Society that negligent firms are subsidised too much by others, that conveyancing work ought to attract a levy, that there are insufficient penalties on those with claims and that claims loadings continue for too long.

Review Conclusion

The allocation of the losses from claims which account for the greatest part of contributions from all members of a mutual ought to be as transparent and as fair as possible. The underlying principle of all mutual insurance arrangements depends on the members accepting that there will be subsidisation of bad risks by good risks. That allocation will always be seen as unfair by some sections and, as a matter of economics, will be arbitrary to some degree. Transparent penalties ought to be more in line with commercial practices so long as there is power to exercise discretion in cases of severe hardship.

More can be done to reallocate the present distribution as well as to make the process more acceptable to members. More penalty deductibles would demonstrate to the overall membership that the "user is paying" as would an increase in claims loadings. It is unrealistic for the members to expect that firms with claims can contribute sufficiently to the claims costs incurred across the Profession to make a substantial impact on contributions of firms with no claims. Nonetheless, deductibles should be increased overall. There has been no increase since 1989 even though the limit of indemnity doubled in 1994.

If there are further calls to fund the HIH shortfall, those firms that notified claims prior to 30th September 2000, (paid or outstanding) ought to pay a loading on their shortfall contribution. We suggest say 25%, as an appropriate level of loading. We note that an existing claim loadings have been factored in to the short fall contribution.

It is a misconception to classify those with claims as "negligent firms ", as opposed to firms that have made an error amounting to negligence. In the last thirteen years the number of firms with multiple paid claims, we were advised by Essar, is sixteen. One third of firms have notified claims. The best, and probably the only effective method to satisfy the complaints of members is for the whole profession to concertedly implement risk management strategies within their firms, so that the risk and cost of claims is reduced.

2.1.7. Relevant Decision – Risk Management

What level of risk management will insurers require to be in place if they are to quote reasonable premiums?

Review Conclusion

A level of risk management sufficiently effective to reduce the number and cost of claims across the profession, is required. This is not an insurer's requirement, but imperative to reduce claims and premiums regardless of how insurance is being provided.

It is almost universally recognised that most claims against solicitors do not arise from technical errors involving lack of knowledge of the law. Most claims arise from failures in the management of the business operations of a legal practice. The causes of claims are most frequently the lack of office procedures and systems, such as recording time limits, recording information, and ensuring that there are adequate reminder systems and established processes that all staff know, that all staff are trained to implement and that are monitored, revised and followed.

The level required can only be measured by the reduction of claims. If the HKSIF continues beyond September 2005, it can play a critical role in driving risk management education for the Profession. Risk management education is only the beginning. The Law Society can carry out that education function, but it cannot have access to the claims files as the identities of firms against whom claims have been made are confidential. Regardless of how much or how well the Society introduces risk management education, it is only each and every solicitor who can practise it. To avoid claims, the level required is for every solicitor, everyday, all day to be aware of and manage the risks of practice and to ensure that all other staff in their practices do the same.

If solicitors are insuring in the commercial market from 2005 insurers will not "require" any level of risk management. It will be up to the firm to decide how it manages its risk. If it does so and can demonstrate that to an insurer, it may be able to obtain a lower premium. Whether it does obtain a lower premium will depend on what other firms the insurer has covered. Each insurer will set a premium to make a profit. As insurers cannot count on having the business of a firm for more than one year, and any new risk management strategy will affect services from which claims may arise in future years, an insurer is unlikely to advise or help a firm with risk management. An increasing feature of underwriting criteria, however, is questioning firms on their risk management principles in their application forms. Any of the resources of the insurer invested helping a firm to manage its own risk would show a return in future years and could well be a return to that insurer's competitor. It typically takes 3-4 years for new risk management initiatives to be reflected in claims experience under a claims made cover.

2.1.8 Matters Relevant to a Qualifying Insurers Scheme (QIS)

2.1.8.1 Criteria for appointment

Review Conclusion

To provide insurance to a solicitor/firm in Hong Kong which will qualify those solicitors to receive a practising certificate on production of proof of the existence of that insurance for the relevant period covered by the practising certificate, the insurer ought to: -

- Be licensed to carry on the business of insurance in Hong Kong.
- Have executed an agreement that the terms and conditions of the insurance offered to solicitors of Hong Kong will be not less favourable than terms stipulated by the

Law Society and that if they are, the prescribed terms will prevail over the contract of insurance with the insured.

- Have executed an agreement with the Law Society agreeing jointly and severally to pay a proportion of any claims losses incurred by solicitors who are insured by an assigned risks pool policy, because they cannot obtain insurance from any commercial insurer. The proportion agreed would be equivalent to that insurer's market share of the whole insurance market for all solicitors in Hong Kong for compulsory insurance.

- Agree to inform the Law Society if an insured does not renew insurance

2.1.8.2 How does the Law Society protect itself in the event of the liquidation of a qualifying insurer

Review Conclusion
If a qualifying insurer were to become insolvent the Law Society would not have any exposure to any liability and no need for any protection. Under a QIS, the contract of insurance is between an insured firm and the insurer. In the event of insolvency of the insurer the insured solicitor/firm would not be able to recover any indemnity from the insolvent insurer if a claim had been notified to that insurer before insolvency. If the claim by the member of the public was successful, the solicitor/firm would have to pay the claim out of personal assets. If the personal assets were insufficient, or the solicitor was dead, or the assets were out of the jurisdiction or otherwise not available for execution, the member of the public concerned would bear the consequences of the insurer's insolvency. That insolvent insurer's future contribution to the ARP will be taken up by other insurers. The ARP could have a shortfall for past liabilities and there is no protection against that. The vehicle or entity managing the ARP and providing the indemnity would be exposed. In England & Wales, qualifying insurers have joint and several liability for contributions to the ARP. If it is not feasible to secure that agreement in 2005, securing an insurer who will front indemnity for the ARP may prove an unsurmountable obstacle to a QIS in Hong Kong.

2.1.8.3 What minimum terms of cover should the Law Society expect insurers to provide?

Review Conclusion
Minimum terms when talked about in this context refers to the terms that are the minimum necessary to qualify a solicitor to practise with insurance that gives minimum protection of solicitors and of the public interest.

A more appropriate approach is for the Law Society to stipulate what it considers are the terms without which the public interest and the insured solicitors would not have adequate protection. Insurers then decide whether or not they will provide cover (do business) on those terms. The terms must take account of market conditions. The Society ought to review the terms each year if some terms are considered necessary to protect the public interest but insurers in the market do not agree to provide those terms. Unless there are enough insurers willing to participate and offer insurance on the terms stipulated, a QIS is not feasible. The Society would have to reduce the protection of the public interest to attract insurers to participate by changing the terms. At some point the minimum level of public protection has to be determined. That is for the Society to determine, not insurers. Insurers decide either to do business on the set terms or not. If no insurers will participate on terms considered to be the absolute minimum, the QIS will not be feasible and a mutual or a captive will be the only alternatives.

Minimum Terms 2005

We consider the following to be the ideal minimum terms.

- All civil liability in connection with the usual and customary activities of private practice as a solicitor in Hong Kong.
- Worldwide cover from an office in Hong Kong provided the solicitor insured is authorised by the Law Society or his/her practising certificate to so practise, but excluding liability arising under laws of the United States of America or awards from American courts.
- Unlimited retroactivity (i.e. does not matter how long before the claim was made that the work was done from which the claim arises).
- Cover to extend to all principals, employees, consultants, prior practice liabilities, and liabilities of partners or employees who permanently ceased practice and who at the time the claim is made had no insurance.
- Insurance not subject to repudiation or recision or reduction of the limit of indemnity below the minimum for innocent misrepresentation or non-disclosure, or other breaches by the insured.
- Payment to be made to any claimant entitled to payment as soon as practicable after that entitlement is established, but in any event no later than 60 days thereafter.
- Duration of the policy shall be the full practising period [adjustable only for new firms].
- Senior Counsel clause for disputes over whether a claim should be defended or settled.
- If the insured, by breach of condition or any other cause, causes prejudice to the insurer in connection with any matter covered by the policy, Insurer must pay the claimant as a condition of recovering from the insured the amount of the insurers loss arising from the insured's breach.
- If an insured permanently ceases practice or dies during the currency of the insurance and a claim is made against the retired insured or the estate of a deceased insured, and no other insurance is in force for that liability, the insurer will indemnify the retired practitioner or the estate of the deceased practitioner.
- Exclusions that are allowed as set out in the Rules Schedule 3 and to be further considered. Items such as the exclusion relating to Carrian Investments, for instance, may no longer be necessary.

2.1.8.4 What would be the appropriate size of the premium pool for a QIS

Review Conclusion

The feasibility of a QIS operating successfully for the Hong Kong legal profession from September 2005 depends almost exclusively on the size of the premium pool. The pool will be determined by the premiums collected by all insurers who participate and write policies. Some may qualify by agreeing to offer cover on the stipulated terms but never issue any policies. There are a number of insurers in England and Wales that do this. There are twenty four qualifying insurers for the year 2003/04. Sixty percent of the 100,000 solicitors are insured by three insurers.

Six qualifying insurers wrote no policies at all. Four wrote less than 1% of the market each and three less than 2% each. We append as Appendix 4 (page167) a list of

insurers in England & Wales. Some insurers only qualify to provide cover to firms with an establish 'top-up' record with that insurer.

To attract insurers to participate (as opposed to merely qualifying) they need to be assured that the potential premium pool is large enough for them to compete for the business and that the risk being insured can be assessed with enough certainty for the premium to be set at a profitable level.

We conclude that with a QIS it is likely, in the long term, to cost the Profession of Hong Kong as much as it now pays, probably more, but some firms will have lower premiums, some more, some very much more. To predict the size of the premium pool in 2005 which will be affected by claims between now and then, by market conditions, by whether the land title registration legislation is passed by then, by whether the Administration introduces a scheme to protect policyholders against insurer insolvency which imposes a levy on all insurers, whether mainland Chinese insurers extend their business to cover professional indemnity is on our part not a scientific process. We have used HK$250,000,000 as the best estimate on past data. An allowance of a quarter above or below is foreseeable. The market research on this aspect can only be done by the current broker, Aon. Our limited approach to the market leads us to think a QIS is feasible, provided the number of firms who need to enter an ARP is shown to be no more than about 5% of the profession.

2.1.8.5 Is the Profession in Hong Kong large enough to attract insurers to provide an assigned risks pool

Review Conclusion

An ARP is a condition of a QIS. It does not stand alone.

With the same reservations we have expressed about the size of the premium pool that might attract insurers to participate, it is our conclusion that the existence of an assigned risks pool, on its own, ought not to deter insurers from participating in a QIS from 2005. This depends on how many firms would be likely to need cover from an ARP.

Whatever an insurer has to pay to the ARP will be collected from those firms that are insured by that insurer.

We have not been able to access claims files. We do not know how many firms are likely to be considered uninsurable by the commercial insurance market. It is only firms that no commercial insurer will accept as a risk that are insured by the ARP. AON as an experienced insurance broker, and Essar as manager with access to the claims files, can assess the number firms likely to be uninsurable. If the premium pool for about 600 firms is reduced substantially, for example 150 are uninsurable due to their claims history, an insurer contemplating participating in a QIS may be deterred because the overall premium pool is reduced by 150 firms and the insurer has to agree to pay the claims of those 150, who are, by definition, the worst risks. The insurer will add to the premium of those it covers whatever has to be paid to ARP. At the outset the insurer will not know how much that is, and cannot set an initial premium with security. It is crucial that an estimate of firms likely to need an ARP be made. That estimate can only be made by those with access to the claims files. We have suggested that a 5%-10% of the premium pool may be feasible. We have no scientific or empirical facts to confirm that. It will be matter of market forces in 2005.

When the QIS was introduced in England and Wales it was anticipated that about 700 firms would not get cover. It turned out to be about 40 in 2000/2001 and is now about eighteen, of whom sixteen are sole practitioners. Firms who have to resort to the ARP would have to have multiple claims over several years or claims or a claim that cost about double their premiums for a three year period, or the facts out of which the claim(s) arose have shown a gross recklessness or disregard for the usual standards of

the profession. Insurers in the absence of those features in a firms risk profile are more likely to accept the risk at a large premium than to decline it. The premiums charged by the ARP are a high proportion of gross fess; 25% in England and Wales.

All insurers have their underwriting guidelines. Whether they refuse cover or not can be for any number of reasons. These include, underwriters experience, or lack of it; whether the company wants to build market share, terms of their own reinsurance which might say "no cover for mergers and acquisition work". We are heartened by the information that only sixteen firms would have been liable to pay the now existing penalty deductible on multiple claims if it had existed in past ten years.

We conclude that if any insurer otherwise decides to participate in a QIS in Hong Kong, it may well be accepting of an ARP, unless such a large number of firms are likely to be uninsurable, that the premium pool is substantially reduced. We have no data to speculate on the number of such firms in Hong Kong.

2.1.8.6 What happens to a firm who cannot obtain cover, whose cover from the ARP is for a limited period and then the firm still cannot obtain cover. What is the experience in other jurisdictions?

Review Conclusion
They do not practise as solicitors in private practice again. In England and Wales the experience has been that solicitors in the ARP have decided to retire or they have been made bankrupt and are then disqualified from practice. This is possible because the rules say that if proof of insurance is not produced the ARP issues cover if a practising certificate(s) has or has been applied for by the firm. This creates a liability to pay the premium which is 25% of gross fees for the first £500,000. This can be paid in instalments. If it is not paid, the Manager of the ARP pursues the firm until bankruptcy. No solicitor can practice again as a principal once bankrupted. Solicitors in the ARP are also notified to the Office for the Supervision of Solicitors (OSS).

Qualifying insurers in proposal forms require details of every fee earner and enquire if any, employed solicitor has been referred to the OSS. If yes, that firm knows it will have an increased premium by reason of employing that person and may even be declined insurance itself. Those solicitors are therefore unlikely to be employed in private legal practice. Other employment not requiring insurance is open to them in corporations, Government, education etc.

It should be said that if a firm or solicitor had claims as the result of fraud by an employee or partner or in circumstances that were really unavoidable bad luck, despite risk being managed reasonably, insurers will be open to considering individual cases in a fair way.

2.1.8.7 Could the Law Society expect any input into the handling of claims in QIS in order to protect the public interest?

Review Conclusion
The Law Society could not realistically expect any role in handling claims under a QIS. If particular members asked the Society to advocate on their behalf in a dispute or over some related claims issue, it could choose to do so, but as the professional body offering support to its members at their request, but not otherwise. Under a QIS, claims may be handled in London or elsewhere. It can be anticipated that firms who buy limits above the compulsory HK$ 10,000,000 would purchase the whole cover from the ground up from the same insurer, probably based outside of Hong Kong. If a claim was made it would be usual to have instructions on that claim coming from insurers outside Hong Kong as the top-up insurers tend to write cover of that size from their head office and manage claims from there by instructing solicitors in Hong Kong.

2.2 GROUNDS OF MAIN CONCLUSIONS

Our Brief has been to review the operation of the Scheme to advise what form of insurance arrangement is in the best interests of the public of Hong Kong and of the legal profession commencing from September 2005 when the current arrangements expire.

2.2.1 The Public Interest

We have accepted that the law in Hong Kong is as stated in Swain v The Law Society [1983] AC 598. (Approved in HSBC v HKSIF (HCMP 411 0f 1994)). That case decided that in exercising its statutory powers under section 73A of the Legal Practitioners Ordinance the duty of the Council of the Law Society is to act in what it believes to be the best interests of the section of the public in need of legal advice, assistance or representation, even in the event that the public interest should conflict with the interest of members of the legal profession as a whole or of the Law Society or of its members. The same legal principle has been applied whenever we have had to balance the interest of securing for the public certainty of compensation for financial loss from a solicitor's mistake against the interests of solicitors.

The relative merits of a mutual fund, a qualifying insurer arrangement, a master policy arrangement, prescribed minimum terms with otherwise open market access for solicitors, a captive insurer owned by the Law Society as the representative of the Profession, and combinations of elements of these main types of insurance delivery arrangements have been measured against the past history, statistics, management and operational structures, claims experience, characteristics of the profession, the business environment and risks to the legal profession in Hong Kong.

There is no single arrangement we consider to be the most suitable, feasible and acceptable; which strikes a balance between the interests of the public and of the legal profession; and potentially provides adequate levels of protection likely to be available and affordable in the long term. We have reduced the options to two – a QIS or HKSIF on the proviso that changes are effected to HKSIF, and to reinsurance arrangement so that indemnity is provided by a single commercial policy and HKSIF provide indemnity only for a retained deductible under that policy.

2.2.2 Interests of Legal Profession

The interests of the"legal profession" are not uniform. Large firms, sole practices, medium firms and internationally affiliated firms have differing interests. Within each sized firm, identification of what insurance arrangement is best varies according to the type of legal business transacted and most importantly according to whether a firm has or is likely to have a claim. One third of firms have had claims in the past sixteen years. Sixteen have had more than one claim. Over the next sixteen years, another different third of the Profession may have claims.

2.2.3 Claims Driving Premiums

Dissatisfaction with the current insurance arrangements has its underlying root in claims against legal practitioners in Hong Kong which have caused losses to members of the public and driven the cost of insurance to a level not previously experienced. The obvious answer to reducing the cost of insurance is to reduce the number and cost of claims. The adoption of risk management across all sectors of the legal profession is the best method of achieving

that objective. Without risk management, any change to the structures or form of professional indemnity insurance is unlikely to be of significant, sustainable benefit to the majority of solicitors in Hong Kong.

The number and cost of prior claims drove premiums upwards from September 2000 under an arrangement spreading the cost of those previous losses over a five year period. Insurance contributions by solicitors since 2001 may not be sufficient to cover the claims liabilities and the re-insurance premiums. The agreed base reinsurance premium for 2004/5 is 61% higher than the professions' insurance contributions for 2003/4, about half of that re-insurance premium will reduce proportionately if the claims for 2003/4 are less than 340. The legal profession has additionally been called on to contribute to past claims because of the insolvency of the HIH Group which re-insured part of them prior to March 2001. That imposition, obviously, is a further, but not so proximate, result of claims arising from mistakes of solicitors, their partners or staff. The following table No. 1 comprises contributions with claims losses and re-insurance premiums. The inescapable conclusion from these statistics is that the profession has had its Insurance on credit since about 1996. Contributions from the members fell below claims losses. Those losses were predominantly by re-insurers, but it was inevitable that re-insurance premiums would increase to a level commensurate with the earlier losses and re-insurers' profit.

Re-Insurance Premiums and Contributions as at 30th September 2003

Table No 1

Year	Claims Losses HK Million	Contributions	No. of Claims	Agreed Re-Insurance Premium	Actual Re-Insurance Premium
1998/1999	34.9	104,742,760	367	109,099,050	
1999/2000	129.1	79,171,731	263	2yrs excess of loss 3 yrs stop loss	109,099,050
2000/2001	97.8	88,852,727	227	83,232,650	104,890,865 (40,021,250 HIH Replacement)
2001/2002	78.4	215,352,931	187	113,625,000	113,625
2002/2003	25	206,700,014	195*	164,756,000	117,125,545
2003/2004	?	219,000,000	15*	238,896,563	177,699,519
2004/2005	?	?	?	340,427,602	Minimum – 255,000,000

* As at 24/11/03

If the claims numbers for 2003/2004 are 170 or less, the re-insurance premium to be collected from the profession in September 2004 will b approximately HK$ 255,000,000. In addition HKSIF will have a potential liability for the first HK$1.5 million of each claim. As at 9th October 2003, 15 claims had been reported for the 2003/2004 policy year.

We have conducted some financial modelling with respect to the contributions paid by the profession for years 2002-2003 and 2003-2004. The approximate contribution for 2002/2003 was HK$207,000,000. The reinsurance premium was HK$117,000,000. The approximate contributions for 2003/04 to the end of October 2003 were approximately HK$219,000,000. The reinsurance premium for 2003/04 was approximately HK$177,000,000. There were no reserve funds within HKSIF as at 30th September 2002 and in fact the fund had an accumulated deficit of approximately HK$133,000,000.

What this means is that after payment of administration expenses, reinsurance premiums and allowing credit for anticipated investment earnings the sum of HK$112,000,000 is available to pay claims for the two years 2002-2004 inclusive. Our financial modelling suggests that the amount needed by HKSIF on a conservative estimate assuming an average number of claims of average value is about HK$45,000,000 per annum.

Table No. 2

Policy Year	Retention Band	Value of paid claims and reserves within retention period
1997/98	0 - $1,000,000	HKD 223,260,101
1998/99	0 - $1,500,000	HKD56,859,776
1999/00	0 - $1,500,000	HKD 43,372,901
2000/01	0 - $1,000,000	HKD 40,064,738
2001/02	0 - $1,500,000	HKD 3,371,749

2.2.4 Assumption of High Exposure

In the Law Society Circular 129/89 dated 14th August 1989, when the mutual fund came to be managed by HK SIF Ltd (the Company) and Essar, the then President explained the reason for the change as follows:-

(1) The Company will act as its own insurer of the self-insured fund so that it is no longer necessary to have an insurer to 'front' and issue policies, thereby saving costs.

(2) The Company will in effect act as leading insurer in respect of excess of loss cover and stop loss cover so that through Essar it can pick and choose re-insurers. Such freedom of choice would give the Company complete flexibility in manoeuvring the scope and extent of cover and premium rates to suit our needs.

At that point in time freedom of choice and potential cost savings were the paramount considerations. Claims experience was good, the commercial insurance market was soft, and reinsurance was affordable and readily available, the possibility of re-insurer default was remote and the economy was not in recession.

Now, and most likely in 2005, re-insurer insolvency is a prominent aspect, claims losses, most as yet unpaid, exceeded premiums for five years by an average of over 200%, the insurance market is going through the hardest conditions since about 1986, the economy has been stagnant for several years and freedom of choice has been eroded by lack of insurers willing to accept what has proved to be, with hindsight, unprofitable business. The risk has a loss making reputation in a significantly contracting market.

2.2.5 Protection from Insurer Insolvency

The prominence of re-insurer default as a factor due to the effects of the insolvency of HIH Group the re-insurer of part of the liabilities of HK SIF has been reinforced to us by a large number of solicitors during our review. The structure of the insurance arrangements can be altered so that HK SIF is no longer, in the words of the 1989 circular, *its own insurer or the lead insurer.*

The Rules say that indemnity will be granted by HK SIF. Up to a limit of $HK10 million. The Fund assumes liability for the full limit and has managed the Fund looking to cover the 10% of retained risk (since 2001 -15%). The Fund then places re-insurance. The Fund is principally liable to the Insured and has a right of indemnity from all solicitors. In the event of insurer insolvency the Fund and the solicitors still have liability for the full ten million limit on each and every claim. If arrangements were changed so that the" re-insurers" agreed to indemnify the insured for ten million each and every claim with a deductible of, for example, one million each and every claim (which the Fund assumes liability to pay) in the event of insolvency of one of the insurers there is no liability on the Fund to ever pay more than one million each and every claim, less the insured's excess.

To an insurer that arrangement should have little effect on pricing or exposure, but the Fund and the profession would be protected in the event of insolvency of the insurer/reinsurer. It would leave the solicitor against whom any claim had been made prior to the insurer's insolvency with the liability to bear the loss and not the profession. There would be guaranteed payment of the amount payable by HK SIF and thus provide some protection to the public while sharing the burden of an insolvency between the solicitor liable for the loss and the claimant. If the participation of any one insurer was limited to, for example, one third of the limit of indemnity the public could have confidence in compensation being assured for at least $HK 7.6 million in the above example before having recourse to the personal assets of the solicitor. The commercial market may in 2005, on consideration of the claims experience of the Profession not agree to a limit of HK$1.5 million each claim. HK $2 million may be the realistic level. A lot will depend on the claims over the next two years.

2.2.6 Strategy to Limit Liability of HKSIF

a. Insurer diversification. If the proportion of total indemnity placed with each Insurer is limited, the overall loss is limited if one becomes insolvent. We suggest that no more than one third with any one insurer is prudent even if the price of the overall cover is higher. Each insurer should have a security rating of not less than A-. Market conditions come into play but annual advice on an insurers security from the broker is prudent.

   It is possible to insert a special cancellation clause into the contract with the Insurer along the lines of,

   "In the event that an Insurer:

   i) ceases underwriting (wholly in part) or formally announces its intention to do so, or
   ii) is the subject of an order or resolution for winding-up or formally proposes a scheme of arrangement, or
   iii) has its authority to carry on insurance business withdrawn or modified,
   iv) no longer meets the Assured/Reinsured's requirements

   the Assured may terminate that Insurer's participation on this risk forthwith by giving notice and the premium payable to that Insurer shall be pro rata to the time on risk".

b. The Fund could further cap its liability and protect its members by either negotiating an aggregate limit on the total amount it paid for all claims of one million or by purchasing stop loss cover for its retained liability. This would make certain it had a maximum exposure only for its retained level as opposed to its current arrangements where it has fronted all liability subject to a right of recovery from re-insurers. In 2005 the availability of stop loss cover, and its price, are uncertain.

HKSIF has potential liability in two directions:

1. It has primary liability for each and every claim up to a maximum of HK$10,000,000 each and every claim (less the insured's deductible). To limit that liability it has taken reinsurance for each and every claim of HK$8,500,000. This is called its vertical protection.

2. It has retained to be paid from HKSIF the first HK$1,500,000 (until 2001 HK$1,000,000) on each and every claim. To limit it's liability it traditionally took stop loss insurance so that it limited the total amount it had to pay up to HK$1,500,000. That reinsurance was called stop loss insurance and provided what is called sideways protection.

   Since 1st October 2001 HKSIF has had no stop loss reinsurance. Where as up until September 2001 it had limited it's sideways exposure it now has no reinsurance for that sideways exposure. We recommend that the way in which the liability to provide

indemnity is structure be altered so that vertical exposure is limited, even in the event of insurer insolvency, to the retained level. In effect HKSIF Ltd arranges a single commercial policy on terms negotiated by HKSIF Ltd through the Society's brokers and under that single commercial policy HKSIF becomes liable for a deductible which is paid by HKSIF on top of the insured's deductible. In diagrammatic form it appears as shown in the following two diagrams.

Table No 3A

SINGLE COMMERCIAL POLICY - PROFESSIONAL INDEMNITY FUND COMPONENT

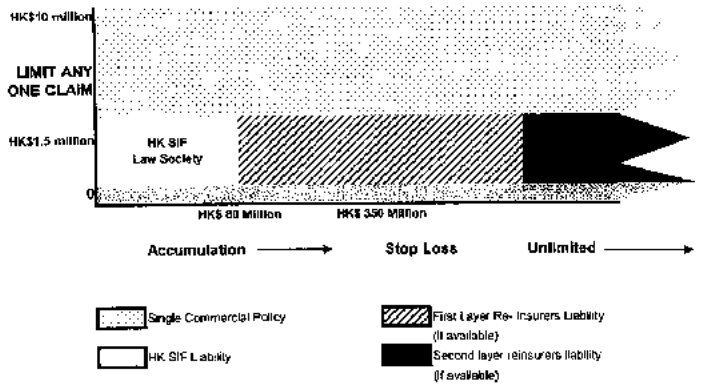
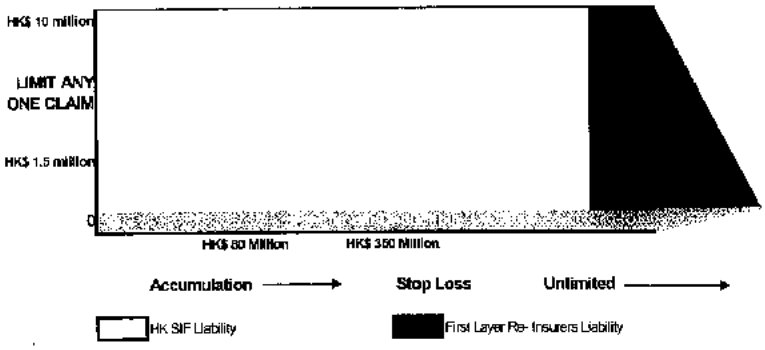


Table No. 3B

HK SIF CURRENT STRUCTURE



For total protection HKSIF needs to purchase stop loss cover to protect its sideways exposure, but the above restructuring will protect the profession (but not those solicitors who have claims nor the public), from unlimited vertical exposure.

The fund had stop loss protection until 30th September 2001. Since that time the cover has not been available at an affordable price. The consequence is that the Profession has a potentially unlimited sideways exposure on the retained level of HK$1,500,000. The consequence of this for the Profession is that sufficient contributions must be collected to cover the liabilities year by year of each and every claim up to the first HK$1,500,000. Until stop loss insurance can be purchased to protect the fund against sideways exposure, each year before contributions are collected from the Profession projections need to be made of the potential liabilities and the contribution formula adjusted to ensure that enough contributions are collected. This is an exercise that is necessary regardless of any risk of insurer insolvency.

As the claims numbers being reported by the profession have declined from their peak in 1997 to 1999 it is possible that once the insurance market cycle softens, sideways stop loss insurance will be available for purchase by HKSIF Limited. Even without that sideways protection adoption of the changed arrangements of a single commercial policy with an underlying mutual fund will limit vertical liability of HKSIF and of the Profession.

2.2.7 HKSIF Ltd - Modifications

This review is part of the continual review that any business undertakes of its business activities. HK SIF Ltd, with the manager Essar Insurance Services Ltd has reviewed its business from time to time. The ability of the Company to respond to emerging claims trends, market forces affecting reinsurance price, alteration of the contribution formula and of deductibles and claims loadings could be enhanced to allow rapid responses that are consistent with modern best practice and commercial and corporate enterprises. The enterprise now being conducted by HKSIF Ltd. is of a size that management of it needs to reflect its complexity and risks. The Company would benefit from bringing in persons to be part of the management of the Company with skills and experience in finance, management, insurance, accounting or corporate business. Corporate governance should be run on accepted lines with committees of the Board. The power of the Council of the Law Society to give directions to the company is not an appropriate division of responsibility for decision making and planning in today's business environment.

The current arrangements in Hong Kong through the mutual scheme, HK SIF, have two drawbacks. These can be removed;

The First:
HK SIF Limited and the present management structures and the Rules under which they operate are cumbersome; the division of functions between the Law Society and HK SIF Ltd overlap. This results in delays, inertia and unresponsiveness that is no longer appropriate for the magnitude of the task of managing an insurance scheme in the prevailing environment.

Outline of Aspects That Could Benefit any Future Operation of the Scheme

- Removal of the contribution formula from the rules.

  The world has changed since 1989 when HK SIF was established. Business today is increasingly conducted by specialists, calling on multi skilled resources and people with expertise in management, finance, insurance, technology and other disciplines. The administration of any insurance scheme when the risk is not wholly placed with others who are operating according to cutting edge practices, is a business activity. If HK SIF Ltd adapts to that environment it has the potential to serve the interests of the profession. It will of necessity continue to administer the run-off of current claims. If it continues as the entity to review the allocation of premium under a master policy, to activate a QIS when, [if], conditions are evaluated as suitable, to establish and review minimum terms, or continues to administer the present arrangements from 2005, the recruitment of others from disciplines other than the practice of the law is likely to enhance its operation in line with modern business practice. Depending on the level of its activity and functions, recruitment of a qualified Chief Executive Officer, who is a professional manager and answerable to a Board of Directors comprised of not only solicitors would be desirable. The addition to the Board of Directors with experience in finance, capital risk management, corporate accounting and insurance is likely to enhance performance.

- Quarantine business and commercial decisions about insurance from the Society's other functions.

- The Rules require any alteration of the contribution formula to be made by solicitors to the premium pool to be approved by Council of the Law Society, the Chief Justice and

any change is liable to veto by the Legislative Council. The process of assessing the need to increase the contributions is: the claims data at 31st March is compiled; that data must be analysed, preferably by an actuary, and the results collated into reports; Essar reports to HK SIF Ltd, Aon then markets the risk to reinsurers, obtaining quotations and reports to HK SIF Ltd; HK SIF Ltd considers the reports and decides on the options; HK SIF Ltd then recommends to Council; Council deliberates. If Council decides to make any change a report must be sent to the Chief Justice. If the Chief Justice approves the proposal, Council votes on the proposal; only then can Aon place the reinsurance in time to calculate and invoice the profession no later than August. Each step needs time and deliberation. The process is not conducive to efficient or timely response to emerging trends in claims, the commercial realities of the insurance market, and the performance by the brokers of their function. The possibility that the Legislative Council may veto the change after the reinsurance has been placed and contractual arrangements entered into with re-Insurers makes the process even more unwieldy. In a hard market especially, insurers are likely to commit their capacity to business that is easier to transact. The ability of the brokers to secure any deal is hampered.

- Review and adopt for HKSIF Ltd management practices prevailing in business enterprise.

- The Rules give power to the Council of the Law Society to give directions to the Board of Directors of HK SIF Ltd. That power may not be conducive to the exercise by the Directors of the company HK SIF Ltd of the level of independent judgment and responsibility imposed by law on directors in the exercise of their duties as directors. At the least it is capable of creating a perception that the Company is the alter ego of The Council. A degree of actual separation between the Council and the operation of what is a business activity, is desirable. Sometimes unpopular decisions must be made on business grounds, a speedy response to take advantage of favourable negotiations can be beneficial, and there may be need to have a definite decision in a commercially reasonable time. The Board of Directors of the Company are presently hampered in the ability to so respond.

- Review claims reserving procedures and timing. Ideally a benchmark time for setting a reserve after investigating the underlying facts is 6-12 months. The current practice is not to set a reserve, other than in exceptional cases, until a panel solicitors' opinion is obtained. Panel solicitors are not instructed until proceedings are issued. The claims committee is not involved in setting reserves. We recommend that at least once a year the Claims Committee reviews all files and recommends reserves.

- Appointment of Chief Executive Officer to HKSIF Ltd. We suggest that the position of Assistant Director of Professional Indemnity become converted to CEO of HKSIF Ltd. This will enable the holder of that position to have access to the claims, act as the liaison person with the Society, steer risk management in light of the knowledge of the claims and demonstrate the independence of HKSIF Ltd from the Society. A permanent CEO accords with accepted good corporate governance practices in today's environment.

The Second:
Members of the profession, the beneficiaries of, and contributors to, the mutual scheme are so disenchanted with the current arrangements that continuing with it could be counterproductive. If the arrangements are unacceptable, those administering it, The Law Society, will not have the confidence of the members it represents. Without that confidence the efforts of the Society to promote a risk management culture among the firms are impaired. The level of dissatisfaction with the current arrangements has eroded the acceptance by a large number of solicitors of the value of the good standing of the profession, public confidence in the solicitors of Hong Kong and loyalty to fellow members of the profession The extent of the financial subsidy by good risks of bad risks is seen as so expensive that it is intolerable.

The insolvency of the HIH Group has exacerbated this decline in confidence so much so that the concept of mutuality as members of the same profession, which is the ideological foundation of a mutual fund's existence, no longer appeals to a significant portion of the profession. Changes to the rating formula, higher payments by those with claims, modernisation and enhancement of the management skills of HK SIF Ltd, risk management rewards by way of reduced claims and a realization by the Profession that the unfortunate factors leading to present dissatisfaction have been guarded against for the future ought to redress these issues and afford public interest the required protection.

2.2.8 Captive Insurers

If a captive insurance company was established in 2005 capping of the exposure of the profession could be achieved because of the ability to wind up the captive should a reinsurer became insolvent. In all other respects, so far as the insured solicitors are affected, a captive would operate as HK SIF does now.

The cost of managing and establishing the captive would not be disproportionate to the value of having limited liability. To be successful the captive would need to be managed on commercial considerations, by professionals in insurance related disciplines, and to have overall control of its day to day activities including terms of cover, allocation of premiums to the profession, claims management. selection of re-insurers, setting of premiums, appointment and evaluation of panel solicitors, recruitment of staff, its operating budgets and expenditure, investment of funds and compliance with statutory obligations.

The captive would ultimately be responsible to the Law Society which would appoint and dismiss the Directors and exercise its voting rights. If there was not that extra one degree of separation and independent operational management the captive would from the profession's perception be another HK SIF. It is not necessary to create a captive to achieve capping of exposure to reinsurer insolvency. This can be achieved by another option. A captive would also be an insurer and liable as such under the Third Parties (Rights Against Insurers) Ordinance. (see HSBC v HK SIF Ltd). AS HKSIF is a statutory fund it has benefits beyond those of a captive.

2.2.9 Uncertainties affecting 2005

The following factors are relevant to the assessment of the risk of insuring the Hong Kong profession, either as a group under a mutual fund, or as individual firms. These uncertainties are likely to affect the appetite of new insurers to enter the market in 2005 or to affect the premiums [in an upward direction]

(a) Entry of Hong Kong solicitors into business in mainland China.
(b) Entry of mainland Chinese solicitors into Hong Kong legal services market.
(c) The enactment of legislation to implement a registered title system for land, currently with a proposed requirement for solicitors to certify that the applying person has good title to interest being registered, which then defeats all other prior interests.
(d) An enquiry by the Administration on the feasibility of establishing a scheme to compensate policyholders in the event of an insurer's insolvency. This could potentially be funded by insurers.
(e) Civil Justice Reform.
(d) Entry of China into the World Trade Organisation.

The cornerstone of all commercial insurance is the ability of an insurer to assess and put a price on a risk. Aspects such as the above potentially create instability of the risk and make it difficult to predict what effect these factors will have in 2005, especially if the market is still in a hard cycle as expected.

If a master policy, captive insurer or the status quo is operating from 2005, each involves the allocation of a single premium pool among solicitors in the profession. Unless that allocation is accepted as fair by the members of the profession it is likely to be unacceptable to the great majority. Those allocating the pool are currently constrained by the structures surrounding the process and the time and resources needed to review and implement any change. As HK SIF will continue until the runoff of claims notified prior to September 2005 is finished and because it has established processes and persons with experience involved in its work it can play a role as a standing review entity, monitoring; conditions in the insurance market, solicitors changing needs for cover, and any deficiency in public protection.

2.2.10 Allocation of Contributions

When allocating the cost of any premium under a policy, or through a captive insurer or under a mutual we recommend that the present approach be modified in the following way to introduce greater financial incentives for adopting risk management and to collect more from firms notifying losses.

(a) Solicitors who derive their fees from areas of practice or from activities which have experienced substantial claims pay higher contributions. On current claims history these areas are conveyancing, civil litigation and securities over interests in hand.

(b) Consistent with a "user pays" approach, deductibles be increased for all and substantially increased for certain claims. The increasing of deductibles is a sound incentive for every firm to pay attention to its risk management efforts and will reduce the overall loss paid by insurers and the total premium pool while adversely affecting only those who have claims. We could not be given access to claims information in sufficient detail to make detailed suggestions on this aspect. There are conveyancing claims reports, but no details about other types of claims. In other jurisdictions increased deductibles are applied to claims on missing deadlines or statutes of limitation, claims involving mergers or acquisitions of companies, certifications to guarantors or financial institutions or acting when a potential conflict of interest should have been avoided. Each jurisdiction applies penalty deductibles in response to claims trends.

(c) The cap of $HK 200,000 on any deductible be raised to $HK 500,000.

(d) The claims loading Rules be amended to provide that the loading be either as currently formulated **or** 2% of a firm's gross fees payable for three years, whichever is the higher. The loading to be payable from the first renewal two years after notification regardless of whether the claim is paid or outstanding.

(e) A provision similar to that in Scotland be introduced whereby an increased deductible is payable for a claim that was attributed to by the legal service from which it arose being performed at a fee that was unreasonably low compared with reasonable fees for that service necessary to carry out the service prudently and according to professional standards. The claims committee to decide on the issue of causation and the reasonableness of the fee.

2.2.11 Claims Loading

The contributions to HK SIF by those firms with claims and those without are differentiated by a claims loading. The average contribution from loadings on those with claims has been 6% from 1998-2002. The other differentiating payment by firms with claims is payment of the deductible. This is paid once a claim is finalised and a payment made to the claimant. For the years from 1986-2002 deductibles were 6.1% of all payments made on claims. There were 230 paid claims as at 30th September 2002. The amount of deductible payable did not increase between 1986 and 2001 when a penalty deductible was introduced for firms with more than one claim in 3 years. Sixteen firms in the previous 5 years fell into that category. The change is not retrospective. Increasing deductibles generally and increasing the capped maximum of $HK 200,000 is a step that is desirable to achieve a greater balance between those managing their risks and avoiding claims and those who are not.

If a loading is payable after 2 years of 2% of gross fees on open claims, precautionary notifications of claims will not be penalised or discouraged. In the normal course after two years a claim will have a reserve which affects premiums, because it is a loss the same as a payment, or it ought to be closed waiting until a claim is paid to collect. A loading is a generosity that is unaffordable. To fairly administer the loading all notifications must have their potential liability assessed within 2 years, a practice which can only benefit the scheme. Those that are assessed as having no potential liability ought to be closed. Loadings are then imposed only on open claims with liabilities. A precautionary notification is a "near miss". It ought to be an incentive to consider a practice's risk management procedures. If the claims managers interview the firm's representative, and read the file, not only will liability be assessed early, but the firm will be involved. The possibility of a loading in two years is a good focus towards risk management.

Defence Costs as a Proportion of losses as at 30 September 2003

We set out in the following table how much it is costing to defend and investigate claim.

Table No. 4

Policy Year	Total Payment	[illegible]	Total Reserve	[illegible]
1987	13,754,211.82	38.9%	-	-
1988	29,236,370.00	24.1%	1,495,562.20	25.8%
1989	12,470,291.29	64.1%	-	-
1990	7,581,520.16	44.1%	426,672.00	53.1%
1991	8,660,713.49	38.4%	914,850.67	26.3%
1992	40,317,944.39	24.3%	6,526,990.41	27.5%
1993	30,200,125.46	47.9%	11,362,664.61	5.4%
1994	47,041,654.77	19.2%	14,524,753.97	6.6%
1995	80,529,797.10	22.3%	22,344,100.90	13.0%
1996	73,026,047.07	25.8%	44,657,246.38	9.5%
1997	143,079,855.62	26.8%	87,540,398.95	7.5%
1998	226,367,898.28	26.9%	168,608,303.32	4.4%
1999	51,026,795.34	39.0%	78,780,272.45	8.7%
2000	26,105,191.17	54.8%	71,785,254.61	4.5%
2001	11,415,442.67	88.7%	65,006,033.57	6.0%
2002	1,213,197.62	67.0%	23,865,548.08	6.1%

Average Defence costs as a percentage of total payments (1987-2000)	29.2%
Average Defence costs as a percentage of total reserves (1987-2000)	7.0%
Average Defence costs as a percentage of total payments and reserves (1987-2000)	20.5%

The percentages in the above table are affected by the fact that the last 4 are on yet undeveloped in the profession of claims. Assume for the sake of argument that 20% of all liabilities of the Scheme is the cost of defending claims that is HK$277,000,000. It is probable that the amount paid to claimants' solicitors would be approximately the same. One obvious method to reduce losses is earlier and less adversarial claims resolution. That is achieved by

alternate dispute resolution. We cannot comment further as we have not seen any claims files to know if matters are mediated rather than litigated.

Regardless of whatever arrangement is in place in Hong Kong from 2005 and beyond the claims experience of the profession has caused the current pricing situation. Even if solicitors had total freedom to buy any insurance they choose with no restraints or requirements to protect the public, as long as the claims record is not ameliorated and the continuing claims redressed all solicitors will pay to some extent.

In an open market situation insurers still have to make a profit or they will not transact the business. The impact of claims is not felt so immediately or uniformly by firms in an open market environment. Ultimately the cost of claims will be passed on to everyone insuring. The whole hearted, widespread and vigorous adoption by firms of improved risk management techniques, procedures and standards cannot be underestimated. The lack of that so far has to be the explanation for the burgeoning losses. Those that do invest the time and resources to evaluate their firm's risks, take steps to manage that risk, introduce systems, train staff and constantly monitor adapt and improve their risk profile will benefit.

Regardless of what insurance arrangements are in place those who do not manage risks will either have to be subsidised by those that do or become uninsurable. The different arrangements will affect to what extent that subsidy occurs, who pays that subsidy, whether its cost is spread uniformly or differentially and who is best placed to decide how it is spread. A mutual fund, a captive insurer a qualifying insurer arrangement with an ARP, and a master policy all protect firms with claims from the consequences of those claims.

2.2.12 Compulsory Insurance

Even without those mechanisms insurance is by definition a business involving subsidy of the bad risks by the good. Left to the open market solicitors would be in no better or worse position as purchasers of insurance than any other person. The difference with professional indemnity cover is that it must protect the public, and ensure that a person who suffers loss arising from a solicitor's negligence must be assured of receiving compensation. That is prescribed in our terms of reference, has been stated by the Department of Justice as the policy of the government of Hong Kong and is a restriction on the freedom of choice that the solicitors of Hong Kong want.

2.2.13 Insurance is a Business Expense

Accepting that the freedom of choice by solicitors must be restricted because of the requirement of public protection does not mean that the cost of that insurance should be exclusively borne by the profession in all circumstances. Insurance is a cost of doing business. Any business passes on its cost to the clients of that business. The insolvency of HIH has made it impossible to recoup the cost from clients because the amounts now outstanding for past claims relate to what should have been passed on as business costs when charging for services rendered mainly in 1996- 2001 inclusive. Neither the clients nor the solicitors are responsible for the default of HIH. It seems fair that the burden of HIH's default is transparently passed on to the beneficiaries of the existing insurance whose interests are the main justification for solicitors current financial predicament. We have raised for consideration the method by which this is done as a matter of course in Ontario and we recommend that approach if there is an undue financial being imposed on firms who are being driven out of practice. As stated in our report we have been unable to confirm how many firms are in that parlous position and why the cost of insurance cannot be passed on to clients as in any other business.

2.2.14 Freedom of Choice

Freedom of choice in descending order

1. An open market arrangement with each solicitor or firm free to choose whatever terms of cover they can obtain, from any insurer of their choice provided the **limit of indemnity is equal to a set minimum**. This would harm the public interest because it would give no certainty that if a claim was justified a member of the public could be assured of compensation, regardless of the financial standing of the solicitor. It would make it administratively unfeasible for practising certificates to be issued with confidence that insurance was in place, would be maintained for the period of the practising certificate, and would respond when a compensation was rightfully due to a member of the public.

2. **Minimum terms and set limit of indemnity** for the public interest established by the Society providing that the cover could not be cancelled during the period for which a practising certificate was issued .This would harm the public because the likely result would be that a number of bad risks would not be able to purchase cover at an affordable price and would cease practice. This would protect the public against future negligent legal services but not against claims. At the time uninsurable firms cease practice there will be years of past services from which a claim could arise for as long a period as the statutes of limitation allow. With a claims made cover, (which all PI insurance is), there would be no run off cover for claims made against firms who are the worst risks arising from previously rendered services. Members of the public could not count on recovering compensation if so entitled and would have to take their chances of recovering against the personal assets of the solicitors concerned, who may have insufficient, who may have left Hong Kong, died or have their assets protected from sequestration.

3. **A qualifying insurer scheme with an assigned risks pool.** This arrangement for insurance would solve the potential harm to the public discussed in paragraph 2, while preserving freedom of choice if insurers were willing to participate in such an arrangement in sufficient numbers to create and maintain some choice.

4. **The existing Hong Kong Solicitors Indemnity Fund.** Choice of insurer with this arrangement still exists, but it is not individual firms or solicitors that make the choice. The choice is made by Hong Kong Solicitors Indemnity Fund Ltd and the Society. The range of insurers to choose from with this arrangement is likely to be greater than those participating in a QIS.

2.2.15 The Public Interest

Every legal service provided to a member of the public comes with a whole package of safeguards: -

- Clients' money is protected by rules made by the Society relating to trust funds including intervention in a solicitors practice.
- Qualification for practice by legal education, admission and continuing professional development ensures appropriate skills of solicitors.
- The power of the Society and of the Disciplinary Tribunals to investigate complaints, take disciplinary action and impose sanctions on solicitors.
- Legal professional privilege.
- Rules of conduct governing solicitors.
- Procedures for reviewing costs charged.
- Compulsory professional indemnity insurance.

The Profession, and the Society as its representative currently provide clients with a level of protection which is unique amongst professionals.

Classification of Insurance

The classification of various arrangements according to the security of available compensation and benefits they provide to the Public in descending order;

1. **A mutual fund.** The terms of cover are uniform and the group being self insured provide financial security as the mutual fund can protect the public and insured in the event of a shortfall by making calls on the members. Run off cover can be provided for all solicitors. It is able to avoid unavailability of some cover during hard market cycles. Cover is guaranteed to all and risk management education can be co-ordinated and even imposed to improve service delivery standards to the public.

2. **A QIS with an ARP** ranks second most favourable. It has the same benefits as a mutual but has no protection for solicitors who have outstanding claims, or for the public, if an insurer becomes insolvent, as there is no general compensation scheme for policy and holders in Hong Kong. It is subject to market cycles and run off cover may not be available for indefinite periods. At other times necessary terms may not be available. It guarantees cover to all except for those who cannot obtain cover after leaving the ARP.

3. **A master policy** arrangement ranks behind a QIS with an ARP because runoff cover cannot be guaranteed and the market determines the terms of the master policy not the professional body. Long term availability of necessary terms of protection is less than with a QIS as in a hard cycle exclusions are likely to be introduced to limit the insurer's risk.

4. **Purchase in the open market when the terms are prescribed.** This enables a greater number of insurers to participate in the business thereby proportionately reducing the number of people who might be adversely affected by a single insurer's insolvency. It is adverse to the public in that as there would be no ARP if a solicitor was unable to obtain cover, that solicitor would not be able to exercise full earning capacity. Claims made after becoming uninsured arising from work done before having to cease practice would not be assured of compensation for the public. Rights of recovering compensation would have to be enforced against a solicitor who could not practise and earn income as a solicitor.

5. **A captive insurer.** The motivation for a group establishing a captive as opposed to maintaining a mutual scheme is the ability to wind up the captive if there is a shortfall between claims losses, expenses (which includes re-insurance premium), or reinsurer failure. In other respects a captive operates the same as a mutual. The differentiating characteristic is the one that does not benefit or protect the public. On winding up the captive, the insured would not have cover for past claims and the public could not be assured of compensation. If run off cover had been given prior to the winding up, retired solicitors would no longer be covered against claims for work done prior to retiring. Any member of the public with a right to compensation could not be ensured of recovering it from the assets of the retired solicitor.

6. **An open market arrangement** when a solicitor could purchase cover on any terms up to a specified limit of indemnity, could not provide confidence in a member of the public having the benefit of insurance against a solicitor's mistakes. Some firms could negotiate appropriate protection others would be liable to having claims for indemnity denied, purchasing the cheapest cover to get a practising certificate which may not provide any indemnity if a claim arose.

2.2.16 Lowest long term price

The arrangements best designed to provide the lowest long term price of appropriate protection (to be distinguished from value for money) varies according to whether a firm has claims or not. We have set out in descending order the insurance arrangements for solicitors without major claims likely to give the lowest **long term** price. In doing so we have estimated that one in three solicitors will have a claim over 20 years of a practising life.

1. **Open market** with no terms prescribed other than the limit of indemnity. The price will vary with market conditions, but in the long term for individual firms price can be negotiated according to the skills of the individual provided adequate understanding of the product being purchased exists. Solicitors purchasing can keep the price low by reducing the risk carried by the insurer by such things as more exclusions, higher deductibles, aggregate limits on claims and reduction of activities covered.

2. **A mutual** insurance arrangement can keep premiums lower because investment income on premium pending payment of claims is used to subsidise administration costs, no profit is retained and thereby premiums are lowered. In a soft market premiums for individual members may be cheaper in the open market .In a hard market a mutual ought to be lower. Over the long term the mutual can offer lower premiums to the majority, but some will benefit in the open market.

3. **A captive insurer.** The premiums of a captive would reflect the investment income that is earned and which is used to reduce premiums. The costs of establishing a captive, administration and corporate compliance are higher than under a mutual and income tax is payable on investment income. Those aspects make it slightly more expensive than a mutual, which is reflected in the premiums it must charge.

4. **Open market with minimum terms prescribed.** The insurers must return a profit and in a soft market will rely on investment income to subsidise underwriting losses. Over a period of insurance cycles the premium must reflect the profit to justify continuing the business. They have the flexibility to control the premium and the risk by selecting, or "cherry picking" only those firms they want.

5. **A master policy** requires insurers who subscribe to it to underwrite all risks and they cannot refuse any insured. They have to make a profit. They do have the benefit of negotiating with one entity and the certainty of a whole group with no competition. The certainty of the bulk or critical mass affords some savings and reduces the premium because the market is unfragmented.

6. Under a **QIS** premiums are priced according to market conditions and the insurers must make a reasonable profit. If the portfolio is not large enough administration costs are disproportionate to overall income and this adds to the premium when compared with an unfragmented arrangement such as a captive. With an ARP the cost of contributing to the ARP for those otherwise uninsurable firms is passed on to other insureds. A QIS has pricing features similar to a master policy, but without the guarantee of full market share, either initially or annually.

2.2.17 Protection from being driven out of practice by uninsurability

If a firm never has major claims there is no descending order of insurance arrangements most beneficial in protecting that firm's solicitors from being driven out of practice. The following is the descending order of the efficacy of insurance arrangements in saving solicitors from having to cease practice because of insurance not being available. Major claims in this context refers to having a number of moderately costly claims far exceeding premiums paid over a number of years: claims exhibiting recklessness, very expensive claims in a short

period, and matters that indicate a lack of risk management. There is no hard and fast rule. Insurers look at risk. Two claims costing a small amount that were from the same error which was made several years apart indicates lack of ability to learn from mistakes and introduce risk management . That could be treated as major compared with one claim costing ten times as much that was caused by a dishonest employee who has now been dismissed and procedures established to ensure that type of error cannot happen again. Recklessness displayed in the facts causing the claim, failure to take remedial steps to prevent a similar thing happening, multiple claims continuing over several years, all could lead a firm to becoming uninsurable, as opposed to being charged very high premiums.

1. **A mutual fund**, a captive and a QIS with an ARP provide absolute protection against uninsurability.

2. **A master policy** arrangement provides very good protection against uninsurability but it is possible in a hard market for an insurer under a master policy to refuse insurance. It would rarely happen but it is possible.

3. **An open market** arrangement where only the limit of indemnity is prescribed provides very little protection against uninsurability but there is the option that an insurer can charge very high premiums and reduce exposure by minimum terms of cover and exclusions.

4. Under an **open market scheme but with terms prescribed** to ensure availability of compensation to the public the insurer cannot customise cover and the solicitors are most vulnerable to being denied insurance comparative to other arrangements. An analogy would be with medical insurance. An insurer might insure someone for all health risks other than heart attack if a person had high blood pressure and a history of chest pains. If the insurer was not free to exclude cover for heart attack there is a greater likelihood that all cover will be declined.

2.2.18 Capping liability of the Profession

HK SIF and the Profession are experiencing the consequences of the insolvency of HIH as well as a claims experience which has made it unaffordable to buy stop loss cover to limit the overall exposure of the profession to pay for the liabilities of claims from past years. We list in descending order of effectiveness the level of protection against such exposure potentially provided by the insurance arrangements we have discussed in this report.

1. A **master policy**, a **QIS**, and an **open market** arrangement either with prescribed minimum terms or prescribed limit of indemnity, all provide complete protection from liability of the whole profession for any losses of other solicitors in the profession. This is because no liability is assumed for anything other than to pay the agreed premium.

2. **A captive insurer** exposes the profession to a risk because such liability can only be avoided by winding up the company. Although the company as a matter of law could be wound up in practice it may not be acceptable. Issues of the future ability of the Profession to run a scheme would arise as well as the fitness of the Legal Profession to regulate it. If the captive was wound up due to re-insurer insolvency it may be acceptable for members of the public and solicitors to bear the consequences of insolvency, but the disregard of the public interest in favour of solicitors' interests might have other ramifications for the Profession that could result in the captive not exercising the facility to avoid liabilities even though legally entitled to do so. With that proviso we consider a captive provides almost complete protection on this aspect

3. **A mutual scheme set up as a fund to pay a deductible under a single commercial policy** affords a very high level of protection against uncapped exposure. For example: with a limit of indemnity for each and every claim of ten million if a single commercial policy was issued to the Society whereby the single commercial policy insurers agreed to indemnify each solicitor according to terms agreed by the Society, in the event of

insolvency of a master policy insurer there would be no liability for the profession to meet that insolvent insurer's share.The cost savings of a mutual would still be available if the mutual under statutory powers bound itself to pay out of the fund the first HK$1.5 million of each claim less the insured's excess.

4. **A mutual fund** that has primary liability for each and every claim and protects itself by reinsurance carries the risk of exposure to the full quantum of all losses in the event of reinsurer insolvency.

2.2.19 Past Losses Still Remain

The finalisation of the existing claims as at 2005 must be administered. The money to pay those liabilities can come from the profession, the public or from both. The Law Society and the members of the profession can jointly lobby the Government of Hong Kong to approve a levy on all conveyancing transactions of, say, $HK 50 to be applied for a period of 4 years and then reviewed as a method of funding the amount for which HIH would have been liable were it not in liquidation. That levy should be part of the insurance contribution if the Fund continues to collect contributions after 2005 If not one of the criteria for a commercial insurer could be that the insurer collects the levy and pays it to HK SIF. HK SIF must continue to administer the runoff of claims notified up to September 2005. As it is in place it seems sensible and efficient for it to collect any levy. The levy can be charged to the client as a disbursement. Even without a transparent levy as insurance is a business cost and there is no mandatory fee scale it ought to be passed on. We append the Rules of the Law Society of upper Canada as an example of this strategy. (Appendix 7, page 189).

SECTION 3

STRUCTURE OF INSURANCE ARRANGEMENTS

3.1 BASIC STRUCTURE OF INSURANCE ARRANGEMENTS

History Of Professional Indemnity Insurance Arrangements

1980-1986

In 1980 it became compulsory for all solicitors in private practices in Hong Kong to arrange and maintain professional indemnity insurance with authorized insurers. Authorised insurers were those who entered into a Master Policy with the Society as agent for its Members. Insurers issued individual Certificates of Insurance to firms and in the event of a claim the insurers representatives managed the claim direct with the Insured. The Society's role was to set the terms of cover, through its brokers, chose the insurers from those offering quotations and to agree the premium for the whole of the profession. The insurers entered into a direct contract of insurance with the Society and issued evidence of insurance to each firm who paid the premium direct to the insurers. There was no insurer insolvency during this period, but had there been any consequences would have been borne only by the firms against whom claims were made, and to their clients.

This collective bargaining arrangement had the potential to benefit the Members by taking advantage of savings from "bulk purchasing" as well as providing Members with the collective expertise of The Society on insurance cover, technicalities and insurance law which individual members may not have had themselves. The formation of this arrangement was in response to requests by small firms at a time of high inflation. Small firms expressed concern that their total assets could be lost if they faced a claim. The large firms at the time had the resources and technical insurance knowledge to arrange their own insurance and usually had done so. They were concerned that a collective marketing arrangement would lead to their premiums increasing because of the claims losses of small firms.

The cost of insurance and the extent of protection available in the insurance market is determined by a number of factors. The two major factors are claims losses and whether the insurance market is in a hard or soft cycle.

By the mid 1980s a hard period in the insurance market cycle was occurring, and the claims of the Profession were rising. The Society had negotiated two three year contracts from 1980 but by the end of the second the above two influences were driving premiums higher. Purchasing insurance as a group from the same insurer results in that insurer having data on risk and losses for an extended period. When first entering into a collective pricing arrangement the insurer is to some extent only able to estimate the premium as there is little data of actual losses through claims.

If the programme continues over several years, eventually the insurer will have statistics or experience of the frequency with which claims occur and of their average cost. If assessment of the risk has been underestimated due to lack of data when the price [premium] was first negotiated, inevitably, the insurer will increase the price once more reliable statistics are known.

Even with reliable long term information the risk can increase suddenly from claims prompted by economic conditions. As a result of the Sino-British talks on resumption of sovereignty Hong Kong went through another property value and development slump in 1982 - 1984. This resulted in a significant number of claims against the Members. That in turn resulted in the insurers of the arrangement seeking substantially increased premiums in late 1985.

1986-1989

In 1986 the first statutory scheme under which not all risk was placed in the insurance market was established. It commenced on 1st October 1986. The major change from the previous six years was the introduction of a layer of self retained risk by the Profession. The arrangement was effected (in simple summary) by policies issued to the Society under which premium matched losses with a refund if losses were below stipulated level.

In 1989 The Society incorporated The Hong Kong Solicitors Indemnity Fund Limited as a company limited by guarantee and appointed it the Manager of the Scheme .The powers of the Company are set out In Schedule 2 of The Solicitors (Professional Indemnity) Rules. The exercise of its powers is subject to directions of the Council. This development was a fundamental change from previous arrangements as the Profession became the direct underwriter of all of its risks with primary obligations for providing indemnity. From this point on HK SIF was the principal indemnity carrier, and the commercial insurance market the secondary re-insurers of liability.

In Law Society Circular 129/89 dated 14th August 1989, when the mutual fund came to be managed by HK SIF Ltd (the Company) and Essar, the President of the Society explained the reason for the change as follows:-

> *(1) The Company will act as its own insurer of the self-insured fund so that it is no longer necessary to have an insurer to 'front' and issue policies, thereby saving costs*
>
> *(2) The Company will in effect act as leading insurer in respect of excess of loss cover and stop loss cover so that through Essar it can pick and choose re-insurers. Such freedom of choice would give the Company complete flexibility in manoeuvring the scope and extent of cover and premium rates to suit our needs.*

At that point in time freedom of choice and potential cost savings were the paramount considerations. Claims experience was good, the commercial insurance market was soft, and reinsurance was affordable and readily available, the possibility of re-insurer default was remote and the economy was not in recession.

3.1.1 Recommendation

Our recommendation is that this assumption of primary liability for the compulsory full limit of indemnity be altered so that if HK SIF continues it has direct liability only for the actual limit of risk that it chooses to retain.

Re-insurer default currently leaves HK SIF with the primary liability for each and every claim up to a limit of HK$ 10 million. It is preferable for insurers to have direct liability to solicitors for the level of indemnity they underwrite so that if an insurer does become insolvent not all members of the Profession will have to subsidise the loss, unless they choose to do so.

The benefits of a mutual fund can still be realised. In effect the arrangement is a single commercial policy with a mutual fund to pay the first layer of risk. That arrangement offers cost savings, uniform terms, bulk purchasing power, claims management input by HKSIF and a scheme that provides every incentive for the Society or HKSIF to co-ordinate risk management education for long term benefit. It also ensures run-off cover for solicitors ceasing practice.

3.2 TERMS OF INSURANCE AND REINSURANCE ARRANGEMENTS

The indemnity arrangements for the solicitors of Hong Kong for the policy year from 1/10/03 to 30/9/04 and the re-insurance arrangements are relevantly;

1. HKSIF under the Rules provides indemnity severally to each solicitor with a limit of HK $10 million (inclusive of deductible) each and every claim. The number of claims is unlimited.

2. HKSIF retains HK $1.5 million of each claim's loss and has arranged reinsurance for HK $8.5 million on an unlimited number of claim.

3. A deductible from an insured is due when payment has been made out of The Fund in respect of any claim and HKSIFL requests payment of the deductible from the insured.

4. Deductibles are variable according to 2 factors
   - the number of solicitors in the firm liable to pay the deductible at the relevant time
   - the total number of claims against the firm (or former practitioner) in the year of the claim and in the 2 preceding policy years (Penalty).

   The relevant time under clause 2A of Schedule 3 to the Rules is when the claimant makes the claim or when the insured notifies Essar (whichever is earlier). For a ceased Practice the relevant date is when the cause of action arose.

5. The amount of deductible, each and every claim, without penalty is:
   - Sole Practitioner --$30,000 + $15,000 x number of other solicitors in the firm at the relevant date
   - Partnerships -- $20,000 multiplied by the number of principals in the firm + $15,000 multiplied by the number of other solicitors in the firm at the relevant date
   - Former practitioners (at date of ceasing practice)

Sole Practitioner	$20,000
Partner	$10,000
Assistant solicitor	$5,000

   A capped maximum applies to the application of the above formula - $200,000.

6. Contributions to the fund are calculated on a formula which is set out in Schedule 1 to the Rules. Without repeating the details of the formulae, contributions are determined by the three factors:

   (1) Number of solicitors
   (2) Firms gross fess
   (3) Paid claims of the firm (or the individual partners) for four years.

These three factors affect a basic contribution which is set at HK$20,000 per principal and HK$13,000 per assistant solicitor and consultant. The basic contribution was increased from 1st October 2001. Basic contribution amount in previous years remained at HK$8,500 per principal and HK$5,500 per assistant from 1989 to 2001. It is the basic contribution amount which constitutes the greater part of the total contribution. Variances in the gross fees of firms affect the overall contributions for a policy year. Increases had occurred in the formula that is used to calculate the gross fee element of the firms' contribution between 1989 and 2001, but they did not match the increased exposure from doubling of the limit of indemnity in 1994.

In 1997 HKSIF had surplus funds over its estimated retained liabilities . However, reinsurers were losing money.

Loss ratios of re-insurers assessed as at June 1997 were: -

Year	Loss Ratio
1986	300%
1988	130%
1992	120%
1993	119%
1995	121%

A review group called the Professional Indemnity Scheme Working Party was established to review (among other things) the contribution formula. It was projected that if gross fees of firms declined by 20% the total contributions of the Profession would reduce by 10%. If gross fees reduced by 30% the contribution collection would decrease by 15%. From 1998 to 2000 the number of claims increased by an average 60% (approx.) below the pre 1997 levels. The next increase in the contribution formula was September 2001.

The contributions can be compared with the claims frequency, re-insurance premiums and the profile of the profession, shown in the next three tables.

Table No 5

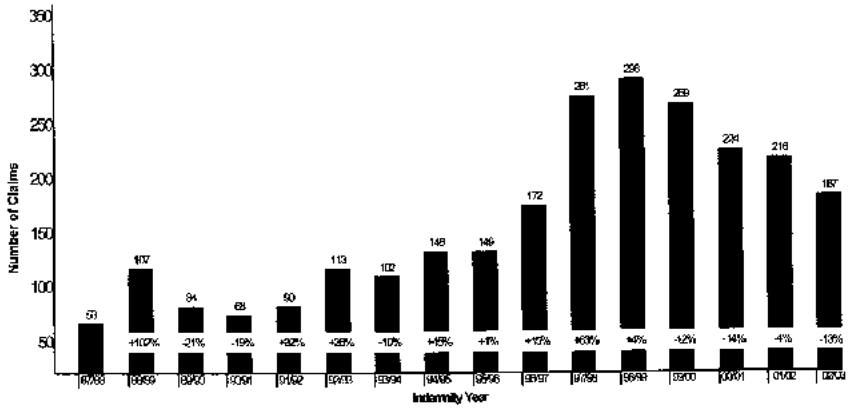


Table 6

Indemnity Year	Annual contributions	Reinsurance
1994/1995	71,107,872	49,015,000
1995/1996	72,015,018	50,175,000
1996/1997	88,894,867	46,190,000
1997/1998	106,778,078	52,755,000
1998/1999	112,178,110	109,090,050
1999/2000	85,231,403	109,090,050
2000/2001	94,700,351	64,869,715*
2001/2002	215,352,931	113,625,000
2002/2003	206,700,014	117,125,545

No. of claims for the past fifteen indemnity years and the number of members as at 30 September 2001 are *(TABLE 7)*: -

Year	Number of Claims*	Increase/Decrease from Previous Year	Number of Members
1986/87	84	--	1,384
1987/88	55	(14%)	1,625
1988/89	119	116%	1,754
1989/90	173	45%	2,060
1990/91	69	(60%)	2,350
1991/92	93	35%	2,572
1992/93	116	25%	2,847
1993/94	152	31%	3,161
1994/95	148	(3%)	3,451
1995/96	151	2%	3,784
1996/97	172	14%	4,197
1997/98	309	80%	4,494
1998/99	292	(6%)	4,612
1999/00	263	(10%)	4,771
2000/01	224	(15%)	4,946

3.3 MINIMUM TERMS AND CONDITIONS

We have appended to DD the minimum terms considered in Ireland to be necessary for the protection of the public and of practitioners (see Appendix 1 of DD pages 63-71). We reproduce below the minimum terms that a qualifying insurer must offer to solicitors in England & Wales.

Minimum Terms and Conditions of Professional Indemnity insurance for Solicitors and Registered European Lawyers in England and Wales

1. Scope of cover

1.1 Civil liability

The insurance must indemnify each insured against civil liability to the extent that it arises from Private Legal Practice in connection with the Firm's Practice, provided that a Claim in respect of such liability

(a) is first made against an Insured during the Period of Insurance; or

(b) is made against an Insured during or after the Period of Insurance and arising from Circumstances first notified to the Insurer during the Period of Insurance.

1.2 Defence Costs

The insurance must also indemnify the Insured against Defence Costs in relation to

(a) any Claim referred to in clause 1.1, 1.4 or 1.6; or

(b) any Circumstances first notified to the Insurer during the Period of Insurance; or

(c) any investigation, inquiry or disciplinary proceeding during or after the Period of Insurance arising from any Claim referred to in clause 1.1, 1.4 or 1.6 or from Circumstances first notified to the Insurer during the Period of Insurance.

1.3 The Insured

For the purposes of the cover contemplated by clause 1. 1, The insured must include -

(a) the Firm; and

(b) each service, administration, trustee or nominee company owned as at the date of occurrence of relevant Circumstances by the Firm and/or the Principals of the Firm; and

(c) each Principal, each former Principal and each person who becomes a Principal during the Period of Insurance of the Firm or a company referred to in paragraph (b); and

(d) *each Employee, each former Employee and each person who becomes during the Period of Insurance an Employee of the Firm or a company referred to in paragraph (b); and*

(e) *the estate or legal personal representative of any deceased or legally incapacitated person referred to in paragraph (c)or (d).*

1.4 Prior Practice

The insurance must indemnify each Insured against civil liability to the extent that it arises from Private Legal Practice in connection with a Prior Practice, provided that a Claim in respect of such liability is first made against an Insured

(a) *during the Period of Insurance; or*

(b) *during or after the Period of Insurance and arising from Circumstances first notified to the Insurer during the Period of Insurance.*

1.5 The Insured - Prior Practice

For the purposes of the cover contemplated by clause 1.4, the Insured must include

(a) *each Partnership or Recognised Body which, or sole practitioner who, carried on the Prior Practice; and*

(b) *each service, administration, trustee or nominee company owned as at the date of occurrence of relevant Circumstances by the Partnership or Recognised Body which, or sole practitioner who, carried on the Prior Practice and/or the Principals of such Partnership or Recognised Body; and*

(c) *each Principal and former Principal of each Partnership or Recognised Body referred to in paragraph (a)or company referred to in paragraph (b); and*

(d) *each Employee and former Employee of the Partnership, Recognised Body or sole practitioner referred to in paragraph (a)or company referred to in paragraph (b); and*

(e) *the estate or legal personal representative of any deceased or legally incapacitated sole practitioner referred to in paragraph (a)or person referred to in paragraph (c)or (d).*

1.6 Successor Practice

The insurance must indemnify each insured against civil liability to the extent that it arises from Private Legal Practice in connection with a Successor Practice to the Firm's Practice (where succession is as a result of one or more separate mergers, acquisitions, absorptions or other transitions), provided that a Claim in respect of such liability is first made against an Insured

(a) *during the Period of Insurance; or*

(b) *during or after the Period of Insurance and arising from Circumstances first notified to the Insurer during the Period of Insurance.*

1.7 The Insured -Successor Practice

For the purposes of the cover contemplated by clause 1.6, the Insured must include

(a) each Partnership or Recognised Body which, or sole practitioner who, carries on the Successor Practice during the Period of Insurance; and

(b) each service, administration, trustee or nominee company owned as at the date of occurrence of relevant Circumstances by the Partnership or Recognised Body which, or sole practitioner who, carries on the Successor Practice and/or the Principals of such Partnership or Recognised Body; and

(c) each Principal, each former Principal and each person who becomes during the Period of Insurance a Principal of any Partnership or Recognised Body referred to in paragraph (a)or company referred to in paragraph (b); and

(d) each Employee, each former Employee and each person who becomes during the Period of Insurance an Employee of the Partnership, Recognised Body or sole practitioner referred to in paragraph (a)or company referred to in paragraph (b); and

(e) the estate or legal personal representative of any deceased or legally incapacitated sole practitioner referred to in paragraph (a)or person referred to in paragraph (c)or (d).

1.8 Award by legal ombudsman

The insurance must indemnify each Insured against any amount paid or payable in accordance with the recommendation of the Legal Services Ombudsman or any other regulatory authority to the same extent as it indemnifies the Insured against civil liability.

2 Limit of insurance cover

2.1 Any one Claim

The Sum Insured for any one Claim (exclusive of Defence Costs)must be at least f 1 million.

2.2 No limit on Defence Costs

There must be no monetary limit on the cover for Defence Costs.

2.3 Proportionate limit on Defence Costs

Notwithstanding clauses 2.1 and 2.2, the insurance may provide that the Insurer's liability for Defence Costs in relation to a Claim which exceeds the Sum Insured is limited to the proportion that the Sum Insured bears to the total amount paid or payable to dispose of the Claim.

2.4 No other limit

The insurance must not limit the Insurer's liability to any monetary amount (whether by way of an aggregate limit or otherwise)except as contemplated by clauses 2.1 and 2.3.

2.5 One Claim

The insurance may provide that all Claims against any one or more Insured arising from the same act or omission or from one series of related acts or omissions will be regarded as one Claim for the purposes of the limits contemplated by clauses 2.1 and 2.3.

3 Excesses

3.1 The Excess

The insurance may be subject to an Excess of such monetary amount and on such terms as the Insurer and the Firm agree. Subject to clause 3.4, the Excess may be 'self insure' or partly or wholly insured without regard to these minimum terms and conditions.

3.2 No deductibles

The insurance must provide that the Excess does not reduce the limit of the Insurer's liability contemplated by clause 2.1.

3.3 Excess not to apply to Defence Costs

The Excess must not apply to Defence Costs.

3.4 Funding of the Excess

The insurance must provide that, if an Insured fails to pay to a Claimant any amount which is within the Excess within 30 days of it becoming due for payment, the Claimant may give notice of the Insured's default to the insurer, whereupon the Insurer is liable to remedy the default on the Insured's behalf. The insurance may provide that any amount paid by the Insurer to remedy such a default erodes the Sum Insured.

3.5 One Claim

The insurance may provide for multiple Claims to be treated as one Claim for the purposes of an Excess contemplated by clause 3.1 on such terms as the Firm and the Insurer agree.

4 Special conditions

4.1 No avoidance or repudiation

The insurance must provide that the Insurer is not entitled to avoid or repudiate the insurance on any grounds whatsoever including, without limitation, non-disclosure or misrepresentation, whether fraudulent or not.

4.2 No adjustment or denial

The insurance must provide that the Insurer is not entitled to reduce or deny its liability under the insurance on any grounds whatsoever including, without limitation, any breach of any term or condition of the insurance, except to the extent that one of the exclusions contemplated by clause 6 applies.

4.3 No cancellation

The insurance must provide that it cannot be cancelled other than if (and with effect from the date upon which)

(a) the Firm's Practice is merged into a Successor Practice, provided that there is insurance complying with these minimum terms and conditions in relation to that Successor Practice; or

(b) replacement insurance complying with these minimum terms and conditions commences.

Cancellation must not affect the rights and obligations of the parties accrued under the insurance prior to the date of cancellation.

4.4 No set-off

The insurance must provide that any amount payable by the Insurer to indemnify an Insured against civil liability to a Claimant will be paid only to the Claimant, or at the Claimant's direction, and that the Insurer is not entitled to set-off against any such amount any payment due to it by any insured including, without limitation, any payment of premium or to reimburse the Insurer.

4.5 No 'other insurance provision

The insurance must not provide that the liability of the Insurer is reduced or excluded by reason of the existence or availability of any other insurance other than as contemplated by clause 6.2. For the avoidance of doubt, this requirement is not intended to affect any right of the Insurer to claim contribution from any other insurer which is also liable to indemnify any Insured.

4.6 No retroactive date

The insurance must not exclude or limit the liability of the Insurer in respect of Claims arising from incidents, occurrences, facts, matters, acts and/or omissions which occurred prior to a specified date.

4.7 Successor Practice -'double insurance'

The insurance may provide that, if the Firm's Practice is succeeded during the Period of Insurance and, as a result, a situation of 'double insurance' exists between two or more insurers of the Successor Practice, contribution between insurers is to be determined in accordance with the relative numbers of Principals of the owners of the constituent practices

immediately prior to succession.

4.8 Advancement of Defence Costs

The insurance must provide that the Insurer will meet Defence Costs as and when they are Insured, including Defence Costs incurred on behalf of an Insured who is alleged to have committed or condoned dishonesty or a fraudulent act or omission, provided that the Insurer is not liable for Defence Costs incurred on behalf of that Insured after the earlier of:

a) It is satisfied in good faith that there is a reasonable prospect that the coverage dispute will be resolved or determined in the Insured's favour; or

b) That it is fair and equitable in all the circumstances for such direction to be given

4.9 Resolution of disputes

The insurance must provide that, if there is a dispute as to whether a practice is a Successor Practice for the purposes of clauses 1.4, 1.6 or 5.3, the Insured and the Insurer will take all reasonable steps (including, if appropriate, referring the dispute to arbitration)to resolve the dispute in conjunction with any related dispute between any other party which has insurance complying with these minimum terms and conditions and that party's insurer.

4.10 Conduct of a Claim pending dispute resolution

The insurance must provide that, pending resolution of any coverage dispute and without prejudice to any issue in dispute, the Insurer will, if so directed by the Law Society of England and Wales, conduct any Claim, advance Defence Costs and, if appropriate, compromise and pay the Claim. The Society will only give such direction if:

(a) it is satisfied in good faith that there is a reasonable prospect that the coverage dispute will be resolved or determined in the Insured's favour; or

(b) that it is fair and equitable in all the circumstances for such direction to be given.

4.11 Minimum terms and conditions to prevail

The insurance must provide that

(a) the insurance is to be construed or rectified so as to comply with the requirements of these minimum terms and conditions; and

(b) any provision which is inconsistent with these minimum terms and conditions is to be severed or rectified to comply.

4.12 Period of Insurance

The Period of Insurance must not expire prior to 30 September 2004, provided that a policy of insurance incepting prior to 1 September 2003 and written on terms that the Period of Insurance shall expire on 31 August 2004 may expire either on 31 August 2004 or on 30th September 2004.

5 Run-off cover

5.1 Cessation of the Firm's Practice

The insurance must provide that, if the Firm's Practice ceases

(a) during the Period of Insurance; or

(b) on or after expiry of the Period of Insurance and the Firm has not obtained succeeding insurance in compliance with these minimum terms and conditions, the insurance will provide run-off cover.

5.2 Scope of run-off cover

The run-off cover referred to in clause 5.1 must indemnify each Insured in accordance with clauses 1.1 to 1.8 (but subject to the limits, exclusions and conditions of the insurance which are in accordance with these minimum terms and conditions) of the insurance which are in accordance with these minimum terms and conditions on the basis that the Period of Insurance extends for an additional six years (ending on the sixth anniversary of the date upon which, but for this requirement, it would have ended).

5.3 Succession

The insurance must provide that run-off cover is not activated if there is a Successor Practice to the ceased practice, provided that there is insurance complying with these minimum terms and conditions in relation to that Successor Practice.

6 Exclusions

6.1 No other exclusions

The insurance must not exclude or limit the liability of the Insurer except to the extent that any civil liability or related Defence Costs arise from the matters set out in this clause 6.

6.2 Prior cover

Any Claim in respect of which the Insured is entitled to be indemnified by the Solicitors Indemnity Fund ('SIF')or under a professional indemnity insurance contract for a period earlier than the Period of Insurance, whether by reason of notification of Circumstances to SIF or under the earlier contract or otherwise.

6.3 Death or bodily injury

Any liability of any Insured for causing or contributing to death or bodily injury, except that

the insurance must nonetheless cover liability for psychological injury or emotional distress which arises from a breach of duty in the performance of (or failure to perform) legal work.

6.4 Property damage

Any liability of any Insured for causing or contributing to damage to, or destruction or physical loss of, any property (other than property in the care, custody or control of any Insured in connection with the Firm's Practice and not occupied or used in the course of the Firm's Practice), except that the insurance must nonetheless cover liability for such damage, destruction or loss which arises from breach of duty in the performance of (or failure to perform) legal work.

6.5 Partnership disputes

Any actual or alleged breach of the Firm's Partnership or shareholder agreement or arrangements, including any equivalent agreement or arrangement where the Firm is a limited liability partnership or a company without a share capital.

6.6 Employment breaches, discrimination, etc.

Wrongful dismissal, repudiation or breach of an employment contract or arrangement, termination of a training contract, harassment, discrimination or like conduct in relation to any Partnership or shareholder agreement or arrangement or the equivalent where the Firm is a limited liability partnership or a company without a share capital, or in relation to any employment or training agreement or arrangement.

6.7 Debts and trading liabilities

Any:

a) *trading or personal debt of any Insured; or*

b) *breach by any Insured of the terms of any contract or arrangement for the supply to, or use by, any Insured of goods or services in the course of the Firm's Practice; or*

c) *guarantee, indemnity or undertaking by any particular Insured in connection with the provision of finance, property, assistance or other benefit or advantage directly or indirectly to that Insured.*

7 General conditions

7.1 As agreed

The insurance may contain such general conditions as are agreed between the Insurer and the Firm, but the insurance must provide that the special conditions required by clause 4 prevail to the extent of any inconsistency.

7.2 Reimbursement

The insurance may provide that each Insured who

(a) committed; or

(b) condoned (whether knowingly or recklessly)

(c) non-disclosure or misrepresentation; or

(ii) any breach of the terms or conditions of the insurance; or

(iii) dishonesty or any fraudulent act or omission will

will reimburse the Insurer to the extent that is just and equitable having regard to the prejudice caused to the Insurer's interests by such non-disclosure, misrepresentation, breach, dishonesty, act or omission, provided that no Insured shall be required to make any such reimbursement to the extent that any such breach of the terms or conditions of the insurance was in order to comply with any applicable rules or codes laid down from time to time by the Council of the Law Society of England and Wales, or in the Law Society publication "Keeping Clients -a Client Care Guide for Solicitors" as amended from time to time.

The insurance must provide that no non-disclosure, misrepresentation, breach, dishonesty, act or omission will be imputed to a body corporate unless it was committed or condoned by, in the case of a company, all directors of that company, or, in the case of a limited liability partnership, all members of that limited liability partnership. The insurance must provide further that any right of reimbursement contemplated by this clause 7.2 against any person referred to in clauses 1.3(d), 1.5(d)or 1.7(d) (or against the estate or legal personal representative of any such person if they die or become legally incapacitated) is limited to the extent that is just and equitable having regard to the prejudice caused to the Insurer's interests by that person having committed or condoned (whether knowingly or recklessly) dishonesty or any fraudulent act or omission.

7.3 Reimbursement of Defence Costs

The insurance may provide that each Insured will reimburse the Insurer for Defence Costs advanced on that Insured's behalf which the Insurer is not ultimately liable to pay.

7.4 Reimbursement of the Excess

The insurance may provide for those persons who are at any time during the Period of Insurance Principals of the Firm to reimburse the Insurer for any Excess paid by the Insurer on an Insured's behalf. The Sum Insured must be reinstated to the extent of reimbursement of any amount which eroded it as contemplated by clause 3.4.

7.5 Reimbursement of moneys paid pending dispute resolution

The insurance may provide that each Insured will reimburse the Insurer following resolution of any coverage dispute for any amount paid by the Insurer on that Insured's behalf which, on the basis of the resolution of the dispute, the Insurer is not ultimately liable to pay.

7.6 Withholding assets or entitlements

The insurance may require the Firm to account to the Insurer for any asset or entitlement of any person who committed or condoned any dishonesty or fraudulent act or omission, provided that the Firm is legally entitled to withhold that asset or entitlement from that person.

7.7 Premium

The premium may be calculated on such basis as the Insurer determines and the Firm accepts including, without limitation, a basis which recognises Claims history, categories of work performed by the Firm, numbers of Principals and Employees, revenue derived from Firm's the

8 Definitions

8.1 General

In these minimum terms and conditions, unless the context otherwise requires

(a) the singular includes the plural, and vice versa; and

(b) the male gender includes the female and neuter genders; and

(c) person includes a body corporate; and

(d) a reference to a partnership does not include a limited liability partnership which is a body corporate; and

(e) a reference to a director includes a member of a limited liability partnership; and

(f) headings are merely descriptive and not an aid to interpretation; and

(g) words and expressions which begin with a capital letter in these minimum terms and conditions have the meaning set out in this clause 8; and

(h) words and expressions in these minimum terms and conditions are to be construed consistently with the same or similar words or expressions in the Solicitors'Indemnity Insurance Rules 2003.

8.2 'Circumstances'

Circumstances means an incident, occurrence, fact, matter, act or omission which may give rise to a Claim in respect of civil liability.

8.3 'Claim'

Claim means a demand for, or an assertion of a right to, civil compensation or civil damages or an intimation of an intention to seek such compensation or damages. For these purposes, an obligation on a Firm and/or any Insured to remedy a breach of the Solicitors 'Accounts Rules 1998 (as amended from time to time), or any rules which replace the Solicitors 'Accounts Rules 1998 in whole or in part, shall be treated as a Claim, and the obligation to remedy such breach shall be treated as a civil liability for the purposes of clause 1, whether or not any person makes a demand for, or an assertion of a right to, civil compensation or civil damages or an intimation of an intention to seek such compensation or damages as a result of such breach.

8.4 'Claimant'

Claimant means a person or entity which has made or may make a Claim including a Claim for contribution or indemnity.

8.5 'Defence Costs'

Defence Costs mean legal costs and disbursements and investigative and related expenses reasonably and necessarily incurred with the consent of the Insurer in

(a) defending any proceedings relating to a Claim; or

(b) conducting any proceedings for indemnity, contribution or recovery relating to a Claim; or

(c) investigating, reducing, avoiding or compromising any actual or potential Claim; or

(d) acting for any Insured in connection with any investigation, inquiry or disciplinary proceeding.

Defence Costs do not include any internal or overhead expenses of the Firm or the Insurer or the cost of any Insured's time.

8.6 'Employee'

Employee means any person other than a Principal

(a) employed or otherwise engaged in the Firm's Practice (including under a contract for services)including, without limitation, as a solicitor, lawyer, trainee solicitor or lawyer, consultant, associate, locum tenens, agent, appointed person (as defined in the Solicitors' indemnity insurance Rules 20003), office or clerical staff member or otherwise;

(b) seconded to work in the Firm's Practice; or

(c) seconded by the Firm to work elsewhere.

Employee does not include any person who is engaged by the Firm under a contract for services in respect of any work where that person is required, whether under the Solicitors' Indemnity Insurance Rules 2003 or under the rules of any other professional body, to take out or to be insured under separate professional indemnity insurance in respect of that work.

8.7 'Excess'

The Excess means the first amount of a Claim which is not covered by the insurance.

8.8 'The Firm'

The Firm means

(a) the Partnership (as constituted as at commencement of the Period of Insurance)or Recognised Body which, or sole practitioner who, contracted with the Insurer to provide this insurance; and

(b) the Partnership referred to in paragraph (a)as constituted from time to time, whether prior to or during the Period of Insurance.

8.9 'The Firm's Practice'

The Firm's Practice means

(a) the legal practice carried on by the Firm as at the commencement of the Period Of Insurance; and

(b) the continuous legal practice preceding and succeeding the practice referred to in paragraph (a)(irrespective of changes in ownership of the practice or in the composition of any Partnership which owns or owned the practice).

8.10 'Insured'

Insured means each person and entity named or described as a person to whom the insurance extends and includes, without limitation, those referred to in clause 1 .3 and, in relation to Prior and Successor Practices respectively, those referred to in clauses 1.5 and 1.7.

8.11 'The Insurer'

The Insurer means the underwriter of the insurance.

8.12 'Partnership' and 'Partner'

Partnership means an unincorporated Firm, and does not mean a Firm incorporated as a limited liability partnership, and Partner means a partner in an unincorporated Firm.

8.13 'Period of Insurance'

The Period of Insurance means the period for which the insurance operates.

8.14 'Principal'

Principal means, in relation to

(a) a Recognised Body or other body corporate which is a company -each director or officer of that body and any person held out as a director or officer; and

(b) a Recognised Body which is a limited liability partnership - each member of that body; and

(c) a Partnership -each Partner of that firm and any person held out as a Partner (and where a Recognised Body is a Partner -each director and officer of that body and each person held out as a director or officer, if the body is a company; and each member of that body if the body is a limited liability partnership); and

(d) a sole practitioner -that practitioner.

8.15 'Prior Practice'

Prior Practice means each practice to which the Firm's Practice is ultimately a Successor Practice by way of one or more mergers, acquisitions, absorptions or other transitions.

8.16 'Private Legal Practice'

Private Legal Practice means the provision of services in private practice as a solicitor or registered European lawyer including, without limitation

(a) providing such services in England, Wales or anywhere in the world, whether alone or with other lawyers in a Partnership permitted by rule 7(6)of the Solicitors 'Practice Rules 1990, or a recognised body; and

(b) the provision of such services as a secondee of the Firm; and

(c) any Insured acting as an executor, trustee, attorney, notary, insolvency practitioner or other personal appointment; and

(d) the provision of such services by any Employee.

Private Legal Practice does not include practising as an Employee of an employer other than a solicitor, a registered European lawyer, a Partnership permitted by rule 7(6) of the Solicitors' Practice Rules 1990, or a Recognised Body.

8.17 'Recognised Body'

Recognised Body means a body corporate for the time being recognised under Section 9 of the Administration of Justice Act 1985.

8.18 'Successor Practice'

Successor Practice means a practice identified in this definition as 'B', where

(a) 'A' is the practice to which B succeeds; and

(b) 'A's owner' is the owner of A immediately prior to transition; and

(c) 'B's owner' is the owner of B immediately following transition; and

(d) 'transition' means merger, acquisition, absorption or other transition which results in A no longer being carried on as a discrete legal practice.

B is a Successor Practice to A where

i. B is or was held or, expressly or by implication, by B's owner as being the successor of A or as incorporating A, whether such holding out is contained in notepaper, business cards, form of electronic communications, publications, promotional material or otherwise, or is contained in any statement or declaration by B's owner to any regulatory or taxation authority; and/or

ii. *(where A's owner was a sole practitioner and the transition occurred on or before 31 August 2000) – the sole practitioner is a Principal of B's owner; and/or*

iii. *(where A's owner was a sole practitioner and the transition occurred on or after 1 September 2000) – the sole practitioner is a Principal or Employee of B's owner and/or*

iv. *(where A's owner was a Recognised Body) – that body is a Principal of B's owner; and/or*

v. *(where A's owner was a Partnership) - the majority of the Principals of A's owner have become Principals of B's owner; and/or*

vi. *(where A's owner was a Partnership and the majority of Principals of A's owner did not become Principals of the owner of another legal practice as a result of the transition - one or more of the Principals of A's owner have become Principals of B's owner and –*

a. *B is carried on under the same name as A or name which substantially incorporates the name of A (or substantial part of the name of A); and/or*

b. *B is carried on from the same premises as A; and/or*

c. *The owner of B acquired the goodwill and/or assets of A; and/or*

d. *The owner of B assumed the liabilities of A; and/or*

e. *The majority of staff employed by A's owner became employees of B's owner*

Notwithstanding the foregoing, B is not a Successor Practice to A under paragraph (ii), (iii), (iv), (v) or (vi) if another practice is or was held out by the owner of that other practice as the successor of A or as incorporating A, provided that there is insurance complying with these minimum terms and conditions in relation to that other practice.

8.19 'Sum Insured'

Sum Insured means the limit of the Insurer's liability under the insurance.

3.3.1 Potential restrictions in minimum terms

In all of the Australian states, Scotland and all of the states in Canada the terms and conditions are closer to the Irish terms and conditions than to those in England & Wales. The terms and conditions in England & Wales were negotiated in 1999 when the insurance market was in a much softer cycle. The Law Society was able to capitalise on a unique position of being about to open up the previous monopoly to commercial insurers, with the promise of a premium pool of approximately £200,000,000 (HK$2,400,000,000).

It is unlikely that in 2005 certain terms and conditions obtained by the Law Society of England & Wales will be available in the commercial market. By reference to the paragraph numbers of the terms and conditions it is our belief that the following are unlikely to be available.

- Paragraph 1.2 Defence Costs and Paragraph 2.2 No Limit on Defence Costs
  Costs in addition to the limit of indemnity with no limit on those defence costs.

- Paragraph 2.4 No Other Limit
  Although it may be possible to obtain cover on an each and every claim basis the claim's history of solicitors in Hong Kong is such that insurers may want to put an aggregate limit

on certain types of claims such as fraud, dishonesty of employees or principals, or conveyancing claims.

- Paragraph 3.2 No Deductibles.

  A "deductible" and an "excess" are not the same. Both are amounts payable by an insured towards the claim. A deductible as the name suggests is deducted from the total limit of indemnity and the insurer has a liability to repay the remainder. If an excess is paid regardless of its size the insurers obligation to pay the total limit of indemnity remains unchanged.

- Paragraph 3.4 Funding of the Excess.
- Paragraph 4.2 No Adjustment or Denial.
- Paragraph 4.4 No Set Off.
- Paragraph 4.10 Conduct of a Claim Pending Dispute Resolution.
- Run-Off Cover.
- 5.1(b).
- Paragraph 6.9 (Fraud or Dishonesty)
  If this cover is available the cost is likely to be higher and those excluded to be more than persons committing or condoning the dishonesty.

3.3.2 Feasible Minimum Terms 2005

The minimum terms for 2005 necessary for public protection we suggest are summarised below. Those drafting the terms ought to adopt the extensive cover now provided by the Rules and arrange for the Society's brokers to approach the insurance market to see what is feasible. What we specify below are the lowest common denominator. If HKSIF remains as the provider of indemnity the cover it currently provides is ideally retained. Each year as market conditions changed most feasible and affordable increased protection can be sought by reviewing any terms that are the criteria for qualifying as an insurer. That will be in response to claims experience and knowledge of losses commonly occurring which surface from time to time. The source of knowledge about matters not covered by the minimum terms will be complaints by the public to the Compliance Committee of the Society and Solicitors' feedback to the Society.

- All civil liability in connection with the usual and customary activities of private practise as a solicitor in Hong Kong.
- Worldwide cover from an office in Hong Kong provided the solicitor insured is authorised by the Law Society or his/her practising certificate to so practice, but excluding liability arising under laws of the United States of America or awards from American courts.
- Unlimited retroactivity (i.e. does not matter how long before the claim was made that the work was done from which the claim arises).
- Cover to extend to all principals, employees, consultants, prior practice liabilities, and liabilities of partners or employees who permanently ceased practice, and who at the time the claim is made had no insurance.

- Insurance not subject to repudiation or recision or reduction of the limit of indemnity below the minimum for innocent misrepresentation or non-disclosure.
- Payment to be made to any claimant entitled to payment as soon as practicable after that entitlement is established but in any event no later than 60 days thereafter.
- Duration of the policy shall be the full practising period [adjustable only for new firms].
- Senior Counsel clause for disputes over whether a claim should be defended or settled.
- If the insured, by breach of condition or any other cause, causes prejudice to the insurer in connection with any matter covered by the policy, Insurer must pay the claimant as a condition of recovering from the insured the amount of the insurers loss arising from the insured's breach.
- If an insured permanently ceases practice or dies during the currency of the insurance and a claim is made against the retired insured or the estate of a deceased insured, and no other insurance is in force for that liability the insurer will indemnify the retired practitioner or the estate of the deceased practitioner.
- Exclusions that are allowed as set out in the Rules Schedule 3 and to be further considered . Items such as the exclusion relating to Carrian Investments, for instance, may no longer be necessary.

3.3.3 Importance of Non-Recision or Non-Denial Term

If insurance is compulsory, which it is, the ability of an insurer to either deny payment of a claim or rescind the policy because of an omission of the insured solicitor amounting to a breach of the duty of disclosure, or breach of a condition of the cover, is equivalent to allowing the insurance to not exist if those omissions or breaches occur. The limiting of the right on an insurer to recover from the insured, after payment of the claimant, (a member of the public), is fundamental to ensuring that the public is adequately protected.

Our research and experience of the current hard insurance market in 2003 indicates that this fundamental protection is unlikely to be obtainable from any source other than HKSIF (or a captive operating in the same way). If that remains the case in 2005 any insurance arrangement that requires solicitors to purchase cover in the open market, such as a QIS, is not acceptable or sufficient for the protection of the public interest or the interest of solicitors. Any decision to introduce a QIS ought to depend on the availability of such cover. That can only be determined by the Society's insurance market research supported by the adequate data presented to the market by the Society's insurance brokers.

3.4 A QUALIFYING INSURER SCHEME

England & Wales

From 1st September 2000 solicitors in England & Wales adopted a QIS arrangement for the supply of PI insurance in place of a mutual scheme that had been in place as a compulsory monopoly since 1987.

Can comparisons be drawn between the English experience with a mutual arrangement and that of Hong Kong? Would the experience of the English & Welsh profession since 2000 under a qualified insurer arrangement be similar in Hong Kong if Hong Kong solicitors were to adopt similar arrangements.

The Debate in England & Wales -1996-2000

The solicitors of England & Wales were insured under a Master Policy Scheme between 1976 and 1987.

In 1987 The Law Society established a mutual scheme, the Solicitors Indemnity Fund (SIF). SIF was at first reinsured but from 1990-1994 was wholly funded by the Profession and did not purchase re-insurance to transfer any risk to commercial insurers. By 1997 the claims experience of the Profession had caused contributions to escalate. For 1997 the premium pool increased by about 50%, penalty deductibles were introduced and deductibles generally were adjusted upwards. This was in response to adverse development of claims from earlier years. The assets of SIF were insufficient to cover the estimated liabilities for claims reported in earlier years and not finalised **[outstanding claims]**.
The amount of the deficit, to which all solicitors had a liability to contribute, was estimated in 1997 at about £433 million. Levies could be imposed on the profession to fund the shortfall between outstanding claims liabilities and the assets of SIF.

The 1997 annual report of SIF set out the anticipated shortfall and the amount the profession were expected to contribute (in addition to each current years contribution) over a seven year instalment plan. At the time the prospect of this shortfall was the main catalyst leading to the review of and restructuring of the insurance arrangements in England & Wales. As it transpired the projection of liabilities was pessimistic and the shortfall was collected in 3 years and was about £250,000,000.

The profession advocated for change and for the right to insure with insurers in the commercial market. In earlier years discord over the allocation of the premium among members had been addressed by SIF's administration aiming for fairness and parity between firms differing in size, location, fee income claims experience and field of practice. The various formulae changes were always subject to criticism from some sectors.

The modifications attempted to balance the contributions of different sized firms. In 1994 contributions were based on gross fees of a firm without reference to the number of partners, staff or area of practice although retaining claims loadings and discounts for low risk work. At the time these events occurred the insurance market was in a soft cycle which had lasted for about twelve years. In that market environment various studies indicated that for the majority of firms premiums would be lower than contributions to SIF if they were free to purchase cover direct from the open market.

The market was approached to gauge its willingness to insure solicitors on standard minimum terms including participating in an ARP, and to obtain an indication of the price commercial insurers could offer. The indications were that cover would be cheaper without sacrificing minimum protection considered necessary for the interests of the consumers of legal services

[the public] and solicitors. Approaches were made to the market. 15 insurers responded that they would be prepared give cover on an approved policy wording with the minimum limit of SIF £1 million for any one claim as well as participate in an ARP.

As a result The Law Society resolved to adopt from 1st September 2000 a scheme providing for a Managing General Agency (MGA), underwritten by commercial insurers operating alongside individual qualifying insurers.

SIF located an MGA and entered into a joint venture with St Paul International through a company called Solicitors Professional Indemnity Limited. The Law Society retained 51% ownership and St Paul took over the management of the SIF run-off for 5 years under a management agreement.

The MGA continues to manage the claims reported before 1st September 2000 to SIF. The fund and the company that managed it remains. The Law Society and that company are the contracting parties with the managers.

The amount contributed to the shortfall in 2000/2001 was £25 million. At 31st August 2000 the shortfall in SIF was £61.2 million. Qualifying insurers agreed to provide run-off cover for claims against solicitors to whom they issued cover after 1st September 2000. Any claims made after 1st September 2000 against solicitors who retired before that date are paid by SIF and funded by contributions from existing firms [in addition to premiums paid to their qualifying insurer]. The Law Society has limited the contractual arrangements to 5 years and returned SIF case the QIS is not successful. SIF can then be re-activated.

The minimum terms approved in England & Wales include:-

- Cover for all civil liability in connection with private legal practice and any award by the Legal Services Ombudsman.
- Unlimited defence costs in addition to the limit of indemnity.
- Insured to include all present and former solicitors and employees and their estates.
- Liabilities from a former or successor practice.
- £1million minimum for any one claim.
- Excess not to reduce the limit of indemnity payable by insurer [in other words is not to be a" deductible"] and insurer must pay excess to claimant and recover it from insured[Note: to protect the claimant].
- No avoidance, repudiation, cancellation, denial of liability, right of set-off or dual insurance reduction or exclusion by insurer.
- Unlimited period of past services covered if claim made during the indemnity period.
- Insurer must defend at insurer's cost a claim arising from alleged dishonesty until a finding or admission of dishonesty is made.
- If there is a dispute about coverage for a claim the Law Society can direct the insurer to defend and pay the claimant pending resolution of the dispute.
- Run off cover to be provided for six years unless an insured successor firm exists.
- No other exclusions permitted apart from approved ones, which are substantially the same as in Hong Kong.

- Insurer has right to recover the amount of prejudice to the insurer in monetary terms occasioned by any breach of conditions or non-disclosure or dishonest act or omission from anyone who committed or condoned such act or omission. The terms approved state: -

The premium may be calculated on such basis as the Insurer determines and the Firm accepts.

When the QIS started in England & Wales there were approximately 25 Insurers entered the market to compete for the new business. Prior to 1st September 2000 in response to the Law Society's warning, firms notified SIF of every possible problem that had the remotest chance of developing into a claim. SIF received 37,352 notifications in that year; nearly triple the number in 1999, and 2.5 times the average for the previous 11 years. [Approx 32,000 were closed within a year].

The result of this "laundry listing" for the commercial market was that in the first year 2001-2002 claims incidence was most likely lower than under SIF. Reports in the media and anecdotally were to the effect that most firms paid lower premiums to insurers than in the previous year. They also contributed £67.84 million to the shortfall in SIF.

Commercial insurers do not release statistics except those required by regulatory authorities. We do know however that the total premium collection for the first year was £148 million. The exact spread of that sum across the profession is not known to compare that with the total collection by SIF in the previous year of £220 million, can be misleading because SIF anticipated the laundry listing and collected extra to cover it.

On renewal in September 2001 the premium charged by insurers was £161 million. By September 2002 the premium pool was £225 million. The renewal date in England and Wales is 1st September so nearly all firms would have renewed before the catastrophic insurance loses arising from the destruction of the World Trade Centre in New York. (WTC). It is now 1st October. The pool for 2003/2004 is for 13 months.

Between the end of August 2001 and 2003 several factors were influencing the cost of PI insurance for solicitors in England & Wales.

3.4.1 Factors Influencing Premiums in England and Wales

1. Insurers were seeing claims develop from 2000 and 2001 e.g. what might have been a letter of demand when notified in 2000 was by 2002 a fully blown suit.

2. The losses from the WTC, prospective losses from the ENRON collapse and other major losses caused re-insurance premiums to rise between 200%-400%.

3. Insurers writing professional indemnity insurance could no longer rely for profit on investment income from the premiums they collected and kept for many years on long tail business. Investment returns were low and the tail from claims notified in earlier years in the soft market was seeing those claims develop to proportions not adequately priced when competition for premium income was intense during the soft market.

4. The market hardened. Some insurers withdrew from professional indemnity business. There were several collapses of major insurers, notably, Independent Insurance in the U.K. and the HIH Group.

5. Qualifying insurers had been called on to make payments to the assigned risks pool for claims against solicitors insured under the assigned risks pool facility.

Solicitors in England & Wales have just completed renewal for 2003/2004. The premium pool has been reported to be £245 million (13 months).

3.4.2 Transition to a QIS - Practicalities

The transition from a mutual scheme to a QIS entailed making arrangements for:

1. Payment of the shortfall in the mutual until all outstanding claims liabilities were met.

2. Administrative arrangements to handle outstanding claims for the duration of the run-off of the mutual's long tail.

3. Establishing an ARP to provide cover to solicitors' declined cover and making arrangements to fund any claims against those in the ARP. This was done through agreements with qualifying insurers who contribute to the pool in the proportion that their market share [by premium income] bears to the premium for the whole of the profession. There have been two calls on qualifying insurers for payments to the ARP. The loss ratios of the ARP after 3 years is around 500%. Obviously not having critical mass the loss ratios will be high as the solutions in the ARP have the worst risk profiles.

4. Collecting funds from the profession to pay the cost of future claims against retired, deceased or other solicitors ceasing practice who were entitled to run off cover from the mutual and who retired before the change from a mutual scheme to a QIS.

5. Making provision for and collecting funds to cover any claims that might arise against former solicitors more than six years after death, retirement or cessation of practice without any successor practice remaining.

Any mutual scheme making the same transition will have similar liabilities to be met by the members in addition to the cost of cover purchased from a qualifying insurer. The members could decide not to honour pre- existing obligations to provide run-off cover, but it could not be said that such an omission was in the best interests of either the former solicitors or of the public.

3.4.3 The Assigned Risks Pool

A qualifying insurers arrangement operates in most respects the same as an open market arrangement with prescribed terms to ensure adequate public protection, but with one important additional feature. That additional feature is the supplement of an assigned risks pool (ARP). Each insurer who sells insurance to a member of the profession agrees to pay the claims of those solicitors who are unable to find an insurer in the open market. The otherwise uninsurable solicitors are then issued indemnity cover by the ARP. They pay a premium, that is usually high. In England and Wales it is 25%-30% of gross fees. If the premiums paid by those in the ARP are insufficient to cover their claims the insurers selected in the open market must contribute to the ARP. This is added to the premium of those solicitors purchasing on the open market. Thus cross subsidy of poor risks by better risks continues. It is possible to impose criteria that qualifying insurers must meet.

The Law Society is not in a position to, and ought not endorse any insurer's financial standing by specifying its security rating or capital size. That is a function of regulatory authorities such as the Insurance Commissioner. One criterion could be that the insurer has its registered office in Hong Kong but this may limit the participating insurers and reduce competition thereby reducing freedom of choice for solicitors which is the main objective of a QIS. Other criteria: providing information to the Law Society, reporting statistics, collecting contributions for HK SIF run-off ,are also likely to deter insurers. The criteria ought to be limited to providing cover not below set terms, holding a licence to carry on business in Hong Kong, contributing to an ARP according to the market share of the insurer, and advising the Law Society of a solicitor does not renew an existing policy on expiry.

The other option that we considered might be feasible is open market choice under which minimum terms to protect the public interest are set, but insurers are not required to contribute to an ARP. It is likely that a number of firms would be unable to obtain insurance if this was established. Whether otherwise competent solicitors ought to lose their earning capacity because of honest mistakes and be driven out of practice is not an insurance issue on which we can offer an opinion any more informed than that of any member of the Profession. There is the possibility that under a claims made policy a firm may be declined insurance and any client who received legal services in previous years would not be assured of compensation even though when the services were given when insurance was in place. The public interest, we consider, would not be adequately protected under this option.

3.4.4 Value in Retaining HKSIF

We see value in retaining HK SIF provided it reviews and modernises its operations to reflect the size and complexity of its undertaking and caps its liability. Once it withdraws as an indemnity provider it, and the Profession will lose opportunities that may not be recoverable. It must remain in existence in any event to run off existing claims, as provided by Rule 14 of the Rules. That is likely to take 8-10 years. 2005 is likely to be an unfavourable time to replace it. The reasons are:-

- the recent claims history,
- the insurance market is going through a most unfavourable hard cycle,
- there are uncertainties affecting the economic and legal climate in Hong Kong,
- the mutual offers the promise of salvaging the future at the lowest cost provided it is modified to introduce a greater "user pays" approach,
- modifications to the mutual scheme, if made, offer an opportunity to remove dissatisfaction with its operation and remove unlimited liability if there is re-insurer default,
- alternatives may benefit some sections of the profession but in the long term fail to sustain extensive, profession wide protection of the public, of individual practices, and of the reputation and standing of the profession.

The acceptance that a common interest exists among the whole of a profession is the foundation of any mutual fund (or master policy or captive insurer arrangement). This acceptance has been weakened by the claims losses and burgeoning cost of insurance to the Hong Kong Profession . The reaction of those members of the profession who have not had claims is to call for freedom of choice, reduction of subsidies to bad risks and a capping of potential liability. If the Profession values those objectives for individual firms and places less weight on the consequences to others of their profession those objectives may be attainable through a Qualifying Insurer Scheme. Cross subsidy of solicitors who have had claims will exist and in a hard market cover is likely to be more expensive than with a mutual fund, but this option will ensure the level of cover that is the minimum the public interest requires. It will also allow the freedom of choice espoused by a great number of the profession. That choice may not be wide if only few Insurers participate.

The existence of an ARP is considered to be the cornerstone of any arrangement for a profession which requires its practising members to have insurance as a condition of practising. This is so because those professions accept that the public interest requires appropriate levels of insurance protection and also accept that their members ought not to be forced out of practice by the commercial insurance market with no chance of a remedy.

In the England & Wales when the change to a QIS was under consideration ARPs existed for other professions. The commercial market participated in approved compulsory insurance schemes for Members of the Institution of Chartered Surveyors, The Institution of Chartered Accountants in England & Wales and The Law Society of Ireland.

We have appended the Rules of the Law Society of Ireland relating to the ARP as Appendix 5 (page 168). The arrangements behind the ARP are set out in agreements with commercial insurers that are a condition of qualifying.

The period a firm can receive protection from the ARP is usually two years. A common feature is that firms in the pool are subject to risk management directives from the ARP administrator or the commercial insurers.

There was a concern prior to the introduction of the QIS in England & Wales that the number of solicitors/firms who would need to resort to the ARP would be so large that it would not be viable or acceptable to insurers who would refrain from seeking qualification to provide insurance to solicitors. Those concerns did not eventuate as anticipated. Insurers 'guestimated' there would be up to 700 firms in the ARP. In the event 40 were admitted. It is not known how many firms were rescued from the ARP by one insurer who offered cover at 22% of gross fees.

The premium charged by the ARP is in the range of 25% to 30% of a firms gross fees. Commercial insurers have offered some selected firms a premium that is slightly less than that range to avoid the ARP.

3.4.5 Cost of an ARP

It stands to reason that whatever a commercial insurer may have to contribute to the ARP will be added to the premium charged to its other insureds. The cross subsidy of firms with losses by firms with no losses which is characteristic of a mutual scheme thereby continues. The differences from mutual scheme cross-subsidization from a particular firm's, perspective is:

- That firm's insurer may lack sufficient information to assess the risk of "underwriting" those in the pool and may underestimate it, resulting in an underpricing of the premium for that firm.
- That firm's insurer may differentially pass on the cost of "underwriting" the ARP risk so that lower risk firms are not allocated that ARP cost uniformly as usually occurs with a mutual arrangement.
- The period of cross subsidy element of a firm's premium is limited. The subsidising is likely to reduce as the number of solicitors in the ARP decreases because of the two year limit. When leaving the ARP they either benefit from the intensive risk management undertaken while in the ARP and stop being so high risk or they go out of practice, at least as principals.

When considering establishing a QIS and comparing it with a mutual scheme arrangement, analysis of the operation of an ARP highlights that both are forms of subsidy of bad risks by low risks. Any differences or potential benefits to good risks derive not from the form of arrangement, but from either bad risks being forced out of practice or by risk management effectively converting bad risks into good risks, eliminating the need for ongoing subsidy.

Another example of the operation of an ARP is the Scheme for Chartered Surveyors in England. The Royal Institute of Chartered Surveyors requires compulsory cover.

Royal Institution of Chartered Surveyors

If a surveyor cannot get cover the ARP provides cover for 3 months at 200% of the last insured year's premium. RICS reviews the business. ARP Board reviews the surveyors risk profile. The RICS arranges for the ARP manager, who is a broker to try the market again. If cover cannot be found the ARP will offer cover on terms which may include risk management changes being adopted within the business. The scheme used to refer to "approved insurer". Use of the term "approved insurer" was also stopped by the accountancy profession. That term suggests that the financial standing or quality of an insurer is being endorsed or arranged which is not prudent for a professional body. The term now used is "listed insurer".

We have appended as Appendix 6 (page 173) part of the members guidelines on the ARP from RICS. They explain well how a ARP operates from a member's perspective

3.4.6 Criteria for Qualifying Insurers

The Law Society is not in a position to, and ought not endorse any insurer's financial standing by specifying its security rating or capital size. That is a function of regulatory authorities such as the Insurance Commissioner . One criterion could be that the insurer has its registered office in Hong Kong but this may limit the participating insurers and reduce competition thereby reducing freedom of choice for solicitors which is the main objective of a QIS. Other criteria: providing information to the Law Society, reporting statistics, collecting contributions for HK SIF run-off,are also likely to deter insurers. The criteria ought to be limited to providing cover not below set terms , holding a licence to carry on business in Hong Kong, contributing to an ARP according to the market share of the insurer, and advising the Law Society of a solution does not renew an existing policy on expiry.

Those considering the choice between the current mutual fund with the modifications we suggest and a QIS will need to balance the following aspects of a QIS against the freedom of choice it offers compared with the current HK SIF.

(a) The subsidisation of bad risks by good risks continues through an ARP.
(b) The freedom of choice given to solicitors to purchase cover in the open market is likely to be illusory in Hong Kong. This is because the profession is not big enough to attract a sufficient number of insurers prepared to offer cover on prescribed terms to create any competition.
(c) There is no protection for a solicitor in the case of insurer insolvency.
(d) In the medium to long term premiums will be higher than under a professionally managed HK SIF that is streamlined to operate more as a modern commercial enterprise.

Although not a comparative factor, the cost of administering HK SIF, if it is removed as the carrier of insurance will still have to be borne by the profession. There will be a cost to providing run-off cover to solicitors who retired before a QIS was introduced.

We see value in retaining HK SIF provided it reviews and modernises its operations to reflect the size and complexity of its undertaking and caps its liability. Once it withdraws as an indemnity provider it, and the Profession will lose opportunities that may not be recoverable. It must remain in existence in any event to run off existing claims, as provided by Rule 14 of the Rules. That is likely to take 8-10 years. 2005 is likely to be an unfavourable time to replace it. The reasons are:-

- the recent claims history,
- the insurance market is going through a most unfavourable hard cycle,
- there are uncertainties affecting the economic and legal climate in Hong Kong,
- the mutual offers the promise of salvaging the future at the lowest cost provided it is modified to introduce a greater 'user pays" approach
- modifications to the mutual scheme, if made, offer an opportunity to remove dissatisfaction with its operation and remove unlimited liability if there is re-insurer default
- alternatives may benefit some sections of the profession but in the long term fail to sustain extensive, profession wide protection of the public, of individual practices, and of the reputation and standing of the profession.

3.4.7 Setting Up a QIS – The Process

In order to establish a viable and sustainable qualifying insurer scheme in Hong Kong the following processes need to be followed:

1. Market research by the Society's brokers to select an insurer prepared to be the manage general agency for the QIS scheme. The managing general agency will be an insurer who is prepared to agree with the Society to receive proposal forms and give quotations to the greater majority of the profession.

   Negotiations need to be undertaken with managing general agency to induce the insurer concerned to take over the run off of the claims that will still be open for HKSIF in September 2005. It may be necessary to negotiate a fee for the managing general agent. In England and Wales the managing general agency paid a fee to the Law Society in return for being promoted to the profession as the preferred insurer.

2. The minimum terms and conditions of cover need to be decided and drafted.

3. The terms and conditions for entry into the assigned risk pool need to be decided and drafted together with the terms and conditions of indemnity for firms in the assigned risk pool. This will require a decision as to how long a firm may remain in the ARP.

   In England and Wales the rules are so drafted that if a firm does not produce proof of insurance from a qualifying insurer within a specified period after expiry of previous insurance the assigned pool automatically issues a policy to that firm together with an invoice for that premium. The level of premium payable for firms in the assigned risk pool also needs to be determined. During our research we have been informed that despite firms in the assigned risk pool in England and Wales paying between 25% and 30% of their gross annual fees as a premium the assigned risk pool after 3 years of operation has a loss ratio of approximately 500%.

   A decision will need to be made as to whether insurers who qualify must contribute to the ARP on a joint basis so that if one becomes insolvent the remaining insurers pay the insolvent insurers share. We have doubts about whether joint liability will be agreed to by qualifying insurers in which event consideration needs to be given to whether HKSIF needs to be contributed to the ARP of the last resort. This can only be determined by full market research which can only be done by the Society's brokers.

4. The terms of agreement with the insurer issuing indemnity through the ARP needs to be negotiated, drafted and finalised.

5. Amendments to the Rules and appropriate commentary must be drafted with a report to the Chief Justice. We raise consideration whether it might not be wise at this stage to also provide those to the Legislative Council to obtain in principle approval before any further negotiations are undertaken.

6. Once the approval of the Chief Justice has been obtained to the proposed changes the Profession should be provided with details of the proposed minimum terms and conditions and changes in the Rules and given an opportunity to comment or make submissions.

7. Council must deliberate on the proposed arrangements. If changes to the proposal the Chief Justice result from consultation with the Profession the proposed arrangements should be resubmitted to the Chief Justice for approval and, at the discretion of the Society, to the Legislative Council.

8. If Council approves the proposed changes a strategic plan for management of the run off and the future activities of HKSIF, together with an assessment of projected future liabilities prepared. Changes to the Rules need to be drafted to cover the situation of HKSIF. Those rules relating to HSKIF will then need to be approved by the Chief Justice and Council of the Society.

9. The commercial insurance market needs to be informed and invited to participate in the QIS. The invitation to the market could proceed pending the expiry period for the Legislative Council to consider changes to the Rules.

10. The amended rules and all associated minimum terms and reports need to be provided to the Legislative Council for negative vetting.

11. Once the period during which the Legislative Council can disallow any of the proposed changes has expired the necessary education and information material needs to be prepared and circulated to the Profession and to the commercial insurance market to enable them to arrange their insurance in time for renewal from 1st October 2005.

12. A transfer of all data files and material relating to the Scheme from Essar and Aon to be co-ordinated with a transfer to the Managing General Agency, or HKSIF Ltd or to whomever is contracted to manage the run-off of HKSIF.

3.4.8 Feasibility of a QIS in Hong Kong

In order to predict whether a qualifying insurance scheme would be feasible in Hong Kong we have undertaken market research. Such an exercise at this stage, nearly two years before the time when insurers will be asked to participate in a QIS, can only be treated as a broad indication. A number of key insurers approached elected not to participate in our market survey preferring to address the issue in 2005. Without access to appropriate data, without knowing details of what liability the qualifying insurers might be undertaking to the ARP, the number of firms that are likely to be in the ARP, any such market research must be treated as indicative only. The insurance market conditions prevailing at the time will be an additional factor.

3.4.9 Market Research Result

In assessing the viable Insurers in Hong Kong, we have evaluated Insurers and Reinsurers that have the ability to offer Primary Professional Indemnity, all of whom have a financial rating of an Standard and Poors rating of "A" or above. Any insurer that does not qualify for such a rating has been excluded from this survey.

It is our findings after consultation with Insurers and the studying of financial reports and accounts that the Hong Kong domestic insurance market has the financial ability to absorb the new income derived from the premium generated by the lawyers in the event the lawyers were to buy their Insurance in the "open market".

The office of the Commissioner of Insurance report dated 27th November 2003 states that General Liability in Hong Kong has seen a growth of 13.6% in the 1st three quarters of 2003. The total premium this year to date is HK$ 5,475m of this premium the allocated premium derived from "Financial lines" business is included in this. The Lawyers professional indemnity premium would contribute towards this and account for about 4% approximately of all General Liability insurance.

The questions put to Insurers are concise in their nature. In addressing the coverage afforded under the existing scheme and those minimum requirements we have evaluated Underwriters appetite and ability to offer and provide primary professional indemnity insurance to Hong Kong lawyers in accordance with the requirements of the Law Society.

Of those Insurers that completed the questionnaire they are prepared to offer the following cover:

Cover	Percentage of Insurers willing to offer the coverage
Civil liability	50%
Defence costs in Addition	25%
Advance defense costs	25%
Offer HK$10m	37.5%
Free run off cover	12.5%
Provide Non Avoidance cover	0%
Participate in an assigned risk pool	52.5%
Notify the law society of non renewal	50%
Agree a dispute resolution clause	75%

Of the insurers that returned the questionnaire, the total premium they could allocate to primary lawyers professional indemnity is HK$350m

All of the insurers that returned our questionnaires are open to offer cover for the full range of classes of business Lawyers undertake.

With regard to rating and costs of "open market" primary lawyers professional indemnity Underwriters have indicated they would prefer to rate lawyers as a firm based as a percentage of their fee income combined with their split of professional services.

A number of key insurers have elected not to participate in this survey preferring to address the issue at the time. In many of our meetings with insurers the inference has been in the event lawyers seek primary professional indemnity in the "open market" they would be open to seriously consider writing this business on the existing cover.

3.4.10 Conclusion of Market Research

In order to obtain a truly clear picture of Underwriters' intentions all Insurers would have to state their intentions now. The above information is based purely on fact as stated by Insurers that have agreed to go into print. This may not paint a completely true picture of the overall Insurance markets appetite to offer this cover.

With knowledge of comments made by insurers we have interviewed, it is our opinion that should lawyers wish to buy in the open market then there would be a receptive and very capable Insurance Industry in Hong Kong to offer such coverage.

What is notable from the market research is that none of the insurers approached who responded were prepared to provide cover which could not be avoided for breach of condition or non-disclosure. It is also notable that only 12.5% would be agreeable to offer free run off cover. This indicates no guarantee that the public will be appropriately protected by one of the crucial terms of public protection, namely non-avoidance of the cover as against a claimant. The indication of that is consistent with the insurance cycle being in a hard phase. The absence of a term that prevents an insurer from denying indemnity for a claim, as opposed to paying the claim and recovering from the insured, is one of the major protections the public requires. The research indicates that a qualifying insurer scheme is likely to be feasible but the freedom of choice a QIS offers solicitors may be at the price of reduced protection for the public.

Our methodology was to address the coverage required and seek Underwriter comments in offering the coverage in question.;

- what are the insurers appetite to write Lawyers Professional Indemnity on a primary basis and,

- what is the ability of the insurers to "soak up" a potential new premium revenue pool of circa HK$225,000,000 in one year.

The information obtained is derived from research carried out in the form of conducting personal interviews and completion of questionnaires by the insurers. A reasonable number of Insurers we have spoken to have elected not to offer information on their future underwriting philosophy, preferring to judge their position at the time should the solicitors elect to seek open market insurance.

We have selected the Insurers to be consulted that met the following criteria:

- A standard and Poors rating of not Less that "A"
- Have existing experience in Hong Kong writing Professional Indemnity

In identifying those insurers we,

- addressed over 20 Insurers professional Indemnity In Hong Kong discussing their views of the potential new business to the market
- requested the completion of questionnaires detailing Underwriters appetite for specific elements of coverage

3.5 CLAIMS EXPERIENCE AND LIABILITIES OF HKSIF

At 30th September 1999 HKSIF had no estimated unfunded liabilities for claims reported to that date as all liabilities were re-insured. The balance sheet of HK SIF showed an excess of assets over liabilities of $HK 191,114,076.

LIABILITIES INCURRED (CLAIMS PAID AND RESERVED) BY THE FUND AS AT 30 SEPTEMBER 1999 *(TABLE 8)*

Indemnity Year	Claims Paid	Claims Reserved	Total Incurred	Retention Limit	Stop Loss Limit	Estimated Liabilities
				(HK$ Million)		
1987-88	7,854,751.62	300,00.00	8,154,751.62	25	25	0
1988-89	22,656,146.82	1,212,443.45	23,868,590.27	30	20	0
1989-90	10,121,148.03	1,294,071.00	11,415,219.03	30	20	0
1990-91	3,976,084.64	976,672.00	4,952,756.64	30	20	0
1991-92	4,132,049.38	1,606,495.81	5,738,545.19	30	40	0
1992-93	17,679,269.89	4,356,405.46	22,035,675.35	30	60	0
1993-94	15,175,197.14	53,122,208.10	68,297,405.24	30	60	0
1994-95	16,566,846.85	4,427,075.20	20,993,922.05	30	60	0
1995-96	17,844,669.39	9,501,449.22	27,346,118.61	30	60	0
1996-97	22,773,574.18	16,904,322.81	39,677,896.99	30	90	0
1997-98	17,831,070.67	50,518,254.00	68,349,324.67	30	90	0
1998-99	4,955,315.86	121,194,091.20	126,149,407.06	90*	100*	0

*These limits cover a period of 3 years from 1 October, 1998 to 30 September, 2001

As at 30th September 2002 the liabilities of the HK SIF for claims to 30th September 1999 were as shown below and there was a deficit of $HK 132,893.286 between assets and liabilities. The table No. 8 gives the figures for each year up to 30th September 1999. We have not included claims beyond 30th September 1999 as later claims are too underdeveloped for true comparison without actuarial expertise. Contributions were not increased until August 2001 and reserves were being eroded to subsidise the cost of indemnity and reinsurance in the meanwhile, Table 9 shows the losses three years later.

OUTSTANDING LIABILITIES OF HKSIF FOR CLAIMS TO 30 SEPTEMBER 1999 AS AT 30TH SEPTEMBER 2002 *(TABLE 9)*

Indemnity Year	Total Claims Payments (HK$)	Total Claim Reserves (HK$)	Total Paid and Reserved Claims (HK$)	HK SIF estimated Liabilities
1986/87	24,938,021	--	24,938,021	--
1987/88	13,754,212	--	13,754,212	--
1988/89	29,210,385	1,345,562	30,555,947	1,383,562
1989/90	12,470,291	--	12,470,291	--
1990/91	7,581,520	426,672	8,008,192	426,672
1991/92	8,660,654	914,910	9,575,564	914,857
1992/93	40,310,346	6,534,589	46,844,935	4,601,856
1993/94	29,905,069	11,414,817	41,319,886	9,926,268
1994/95	47,200,685	14,113,332	61,314,017	12,093,496
1995/96	73,556,619	35,884,835	109,443,454	23,095,941
1996/97	71,971,123	41,497,133	113,468,256	28,503,712
1997/98	120,123,351	110,565,150	230,688,501	105,514,246
1998/99	187,393,508	203,127,089	390,520,597	137,290,270
TOTAL	667,077,784	425,824,089	1,256,318,815	323,750,880

Comparison of the two tables shows that during the three year period the claims liabilities for claims to 1999 increased from HK$ 126,149,407 to HK$ 390,520,577, which is a percentage increase by the process of claims development and time of 209%. Without any intervening insolvency of HIH the claims experience of the profession was driving significant increases in re-insurance premiums for future years.

The next table includes the three years after the close of the 1999 policy year. As at 30th September 2002 there were 1,667 claims open for which HK SIF may have a potential liability Even if no liability eventuates those files must be closed before the Fund can be closed. The numbers are set out below for each year together with the liabilities for each year.

Table No 10

Indemnity Year	Total Claim Payments (HK$)	Total Reserved Claims (HK$)	Total No. of Claims	Open Claims
1986/87	24,938,021	–	--	
1987/88	13,754,212	–	53	1
1988/89	29,210,385	1,345,562	107	15
1989/90	12,470,291	--	84	5
1990/91	7,581,520	426,672	68	7
1991/92	8,660,654	914,910	90	31
1992/93	40,310,346	6,534,589	113	48
1993/94	29,905,068	11,414,817	102	55
1994/95	47,200,685	14,113,332	146	42
1995/96	73,558,619	35,884,835	149	61
1996/97	71,971,123	41,497,133	172	101
1997/98	120,123,351	110,565,150	281	277
1998/99	187,393,508	203,127,089	293	364
1999/00	23,615,761	91,192,658	259	250
2000/01	13,175,774	66,328,112	224	221
2001/02	929,885	32,829,270	216	189
TOTAL	**704,799,204**	**616,174,129**	**2,359**	**1667**

Features to note are:

1. Of the total 2,359 claims [which includes potential claims or "circumstances] notified between 1st October 1986 and 30th September 2002, 1,667 were still open. The significance of that for any future arrangements is that those outstanding claims liabilities will remain regardless of what future arrangements are adopted. The proportion of open claims that are 10 years old is quite small in number and value. The outstanding claims notified between 1st October 1992 and 30th September 2002 number 1,428 from a total number of 1,957. In other words 73% of notifications in the last 10 years are not finalised. Essar advised us following release of the DD they will soon be closing 353 of files that are open.

2. The number of claims each year started increasing rapidly from the end of 1994. Between 1st October 1994 and 30th September 1998 the number of claims doubled and have remained at or above double the October 1994 number per annum ever since.

   The Annual Report of the Law Society for 2001 details the increase year by year of the number of claims and compares it with the number of members of the Society (that data is in Table 7 page 62).

3. The value of the claims from 1st October 1994 to 30th September 2001 [according to their development status at 30/9/02] has more than doubled. The liabilities on claims for the five years from 1st October 1995 to 30th September 2000 are 304% of the claims liabilities for all the other ten years between 1st October 1986 to 30th September 2002.

4. If estimating the probable length and likely cost of running off (resolving-paying-closing) the long tail on claims notified at 30th September 2002 regard needs to be taken of the development time on average for claims from past years. This is done by an actuarial assessment, but it can be seen that[for example] out of the 281 claims notified in the twelve month period ending 30th September 1998 226, that is 80% were not resolved (closed) four years later. Of those claims from the previous year ending 30th September 1997 56% were still open on the fifth anniversary of the close of claims made in that year. Our study of the pattern of development of claims for the HKSIF concludes that an accurate assessment of losses close to the final loss ratio for a year does not emerge until the fifth year of claims development. The reserving approach of HKSIF makes

analysis even more difficult as claims are usually not reserved until proceedings are issued.

3.5.1 The 2000 Five Year Plan

The action taken by the Managers of HKSIF from April 2000 led to: -

- Cancellation by mutual agreement with the re-insurers of the existing re-insurance for indemnity between $1million and $10 million on each and every claim a year before expiry.
- An agreement with re-insurers for a 5 year period expiring 30th September 2005 which in essence fixed the re-insurance premium for the whole of the period; spread the increased premium due to past losses by the re-insurers over a 5 year period, made provision for the premium to decrease in the 4th and 5th years if the claims experience showed significant improvement from the projections and gave HKSIF the right to cancel the agreement if the insurers' security (solvency) rating fell below a set level.
- Use of reserves to pay the increased re-insurance premium for 2000/2001 and no amendment to the formula for the collection of contributions from firms.
- Steps being expedited to introduce a comprehensive and compulsory risk management programme.
- Consultation with the profession to inform them of the changes, future likely increases in contributions and of the unsatisfactory claims experience.
- Consideration and research on the feasibility and impact of increasing deductibles, introducing penalty deductibles, adjusting the contribution formula on the "user pays" principle, title insurance and introducing risk banding. The management also took advice on and researched the desirability of a qualified insurer arrangement. Reviews were done from 1995, but did not result in significant changes.

The plan had three factors over the five year period from 1st September 2000 that were likely to stabilise contributions for the solicitors: -

1. $1.5 million risk of all claims would be retained by HKSIF from 2001 to 2005.
2. Increased re-insurance premiums were to be phased in over a five year period increasing the premium in each year :-
   The first year by 50%
   The second year by 50 %
   The third year by 45%
   The fourth year by 45%
   The fifth year by 42.5%.
3. Reinsurance premiums were fixed for five years unless the number of claims notified in any one of those five years exceeded 340. If claims did exceed that number a formula effectively increased the re-insurance premium by 1% for every 4 claims over 340.

The major benefit was that the restructured arrangement avoided an inevitable increase in contributions from solicitors of about 250% in September 2000 arising solely from claims prior to September 2000. Increases in contributions were to be phased in over a four year period. The contribution formula has remained the same since 2001. This has not allowed HKSIF to build up a surplus over liabilities.

Another major benefit was that if claims between 2000 and 2005 cost less than predicted by an actuarial assumption that they would increase by 7% the re-insurance premium would reduce according to a formula potentially giving a reduction of 25% maximum. In other words the solicitors by adopting better risk management and practice standards were given an opportunity to alleviate the consequences of past claims.

The 2001 arrangements were implemented. It is now known that claims for 2000 were 224; in 2001 they were 216; and the number for 2002 was 195 to 26 November 2003. For 2003/4 15 had been reported by 24th November 2003. Rules have been passed to implement a compulsory risk management programme for all solicitors. The Law Society called for tenders for provision of approved risk management education courses and has appointed a provider. The courses are due to start shortly.

The 2000 restructured arrangements were timed fortuitously because they sheltered HKSIF from the consequences of the WTC insurance market decline and from the current hard market conditions on the reinsurance on each and every claim from HK$1.5 million up to HK$10million.

The cap on the Fund's total liability has not been affordably available since expiry of the Stop Loss insurance on 30st September 2001. The total liability of the Fund prior to this expiry was capped at $90 million in a three year period. Now its liability is up to HK$1.5 million on however many claims must be paid.

In March 2001 the arrangements entered into in September 2000 were cancelled as the lead insurer, one of the HIH Group, came under Administration, and subsequently went into liquidation. Arrangements in substantially the same terms were replaced on 25th April 2001. The potential saving of 25% of the re-insurance premiums was reduced, however, to 12%.

This had financial consequences for HKSIF and for the solicitors contributing to it.

- Additional premium for re-insurance was paid to the insurers substituted for the HIH Group. Total re-insurance premiums for 2000/2001 were HK$123,253.900. This is to be compared with total contributions by the profession for 2000/2001 of HK$98,236.018. The total re-insurance premium for the next year 2001/2002 was HK$89,422,227.

- The assets of HKSIF were reduced by the amount of liabilities for outstanding claims that the HIH Group had reinsured. That amount is a variable over the development life of those claims but assessment of the amount has been made in the financial accounts. For 2000/2001 it was HK$374,682,777 and for 2001/2002 was HK$101,861,054, a grand total of HK$476,543,831.

  The reinsurance premiums were fixed for 5 years subject to the above formula. The following table shows the annual contribution of the whole profession from 1998 to 2003 compared with the reinsurance premiums that have been paid, the number of claims in each of the relevant years and the agreed reinsurance premiums for the same period.

Re-Insurance Premiums and Contributions as at 30th September 2003 *(Table No 11)*

Year	Claims Losses HK Million	Contributions	No. of Claims	Agreed Re-Insurance Premium	Actual Re-Insurance Premium
1998/1999	34.9	104,742,760	367	109,099,050	
1999/2000	129.1	79,171,731	263	2yrs excess of loss 3 yrs stop loss	109,099,050
2000/2001	97.8	88,852,727	227	83,232,650	104,890,865 (40,021,250 HIH Replacement)
2001/2002	76.4	215,352,931	187	113,625,000	113,625
2002/2003	25	208,700,014	195*	164,756,000	117,125,545
2003/2004	?	219,000,000	15*	238,898,563	177,699,519
2004/2005	?	?	?	340,427,602	Minimum – 255,000,000

* As at 24/11/03

3.5.2 Loss Ratio

The loss ratios of HKSIF are set out in the table below. The estimates of losses are as at 30th September 2002. The loss ratios take the total contributions of the Profession for each year and compare them with the payments made and estimates of future liabilities on already reported claims that have reserves for each year. When considering these loss ratios it must be remembered that it takes about 4 years before claims are developed enough to rely on the estimates as representing the final loss ratios. The great majority of claims for 2001 – 2003 carry no reserves as yet.

Until that point estimates must rely on actuarial assessment. HKSIF and the managers obtain such estimates from actuaries and they have been shown to us but they could compromise future negotiations by the brokers if the details were disclosed about projections of future losses. The audited financial statements of HKSIF which have been published up to 30th September 2002 as a matter of accounting best practice, would have taken account of actuarial projections to determine the true financial position of HKSIF.

The loss ratios of the PI scheme are as set out in the following Table:

Table No 12

Year of account	Number of claims	Loss ratio @ 30/09/99	Loss ratio @ 30/09/02	% change for period
1994/95	148	31%	89%	58%
1995/96	149	38%	152%	114%
1996/97	172	49%	141%	92%
1997/98	281	65%	220%	155%
1998/99	293	114%	354%	240%
Cumulative loss ratio		59%	191%	132%

As at 30th September 2002 the loss ratio for the year 1998-1999 is 354%. This means that the premium paid to reinsurers and the contribution retained by HKSIF is two and a half times less than the amount paid or expected to be paid for the claims reported in 1998-1999. As a general rule of thumb a re-insurer will not make profit unless the loss ratio is less than 65%-70% of premium. Investment returns have an effect on this aspect.

3.5.3 Financial Consequences for Firms with Claims

Examination of the previous statistics lead to the conclusion that the Profession was facing increases regardless of any HIH Group insolvency. The following statistics give a quantative analysis of the effect of the claims losses on the Profession.

HONG KONG SOLICITORS INDEMNITY FUND
COMPARISON OF CONTRIBUTIONS, LOADING AND LOSSES *TABLE 13*

Indemnity Year	Annual Contribution	Claims Loading	Total Incurred Losses	Loadings as % of Losses	Loadings as % of Contribution	Recovery from Insureds' Deductibles
1998/1999	104,742,760	5,815,656	390,520,597	1.48%	5.50%	13,200,207
1999/2000	79,171,731	4,187,326	114,808,419	3.64%	5.20%	1,986,568
2000/2001	88,852,727	5,547,161	79,503,886	6.90%	6.20%	1,138,000
2001/2002	215,352,931	16,138,943	33,759,155	47.00%	7.40%	30,000
2002/2003	206,700,014	11,696,718			5.60%	

*Total Incurred Losses includes reserves, some of which will be covered by Insureds' deductibles

**Information as at 30 September 2002

The tables below show the overall impact of increased contributions on firms in different streams of income.

Table 14

HONG KONG SOLICITORS INDEMNITY FUND
COMPARISON OF CONTRIBUTIONS WITH GROSS FEES

	2001/02		2002/03			
	Basic Contribution		Basic Contribution		Basic Contribution plus HIH 'Call'	
Average contribution as a % of gross fees	No. of Firms	As a % of all Firms	No. of Firms	As a % of all Firms	No. of Firms	As a % of all Firms
Below 1%	5	0.88%	5	0.87%	0	0.00%
1% to 2%	74	13.03%	68	11.76%	18	3.20%
2% to 3%	101	17.78%	89	15.40%	41	7.28%
3% to 4%	215	37.85%	214	37.02%	47	8.35%
4% to 5%	102	17.96%	124	21.45%	73	12.97%
5% to 6%	33	5.81%	40	6.92%	142	25.22%
6% to 7%	13	2.29%	12	2.08%	117	20.78%
7% to 8%	3	0.53%	10	1.73%	47	8.35%
8% to 9%	4	0.70%	4	0.69%	28	4.97%
9% to 10%	5	0.88%	4	0.69%	20	3.55%
10% to 15%	6	1.06%	4	0.69%	19	3.37%
15% to 20%	4	0.70%	1	0.17%	7	1.24%
over 20%	3	0.53%	3	0.52%	4	0.71%
TOTAL	568	100.00%	578	100.00%	563	100.00%

This shows the income number of firms, and the percentage of gross fees in relation to the firms' contributions for 2002/2003 with and without the deficit HIH call and compares it with contributions on the same basis for 2001/2002.

The next table is a comparison of the overall fees of the profession and the contribution.

HONG KONG SOLICITORS INDEMNITY FUND
COMPARISON OF CONTRIBUTION AS % OF PROFESSION'S GROSS FEES

Table No 15

Indemnity Year	Gross Fees of Profession	Basic Contribution	Contribution as a % of Gross Fees
2000/01	10,966,617,312	84,245,634	0.77%
2001/02	11,563,651,516	204,867,538	1.77%
2002/03	11,078,820,120	207,569,649	1.87%

In our questionnaire distributed in October 2003 we sought an indication of how the increases affected individual firms. We refer you to page 20 of this report for the results.

The survey conducted by Margaret Ng, Legislative Councillor in October 2003 collected and reported information on this same topic. Those wishing to follow up this topic can refer to her office, or her website.

HKSIF COMPARISON OF CONTRIBUTIONS WITH GROSS FEES

Table No 16

Contribution as a % of gross fess	2001/2002	2002/2003	No of Firms	
	Gross Fees Range	Gross Fees Range	Without HIH Levy	With HIH Levy
4% to 5%	936K – 9M	882K – 8.2M	124	73
5% to 6%	640K – 5M	644 – 5M	40	142
6% to 7%	476K – 2.2M	520K – 2.7M	12	117
7% to 8%	454K – 2.8M	389 -1.5M	10	47
8% to 9%	321K – 780K	317K – 1M	4	28
9% to 10%	309K – 986K	289K – 1M	4	20
10% to 15%	307K – 340K	223K – 578K	4	19
15% to 20%	245K – 373K	231K	1	7
Over 20%	77K – 219K	52K – 195K	3	4

This table shows the income band of firms and the number of firms within each band to enable an overview of the effect of the insolvency of the HIH Group on firms. For the majority of firms the HIH element has meant an increase of 1% of gross fees. Rising premiums would have been inevitable solely due to the claims being incurred. In 2004 it may be imprudent if the contributions are not increased.

If HKSIF ceases as the provider of indemnity on 30th September 2005 it will need to have sufficient funds to cover the following estimated potential and actual liabilities and expenses. If it does not collect funds by then calls will need to be made after 2005.

1. Claims liabilities for claims reported prior to 30 September 2005, including claims that are laundry listed in 2005.

2. Administrative expenses for the run off claims to 30 September 2005. We estimate this to be for a period of 10 years, subject to outsourcing for a lump sum payment.

3. Claims liabilities for practitioners who retired prior to 30 September 2005 but have claims after 30 September 2005.

4. Cost of administration of any ARP if a QIS is adopted.

Any estimate of (1) will need to allow for "laundry listing" of claims prior to any change. In England in the last year claims notified were approximately 38,000 as opposed to the average of about 12,000 in earlier years. No one yet knows the amount of claims liabilities for 2003/04 and 2004/05. Actuarial assessment of liabilities to 30 September 2002 indicate that for claims to September 2002 the amount required by HKSIF (approximately) was, optimistically, HK$420,000,000 million, and realistically HK$700,000,000. Analysis of the amount available to meet claims after payment of re-insurance premiums for the years 2002-2005 (see Table No 11 page 93) suggest that HKSIF will not have sufficient funds in 2004 unless contributions for 2004/2005 are significantly increased.

3.6 LIMIT OF INDEMNITY

The limit of indemnity for each claim is currently ten million dollars. In 1994 the limit was doubled from HK$ five million to HK$ ten million. When that happened the claims losses of the profession for the previous six years were far less than the contributions that had been paid. The table below shows the loss ratios at September 1993.

Year					
1987/88	1988/89	1989/90	1990/91	1991/1992	1992/93
Loss Ratios					
83.30 %	83.55%	44.83%	19.52%	19.40%	77.25%

It is interesting to compare these with the re-insurers loss ratios.

Because of that favourable claims experience HK SIF was able to increase the limit of indemnity on each and every claim, while increasing the excess of loss and stop loss reinsurance premium by only 40%. The reserves of HK SIF at that time absorbed the increase in reinsurance premiums and there was no increased contribution from the Profession to double the limit of claims. Nor was there any increase in the deductible that was to be paid by those who had claims. We have not seen any record to suggest that the increase in the limit was in response to any claims trend in claims over the existing limit of HK$ five million.

The announcement made by the Law Society at the time was that the increase in the limit was considered prudent to protect the public and solicitors as the price of property had increased significantly since 1986.

In a compulsory arrangement the limit of indemnity is typically related to damages awarded for personal injury claims. The public interest requires that people who have severe personal injuries, and above all a total loss of earning capacity, ought to be confident that the insurance of their legal adviser is equivalent to what their damages might be under the general law. We have attempted to obtain more detailed information on the average award of damages under Hong Kong law to a person who suffers a total loss of working capacity and has an action against a third party for that loss.

We are informed that in 1996 there was an award of approximately HK$14,000,000. There have been awards above HK$10,000,00, namely, HK$19,300,000, HK$19,6000,000 and HK$25,700,000.

We accept that for the proper protection of the public interest the limit of indemnity ought to set an amount that roughly approximates the loss that an average consumer of legal services, on transactions most commonly entered into by average members of the public could suffer in the event of default or error by a solicitor. The choice of that amount will have some arbitrary factors because the nature of consumers of legal services are as varied as humans themselves.

Underlying that choice also is regard to the fact that because the insurance is compulsory the minimum level should be prescribed consistent with the public need leaving those whose practice as solicitors, or whose client expectations , exceed that minimum, to exercise freedom of choice about, of any higher limit. The great majority of personal injury damages awards, personal estates to be administered, home purchases, rental transactions, taxation planning advices, personal property sales, non-financial institution loans, are within the current limit of HK$ 10 million.

3.7 RISK BANDING

This is sometimes called "risk rating" Risk banding is where differential premiums are applied to common characteristics of an insured group. The characteristic can be an activity, a field of work ,staff to professional ratio etc. It is referred to here as excluding rating according to claims history.

There is no exact scientific formula to arrive at the correct figure for the premium for a particular risk. This is particularly so as insurance is based on the premise of subsidy. There will always be subsidy in insurance, and indeed subsidy is necessary for insurance to exist. The good risks will always subsidise the bad, and the challenge is to devise a fair premium calculation to achieve a desired result.

There is a great deal of information which could have a bearing on the premium, such as the size and type of practice, the areas of practice, whether or not the firm sets out to specialize in one or more particular fields, the experience of practitioners, and the list goes on. True risk rating is reliant on the quality and accuracy of this information.

To obtain this information, an underwriter of professional indemnity insurance will always require an up-to-date proposal form, and possibly, additional information or clarification of answers in the proposal form .
In calculating a premium, it is essential for an underwriter to be confident that the information contained in the proposal form is accurate as the proposal form becomes the basis of the contract of insurance.

Whilst the premium to be charged will vary from one underwriter to another, and from profession to profession, each underwriter will have his own scale of rates which will form the basis of his underwriting. The exact formula by which these rates will have been arrived at is purely personal to the underwriter concerned, usually from extensive statistical information. They are designed to make some underwriters competitive on certain professions and certain risks and less competitive on others, or more competitive for certain sized firms or limits of indemnity than for others. It is not unusual for an underwriter to have a "decline list" of professions that they will not insure no matter what that individual or firm's actual situation is. This list may be as a result of past experience with claims, reinsurance issues, or a lack of underwriter expertise in the area. If a QIS is adopted all solicitors will be so assessed and charged by insurers. Under HK SIF solicitors are shielded from that. Nonetheless it is appropriate and equitable when allocating a premium pool under a mutual to follow commercial practice, or if not, to depart from it only for some other good reason.

3.7.1 Base Premium Calculation

Contributions for professional indemnity are based on the gross fees.

The simple base premium calculation is based on the formula set out in Schedule 1 to the Rules.

Common aspects used in risk banding are-:

- *Claims Experience*
- *Size Factors*
- *Areas of Practice (Discipline Factors)*
- *Number of Offices*

- *Location of Offices*
- *Ages of Partners or Experience of the Business*
- *Ratio of Partners to Staff*
- *Geographical Factors*

The current formula differentiates contributions only according to the first two.

Claims experience, size and discipline factors could be considered to be of greater importance in arriving at the final premium than others in commercial insurers' underwriting.

3.7.2 Premium Loading / Discount Factors - Relevance

- *Number of Offices*

Supervision of the business is an important premium consideration and, where there is more than one office, the risk may be increased because of the difficulties of control, monitoring and communication between the different locations. The underwriter will need to be satisfied that all the offices are being managed by experienced and competent staff. If there is not a partner in charge at any of these other locations, the underwriter will have to investigate how control is exercised, and therefore how the risk is managed. This factor is likely to assume more significance as Hong Kong solicitors open offices in mainland China.

- *Location of Offices*

The location of an office may dictate the type of work undertaken and therefore the risk to an underwriter. For example, a practice or branch office in may be weighted with a client base requiring advice on domestic or consumer matters, while a practice with a Hong Kong CBD address may well be weighted to a client base requiring complex advice for matters involving multi million dollar transactions. If there is also a branch in mainland China not only may the work be for a differently profiled client base, but the ability of the head office to supervise may be lessened.

- *Claims Experience*

As with all classes of insurance, the premium is influenced by the past experience of the risk. An unsatisfactory claims record normally involves an increase in the basic premium and may also call for an increase in the excess. In assessing this, an underwriter will look at both the frequency and size of claims.

A number of claims, however, will put the underwriter on notice and an investigation of the causes and steps taken to prevent recurrences should be made. Frequency of notification is also an important factor. Isolated or "one off" claims may be disregarded unless of recent origin as an aberration, likewise, underwriters are interested to know whether there is a pattern of claims, in which event, the underwriter may wish to exclude their consequences from the policy and/or inquire as to the cause and the precautions taken to prevent a recurrence.

A reluctant notifier may present as a greater risk, than the prolific notifier. An underwriter can be reasonably confident that the prolific notifier is an "open book", but he may not be quite so confident with the reluctant notifier.

- *Age, Experience and Qualifications of Partners or Experience of the Business*

The underwriter has to be satisfied that the proposer is competent to act and give advice in the particular profession. Age and experience are relevant generally to the risk, and an initial measure of competence is the tertiary or other qualification required to practise. This is obviously more relevant in the case of a profession where there are not necessarily formal qualification requirements such as a legal or medical degree.

An increased premium may be required where the partners are young or where the business has only recently been established.

- *Ratio of Partners to Staff*

Any loading will depend entirely on the insurers' view of the risk as a whole and their judgement of an acceptable ratio between "supervisory" and "other" staff. A practice with a low partner to staff ratio may present as a greater risk as more work is done by practitioners without the close supervision of an experienced practitioner. Experience has shown that when some firms do a large amount of conveyancing work the ratio of solicitors to unqualified staff is often higher than in say a predominantly litigious practice of medium size. In Malaysia, for instance, if the ratio of solicitors to other staff exceeds 1:5 a 10 % loading is imposed on the premium.

- *Size Factors*

Often the base premium will be discounted because of the size of the practice to provide a larger practice with a premium which is not prohibitive. This reflects the modern management of legal practices ,because once a firm reaches a particular size it does usually adopt a system of employing professional managers, human resource staff, in-house training and professional development and risk management . The size at which that becomes affordable and efficient varies from jurisdiction .

- *Areas of Practice (Discipline Factors)*

This is an area of particular importance in the legal profession. Often various areas of practice will be determined to be "high" or "low" risk, usually based largely on past claims experiences from within a portfolio of business, and overall experience. For instance, Criminal Law seems to draw fewer claims than conveyancing, and may therefore be classed as a lower risk, and thus worthy of a premium discount.

The debate about branding one area riskier than another has two sides. On the one hand it is said that because one type of work results in more claims. It could be that there are more transactions carried out in that area . For instance, if there are 5 claims in ten years relating to mergers and acquisitions of companies and 500 related to conveyancing and during the same period there were 100 mergers or acquisitions and 1,000,000 conveyancing transactions, then statistically conveyancing is not more risky than M&A work. The argument proceeds from that to saying why should all solicitors who do conveyancing work well pay more when they are less risk statistically than solicitors doing M&A work .

On the other hand, particularly in a mutual scheme, if the total number of conveyancing claims far exceeds the number of M&A claims those with no claims at all are paying higher premiums because of the overall risk from an area of work. If risk banding is adopted it must be accepted that economic necessity to collect sufficient premium pool overrides arguments.

An example from our experience in Tasmania shows that while only 2% of work is performed by the profession in "Mortgage Practices", this work accounts for 8% of all notifications and 30% of the cost of all claims. It is therefore clearly a more risky practice area, given the relatively low amount of work performed in the area, and practice in this area should result in a higher premium being paid. A "discipline factor". In the accounting field, a practice with a large reliance on audit work is viewed as a more "risky" practice, than one which provides routine tax advice to individuals.

We recommend the introduction of risk banding if HKSIF remains as a provider of indemnity. Our grounds are elaborated upon in the next section.

3.8 CONVEYANCING CLAIMS

The following table shows the breakdown of claims according to area of practice as at September 2002 and covers the period 1 October 1997 – 30th September 2002.

Frequency of Claims by Type of Practice (1 October 1997 – 30 September 2002)

Table No 17

TYPE OF PRACTICE	INDEMNITY YEAR					
	1997/98	1998/99	1999/00	2000/1	2001/02	TOTAL
Commercial	33	35	24	33	34	**159**
Conveyancing	160	167	115	95	83	**620**
Litigation	63	76	84	66	65	**354**
Probate	6	5	12	8	14	**45**
Landlord & Tenants	4	1	1	3	1	**10**
Patents, Trademarks	13	5	7	6	6	**37**
Tax Matters	2	1	1	2	1	**7**
Others	0	3	15	11	12	**41**
Total	**281**	**293**	**259**	**224**	**216**	**1273**

The following table shows the value of the claims in the preceding Table (No 17)

Value of Claims by Type of Practice (1 October 1997 – 30 September 2002)

Table No 18

TYPE OF PRACTICE	No. Of Claims	INDEMNITY YEAR				
		1997/98 HK$	1998/99 HK$	1999/00 HK$	2000/1 HK$	2001/02 HK$
Commercial	159	21,364,467	19,375,065	129,369	24,760,804	7,500,000
Conveyancing	620	189,637,349	346,861,271	90,817,651	47,484,485	20,432,250
Litigation	354	13,531,993	21,806,111	21,611,399	4,561,280	4,616,430
Probate	45	4,927,067	78,150	2,150,000	1,815,315	58,075
Landlord & Tenants	10	1,227,625	0	0	414,332	0
Patents, Trademarks	37	0	0	0	350,000	1,150,000
Tax Matters	7	0	0	0	0	0
Others	41	0	400,000	100,000	117,670	400
Total	**1,273**	**230,688,501**	**390,520,597**	**114,808**	**79,503,886**	**33,759,155**

The next two tables give the same information about areas of practice, number of claims and cost of claims for the period 1986-1996. The figures contain the estimates of losses as at 30th September 1996. In other words, the claims are in approximately the same stage of development as those in the preceding tables. With long tail insurance, estimating losses, obtaining information and the time taken going through the legal process makes comparisons difficult. It could create a wrong impression to compare claims in different stages of development. It needs an actuary to make that comparison.

Table No. 19

As at 30th September 1996

Area of Practice	1986/87			1987/88			1988/89			1989/90			1990/91		
	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.
Conveyancing	26	1.861	-	21	2.957	-	70	6.687	3.960	135	7.341	7.869	41	7.262	3.272
Company/ Commercial	23	22.682	-	11	0.189	-	15	0.339	-	15	1.428	4.925	15	0.306	-
Civil Litigation	7	0.100	-	13	7.008	-	21	1.364	-	18	3.180	0.740	8	-	-
Criminal	-	-	-	1	-	-	-	-	-	-	-	-	-	-	-
Matrimonial	-	-	-	-	-	-	3	-	-	-	-	-	3	0.395	0.510
Miscellaneous	6	0.002	-	8	2.751	-	4	-	-	-	-	-	1	-	-
Probate	2	0.195	-	1	-	-	8	20.074	0.425	5	0.288	-	1	-	-

Amounts paid and outstanding are expressed in millions.

Table No. 20

As at 30th September 1996

Area of Practice	1991/92			1992/93			1993/94			1994/95			1995/96		
	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.	No.	Amt. Paid	Amt. Res.
Conveyancing	53	1.593	2.756	64	25.195	16.781	98	7.950	75.293	69	27.491	15.946	77	4.580	17.236
Company/ Commercial	14	0.102	2.196	18	1.968	5.103	1.288	1.506	-	25	0.657	-	20	0.214	-
Civil Litigation	26	1.888	3.350	31	3.527	1.467	-	4.887	5.986	45	2.534	1.060	47	1.574	1.740
Criminal	-	-	-	-	-	-	-	-	-	1	-	-	-	-	-
Matrimonial	-	-	-	-	-	-	4	-	-	2	-	-	4	-	-
Miscellaneous	-	-	-	-	-	-	1	-	-	-	-	-	-	-	-
Probate	-	-	-	2	-	-	4	-	-	6	0.400	-	-	-	-

Amounts paid and outstanding are expressed in millions.

The next table shows the type of errors made which account for claims over the 5 years, 1997-2002.

Number and Value of Claims by Type of Errors in Conveyancing
(1 October 1997 – 30 September 2002)

Table No. 21

Type of Errors in Conveyancing	No. of Claims	% of Total No. of Claims	% of Total Value of Claims	INDEMNITY YEAR				
				1997/98	1998/99	1999/00	2000/01	2001/02
				VALUE OF CLAIMS				
Breach of undertaking	18	1.41%	1.72%	4,015,463	5,740,034			4,816,000
Conflict of interest	19	1.49%	1.12%	4,545,905	3,840,000	1,091,100		
Delay Irrespective of time limits	13	1.02%	3.91%	3,995,738	19,400,000	9,850,000		
Failure to spot/investigate defect	123	9.66%	10.48%	39,767,583	10,464,842	26,878,359	10,440,000	1,450,000
Failure to act per client instruction	16	1.26%	1.22%	2,963,00	461,521		2,545,060	4,341,000
Failure to advise correctly	130	10.21%	28.59%	26,478,629	183,436,465	11,909,255	11,854,402	9,161,191
Failure to answer requisitions	27	2.12% %	6.93%	17,356,801	22,130,375	12,829,364	6,505,000	
Failure to search properly	10	0.79%	0.94%	4,254,218	2,721,000	1,000,000		
Failure to supervise	1	0.08%	0.13%				1,117,313	
Failure to verify/check information	25	1.96%	2.32%	3,527,403	12,856,977	1,520,583	1,800,000	
Fraud by clients*	14	1.10%	2.05%	815,281	16,081,091	1,500	377,178	
Fraud by employee*	9	0.71%%	0.73%	886,651	3,005,000		2,335,014	
Fraud by Principal*	19	1.49%%	6.85%	18,847,066	38,855,548	2,168,495	380,000	12,085
Incorrect preparation/drafting	36	2.83%%	3.63%	20,057,176	1,200,000		7,398,929	
Insufficient information	19	1.49%	0.28%				990,000	1,974
Late pleadings/requisitions	1	0.08%	0.13%	1,085,000				
Late/failed issue of proceedings	2	0.16%	0.26%	2,213,000				
Late/failed registration	26	2.04%	1.77%	2,245,736	8,767,091	3,951,999	66,200	
Late/failed stamping	4	0.31%	0.24%	3,756,559	2,060,536			
Loss of documents	7	0.55%%	0.02%	175,000				
Missed time limits	9	0.71%%	2.50%	17,142,107	2,333,548	1,755,000		
No apparent negligence**	33	2.59%%	0.63%	3,756,559	630,000	53,704	634,102	
Other failure to take correct action	51	4.01%%	5.00%	14,859,031	8,800,001	17,409,792	1,039,287	300,000
Causes not specified	8	0.63%	0.65%	650,000	4,673,728			350,000
TOTAL	**620**	**48.70%**	**82.10%**	**189,637,349**	**348,861,271**	**90,817,651**	**47,484,485**	**20,432,250**

3.8.1 Segregated Conveyancing Insurance

It has been suggested that Hong Kong SIF amend the Rules so that indemnity is not provided with respect to any conveyancing work. That option is not feasible for the following reasons.

- A mutual scheme and HKSIF can only operate successfully if the number of contributors is large enough to generate a critical mass of contributions. Declining cover for any conveyancing work would reduce the premium pool by removing firms that do only conveyancing work.
- It is unrealistic to expect that any firm does 100% conveyancing work and any firm that does any type of conveyancing work at all would need double insurance.
- Insurance for conveyancing work has to remain compulsory in the public interest and according to Government policy.

We see a better solution to be mechanisms whereby those undertaking conveyancing work contribute more to HKSIF. This can be done by at least three methods: -

- Risk Banding.
- Penalty deductibles on certain types of errors.
- A levy on each conveyancing transaction such as occurs in Ontario, see Appendix 7 (page 189).

3.8.2 Risk Banding for Conveyancing Work

At the moment there is insufficient data to indicate to us how many firms have claims compared with the amount of conveyancing work those firms do and compared with the amount of conveyancing work done by all firms in Hong Kong. Until that data is available we recommend that if HKSIF is the provider of professional indemnity to the profession after September 2005 that contributions be increased so that an additional percentage of contribution is paid with respect to conveyancing work. It will be for HKSIF to decide the actual percentages, but we suggest the following method

Suggested Methodology for Loadings *(Table No. 22)*

Categories of work:-

a. Personal Injuries
b. Other Civil Litigation
c. Taxation Corporate Financial Services, and Commercial work
d. Criminal Law
e. Family Law
f. Mortgages, Loans, Securities with respect to interests in land
g. Conveyancing Excluding (f)

Total Percentage of Gross Fees from a+b+f+g	Percentage Contribution Loading
0% - 25%	Nil
26% - 40%	10%
41% - 60%	15%
61% - 75%	17.5%
76% - 100%	20%

This methodology is a form of risk banding. Once data as to firms' areas of work is collected, the categories of the band can be refined. Correlation of any features of a firms work area. Staff ratios between solicitors and others, once analysed from study of the claims files will enable refinement of what must commence as a rather arbitrary exercise, based on current data. Without this type of exercise members of the mutual are likely to continue to be aggrieved about subsidies of high risks by good risks. At this point it is not possible to say if that grievance is justified. Only those who have access to details of the claims and features of the firms they are made against can report that.

If it is the fact that there is a correlation between the frequency of conveyancing claims and the staff ratios within a firm, a further percentage increase to the contribution ought to be imposed. In some jurisdictions in conveyancing work a firm is constituted of a number of practitioners who employ conveyancing clerks who in effect do most of the work and earn most of the fees. Under HKSIF no charge is made for conveyancing clerks. As we have had no access to examine the features of claims we do not know whether they are arising from practices so constituted in Hong Kong. The chart (Table no 21) indicates that for the period from 1st October 1997 – 30th September 2002 there has only been one claim resulting from failure to supervise.

As we do not know the criteria and how it is applied to the facts of claims to determine the types of errors or the causal relationship between the error and such things as staff ratios, we are unable to make any recommendation on this issue. We suggest that closer examination of the files be carried out on matters such as failure to search properly, failure to answer requisitions, late/failed stamping, loss of documents and missed times limits to identify underlying causes. Lack of supervision of non-legally qualified staff doing conveyancing work may be the cause of those errors. If that proved to be so a further percentage ought to be added to the contribution of firms where the relevant staff constitution exists.

That information needs to be collected at the time of any renewal. The appropriate percentage increase is a matter for HKSIF, Essar and actuarial advice. In Malaysia, for example, if the legally qualified to non-legally qualified staff ratio exceeds one to five a 10% loading is imposed on the premium. The amount collected will not be large enough to impact on the overall contribution required to fund HKSIF but will serve as a risk management incentive. In the absence of data we are unable to comment further.

3.8.3 Penalty Deductibles

It is apparent from consideration of the types of errors in conveyancing claims Table 21 that certain areas are susceptible to penalty deductibles. We suggest that if HKSIF continues to be the provider of indemnity that penalty deductibles be applied whenever the following type of error caused or contributed to the occurrence of a claim: -

- Breach of undertaking.
- Conflict of interest.
- Delay or breach of time limit. In this category we will include late registration, late stamping, missed time limits and delay irrespective of time limits.
- Failure to spot/investigate a defect. As this type of error accounts for 10% of losses totalling approximately HK$86,000,000 in a five year period (estimated at 30th September 2002) the penalty deductible for this type of error we recommend ought to be double the penalties on other types of errors.

This will have particular importance in the future if the Land Titles Bill becomes law. The losses that potentially may arise when land is first bought under the registration system

could be very high. In other jurisdictions, where the Torrens System, operates, it is recognised that errors occurring when land is first registered are unavoidable and statutory funds exist to provide compensation. A levy is placed on each transaction that is registered. The levy is quite small because of the large number of registrations. As we understand the legislation, it is not proposed to have such a fund in Hong Kong. It is likely that the burden of any errors will therefore fall on the solicitors who are required to certify that the interest being registered has good title. This is likely to result in liabilities for HKSIF, if it is extant.

- Failure to answer requisitions. This category of claim accounts for 6.93% of the total value of all claims. As at 30th September 2002 the value of the claims was approximately HK$58,000,000. We recommend that the penalty deductible for claims causing this type of error be the same as for failure to spot or investigate a defect: -

- Failure to search properly.

- Fraud by employee.

- Fraud by principal.

Although Solicitors may be victims of fraud in one sense, they have sole control over the money and assets of others. Such a deductible ought to be an incentive to invest time in managing the risk, supervising and establishing processes to reduce opportunities for others to be dishonest.

3.8.4 Levies on Conveyancing Transactions

We have appended as Appendix 7 (page 189) the rules of LawPro, the captive of the Law Society of Upper Canada which provides indemnity to the solicitors of Ontario. That jurisdiction has a high incidence of conveyancing claims as well as litigation claims. Firms who do conveyancing work are obliged to pay a sum of CA$50 per transaction as part of the insurance contribution. Relevant transactions extend to mortgages as well as transfers. Firms are required to submit returns of the number of transactions and make payment within a specified period. Failure to make the payment or the provision of an inaccurate return amounts to professional misconduct enforced by disciplinary proceedings and ultimately by striking off.

By this mechanism the cost of insurance is identified as a particular sum. The conduct rules of the Society enable the sum of CA$50 to be charged as a disbursement to the client. There is no statutory warrant for that. Some sophisticated clients decline to pay it, but most clients do without question, as in the overall cost of a conveyancing transaction, be it a mortgage or a sale and purchase, the sum is not large. We recommend the introduction of such a mechanism in Hong Kong to help avoid increasing contributions by the whole of the Profession arising from conveyancing. Such a mechanism will only be relevant if HKSIF continues as the provider of indemnity beyond 2005. In any event, there is nothing preventing solicitors building their fees an element to cover insurance. All fees should reflect business expense plus profit. We have not discovered why solicitors are not doing that.

The mechanism of a levy on each transaction is not unique. In Hong Kong there already exists the Travel Industry Compensation Fund. This fund provides compensation to consumers in case of default of a travel agent. It is funded by a percentage on outward bound travellers from Hong Kong. The levy percentage is currently 0.3%. We attach as Appendix 8 (page 193) details of the fund.

The Hong Kong Government has also established the Employees Compensation Insolvency Scheme. This is funded by a levy on all insurers who sell employees' compensation insurance. It has been set up to protect workers against insurer insolvency.

In Australia when a major airline became insolvent, Ansett, the Australian Government imposed a A$10 levy on all air tickets sold to set up a fund to pay accrued employee benefits such as holiday pay, long service leave and superannuation. There are many examples of such financial strategies, where the public, or the interest of a particular section of the public, is compromised because of insolvency.

It has been suggested to us by a number of solicitors during our consultation process that any such levy ought to be tied to the value of the property concerned. We do not favour that course because it is complicated, and it will not allow an accurate assessment of how much HKSIF can plan to collect when it otherwise collects contributions.

Between 1997 and 2003 property prices in Hong Kong were in a freefall dropping by 60%. Published reports indicated that 168,500 homes were in negative equity. According to the Managing Director of Knight Frank Hong Kong, house prices in Hong Kong have turned around. Prices increased by 6% in the quarter ended 30th September 2003. The number of commercial property transactions doubled to 11,000 in October 2003 alone. The Government has introduced an initiative whereby a person who invests the equivalent HK$6 million is entitled to automatic Hong Kong residency which normally takes 7 years. This is causing an upsurge in the number of buyers. Mortgage rates are competitively low with some banks offering mortgage rates of 2.5% below the current rate.

To tie any levy to the value of property would make the process cumbersome and not necessarily any fairer. The liabilities such a levy would fund are past liabilities, being recovered form clients because a business cost was not passed on to the clients in earlier years. Disclosing the passing on of that business cost is the only result of a levy. It ought to be passed on to the client in fees charged, disclosed or not.

3.8.5 Registration System – Land Titles Bill

We considered a great deal of information relating to the pending introduction of a registered title system for interests in land in Hong Kong. We consider that the introduction of a registered title system will have benefits in reducing liabilities in the long term for conveyancing claims that are related to a solicitors failing to investigate or identify a defect in the title (interest in land refers not just to ownership but an interest as a mortgagee). Those type of errors, account only for 10.48% of conveyancing claims.

Under a registered title system mistakes such as breach of undertaking, conflict of interest, delay, failure to answer requisitions, failure to conduct searches, fraud, late stamping, loss of documents and missed timed limits will still continue. Any benefits from the introduction of a registered system on the insurance scheme are not likely to be apparent until all of the land in Hong Kong has been brought under the registered system. We do not know the estimate of that period, but it may be at least the period that it takes for one generation to pass family land holdings to the next.

The introduction of the system however, does potentially create greater risks for solicitors and therefore greater liabilities for HKSIF, or any other insurer. As currently proposed the legislation requires a solicitor to certify that the applicant who registers an interest has a good title to that interest. Upon registration, title becomes indefeasible, subject to fraud and forgery.

Solicitors will therefore be increasing their potential liability as the class of persons to whom they become liable will be greatly extended and the period over which that indemnity might arise will be greatly increased. There is no proposal to establish a fund to compensate people who lose out on an interest because of registration. When the Torrens Land Title system of registration was invented in 1886 the existence of a compensation fund and a levy on every application to register any interest was imposed. In the absence of such a fund the adoption of the registered title system is likely to result in greatly increased liabilities for insurers of solicitors in Hong Kong for ten to thirty years after introduction of the system.

If the promoters of the Land Titles Bill cannot be persuaded to introduce such a fund some other funding of the liabilities or insurance is an imperative. If HKSIF continues to be the provider of indemnity to the Profession, excluding any liability arising from first bringing an interest in land under the registered system would not provide adequate protection to the public. In our view any such liabilities however, must be quarantined from the rest of HKSIF and funded differently. There are mechanisms to achieve this but because the legislation has not been passed and our efforts to find out when it will come into operation has resulted in us being informed that it may not come into operation in 2004 we do not elaborate on them.

If and when the registration of title land does becomes law in Hong Kong and if HKSIF continues to be the provider of indemnity insurance for certifying a title ought to be funded both by the practitioner concerned and the interest being registered. Those interests include financiers registering mortgages and other securities.

Contributions ought to be calculated differentially for this service (risk banded) and a penalty deductible applied. We have not recommended this course generally for liability arising from conveyancing transactions because the existing liabilities relate to transactions in past years and it is now too late to impose an extra business cost on either the solicitors conducting conveyancing transactions or their clients for transactions that have occurred in past years.

We mention in passing that we have seen two proposals from First American Title Insurance Company. The proposal to provide insurance of the title will not assist HKSIF insurers as under the proposal, is not proposed to surrender a right of subrogation against solicitors (and HKSIF) with respect to losses arising from defects in titles.

This means that if any loss arose from a defect in title as a result of negligence of a solicitor the title insurance company could claim the equivalent of that loss back from the solicitor and that solicitor's insurer or HKSIF.

Another proposal with respect to all conveyancing liabilities from all types of errors has been put to the Society. If the Society was inclined to follow that route there is no reason why it cannot do so itself by its own segregated insurance arrangements rather than through a commercial insurer. It is to be noted that in Ontario the Legal Practitioners Indemnity Company has a separate captive through which it offers title insurance in competition to commercial title insurance companies. The insured under these schemes is not the solicitor but the owner of the legal interest who pays the premium. Because the cover is offered by a captive insurer that is owned by the Law Society of Upper Canada which also owns the captive operating the professional indemnity cover for solicitors any rights of subrogation between the two are waived.

3.8.6 Low Fees on Conveyancing Transactions

During our consultation it was suggested to us that the rising conveyancing claims was partly due, or at least contributed to, by a charging of fees for conveyancing transactions which were economically unviable. This is not an insurance issue until a correlation between low fees and claims is shown.

To determine whether there is a connection or correlation between the charging of low fees and the claim, needs a detailed analysis of the facts of each claim compared with the fee charged on the transaction and other factors that might vary such as size of firm, staff ratios or the nature of the error. We have not been able to have access to any of the claims files as they would have identified firms against whom claims had been made. Our information is limited to statistics.

If there is any correlation between the two, which can only be determined by the Claims Committee HKSIF Limited and Essar, we recommend that a penalty deductible be applied to any such claim. It must be borne in mind that under a claims made policy work done in one

year is unlikely to result in a claim in that year. It is our understanding that scale fees ceased being compulsory in September 1997. Any claims losses from conveyancing before that time cannot as a matter of logic be the result of charging low fees as until then the scale was mandatory. It is likely that if low fees are a factor in increasing claims this would show up not before two years after scale fees were no longer mandatory. The claims statistics indicate that the greatest number of losses from conveyancing occurred in 1997 and 1998 with a large number in 1999. This may indicate that the claims arose from work done before scale fees ceased to be mandatory. This is a matter to be examined by HKSIF Limited on advice from those with access to the claims. We could not have access as identities of firms with claims is confidential.

If it is determined by the Claims Committee that a claim in the conveyancing area was causatively related to the charging of low fees a good risk management strategy would be to impose on that claim the normal deductible plus any deductible related to the type of error causing the claim and then to add a further deductible of say 10 times the difference between the fee charged and what would have been a reasonable fee.

Solicitors are free to set their own fees for conveyancing and if services are being provided for fees that are economically unviable that is a matter for market forces and not for any Insurance scheme to regulate or police.

If the Practice is not making a profit because of the level of fees that it is charging it will either increase its fees or go out of business in due course. If it is viable to charge those fees and make a profit then the public benefits because of the efficiencies created by competition. An insurers only interest appropriately is if the fee charged is causatively related to the claim. In that event those firms having claims ought to be penalised. To penalise all firms charging below recommend scale fees would be anti competitive and arguably not in the public interest. We refer to the jurisdiction of Scotland in Section 5E.

3.9 GEOGRAPHICAL EXTENT OF COVER

The cover presently given is for" all civil liability" in connection with private legal practice *wheresoever occurring*. Schedule 3 of the Solicitors (Professional Indemnity) Rules excludes indemnity for any loss(2) *(c)(v) in respect of any liability incurred in connection with a Practice conducted wholly outside Hong Kong.*

That is the extent of current geographical limitation. There is some doubt about whether a branch office outside Hong Kong is **a practice** wholly outside Hong Kong . It depends how it is set up, on how it is held out, how it's fees are shared with "Head Office", what is on it's letterhead and how much interaction it has with head office. Each case turns on its circumstances.

Hong Kong is an international centre and has various categories of solicitors entitled to practise within certain restrictions. We append as Appendix 9 (page 194) a chart of various qualifications and practice limitations prepared by PIAC and the two circulars issued by the Law Society.

We are informed that there have not been many claims where liability of a solicitor related to proceedings in another jurisdiction ,or to services provided outside of Hong Kong. We are asked to consider whether there is any reason to change the existing extent of cover. This decision needs to take into account a number of factors that are likely to affect the pricing of insurance and the protection of the public. The public can be confined to those persons or business entities who live or are registered in Hong Kong. It can be extended to those from outside of Hong Kong who are doing business in Hong Kong, contributing to the economic life of Hong Kong and are consumers of the legal services of Hong Kong . We consider that the latter group are legitimate recipients of protection by compulsory insurance against errors by solicitors.

Hong Kong is an administrative region of the People's Republic of China (China). China has been admitted into the World Trade Organisation. The Government has relaxed the rules and solicitors based in Hong Kong may now operate offices in China but will not be able to advise on Chinese Law. It is proposed that lawyers qualified in China will be able to open offices in Hong Kong and practise Chinese law. The Basic Law of Hong Kong, Section 84, allows Courts in Hong Kong to rely on precedents from numerous jurisdictions. Government policy is to encourage the interchange of skills and trade between the mainland of China and Hong Kong. Overseas businesses are likely to be seeking the services of Hong Kong solicitors in their development of and entry into China. The challenges, changes and uncertainties facing the solicitors of Hong Kong are opportunities for growth. The risks are as yet only theoretically predictable. Insurers from more established centres such as Europe, London, New York and the Bahamas will in 2005 most likely be in a hard market cycle. They will have little incentive to be pursuing new business as in a hard market they can pick the most favourable risks, there being more "buyers than sellers". The risk of insuring the profession in Hong Kong is not attractive due to its claims history, and lack of progress to address it by concerted, wholesale, patent risk management initiatives. New insurers based in China, Hong Kong or Asia may enter the gap.

The November 2003 edition of "The Journal", the magazine of the Chartered Insurance Institute of the United Kingdom reports an interview with the Chief Executive Officer of Swiss Re, John Coomber, in which he says

"The US tort system represents a significant threat to the industry as the uncertainty it introduces questions the entire concept of insurability".

Commercial insurers outside of the USA exclude damages in an American court for the reasons cited by the CEO of Swiss Re. Most contracts of professional indemnity in Australia

exclude indemnity for any damages or judgments obtained in a court of the United States. The minimum terms in England & Wales do not permit such an exclusion for qualifying insurers in minimum terms stipulated. Ireland allows exclusions for loss occurring as a result of practice conducted through a branch office situated outside the Republic of Ireland; loss occurring from advice given or action taken or omitted in relation to any law other than the law of Ireland or the European Union or any loss in relation to proceedings which have been issued outside the European Union.

During our review however, concerns have been expressed by a number of solicitors who foresee an increased risk from the lowering of barriers to practice spanning Hong Kong and Chinese qualified solicitors employed in the office of a Hong Kong firm are not authorized to provide advice on Hong Kong law. We have been informed that they do so and the level of supervision to prevent it happening is not feasible.

It is also highly foreseeable that if a firm conducts an office which is situated in Beijing or Shanghai the ability to supervise the advice being given to ensure that it is only on areas of law for which the particular solicitors are trained is unlikely to happen. We believe there should be a balance between the need to extend business of solicitors and the potential cost to all purchasing compulsory cover, many of them may not want to extend their practice..

If the commercial insurance market is the main carrier of professional indemnity insurance for solicitors beyond 2005 it is likely that there will be either some extra premium or some exclusion relating to practice out of Hong Kong either in China through a branch office or for legal service provided with respect to Chinese law. If HKSIF continues as the main carrier of professional indemnity insurance for solicitors in Hong Kong it ought to recognize that one of the frequent legal services that may be provided by Hong Kong firms is advice to clients on the comparative benefits of doing business in China and being regulated or subject to Hong Kong law or Chinese law.

3.9.1 Conclusion

1. Either the minimum terms stipulate or the Rules alter the existing exclusion to exclude any loss.

   In respect of any liability incurred in connection with the practice conducted wholly outside of Hong Kong, including a branch office outside of the Special Administrative Region of Hong Kong.

   or

2. Wholly or partially caused or contributed to by the act or omission of any individual indemnified within the practice with respect to a law, statutory provision, rights or obligations of any persons under a law of a country when the indemnified was not qualified to advise on any matters relating to the law of that country.

3. With respect to any judgement or award of compensation or damages of a court or tribunal or arising from an arbitration in the United States of America or by virtue of any law of the United States of America.

If a need arises at the compulsory level in the future, for such cover HKSIF could offer removal of the exclusions as an extension for additional premium. We envisage that if HKSIF Ltd is modernised it ought to have such flexibility.

Insurance alone cannot address any of the risks arising from solicitors of Hong Kong extending their business into China. If HKSIF or The Society are directing risk management education for the profession the identification of the risks, education on how to manage them, and if necessary other regulations under the qualification and admissions rules of the profession ought to be coordinated. The object is to encourage extension of business

activities and only to limit the compulsory cover for that activity if, under a mutual fund, master policy, captive or other Group arrangements foreseeable risks are causing loss to all.

3.10 LIMITATION OF LIABILITY FOR PROFESSIONS

We have been asked to comment on the potential benefit to insurance cost if liability could be capped by the introduction of limited liability partnerships for legal practices in Hong Kong.

We set out some general observations and background information. The adoption of incorporated practices has not substantially affected the liability of insurers when incorporation has been permitted because the protection of the public has been maintained despite incorporation.

Various professionals around the world have sought the protection of incorporation as something that is available to limit a business unlimited exposure to liability. It is a medium through which business is commonly conducted and subject to the duties of directors and officers requiring proper corporate governance and subject to the criminal sanctions against misuse of corporate structures it is a form of limitation of liability available to all businesses.

It has traditionally not been available to professionals in the carrying on of their profession. In the Australian and Canadian States incorporation of service companies for legal practices has been permissible since the early nineteen eighties. A strict separation has been prescribed to ensure that no fees earned by solicitors are shared with others who are not qualified. The prohibition of sharing fees has been part of legal ethics since the seventeenth century at least. The very essence of a solicitor's duty is the need to bring independent, impartial judgment to advising and representing citizens with respect to their rights and obligations under the law. In the common law jurisdictions a solicitor is an officer of the Court and has a fiduciary relationship to act with utmost good faith in rendering legal services to members of the public. The ability to limit, share, delegate or compromise those fundamental duties through incorporation, and sharing fees with the company and its shareholders, has the potential to create conflicts of interest and undermine the personal responsibility of legal practitioners, at least in the perception of the public, if not in fact. It is the price legal practitioners must pay for the privileged position of having a monopoly on the right to charge fees to the public for legal services and the right to advocate before Courts.

Incorporated legal practices came to be permitted in most States of Australia by the early nineteen nineties. They were permitted as vehicles through which solicitors and barristers could carry on practice. They were incorporated under the normal Company Codes, but their liability was subject to restrictions under the statutes that regulated the legal professions. The restrictions imposed were that despite incorporation the legal practitioners remained personally liable for "professional default"; the shareholders and officers of the company were limited to defined relatives, spouses or other legal practitioners holding practising certificates; control of the company had to remain with the directors who had to be legal practitioners and the company itself had to effect professional indemnity insurance for the acts of the solicitors practising through the corporate structure. They were allowable to enable legal practitioners to minimise their tax which is a top rate of 48.5% in Australia, but otherwise did not, and still do not, limit liability. They became a more convenient and modern way of managing changes in a practice when partners joined or left, avoiding the need to dissolve one partnership and form another.

No jurisdiction in Australia allows incorporation of a legal practice, (barrister or solicitor) to reduce or limit personal liability for negligence or professional default which is variously defined but includes negligent acts or omissions, breach of contract with a client, defalcation, breach of trust, breach of fiduciary duty and even, in some jurisdictions, acting contrary to ethical or conduct rulings or rules. Incorporation limits other liability as with any corporation.

In Canada a number of States allow practice through incorporated entities with a prescription against sharing fees through shareholding with others and with management of the company vested only in legal practitioners. The corporations are required to effect insurance from the

various compulsory insurance arrangements in place for legal practitioners in the various states.

Singapore allows practice companies which are required to be insured by the master policy. An incorporated practice must purchase a limit of S$ 2 million each claim as opposed to a partnership or sole practice which must purchase S$1 million.

England and Wales has legislated to allow the formation of limited liability partnerships. Personal liability of a partner, however, remains. The forming of a limited liability partnership provides protection against joint and several liabilities arising from partners' acts if the partnership is wound up. The relevant legislation is The Limited Liability Partnerships Act 2000. It came into force on 6th April 2001. Limited liability partnerships are required by the Solicitors Indemnity Insurance Rules to obtain insurance covering all its members and employees and are required to obtain additional cover of £500,000 each and every claim or £2 million in the aggregate.

Scotland allows practice through limited liability partnerships as does Ontario. Insofar as the adoption of that form of practice is available elsewhere it has not reduced the requirement for professional indemnity insurance in order to protect the public interest. In the event of insolvency of an insurer of a limited liability partnership the LLP could, if it was insolvent and unable to pay a claim, be wound up and the partners of a solicitor could achieve protection of their personal assets. The partner responsible for the act or omission resulting in the loss to the client could remain liable if the reasoning in Williams v Natural Life Health Foods & Mistlin (1998)1 WLR 830 was applied, as some commentators think. The legal principle is similar to a live authority on company directors who can be personally liable for their acts as a director separately from the Company.

3.10.1 Legislation capping liability for loss

In Australia, since the collapse of the HIH Group, Western Australia and New South Wales have legislation capping a professional persons liability for loss. Queensland has introduced a Bill to enact legislation along similar lines.

New South Wales has a Professional Standards Act. Under that Act a profession can apply to be registered and if registered the cap on damages is limited. These types of strategies, which have been introduced in response to the high cost and difficulty of professionals obtaining professional indemnity insurance, are too recent to comment on their effect. The level of the cap in most cases is so high that they are unlikely to affect the primary layer of compulsory insurance.

A notable feature of them also is that certain sections of the public are still protected and exempted from a limit on the professional's liability, most noticeably persons seeking damages with respect to personal injuries. That would include not only claims against doctors, but against solicitors where a personal injury damages cause of action was time barred or lost as a result of a legal practitioner's negligence. Under the Professional Standards Act one of the criteria for obtaining registration is a requirement that all members of the profession have compulsory insurance.

3.10.2 Apportionment of Liability Bill - Australia

Australia is also enacting legislation to limit a professional's liability to the portion of the loss attributable to the professional's default. Because of joint and several liability of tortfeasors a professional (and the insurer) is frequently forced to pay one hundred percent of a claimant's loss when only partially responsible because co-tortfeasors are uninsured and impecunious. The Law Commission has proposed model legislation for adoption in all States to limit liability as against all persons even though they are not a party to a piece of litigation. The absence of

legislation of this type prevents settlement of cases and results in the insurers of professionals having to fight costly cases with co-defendants who have nothing to lose.

We mention these initiatives to give examples of the importance placed on the public interest and as possible initiatives that the Society on behalf of the Profession may keep under review for consideration in Hong Kong.

SECTION 4

4.1 INSURANCE MARKET ENVIRONMENT 2003

The insurance business is cyclical in nature and we are currently experiencing a hard market. Characteristics of a hard market are increased premiums, higher self insured excess levels and more restricted cover. The professional indemnity sector, as a small, specialist niche market, is therefore more subject to these variances than the industry as a whole. When things get tough, insurers simply withdraw to their core businesses and professionals face higher costs and narrower cover.

Whilst 11th September 2001 has contributed to the current harsh environment, the tragedy was only one of several triggers which have led to hard market conditions globally. Other contributing factors include:

- the onset of recession
- decline in worldwide stock markets
- reducing interest rates
- the "dotcom" bubble
- corporate scandals in the US
- resulting lack of confidence in professional firms

The position further deteriorated with the shrinkage in insurance industry capacity which began in mid 2002 as smaller and weaker insurers became so depleted of capital that they were, and continue to be, forced to withdraw from the professional indemnity market. The reserves of remaining insurers are so significantly reduced that they are extremely reluctant to deal in business perceived as high risk.

Market Capitalization

Table No. 23

		2000 billion	2002 billion
Aviva Plc	£	24.3	10.00
RSA	£	8.2	1.7
ZFS	SFF	81.6	18.3
Allianz	€	97.8	24.2
AIG	USD	258.5	151.0
Fortis	€	44.6	21.8

Demand now exceeds supply. According to the insurance rating agency Standard and Poor's, the total lost capital from the insurance market between 2000 and 2002 was US$170 billion – against new capital of only US$30 billion.

The mid-nineties saw unprecedented rationalisation of the insurance industry through mergers and acquisitions and during this time over 30 insurance entities disappeared. As a result, many insurers started writing business at cost, hoping for low levels of claims and relying on investment income that was boosted by reasonably high interest rates and a buoyant stock market.

However, underwriters continued to make losses and premium rates began to rise through 2000 and 2001. The collapse of investment markets post September 11 hastened the premium rate rises as insurers could no longer sustain an underwriting loss by relying on investment income to bolster their results.

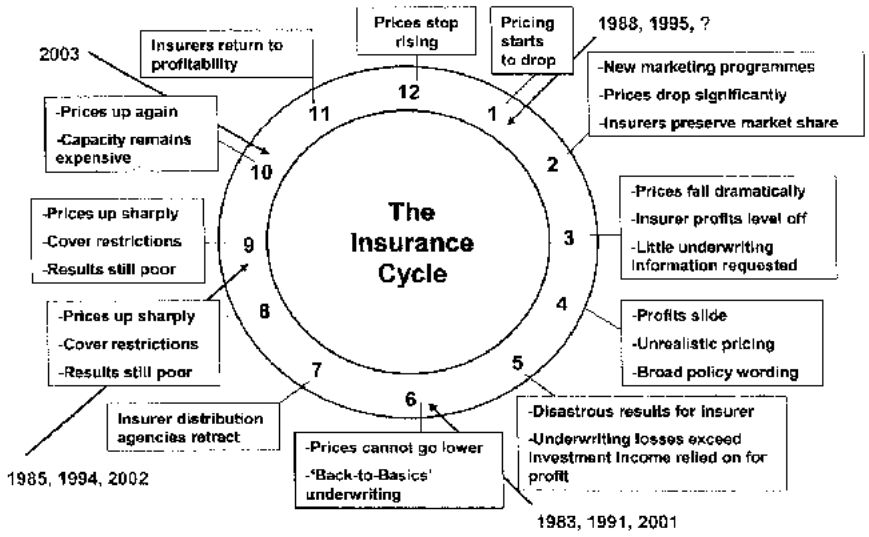
Insurers who have higher security ratings have been affected by the cost of having high levels of capital in short-term investments in order to maintain the required solvency ratios.

The cost of reinsurance for direct insurers increased significantly when they renewed their reinsurance treaties in January 2002 and these increases are now being passed on to their customers.

Reinsurers have also imposed limitations on the breadth of cover that can be given by insurers to policyholders in an attempt to limit their liabilities.

In the past two years, insurance capacity in the professional indemnity insurance markets has further diminished following the collapse of the Independent Insurance Company, HIH in Australia and the winding up of a number of Lloyd's syndicates. Other large insurers have withdrawn from the class as a result of conscious changes in their underwriting strategies.

Table No. 24



This is a pictorial representation of how market forces and the inflow of capital creates cycles in insurance.

4.2 FOUNDATION OF COMPULSORY INSURANCE

The following principle lays the foundation of this review. It is part of our terms of reference.

"The unequivocal position of the Society is that adequate levels of compulsory professional indemnity insurance as a condition of private practice of the law in Hong Kong must be maintained by solicitors in Hong Kong."

We mention this because during our consultation process the view was expressed by some solicitors that they would like to see a review of whether there should be compulsory professional indemnity cover at all. We have not considered the option of non mandatory indemnity.

At a symposium held on 18th September 2003 several solicitors criticised us for not considering that option as part of our review. We have been given sufficiently broad terms of reference to have enabled us to report on the issue of non mandatory insurance. Alternatively we could have asked the Society to alter its stated position for the purposes of hearing another view. We did not do so because we consider that non mandatory insurance would not be acceptable to the public or to the Administration.

We have had discussions with representatives of the Administration of the Region of Hong Kong. The firm view of the Government is that professional liability insurance in some form must remain compulsory. During open meetings of the Legislative Council Subcommittee on Solicitors (Professional Indemnity) (Amendment) Rules 2001 held in October 2001 this issue was raised by some solicitors. The Department of Justice wrote to the Clerk of the Subcommittee on 15th October 2001 to specifically confirm in writing the Administration's public policy on issues raised at the meeting. The terms of the letter relevantly stated:

"It is clearly in the public interest that there should be a requirement for professional indemnity insurance as provided under the Ordinance. The coverage of the insurance must also be adequate so that the public is assured that law firms have taken out at least a minimum amount of insurance."

"Meanwhile, it is in the public interest that clients are assured that any successful claim they may have against solicitors will be met. Adequate indemnity insurance must therefore continue to be a mandatory requirement."

Although in undertaking our review we have not researched the grounds for professional indemnity insurance being compulsory, in most Common Law jurisdictions in the developed world we report that the policy of the Administration of Hong Kong accords with that of most governments, regulatory authorities of the legal profession as well as with the opinion of bodies representing other professions, namely that the public interest requires insurance to be in place.

Hong Kong is and aims to continue as a world class centre of commerce and finance. Businesses operating in other jurisdictions where indemnity insurance is mandatory expect an equivalent level of protection and Hong Kong may risk a decline in users of its financial and other trade and commercial services if the users of those services perceive that standards of consumer protection in Hong Kong are below that available from Hong Kong's competitors. Singapore was one of the latest jurisdictions to introduce mandatory indemnity insurance for lawyers in 1991 and the above commercial reality was one of the driving forces.

Those solicitors in Hong Kong who buy a limit of indemnity beyond the mandatory limit will be aware of the frequency with which major clients want evidence of limits of insurance equivalent to the amount of money involved in a transaction before retaining a firm.

During our review we have heard from a number of practitioners comments about other professions such as accountants for whom insurance is not compulsory. In the questionnaire

that we circulated we sought the views of the profession and in both surveys 66% of respondents agreed that professional indemnity insurance for solicitors in Hong Kong should be compulsory.

4.3 CURRENT STRUCTURE IN HONG KONG

The Law Society is the representative body for the solicitors of Hong Kong. In the exercise of powers granted to it by Sec 73A of the Legal Practitioners Ordinance(the Ordinance) the Law Society has established a Scheme, the features of which are:-

a) Every solicitor in private practice must maintain current cover provided by the HKSIF as a prerequisite to practising (subject to exemption).

b) The terms and conditions of indemnity, the level of the insured's deductible, exclusions and the formulae for calculating the contributions to the Fund by all solicitors, are set uniformly for all solicitors by a company incorporated by the Society in 1989 and called The Hong Kong Solicitors Indemnity Fund Limited (HKSIFL).

c) HKSIFL has been granted power to manage the activities of The Fund by rules made under The Ordinance. The Society acting in Council retains the power to give directions to HKSIFL.

d) HKSIFL has appointed Essar Insurance Services Ltd (Essar) to carry out some aspects of the management and administration of The Fund. Those aspects include managing claims, maintaining records and statistics as required by HKSIFL and by reinsurers. Essar is also responsible for establishing, reviewing and maintaining accurate reserves (loss estimate).

e) A committee of solicitors called The Claims Committee whose members are appointed by The Law Society determine the manner in which claims will be handled. This committee considers the known facts and evidence, the advice of panel solicitors retained to defend the insured and determines the likely liability of the insured.

f) The defence of claims [and advice to the Claims Committee] is provided by solicitors retained by HKSIFL who are selected from a panel of solicitors appointed by Council of The Society under rule 17 of The Rules. A Panel Solicitor Selection Board advises Council on appointments to the panel.

g) Aon Hong Kong Limited (Aon) has been appointed by HKSIFL as its insurance broker to advise on The Fund's operation and to arrange re-insurance of the Fund's liabilities. Essar is a wholly owned subsidiary of the Aon Group of Companies.

h) The fund has appointed two investment managers who manage The Fund's investments in collaboration with a committee of HKSIFL, called The Professional Indemnity Investment Subcommittee.

i) A Professional Indemnity Advisory Committee (PIAC) has been set up to consider and advise on any professional indemnity issue referred to it by the Council of the Law Society or by HKSIFL or by The Claims Committee.

j) HKSIF is audited annually and, when considered desirable, actuarial services are used.

k) Any Rules made or altered require the prior approval of the Chief Justice. The Legislative Council has a power to vet the Rules and disallow any of them. The Administration in October 2001 advised the Subcommittee of the Legislative Council considering amendments to the Rules that "*...as a general rule, The Administration will not interfere with* [rules made by the Society with the prior approval of the Chief Justice]. *Only if the manner of such rulemaking was clearly against the public interest would the Administration consider ways of protecting the public interest.*"

4.4 EXTENT OF PROTECTION

The public who use legal services provided by solicitors derive their protection not only from all solicitors having compulsory insurance but from the terms, or "wordings" of that insurance. The limit of indemnity is but one term in a professional indemnity policy. In the open commercial insurance market the purchasing of insurance involves the completion of the insured of a proposal form. Failure by the insured to accurately provide all information relevant to the insurer's risk normally entitles the insurer to deny indemnity. Breach of any condition relating to notification of claims, or cooperation in the defence of a claim, for example, may entitle the insurer to deny payment of a particular claim. If insurance is compulsory as a condition of legal practice any term of the policy enabling cancellation of the policy period for which the practising certificate is issued could be exercised without the knowledge of the authority issuing the practising certificate. Any member of the public therefore with a right to compensation could not be assured of appropriate compensation if a solicitor made a mistake and had insufficient personal means to pay that compensation. The terms of insurance therefore are crucial to protecting the public.

The operative clause of the Rules relevantly provides:-

"*..the indemnified shall be entitled* (to indemnity) *against all losses to the indemnified whensoever occurring arising from any claim first made against the indemnified during the period of indemnity in respect of any description of civil liability whatsoever incurred in connection with the Practice or from any claim made during or subsequent the period of indemnity arising out of circumstances notified ... during the period of indemnity...*"

The following chart sets out a comparison of common terms in professional indemnity policies and compares those terms with terms provided by HK SIF. (see also section 1, in respect of Minimum Terms).

4.4.1 Comparison Between a Standard Cover And Hong Kong SIF (2003)

Table No. 25

		Standard	HK SIF Cover
1)	Policy Cover	'by reason of any negligent act error or omission'	'in respect of any civil liability'
2)	Insurability	If practice has bad claims experience, insurers have refused cover or charged exorbitant rates	Insurability guaranteed at scheme prices, irrespective of claims record
3)	Policy Limits	Normally limits of the policy cover are 'in the aggregate'	Each and every claim
4)	Retroactive cover	Negotiable price	Included automatically – full retroactive cover subject to "awareness" after 1.4.91 (now after 1.4.94)
5)	Partners previous practice extension	Negotiable	Automatic. All former and retired practitioners before and after the Scheme are covered
6)	Retired sole practitioners	Policy needs to be purchased	Covered automatically at no extra cost
7)	Loss of documents	Negotiable	Automatic
8)	Dishonesty of all staff/legal assistants	Negotiable	Covered at no extra cost unless principals were reckless
9)	Dishonesty Partners	Negotiable	Covered at no extra cost unless principals were reckless
10)	Libel, slander, defamation	Negotiable	Automatic

11)	Jurisdiction	Usually country or continent of practice	World-
12)	Excess	HK$20,000 – HK$2,000,000 or 2%/5% of claim	HK$30,000 – HK$200,000
13)	Claims Panel	All Claims are dealt with by insurers	All claims are dealt with by a claims panel
14)	Proposal form	Proposal form required	No proposal form required
15)	Non-avoidance of claims clause	Not present	Present

4.4.2 Legal Schemes

We introduce at this point a term that is a little different to what we have used in the rest of this report and that is "legal scheme". "Legal Scheme" is intended to cover options such as the mutual, the master policy, the captive, being effectively the collective bargaining arrangements that most Law Society schemes have. The standard PI policy is what is likely to become more the available option in the situation where there is a free market competition.

The legal schemes do usually provide better cover than is generally available to an individual firm purchasing its own insurance in the insurance market. Legal scheme policies provide civil liability cover, which is very broad. It includes cover for matters such as breach of contract of retainer. A standard PI policy with a negligent act, error of omission cover may not cover a breach of contract of retainer, or breach of fiduciary duty depending on the way a claim is pleaded. As the relationship of solicitor client is a fiduciary one it is becoming more common for breach of fiduciary duty to be pleaded.

A legal scheme policy, because of its ongoing nature, the continuous scheme type arrangement of legal scheme over a number of years, tends to be claims made policy as opposed to standard PI policy, which is claims made and notified policy. The distinction is very subtle but, in essence, a claims made policy requires that a claim be notified during the period during which it is made against you. The claims made nature of the legal scheme policy allows a bit of flexibility on that because of the ongoing scheme arrangements and the inability of underwriters to avoid or cancel the policy.

Legal schemes policies traditionally provide unlimited reinstatements of limit of indemnity. That means that any number of claims against each firm can be covered by the scheme. A standard PI policy will normally provide one reinstatement with the limit of indemnity, which effectively means you may only have cover for two claims of the limit so there are greater covers in the legal scheme policy.

The legal scheme policy tends to have a costs exclusive excess, which means that defence costs, in the event that a claim against you is not successful, will be paid by the scheme rather than by the practitioner. Generally, a standard PI policy in the current insurance market has a costs inclusive excess, which means in the event that a claim is successful against you and defence costs are incurred you are still liable for the defence. HKSIF varies from the usual pattern in this regard that prompted us to specifically ask about this aspect in our surveys.

The legal scheme policies have always had as a requirement non-avoidance clauses and non-cancellation clauses, which effective provides greater protection to both the profession and to the public. The standard PI policy does not have those clauses so the policy is avoidable or cancellable for such matters as misrepresentation, non-disclosure, breach of the conditions of the policy, breach of good faith, etc. Once again, rather a restriction on both the profession and the consumers.

The legal scheme policy generally only requires an annual declaration with respect to such matters as the number of practitioners in the firm, gross fees, etc. A standard PI policy requires a full proposal form to be completed, which includes a declaration in respect of claim and a declaration that you have made inquiry of all the members of your firm that they are aware of all claims and all circumstances which may be in the pipeline. Breach of that duty of

disclosure can often lead to the policy being avoidable or cancellable or a claim being denied. Generally, not the case in the legal scheme policies.

Legal scheme policies provide guaranteed cover for all members of the profession. Standard PI policies are based on the premise of offer and acceptance, being the underwriter who provides an offer of cover to you based on the matters disclosed in the proposal form and that need to be accepted. There may not be an offer of insurance. The conditions may be onerous. The premium may be too high. Generally, a standard PI policy is a little more difficult for individuals to obtain than a legal scheme policy for the group.

The legal scheme policies have always required free run-off cover for the members. In a standard PI policy there is no free run-off, no guarantee that a run-off policy will be provided in the event of ceasing to practise, for whatever reason. Once again, there are serious limitations in policies negotiable by individual firms.

Consumer protection has always been a major intention of the legal scheme. They provide negotiating and bargaining power to the profession on matters such as price and terms and conditions.

Legal schemes also enable the collection of centralised claims data through the aid of centralised claims management. It provides a good basis for risk management, as well as for the use of those statistics benefit the scheme in exercising, negotiating and bargaining power.

The extent of protection provided by the Scheme is very wide as it extends to all losses

Whensoever occurring, and whatsoever type of civil liability

The exclusions from this extensive cover are, (summarised to give the essence only);

- claims from third parties prior to 1st October 1989 [i.e. when HKSIF commenced operation]
- claims for death, bodily injury, physical loss or damage to property unless a third party's for which the solicitor is responsible as part of the practice
- trading debts
- some claims involving recklessness by the firm was a causative factor
- claims caused by radiation, contamination, nuclear events, aircraft, war, revolution etc
- losses from Practice wholly outside Hong Kong
- claims made by the Carrian Group of Companies
- amounts attributable to any prejudice to the handling or settlement of any claim caused by the solicitors non compliance with conditions in the Rules
- losses from employment contracts, or contracts relating to the supply of goods and services
- losses in respect of undertakings given in connection with finance, property or other benefit to the solicitor the Practice or associated entities or spouse or children
- losses arising when indemnity was not maintained due to non compliance with the Rules
- Y2K losses
- Fees and disbursements

- Any loss or expense incurred by the firm incidental to defence of a claim and/or providing information in connection with a claim

(refer to full rules for the full terms)

Other conditions of the cover are on terms worth noting for evaluation and comparison with terms available in the commercial open insurance market:

- entitlement to indemnity for a claim that is within the terms of indemnity cannot be refused to a claimant, i.e. member of the public, for any extraneous matters such as non–disclosure or non compliance with any condition by the insured.
- practitioners who have ceased practice and their estates are entitled to indemnify for claims made after ceasing practice without paying any premium. [Lower limits of indemnity apply if the solicitor ceased practice prior to 1 October 1986]
- HKSIF has no right of set-off against the amount of indemnity for any amount attributable to prejudice arising from the solicitors non compliance with the terms of cover
- dispute resolution clause by way of reference to Senior Counsel to determine whether a claim is to be defended or settled
- contributions [premiums] cannot be increased beyond a reasonable fixed maximum regardless of a firm's claims experience.
- deductibles are capped at a maximum level

The cover provided is characterised as claims made **or** claims notified. The insured activates the cover, and the insurer is called on to respond , (i.e. has a potential liability) by the occurrence of either a third party making a claim or the insured notifying circumstances of which the insured becomes aware which may give rise to claim. Those circumstances may never give rise to any actual claim by a third party nor to any cost to HKSIFL to provide funds for future payment but, once notified HKSIF and its reinsurers must take account of that contingent liability. This aspect has important ramifications that need to be understood when considering the Scheme and other options for professional indemnity insurance.

A circumstance notified in one year may result in payments from that year's premium being made many years later. In the intervening years, as long as that contingent liability exists, the solicitor notifying may be subject to increased cost of insurance. If the circumstances never result in any liability for the solicitor whatever "penalty" the solicitor has paid during the intervening years could be unjustified in terms of equity.

In commercial insurance practice increased premiums are the norm during this intervening period.

Failure to treat these contingent liabilities as future payments is likely to lead to insurer insolvency. The essence of the report of the Royal Commission into HIH was that HIH became insolvent because it failed to assess these contingent liabilities and set aside (make provision) sufficient funds for them.

4.5 INSURANCE ARRANGEMENTS GENERAL OUTLINE

4.5.1 Master Policy Scheme

A Master Policy arrangement is one where a single insurance policy is issued by commercial insurers to a body representing the members of a profession and covers every member of the profession within limits and terms and for a premium that is predetermined by agreement between the master policy holder [The Society] and insurers.

Suitability

A Master Policy arrangement has the ability to achieve adequate consumer and solicitor protection. Its suitability has been proven in Hong Kong by the operation of a Master Policy between 1980 and 1986 when the mutual arrangement, close to HKSIF was introduced. The reasons it was suitable in the eighties and might be considered suitable again are because:-

1. A master policy gives market power to the group. The market power is commensurate with the size of the profession in Hong Kong. The ability of an insurer to assess the risk and set a premium for the whole group increases the appetite of an insurer for that risk.

2. Under a Master Policy arrangement all risk is placed outside of the profession in the commercial market. If there is an unanticipated rise in claim numbers during the life of claims that is greater than the premium collected for the year the claims arose there is no recourse to the solicitors. Premium may rise in future years because of the claims, but if there is sufficient market competition and a new insurer takes the risk it creates the best opportunity to minimise the consequences to the group of an adverse claims history.

3. All members are guaranteed cover regardless of individual claims experience.

4. Because of group purchasing power, run-off cover for members ceasing practice can be effected because the Society would insist on it not only for the benefit of its members, but for the interest of the public.

5. Access to the profession's data about claims and premium pool is usually accessible by the master policy holder because the master policy holder can negotiate that.

6. Uniformity of terms of cover is secured by a master policy which is needed for administering the renewal of practising certificates.

7. Because group claims experience determine the group premium there are incentives for the profession through its professional body to implement risk management programmes on a long term basis.

8. A master policy provides greater opportunity for a policy that is longer than one year. This is more so in a softer market.

9. Usually the existence of a Master Policy relieves the insured members of the group from having to complete a proposal form.

10. The master policy holder, the Society, has the ability to allocate the insurers' premium differentially among its insuring members if it chooses.

11. The Society has a duty to consider and protect the interest of the public and from the consumer's point of view a master policy negotiated by the Society provides a chance for the public to be considered in negotiations that would otherwise be solely on commercial terms.

Feasibility

The essential difference between the HKSIF scheme and a Master Policy scheme is the existence under the current scheme of a layer of retained risk. In all other respects the two are very similar. The HKSIF scheme has all of the suitable attributes outlined above except that by way of reinsurance it transfers only part of the risk. The HKSIF had been viable and feasible since it commenced in 1986. Were it not for several years of unanticipated sharply increased claims losses and the insolvency of its re-insurers we believe that its feasibility would not have been doubted or reviewed. A Master policy arrangement would self evidently have been able to provide the necessary continuity and extent of cover in Hong Kong from 1986 to now.

A master policy without any level of self retention would most likely be feasible in 2005. The questions to be asked though are - at what price and are that price feasible and sustainable.

The prevailing price in 2005 is in one sense a matter of conjecture. The process is similar to Counsel assessing the evidence in a brief and giving an opinion which is a prediction of what a judge may infer as a matter of fact from equivocal evidence, presented on a particular day by a particular witness and further predicting how a judge will apply the law to those facts as found by the judge. There are principles, rules and predictable matters that make an opinion of Counsel reliable subject to the exigencies of litigation. Analogous to that it is predictable that the price will be determined by a number of factors, whether the market is hard or soft, economic conditions generally which affect return on investments, how much data is available to assess the risk, how keen the insurer is about writing the business, whether the insurer is more interested in premium income gaining market share than underwriting profit for that year, experience of the underwriter, skill level of the broker involved and so on. The overwhelming determinant of price will be the claims experience of the profession.

Acceptability

From a consumer point of view this option provides protection equivalent to the HKSIF as it affords the public the benefit of the Society's experience in negotiating from a collective bargaining position combined with the Society's obligation to consider and protect the public's interest in any insurance arrangements. From the individual solicitor's position there is no individual freedom to choose an insurer or to negotiate terms. Overall this option is subject to the fluctuations of market forces; is likely to be more expensive than a Mutual Scheme starting up. It may be criticised if claims management is conducted by commercial insurers on commercial terms only, disregarding the public's reasonable expectation of prompt compensation, or taking no account of the need to avoid undesirable precedents or other principles with application to the standing of the legal profession or the Society.

The decision for the Society and the solicitors of Hong Kong is whether or not these unacceptable aspects are outweighed by the benefit of transferring all of the risk to the commercial market as opposed to other options where it is retained to some degree.

When considering this option for 2005 and beyond, it must be remembered that there is still a risk that the insurer(s) issuing the Master Policy may become insolvent. This is a risk that has already crystallized once for the solicitors of Hong Kong. If an insolvency of a master policy insurer occurred there is not in Hong Kong any fund or legislation establishing a facility to meet the liabilities of an insolvent insurer and solicitors against whom claims were outstanding would be personally exposed. Under present arrangements solicitors and the clients making claims against them are protected from the effects of the insolvency of HIH by the obligation of solicitors to maintain HKSIF. Any comparison between the likely premium in 2005 under a master policy arrangement and a mutual scheme excludes the continuing payment for past liabilities of HIH which the profession continues to fund.

Some examples: Singapore, Scotland, Malaysia and Tasmania

4.5.2 Mutual Fund

This is an arrangement under which members of a group decide and agree to pool the risks of all of them and to contribute to the losses that might be incurred by all or any of them. The mutual sets the terms of indemnity to its members which are the same for all; the mutual sets the contribution each member must make and establishes the administrative arrangements for managing the mutual, appointing persons to manage, and the rules for calculating and collecting each member's contribution, the management of claims, compliance with statutory requirements, investment of funds, control mechanisms such as voting rights and ultimately for winding up of the mutual and distribution of any of its remaining assets.

The managers of the mutual decide the limit of the mutual's exposure. It is common to limit the mutual's exposure by setting a total level of retention and transferring any risk beyond the retained maximum level to a reinsurer. The reinsurer may be in the open market or another mutual or a captive.

Advantages

The advantages of a compulsory mutual scheme managed by and on behalf of the members of a profession are generally considered to be:-

1. The creation of a predictable premium pool which enhances scales of economy and increases bargaining power for reinsurance purchase.

2. Lower premiums for members as a mutual does not operate for profit other than to return any contributions and investment income exceeding the cost of claims and administration to the contributing members.

3. A guarantee that all members of the profession operating the mutual arrangement will obtain indemnity even if they are bad risks.

4. The ability to provide indefinite run off cover for claims against members who are deceased, retired or have otherwise ceased practice such as by judicial appointment.

5. The ability of the profession operating the mutual arrangement to control the claims against members and to take account of factors affecting the profession as a whole or the public rather than only commercial considerations.

6. The ability to establish and maintain a single data base accessible by the profession to equitably allocate the premium pool among members, to enhance bulk purchasing power with re-insurers and to identify emerging claims trends early.

7. Greater motivation and ability to design and deliver risk management programmes and to co-ordinate risk management with the professions other entry qualification, self regulation ,and professional development regimes.

8. The ability to adjust or minimise market fluctuations of the cost of insurance and reinsurance by use of retained funds and long term planning thereby delivering more stability to members.

9. Reduced operating costs arising from uniformity, expectation of long term existence and the consequent long term planning ability as well as access to the voluntary skills and expertise of its members administering the arrangement.

10. The ability to provide broader coverage and to maintain it during periods of increased claims from specific risks generated by episodic factors such as a hard insurance market cycle or an economic recession.

11. Less risk of members being unprotected in the event of insolvency of an insurer.

12. The need for an annual assessment by members of their business protection needs, and the completion of a proposal form is eliminated.

Disadvantages

1. The members of the mutual retain a level of risk and potential liability except insofar as reinsurance is purchased. If contributions are insufficient to meet the costs of claims, the members must meet the shortfall.

2. All risks are treated as nearly equal with any differentiation being capped at levels not commensurate with actual risk. Members are uniformly rated. This favours high risk members at the expense of those with low risks and is a disincentive for good risk management practices.

3. Innovation and change are difficult and the arrangements tend to develop into cost plus structures in which specific interests become entrenched.

4. They do not allow any competitive comparison between insurance products.

5. If disbanded with long tail liabilities that exceed assets either the members will have a dual insurance impost for some period or the proportion of the members who contributed to obtain indemnity will be left with personal liabilities and members of the public with rights to compensation will be limited to recourse to particular members' personal assets.

Some examples: South Australia, Victoria, Ontario, South Africa, Oregon

4.5.3 Captives

A captive is similar to a mutual scheme, but it is conducted through the medium of a licensed insurer that is subject to the same regulation and capital requirements of any licensed insurer. The Captive insures only the profession that owns it and operates for the benefit of its owner. Its management can be retained by representatives of the professional body or outsourced to a professional captive manager.

During a hard insurance market phase, organisations often opt to take on a larger level of risk retention in an attempt to lessen the cover restrictions imposed by insurers, but primarily to secure unchanged premium levels or potentially achieve premium discounts. In order to retain an increased and high level of risk, consideration must be given to the funding of potential losses. However, it is vital for an organisation to accept at the outset that a captive is a long-term strategy and likely to encounter varying market conditions over time. As well as providing insurance benefits they may also be tax efficient.

Benefits of Captives

Captives provide the following benefits to those organisations that incorporate the concept within their wider risk management strategy:

- reduce/stabilise insurance costs through the retention of underwriting profits and directly accessing the reinsurance market
- provide alternative capacity to that of commercial insurers
- assist in the provision of long-term stable insurance arrangements
- improve control over insurance function, claim settlements and contract wordings

Limitations of Captives

However, the captive concept does have its disadvantages including:

- capitalisation requirements
- premium levels may be higher than commercial market in times of soft markets
- administration and overhead costs
- ultimately meeting own cost of risk

Suitability

A captive insurer licensed under the Insurance Companies Ordinance and incorporated in Hong Kong could provide to the public and to solicitors all of the benefits of the current scheme with the added benefit to the members of the profession that it would limit their liability for losses in the event of a reinsurer's insolvency of a catastrophic claims loss that had not been anticipated and for which there were insufficient assets.

Feasibility

The principal features of captive regulation in Hong Kong are: -

Legislation	Insurance Companies Ordinance (Cap. 41)
Supervisory Jurisdiction	Insurance Authority
Application to	Office of the Commissioner of Insurance
Reporting Requirements	Audited statutory returns annually
Capitalisation	HK$ 2,000,000 (Minimum)
Minimum Solvency	The greatest of 1. 5% of the net premium income; or 2. 5% of the net claims outstanding; or 3. HK$2,000,000 of assets over liabilities
Fees	Annual Registration Fee HK$ 22,600
Annual Costs	Management, Secretarial, Legal, Audit

It would be feasible for the captive to start with a clean slate on expiry of the present arrangements in September 2005. Any profit of the captive would be subject to tax which would include tax on investment income. HK SIF has had no tax liability since its inception. If the captive operated successfully without the burden of past liabilities of HK SIF tax would be minimised by reducing premiums to solicitors as prudent keeping sufficient to maintain solvency and allow for smoothing out of the highs and lows in the commercial insurance market. The amount of tax paid would in effect be the cost of protecting the profession from the full consequences of the collapse of a reinsurer, a risk that has been realised already, and from liability for any shortfall between assets and any unanticipated extraordinary episode of claims losses. If either of those events occurred the Society and the profession would have the option of winding up the captive rather than trying to meet the shortfall.

Acceptability

The Government of the Hong Kong Special Administrative Region is encouraging the establishment of captive insurers in the territory to promote Hong Kong as a captive centre within the Asian Region. The necessity to pay income tax on any profit and to be monitored by the Insurance Authority might at first sight be considered unacceptable to the Society and to the profession. This unacceptable aspect may have a different complexion when compared with the benefit of the limited liability in the event of insolvency of a reinsurer or catastrophic claims losses and the long terms effects of either or both of those on the solicitors of Hong Kong. From the public perspective a captive subject to regulation and the supervision of the Insurance Authority achieves the same transparent accountability of the profession and the Society expected of other insurers. The objective of the captive would be to provide the same extensive cover and protection both of the public and solicitors that has been provided by HKSIF since 1986 aims which are self evidently acceptable. Every commercial insurer is able to limit its ultimate liability by the mechanism of liquidation and in the absence of any misconduct on the part of the management of that company for which there is a liability under the laws relating to companies that is acceptable.

Some examples: Quebec, British Columbia, Queensland

4.5.4 Licensed Insurer

We have ruled out the option of a dedicated Licensed Insurer set up by the profession as feasible. The level of capitalisation and regulatory control would be too onerous.

4.5.5 Qualifying Insurer Arrangements

This form of insurance is provided direct to the individual members of a group in the open market by direct negotiation between the insurer and the individual. Qualifying criteria are usually by agreement with the profession's representative body to the characteristics of the insurance product being offered to members of the profession. Insurers must agree to provide cover that is at least equivalent to minimum terms and conditions set by the profession's representative body. Beyond the qualifying requirements the insurance is offered on normal commercial terms according to the insurers' business practices, market forces and the risk profile of the individual applying for cover.

Suitability

The advantages of qualifying insurer arrangements are considered to be,

1. They offer to those insured a balance between the benefits of an open market arrangement while avoiding some of the disadvantages.

2. They offer an opportunity, through conditions imposed on qualification, to achieve for the profession and the public uniform minimum terms and the following:-

    - Setting up of an assigned risks pool for otherwise uninsurable solicitors.
    - Access to all data by the profession's representative body.
    - Freedom of choice for both insured and insurers.
    - Capping of deductibles.
    - Satisfactory run-off cover for deceased, retired and other solicitors ceasing practice.
    - Some accountability other than to the owners/shareholders of the insurer.

- Premiums are determined for each insured according to their own risk profile and according to market forces (Differential premiums).
- Insureds have no obligation to retrospectively pay underestimated past losses and can change insurer if one insurer increases premiums because of underestimated past losses.
- They offer incentives for insureds to devote resources to their own practice standards and risk management which they control.
- Firms have the opportunity to exercise their own negotiating skills and insurance expertise and can streamline their insurance arrangements from the ground up to their chosen level of cover provided the minimum is obtained.

Feasibility

The disadvantages of a qualifying insurers arrangement are considered to be:

1. Smaller firms ability to negotiate is often illusory as insurers' business practices impose a uniform rate as a matter of efficiency and most small firms do not have the expertise or time to compare and evaluate the quality of coverage offered by different insurance suppliers.

2. If minimum terms of cover must be obtained as a prerequisite to practise, and an assigned risks pool established to accommodate those declined by insurers, and insurers must provide cover, the regulation and compliance requirements are likely to disincline some insurers towards choosing to participate in the market. Unless an insurer can either be confident of obtaining an economically viable market share for a long enough period the number of insurers competing for the business is unlikely to create real competitive benefit to insureds. The size of the premium pool will determine whether insurers are attracted to participate.

3. Fragmentation of the premium pool for a whole professional group creates additional administrative costs for all qualified insurers, especially with set up costs

4. Premium levels and extent of cover is subject to market influences and volatility and the insureds are exposed to cross subsidy of the global adverse risks in the chosen insurers' portfolio.

5. In the long term the average premiums paid by insureds are likely to be as high, if not higher, than in an open market arrangement. This follows logically and from the experience of those jurisdictions which have adopted a qualified insurer arrangement. If contributions must be made to an assigned risks pool, commercially sensitive data disclosed to a central entity, and minimum terms limit the ability of insurers to reduce risk or transfer it to the insured, or run off cover for retired insureds provided this cost must be passed on.

   All insurance business is conducted on the fundamental premise that risk must be assessed. Insurance priced according to the risk. The business is declined if the price that can be charged cannot equate to the risk plus profit. One usual way of reducing the risk is by limiting the terms of cover. Conditions of qualifying to do business that remove ability and flexibility to change minimum terms will out of business necessity affect the price, usually driving it above the price that can be offered by unregulated insurers (Open Market) who have no such restrictions.

Acceptability

A qualifying insurers scheme was introduced in England & Wales on 1st September 2000. It has so far proved after three years to be acceptable to the profession, and to the Law Society and has not diminished the level of protection for the public that was in place under the previous arrangements. England & Wales had since 1976 the experience of a master policy

arrangement, followed by a mutual, SIF, from 1986 to 2000 and a QIS since 2000. Hong Kong has followed the same pattern since 1980. Whether a QIS is acceptable in Hong Kong would largely be influenced by whether such an arrangement would be acceptable to enough insurers to attract them to do business on the terms set for qualifying.

All cover will be on terms not less favourable than minimum terms approved by the Society. Qualifying insurers will contribute to an assigned risks pool a proportion of the claims losses of solicitors insured by the assigned risks pool. The proportion is calculated by reference to the insurers' share of the market premium pool. England and Wales have approximately 100,000 solicitors insured in 2003.The premium pool is in the range of £200-250 million (HK$ 2,400-3,000 million). There are 18 firms for 2003 who cannot purchase cover in the commercial market 16 of those firms are sole practitioners. In the two previous years the number was about 40. Firms in the ARP are charged 25% of their gross fees as an annual premium if their fees are £500,000 or less. So far the contributions by the qualifying insurers to the ARP losses are about 1% of the premium.

The operation of the English QIS is feasible because of the critical mass involved. In Hong Kong the size of the premium pool in 2005 can be estimated as being in the range HK$ 200 - 300 million (£17- 25 million) i.e. one tenth of England & Wales. It is likely that the local insurance market would not have the capacity or appetite to insure all of that risk. This would result in offshore insurers needing to qualify. Off shore insurers would most likely be reluctant to do so. They have been canvassed extensively over the past six years to accept very similar risk as the re-insurers of HKSIF. The number of insurers who can insure that risk directly to the insured solicitors is less than the number who operate as re-insurers.

An example: England & Wales

4.5.6 Open Market

In a pure open market environment each individual purchases cover of whatever limit, on whatever terms and from any licensed insurer they choose.

The elements of open market insurance to consider when assessing suitability and acceptability are set out as advantages and disadvantages.

Advantages

The advantages of an open market are considered to be:-

1. Competition among insurers will entice insurers into the market and their competition for market share will benefit solicitors in terms of favourable premiums and terms of cover.

2. All risk is transferred to insurers.

3. Individual firms can exercise choice to bargain for streamlined cover at the level that best suits their needs instead of buying their compulsory layer from one insurer and then purchasing additional cover separately.

4. Firms will be charged premiums according to their own risk profile, claims history, risk management practices and chosen deductible instead of subsidising a profession wide risk profile under which they are rated for claims they did not have, charged for risks they do not have and not rewarded for resources they devote to maintaining good risk management and practice standards.

Disadvantages

The disadvantages of an unregulated open market arrangement are considered to be;

1. A member of the public may not receive compensation ,and at least cannot be confident of receiving compensation, as the extent of indemnity is not known, the insured can fail to comply with the conditions of cover to the detriment of the consumer and the policy can be cancelled at any time.

2. Commercial insurers are in business to make a profit and solicitors who are not perceived as good risks will either be declined insurance or offered premiums that are so high as to make practising financially unviable. If maintaining insurance is a prerequisite to practising they will not be able to practise, at least as principals. (There is debate about whether this is an advantage or disadvantage to the public and/or the profession. It is acknowledged as a disadvantage to the insured. If a firm's accountant steals millions of the client's funds is it an advantage to have the partners in the firm driven out of practice?). Issues of fairness, responsibility or vicarious liability are not mitigating factors in the commercial market.

3. Terms available in the open market fluctuate according to factors that cause cycles in the insurance industry resulting in unpredictable sharp fluctuations or the unavailability of wanted cover.

4. Regulatory bodies issuing practising certificates require a minimum level of protection for the public and require a minimum uniformity to be able to assess whether that minimum has been purchased and will be maintained. Production of a Certificate of Insurance showing that a limit of $10 million is in place on 1st January for 12 months may not be acceptable if the insured's deductible is 35% of each claim or if the policy can be cancelled for some reason or even voluntarily during the 12 month period for which a practising certificate is issued. Regulatory bodies have neither the resources nor expertise to evaluate the cover. In some States of Australia cover is compulsory with a limit of $1million in addition to defence costs. In other States the compulsory level is $1.5 million which includes defence costs. Every State accepts other States' cover provided it has a limit that is equivalent. The debate continues about whether $1 million with unlimited defence costs is equivalent to $1.5 million inclusive of costs.

5. The corollary of the advantages of a compulsory mutual arrangement listed above: -

    - Uncertainty of market share from an insurer's perspective and imbalance of negotiating position for individual firms.

    - Difficulty in obtaining cover for claims after retirement or cessation of practice or cost of that cover.

    - Decisions about defending a claim or policy coverage are more likely to be made on commercial considerations without regard to personal or professional ramifications to an individual insured

    - Lack of access to information about claims losses or trends and about premium rates which reduces transparency of pricing and ability of insureds [or their brokers] to negotiate.

    - No real incentive for insurers to drive or provide risk management when the benefit may be for a competitor, that is a subsequent insurer.

Some of these unsuitable or unacceptable facets of the open market can be ameliorated if minimum terms and conditions of cover are stipulated for solicitors and then they go to the open market to purchase as they choose. We do not characterise that as an open market arrangement because the level of risk being assumed by the insurer is controlled. Such an arrangement is a form of qualifying insurer arrangement.

4.5.7 Co-existence of A QIS and a Mutual

The co-existence of a mutual arrangement with a QIS would probably not be financially feasible. If a mutual arrangement was maintained to provide the minimum terms for consumer protection to firms not able to secure that from a qualifying insurer or in the open market on mandatory minimum terms the whole profession, including those purchasing cover outside of the mutual would have to subsidise the mutual to ensure its survival.

In Ireland Co-existence has survived since 1996. We have anecdotal evidence which we are still trying to verify that this is due to loyalty of the profession to the mutual out of gratitude to The Law Society which by its action in 1995 reduced premiums substantially below those paid in previous years in the commercial market.

England & Wales considered Co-existence of their mutual with a QIS when changing the arrangements in 2000. The advice and belief at the time was that co-existence of the mutual with a QIS would reduce the premium pool and thereby reduce the number of potential competing insurers. The way in which the changed arrangements were structured was to create the most favourable conditions to attract sufficient insurers to participate.

SECTION 5

INSURANCE ARRANGEMENTS IN OTHER COMMON LAW JURISDICTIONS

In this section we provide an overview of insurance arrangements in other common law jurisdictions

At the open forum we provided some indication of premiums in other jurisdictions. We do not do so in this report. Premiums are to a very great extent determined by claims numbers and the cost of claims. Other influencing factors such as market cycles, cost of re-insurance, returns on investments size of the profession and structure of arrangements are overlaid and affect the premium. Comparison of premiums in different jurisdictions without comparing the claims loss ratios cannot produce any meaningful information. We have therefore not included any premium comparison. We have had access to claims records of other jurisdictions but they are confidential to the clients and schemes concerned and we cannot disclose them.

Each jurisdiction also has terms and conditions that vary in numerous aspects. The essential elements of the legal schemes described in Section Five are fairly constant despite peripheral differences. If the Society or HK SIF Ltd wants copies of the terms and policies in other jurisdictions we can provide them. Wordings of policies are very technical and we have not reported the details of each as we took the view that the exercise would be too lengthy and technical in this report. When a particular feature of the terms of cover in any jurisdiction was considered significant for the matters under review we referred to it in other sections of the report.

One practitioner asked us on 12th November 2003 to report on protection for legal schemes against re-insurer insolvency in other jurisdictions. In Australia there is no general protective legislation. Following the collapse of the HIH Group the Australian Government established a fund to compensate policy holders, HIH Claims Support Limited, but solicitors' compulsory insurance was excluded from it. In the United Kingdom the former Policy Holder Protection Act has been incorporated into the Financial Services Compensation Scheme as part of the restructuring of legislation and regulation of all financial services with the regulatory supervision now vested in the Financial Services Authority. The legislation allows compensation of a specified maximum for some policies, for the FSA to take over the insurers' obligations and run-off claims , and provides other means. Those wishing to consider the matter can access the legislation and guides issued by the FSA at www.fsa.gov.uk/vhb/html/comp/COMPtoc.html

We report also that the Hong Kong Administration has appointed Pricewaterhouse Coopers to investigate and report on the feasibility of establishing a scheme to protect policyholders in Hong Kong in the event of insurer insolvency. The Society has been involved on behalf of its members with the consultations being carried out. No report has yet been made available.

The Hong Kong Government has already set up a new fund called the Employees Compensation Insurers Insolvency Scheme to compensate injured workers who are left without cover by the collapse of an insurance firm. All insurers selling employees' compensation insurance will have to pay a levy.

In Australia, professional indemnity insurance schemes fall broadly into two categories - mutual funds in which practitioners compulsorily contribute to a pool of money administered either directly or indirectly by professional associations or by some form of statutory body, and collectively-arranged commercial insurance which must conform to conditions set by the professional body and/or by some form of legislative prescription.

More likely, PI insurance models will be a mixture of the two, most commonly having a mutual fund covering the lower end of the claims spectrum, with a commercial insurance or reinsurance policy cutting in at much higher levels. This is the case in South Australia and Western Australia. In the case of New South Wales, the reverse obtains - the commercial insurer being the first resort. Victoria has the only 'pure' mutual fund model.

In the case of Queensland the master policy is underwritten through a captive insurer, QLS Insurance P/L, a wholly-owned subsidiary of the Queensland Law Society, with re-insurance arrangements in place.

With the exception of the situation in New Zealand, no jurisdiction has deregulated insurance requirements to the point where practitioners or firms can take out individual policies of insurance.

A. Australia

i. Victoria - Mutual Scheme

General Characteristics of the Jurisdiction

The State of Victoria has a population of some five million persons with almost 3.5 million of these living in the capital city, Melbourne. In the jurisdiction there are some 7000 solicitors and barristers. There is separation of barristers and solicitors in this jurisdiction.

There is separation of barristers and solicitors in this jurisdiction with different qualification paths to admission. The Victorian Bar is functionally and operationally separate from the solicitors' professional body, the Law Institute of Victoria. Barristers do not take out professional indemnity insurance through the Legal Practitioners Liability Committee, the body responsible for the professional indemnity insurance of solicitors and which is discussed in detail below.

The Solicitors Liability Committee ("LPLC"), closely associated with the Law Institute of Victoria, commenced operations in January 1986. The professional indemnity scheme it operated was both compulsory and a monopoly.

In 1996 the State Government amended the *Legal Practitioners Act* to end this monopoly so that practitioners would have a choice between the scheme operated by the Committee and commercial insurers. However, as noted below, the Act was further amended in 1998, to restore the 'monopoly' mutual situation.

To be noted has been the dramatic contraction in the number of Australia's mainstream insurers in recent years with major insurers such as AMP, CIC, FAI, Gerling, GIO, HIH, MMI, Markel, St Paul, Suncorp and others no longer operating in the market for various reasons.

A significant aspect of the report that led to the reversal of the 1996 legislation related to the consideration of an 'open-market' approach to PI insurance.

Its report concluded that "*...if short-term gains are made from reduced premiums under an open-market scheme they are likely to be short-lived.*" The LPB was not convinced that true competition would continue to operate in an open-market for reasons such as:

- Competitive advantage will appear quickly from the uneven incidence and magnitude of claims.
- Insurers may leave the market as a result of individual experience, and, in due course, a monopoly may re-emerge.
- In light of discussions with prospective commercial insurers, the Board did not expect premiums to be lower, even in the shorter-term.

- The administrative costs of a private insurer, together with accountability to shareholders or owners in respect of returns, made it likely that a commercial insurer would not tolerate large underwriting losses indefinitely.

- Professional Indemnity insurance in an open-market would be likely to require considerable additional regulation and monitoring.

- Commercial insurers did not appear to accord sufficient importance to run-off cover.

General Features of the Scheme

The present scheme operating in Victoria is the only 'pure' mutual fund model in Australia.

The Victorian model has evolved as a statutory insurer in its own right with no connections to the professional body. In that respect it sees itself able to take appropriate business decisions in the absence of any direct political pressure from the profession or its professional body.

All solicitors in the State must be insured through the fund operated by the LPLC. Principal features of the scheme include:

- The Committee determines the terms of insurance, the premiums and other arrangements.

- In fixing premiums it is required to take into account different types of risk.

- The Committee pays premiums into a fund and pays claims from that fund (there is provision to levy practitioners if the fund cannot meet liabilities from its resources).

- Predictable risk is retained within the fund, but, in addition commercial insurance is purchased to cover unexpected or catastrophic events.

- The policy must be approved by the Legal Practice Board.

The LPLC establishes premiums based on the claims history of individual firms. Five bands of premium level are used. For the 2003/4 year partners in Band One (loss ratio of <100 per cent) paid a premium of $4501, and employed solicitors $1124; the details relating to the other premium bands are:

Band Two (loss ratio of between 101-200 per cent), partners $6302, employed solicitors, $1573
Band Three (201-300 per cent), $8103 and $2022
Band Four (300+ per cent loss ratio), $9903 and $2472

There is a fifth premium band which relates to costs consultants and criminal advocates for which very low premiums of less than $100pa are charged.

Another aspect of this policy is the very substantial 'deterrent' excesses of $7000 per principal to a maximum of $100,000 applying to seven specified areas such as failure to issue within a period of limitation, acting for more than one party, breach of designated conduct rules, and false execution of documents or making a representation knowing it to be false.

ii. South Australia/Western Australia - Hybrid Mutual Schemes

South Australia

General Characteristics of the Jurisdiction

South Australia has a population of 1.56 million persons. It is a jurisdiction with a 'fused' legal profession with all practitioners undertaking undergraduate law studies followed by or incorporating a legal practice component. There are some 2400 legal practitioners in the State. About 1450 practitioners are insured through the Law Society PI insurance scheme. The annual practitioner premium is derived from the simple process of dividing the amount of the scheme premium quoted by the underwriters by the number of insured practitioners, and adding in administrative costs.

During 2000 the South Australian Government undertook a review of The Legal Practitioners Act 1981.

The report of the Review Panel to the Government, while acknowledging the monopoly situation recommended that there should be "... no change to the present law, provided that premiums remain competitive." Other key elements of the report included:

- A reaffirmation that compulsory insurance against negligent or incompetent legal advice was important, and that it afforded a greater likelihood of recovery of loss by the consumer, and
- Acceptance of the benefits of the compulsory mutual scheme, particularly as it related to the run-off cover and the non-avoidance provisions - aspects which it asserted were unlikely to be available under 'other means' such as open-market insurance.

General Features of the Scheme

The scheme was first introduced in 1982 as a fully-commercially insured model. In 1988 it established the basic Mutual component known as the Professional Indemnity Fund.

The scheme is structured to protect the fund and the profession from any liability beyond its retained layer in the event of the insolvency of an insurer. All insurance is arranged through the fund up to the total limit of indemnity which is AUS$750,000, costs in addition. The fund does not assume primary liability for the full amount. The retained level of risk by the fund is the first AUS$200,000 of each and every claim. The fund arranges a master policy with the commercial insurance market for the full limit of indemnity and under the statutory rules establishing the fund the retained layer of AUS$200,000 is expressed to be a deductible under the master policy. The legal effect of that is it creates a contractual insurance arrangement between the insured firm and the underwriters of the master policy. In the event of insolvency of any insurer the profession have no obligation to pay the share of claims outstanding of the insolvent insurer. The insureds solicitors and public have a guarantee of payment of the first AUS$200,000 of each and every claim regardless of the solvency of any insurer. The amount retained has been determined and is reviewed from time to time by reference to the claims statistics. Approximately 80% of the number of all claims reported fall within the retained layer. This means that 80% of losses are borne by the fund which operates for no profit and returns the benefit of investment income to the profession to subsidise the contributions to the retained layer.

Further protection is also provided to the mutual layer by the purchase of stop loss insurance. Until the hard market cycle the fund had an aggregate cap on its layer after which the insurers of the master policy dropped down. With the onset of the hard market an aggregate cap was no longer available and stop loss insurance has been purchased against a catastrophic number of claims each under AUS$200,000 to further protect the fund. In 2003 100% protection from stop loss insurance was not available in the commercial market and the fund

no longer has absolute protection but it is believed to have sufficient levels to be considered prudent.

It is based upon provisions of The Legal Practitioners Act 1981, which legislates that, with the approval of the Attorney General, the Law Society may establish a scheme for professional indemnity insurance, and which will provide such insurance partially under a Master Policy negotiated between the Law Society and insurers, and partially from a Fund established and administered in accordance with the scheme.

Major features of the present scheme include the following:

- All solicitors, other than low fee earners, pay the same premium irrespective of gross fee income of the firm or of areas of practice
- These premiums are subject to loadings and penalties related to claims history
- The Professional Indemnity Fund provides self-funding for the first $200,000 of each claim to an aggregate liability of $4.25 million in any year
- The terms of the Master Policy are subject to agreement/approval by the Underwriters, the Council of the Law Society and by the Attorney-General
- The PI insurance provides for coverage of $750,000 (plus costs) for any claim
- Barristers in the jurisdiction are insured under the scheme at 13.5 per cent of the annual premium paid by solicitors.

Western Australia

General Characteristics of the Jurisdiction

There is a population of some 1.93 million persons in Western Australia. The legal profession in Western Australia is a 'fused' one.

Until 1995 all solicitors in Western Australia were insured under the New South Wales - based Solicitors Mutual Indemnity Fund (SMIF). This link was dropped in that year with the establishment of a local mutual fund; Law Mutual

In 1999 the locally-insured layer was increased from $50,000 to $100,000.

General Features of the Scheme

The Law Society, through its Law Mutual arm, and using the services of a broker, negotiates a Master Policy with commercial insurers for coverage above the $100,000 of any claim which is borne by the fund. The limit imposed by the Master Policy is $1.5 million, inclusive of costs.

Each firm must pay an annual contribution having regard to its size, claims history, fields of practice, and gross fee income. The Society has power to levy firms if it considers that insufficient funds are available for operational purposes.

Barristers are exempt from this arrangement provided that they hold insurance approved by the Bar Association.

III. New South Wales - Master Policy Scheme

General Characteristics of the Jurisdiction

The most densely populated of the Australian States, New South Wales has a population approaching seven million people and with some 12,000 solicitors and barristers.

The company administering the area of professional indemnity insurance on behalf of the Law Society of New South Wales is known as Lawcover - not-for-profit company and wholly owned subsidiary of the Law Society.

A mutual scheme operated in this State until 1998 when it moved to a commercial insurance model. The mutual operated solicitors mutual indemnity fund from 1987 - 1998 when it was put into run-off and conducted only the run-off of claims made prior to June 1998.

A major factor shaping the present PI insurance model in NSW was the April 2001 crash of the insurer HIH. It was of particular importance in this jurisdiction because, at the time of the crash, the entire underwriting for the three year period 1999 - 2001 was with the failed company.

When HIH collapsed, it was estimated that there were outstanding PI claims liabilities of some A$112 million. At that time the funds held by the Solicitors' Mutual Indemnity Fund were of the order of A$85 million, leaving a potential deficit of A$27 million. The NSW Government quarantined the SMIF surplus funds to help meet the HIH shortfall. The funds in SMIF were provisions for the run-off of claims before HIH became the master policy insurer once the funds are exhausted a call on the profession may be required.

In the context of the need to review/restructure the scheme following the HIH situation, in 2000 and in 2001 Lawcover commenced a major consultative process with the profession. It involved five steps:

- meetings with the Presidents of regional Law Societies
- market research workshops with small/medium firms
- an on-line questionnaire to the profession
- emails to firms
- meetings with large firms.

Ten questions on the profession's views on key elements of the PI insurance issue were posed. These covered matters such as;

- whether premiums should be paid on a per partner or per solicitor basis
- whether the same premium levels should apply to partners and to employees
- whether there should be a premium discount to low-fee-earner firms
- the length of the claims period
- availability of excess options
- the impact of claims history on premiums

Preferred elements were incorporated into what has become known as the Premium Rating Model which is described in the following section.

General Features of the Scheme

In New South Wales, The Legal Practitioners Act 1987 mandated a mutual scheme. Solicitors required to be insured (unless specifically exempted) had to be covered by the Solicitors Mutual Indemnity Fund (SMIF).

In the period 1987-1998 the SMIF 'fund' was used to fund the indemnity insurance arrangements. SMIF retained varying levels of risk during this period, but also bought

insurance from the commercial market to protect against catastrophic loss. From 1 July 1998 the NSW scheme has been totally insured with commercial insurers. Recent years have seen an aggregate cap payable by insurers which is applicable to all claims made under the scheme. The current cap is $95m.

Both the policy of insurance and the insurer(s) must be approved by the Attorney-General who may attach conditions to the approval.

The Premium Rating Model which has developed as a consequence of the 2000-2001 consultation process with the legal profession has the following main features:

- premiums are based on a per solicitor basis
- employed and principal solicitors pay the same premiums
- the claims period is five years (shortened from ten years)
- excess options (attracting a premium discount) are offered but not to low-fee earners
- no-claims bonuses are available
- penalty excesses have been removed

During 2002, Lawcover determined that, based on its research/consultation process, that there were "compelling reasons" to move towards measuring firm size by gross fee income (GFI).

The forward thinking of Lawcover involves consideration of moving towards a Risk retention model involving an APRA-regulated on-shore captive situation. This has been discussed with APRA.

Barristers in New South Wales are required to hold professional indemnity insurance approved by the Attorney-General. For the 2003 - 2004 year, four policies were approved, and barristers were able to choose between the providers of these approved policies.

iv. The Australian Capital Territory - Approved Policy Scheme

Characteristics of the Jurisdiction

The Australian Capital Territory (ACT) is seat of Commonwealth Government. The total population of the ACT is some 325,000 people.

General Characteristics of the Scheme

Like the situation in Western Australia, until 1996 the practitioners in the ACT took out professional indemnity insurance with the Solicitors Mutual Indemnity Fund operated from New South Wales. In that year, the Council of the Law Society determined that it would introduce competition into its provision of PII by inviting an insurance broker to provide an alternative option by proposing a policy negotiated with the commercial market. Each year, both Lawcover and the Broker submit policies for Council approval. The Council of the Law Society then approves the policies and firms are required to choose between the two options. Broadly similar policies based on the "minimum terms and conditions" concept referred to in Section 2 are involved in each option. Cover is $1.5 million (including costs).

v. Tasmania – Northern Territory

Each of these small jurisdictions operates their own compulsory scheme through a Master Policy. The viability of these schemes can be severely affected by a small number of large claims. This is exemplified by the fact that the premium per solicitor in the Northern Territory is approximately triple that in Tasmania, although the profession is about the same size.

Tasmania has been greatly affected by the collapse of the HIH Group.

Since withdrawing from the NSW SMIF Scheme in 1995, the scheme has had two different underwriters, FAI for the first 4½ years and QBE since 1st January 2000.

There are a significant number of open claims from the "FAI years" which have largely lay dormant since the collapse of HIH. While the Australian Federal Government established the "HIH Claims Support Scheme" to protect policy holders and claimants, solicitors compulsory Professional Indemnity Insurance was excluded form the operation of the scheme.

As a result, there continues to be a large liability exposure for those firms against whom claims were made during the period of FAI. The loss falls on those firms, and on their clients, with no obligation on the profession to contribute to all losses.

vi. Queensland - Captive Scheme

General Characteristics of the Jurisdiction

This State has a population of 3.7 million. The State has 4000 or so lawyers.

Prior to 1987 insurance was provided by the retail market from London. From 1987 to 1995 the Society's internal Law Claims Levy Fund (LCLF) was responsible for claims. Until 1994 the LCLF was responsible for the first $100,000; for the 1995 year for the first $500,000 per claim.

The LCLF operated with a 'stop-loss' cover which provided for catastrophic cover, while separating multiple lower-end claims and the costs of managing them from the insurance market.

Coverage from 1996 to 2001 was through APPIIL and St Paul Insurance Australia Ltd. APPIIL, a creation of the Queensland Law Society was, in fact, a form of captive. APPIIL was responsible for the primary layer of insurance, reinsurers supported the aggregate cover.

Then, in 2001, the captive QLS Insurance took a $3 million layer in excess of $12 million.

In the 2002/3 insurance year QLSI became responsible for the $40 million aggregate cover with the captive taking the primary layer of $18 million and reinsurance providing cover for the balance. In recent years the QLS has compared the cost of retail insurance to that of the captive with reinsurance support and has concluded that, in the prevailing market, the captive's capital, supported by reinsurance, is cheaper than retail insurance[2].

Additional to such structural and operational changes, there were two other matters in Queensland in the period under review which caused significant readjustment to the PI insurance scheme. These related to claims arising in the 1996-2001 period from solicitor involvement in mortgage lending and 'two-tier' marketing.

Two-tier marketing involved the bringing of investors from interstate and New Zealand to Queensland and who were given projections on the growth of property values in high pressure seminar situations. After a rushed inspection/selling exercise they would be recommended a solicitor selected in rotation from a panel willing to see such purchasers at short notice. There was undisclosed conflict for the solicitor accepting such referrals from property vendors but purportedly acting for the visiting client. Allegations against solicitors in a significant number of PI claims included failure to disclose agent's fees.

While in 1997-98 mortgage lending accounted for only 1 per cent of solicitors' fees (and 1.5 per cent in 1998-99), claims arising from this practice constituted 32 per cent of all claims. The impact of two-tier marketing on claims is yet to be made clear.

Another important current development which will likely impact on PI insurance for Queensland practitioners in future years is the development of Professional Standards legislation including caps on liability. Queensland Attorney-General Rod Welford is on record as supporting the development of Professional Standards legislation.

In 2003, through QLS Insurance, the Society has retained the same $18 million primary layer as was the case in 2002. The balance of the cover is shared between reinsurers Swiss Re, ERC and Converium.

The 2003 premiums paid by over 66 per cent of the profession were between $9280 and $10440. Principals in firms with a claims history and high staff ratio paid above this base level.

B. New Zealand - The Non-Compulsory, Private Market/Optional Model

General Characteristics of the Jurisdiction

The country of New Zealand is comprised of two large islands with a total land mass of some 268,000 square kilometres making it similar in size to Japan or Britain. It has a population of some 4 million people.

As at July 2002 there were 8430 members of the New Zealand Law (NZLS) Society.

An interesting characteristic of legal practice in the jurisdiction is the absence of personal injury litigation by virtue of a statutory no fault accident compensation scheme which exists in New Zealand. Another interesting characteristic is that real estate transactions and conveyancing carried out by Conveyancers. This is a feature of the Torrens System of Title

[2] The summary of PI scheme developments since 1987 was abstracted from '*How PII Has Changed*' Proctor, July 2003, p.8

Registration. Under the Torrens System once registration occurs the registered proprietor has indefeasible title subject only to fraud and forgery. Once land is first registered the process of dealing with the land is dealt with by persons called Conveyancers who are trained in conveyancing but are not solicitors. South Australia has the same arrangement. Solicitors therefore have little involvement in conveyancing of domestic property and reduced involvement in commercial property transactions. Another feature of the Torrens System is that a fund is created by levy on all registered transactions out of which compensation is paid to anyone who suffers a loss of their interest due to fraud, forgery or misdescription the land or interest in the land when it was first given a registered title. Claims against solicitors therefore with respect to conveyancing mistakes are rare where a Torrens type system is in operation.

PI Insurance in New Zealand

The PI insurance situation in New Zealand is very much different from that which pertains in all Australian jurisdictions. While the Law Society has a Conduct Rule relating to PI cover, it merely reminds practitioners that they must "accept legal responsibility for their actions", and details conditions which should have been met should a 'contract of limitation' be applicable to a lawyer's civil liability in dealings with clients.

It does not compel lawyers to take out insurance, nor specify how it should be taken.

Lawyers wishing to take the risk that there will not be action taken against them by a client for 'act, error or omission' are not compelled to take out indemnity cover. Some, particularly smaller firms, are known to take that risk rather than pay an insurance premium.

In essence, the New Zealand situation offers three options for practitioners and firms in this regard.

PI insurance can be arranged on an individual basis through the commercial market; some firms choose to run their own scheme; some (often smaller) firms take the risk with no insurance.

While there is in theory a competitive market, the reality is that the market has been generally dominated by one or two insurers. Until relatively recently, Lloyd's of London were the major provider of PI insurance in the open market for New Zealand firms, insuring approximately 80% of all insured firms.

The current hard insurance cycle has seen the cost of insurance increase substantially together with increasing deductibles and restricted coverage, with a large American insurer emerging as the predominant insurer.

The role of the New Zealand Law Society is an arm's-length one, and essentially has been to develop and refine the above Conduct Rule (Rule 1.12) which requires a practitioner to "...accept legal responsibility for his or her actions... and be prepared to meet any liability arising out of any act, error or omission in the course of the practitioner's professional duties or business"[3]

The Rule also prohibits a practitioner excluding by contract, liability to a client except as provided by the Rule.

Limitation of liability, through a contract of limitation, is dependent upon the practitioner having "valid professional indemnity cover for civil liability" which (i) provides cover to a minimum of two million dollars (and other specified coverage elements), and (ii) has been obtained through a 'sound and reliable' broker.

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[3] New Zealand Law Society. *Rules of Professional Conduct for Barristers and Solicitors. 6th Edition,* incorporating amendments to 11 April, 2003

In addition, the practitioner must (i)'endeavour' to maintain such cover for at least six years from the date of any contract of limitation, and (ii) must fully advise the client of all aspects of any contract of limitation including making it understood that neither the Law Society or a district Society shall have any liability. Legislation is being debated in New Zealand on this issue. The lawyers and Conveyancers Conveyancing bill had its first reading in the New Zealand Parliament in late July 2003. The date for submission on the bill closed on 3rd October 2003. We append, as Appendix 10 (page 198) the conduct rule for the New Zealand Law Society relating to indemnity, and as Appendix 11 (page 202) an extract from the New Zealand government bill (Lawyers and Conveyancers) relating to professional indemnity.

D. Ireland

Ireland is a jurisdiction that has approximately 6000 solicitors. It introduced compulsory insurance in 1996. It has two arrangements that co-exist. Firms may purchase from insurers who participate in a QIS and agree to contribute to an assigned risks pool or they may purchase from the mutual fund, The Solicitors Mutual Defence Fund.
The limit of indemnity is €1.3 million each and every claim, increased from IR£ 350,000 in 1998. An assigned risks pool has been established.
The definition of "qualified insurer " states
An insurer shall be designated ...as a qualified insurer where the insurer enters into an Assigned Risks Pool Participation Agreement which shall include an agreement with the Society to provide to solicitors acceptable to the qualified insurer at least the minimum level of cover ....
We have appended a copy of the qualifying minimum terms in Ireland and a copy of the agreement that is entered into by insurers. They are similar to those in England & Wales. The two arrangements co-exist in Ireland which makes it unusual. There are less than a dozen qualifying insurers and currently fewer than a handful of firms in the ARP. The profession does not, however, suffer from the same volatility in claims as experienced in Hong Kong. The claims trend in Ireland is high frequency as opposed to severity. Premium levels have increased significantly in recent years, reflecting the rising claims cost.

E. Scotland

Scotland has approximately 11,000 solicitors and a compulsory Master Policy arrangement. The limit of indemnity is £1,250,000 in the aggregate per annum inclusive of defence costs with one automatic reinstatement, effectively a limit of £2,500,000.

Other features include cover for civil liability for "all manner of business which is customarily carried on or transacted by solicitors in Scotland; fraud or dishonesty extension is available for additional premium, as is cover for foreign work. Foreign work means in a foreign place (except USA) or advising on foreign law. A standard excess is £2000 per principal per claim and a 5% discount is available if the insured elects to retain double that as an excess. There is no excess on claims involving defamation or loss of documents. Penalty excesses apply and are double the standard on claims involving conflict of interest, non standard undertakings. Certain time bar matters and where in a conveyancing transaction the fee was unreasonably low in the opinion of the Council and that caused the claim. No excess is payable if defence costs only are incurred but a loading is calculated by reference to those costs.

A proposal form is completed each year. Premiums are rated per partner. For 2002 the premium was

1-3 partners £1853 per partner
all other practices £1975 per partner.

There is a loading of between 10%-30% according to the ratio of partners to other staff. In addition each practice is charged a flat fee of £727.

Claims loadings or discounts are applied similar to the loading formula in Hong Kong. The difference is that the loading is calculated on reserves while the claim is open rather than waiting until it is finalized. In effect each firm's individual loss ratio over a five year period is calculated and premiums rated by reference to the loss ratio.

Part time practice and criminal law practice attract discounts. Limited Liability Partnerships have been allowed for legal practices. These were introduced in 2002. The number of practices incorporating has not been large. The liability limitation stems from the ability to

wind up the LLP in the event of insolvency. The partners still remain personally liable for any losses caused by negligence. There is no potential to affect the cost or level of professional indemnity insurance and the compulsory level applies to LLPs. Directors and Officers liabilities are not covered by the compulsory master policy so the partners need D&O policies to cover such things as failure to appoint an auditor, failure to maintain or file accounting records or annual reports or breach of any Companies regulations.

The feature of practice in Scotland that sets it apart from other jurisdictions is that solicitors conduct the business of real estate agents and have about 40% of that market. The income and economic stability from that source of income may be one reason why there has been no move to reduce premiums by establishing a mutual of other arrangement despite the size of the profession being almost double that of Hong Kong. We have no access to any claims data but were informed that the claims are close to uniform over the years with no peaks of high claims losses at anytime.

In 1991 the Law Society of Scotland investigated changing from a Master Policy which had been in place since 1978. The Law Society of Scotland investigated feasibility of setting up a fund, invited proposals from several brokers, but they elected to maintain the Master Policy Scheme opting for the security of transferring the whole of the risk to the insurance market. There were approximately 6500 solicitors in practice in Scotland at that time and the profession was averaging about 500 claims per year. The likely premium saving to the profession was considered not to outweigh the potential risks associated with retaining some level of risk by the way of a mutual fund.

F. Singapore

Singapore has adopted a Master Policy Scheme under the Legal Profession Act. It came into force on 1st April 1991. Initially for three years, it provided cover against civil liability in connection with legal practice with a limit of indemnity S$500,000 and defence costs of S$100,000 in addition. In 1994 the limit was increased to S$1,000,000 each and every claim with costs in addition of $200,000. In 1995 the limit was reduced to S$1,000,000 inclusive of defence costs.

At that time the President of the Institute of Chartered Accountants, Mr Tan Boen Eng at The 1st Asian Conference on Professional Indemnity and Directors and Officers Liability Insurance as part of his key note address, prepared a useful chart comparing the salient features of the Scheme for Singapore solicitors with the usual professional liability cover offered in the market.

The essential difference between the Singapore arrangement and that in Hong Kong is that all risk for Singapore solicitors is borne by commercial insurers. There is no mutual fund. There were 3533 Solicitors in Singapore as at March 2002. The annual report of the Law Society for 2002 reports that premiums under the Master Policy increased by 15% for 2002.

G. Malaysia

The Malaysian Bar Council in 1994 established a compulsory Master Policy Scheme that is wholly insured by commercial insurers. There are currently about 12,000 solicitors in the Malaysian Scheme. The Scheme applies to West Malaysia and does not include Sabah or Sarawak where insurance is voluntary. Separate qualification is needed in those States to be admitted to practise. Pressure to insure comes from commercial enterprises who require firms

to have appropriate levels of cover as a condition of being retained. Throughout Malaysia business conditions are such that the requirements of financial institutions and major enterprises lead to the majority of firms buying a higher level of indemnity than the compulsory limit.

Until 2002 the same insurers offered cover to a limit of RM 10 million (1$US=3.8RM) so firms tended to purchase their chosen limit through the Bar scheme.

Premiums are rated at a fixed premium per lawyer. The limit of indemnity is on a sliding scale starting at RM250,000 for one solicitor and increasing by about RM50,000 for additional solicitors up to a maximum of RM2 million. There is a no claims discount of 50% for a firm with no claims in the previous five years and 45% for firms with nil cost notifications that have been closed. This was introduced for 2003. The jurisdiction demonstrates how in a compulsory scheme a no claim bonus is a fiction. The base premium for 2002 was RM800 per lawyer. For 2003 the base premium was increased to RM1,100 and a maximum no claim bonus given of 45%. 90% of lawyers paid a premium of about RM800. The only way 90% of lawyers could receive a genuine 45% reduction is if the claims losses reduced by 45% between 2001 and 2002. Premium always equals claims losses plus expenses plus profit, no matter how the premium is configured or presented. Firms with claims also pay claims loading calculated according to the incurred cost of the claims. Risk banding is used. Additional premium is payable according to the firm's percentage of gross fees from conveyancing and/or litigation. Additional premium is payable based on the ratio of solicitors to unqualified staff in a firm.

Deductibles are on a sliding scale according to the number of lawyers in the firm. Penalty deductibles apply to claims involving dishonesty of partners, defamation conveyancing and conflicts of interest. The limit of indemnity is in addition to defence costs and is for each and every claim except for defamation and partner dishonesty claims which have an aggregate limit per year of RM250,000 regardless of the firm size and limit of indemnity on other claims.

Approximately 90% of the solicitors receive a no claims discount .The no claims discount was introduced in 2003 in response to escalating claims losses predominantly arising in the area of conveyancing, partner dishonesty and defamation.

It is to be observed that commercial insurers, in collaboration with the Bar Council, responded to losses by reducing the cover for defamation and dishonesty of partners and increasing the deductibles significantly for claims of that type as well as for conveyancing claims. In 2001 premiums at the compulsory layer increased by 95% across the profession in response to escalating claims losses and loss ratios for the previous 3 years exceeding 200%. There was no increase in the premium at the compulsory level for 2002 as the premium was negotiated in August 2001. The increase at the layer from RM2million to RM10 million, was negotiated after September 11th 2001 and was a 150% increase over the 2001 level.

The 2003 premium per lawyer reduced marginally for the 90% of the profession with good claims histories as opposed to the "top-up" layer where increases were about 20% above the 2002 premium.
Although Malaysia is subject to market forces, the Bar Council by negotiation with commercial insurers and because of long term relationships with the same insurers has reallocated the premium increases to high risk areas and to those having claims for the benefit of the majority of the profession despite escalating claims losses. In 2000 the Bar Council chose to continue its relationship with existing insurers and to reject a quotation from HIH despite it being the cheapest premium offered for 2001.

H. Canada

i. Quebec

Quebec's captive is a shining example of a successful mutual arrangement operated through a licensed captive insurer. The Professional Liability Insurance Fund of the Barreau du Quebec was created by the Quebec Bar and is governed by the Insurance Act. Its Board of Chairperson, Vice Chairperson and seven non executive Directors comprises five lawyers and four others who are an actuary, a banker, a financial advisor and a merchant banker. The day to day management is the responsibility of a Chief Executive Officer.

Its success is attributable to the low frequency of claims against the 14,000 lawyers of Quebec as well as to the management of the Captive since its inception in 1988. It provides cover with a limit of C$10million against all civil liability. The scheme has averaged about 800 claims per year over the last 10 years. In 1999 the contribution by the lawyers was C$1. It now offers cover for no premium and that premium holiday has lasted for 5 yeers.

ii. Ontario

Lawyers' Professional Indemnity Company (LawPro) is the sole compulsory provider of professional indemnity insurance to the lawyers of Ontario and Newfoundland. LawPro is a captive licensed Insurer owned by the Law Society of Upper Canada. Multi Disciplinary partnerships are authorised in Ontario.
LawPro offers standard coverage that is required to practise and endorsements that can be purchased separately.

Run-off cover is provided free of charge at reduced limits below standard cover. Part time lawyers earning less than a set amount of fees or retired lawyers can increase the limits of indemnity for reduced premiums

The standard limit of indemnity is C$1million inclusive of defence costs with an aggregate cap of C$2 million. Innocent party coverage is purchasable as an endorsement as is cover for a multi disciplinary partnership. A firm can choose a level of deductible and options to pay it with a reduction in the standard premium for a higher deductible.

The policy is issued to the Law Society of Upper Canada and the scheme can be characterised as a Master Policy scheme in which the insurer is a captive.

The legislation establishing the scheme refers to "premiums "as "levies". In addition to the professional liability insurance premium levy firms must pay to the Law Society other levies unless exempted. A levy of C$50 is payable *in respect of each real estate transaction in which the member acted for any of the following parties, namely, the transferor ,transferee, chargee ,charger or the title insurer of either or both of the transferee and charge.*

The definition of Real Estate Transaction is
"A transaction that directly or indirectly .....includes one or more of the following services, receipt of instructions, preparation of documents ,searches and/or the providing of one or more opinions with respect to title, transfer or charge and or/ with respect to the issuance of any title insurance."

The collection of the levy is administered on a quarterly basis when all insured firms provide a Real Estate Transaction summary Form to LawPro. A similar levy is charged on

"*The commencement of a proceeding in Ontario by way of notice of action, statement of claim, originating process. Application, notice of appeal, a form prescribed by statute or the response to a commencement of proceedings in Ontario by way of statement of defence or defences to third party or subsequent party claims, answers to petitions a response to any other process or notice of appearance in response to an application*"

If there are multiple parties to proceedings the levy is payable for each party represented by a different firm. Small claims, legally aided proceedings, Public Trustee proceedings and other social agency proceedings are exempted.

The levy is charged to the client as a disbursement.

In the early 1990's Ontario's scheme faced a crisis that has some similarities to Hong Kong. Escalating claims, largely arising from conveyancing and litigation work, left the (then) mutual with a shortfall between outstanding claims liabilities and its assets. The response was to isolate the insurance arrangements from the other activities of The Law Society and allow it to be managed on commercial lines by professionals with insurance expertise. The control of the captive remains ultimately with The Law Society as the owner for the benefit of the members of the Society but the day to day and overall management of the insurance arrangements are done by professionals in insurance. The company is a licensed insurer and a corporation with its directors and officers being subject to the usual corporate governance and accountability standards of corporations. The policy of insurance provides that LawPro will inform the Society of any matter that comes to its knowledge in connection with a claim involving dishonesty, a criminal offence or breach of the rules of professional conduct.

Iii. Other provinces - Canadian Lawyers Insurance Association

History & Structure

Canadian law societies are traditionally both the professional regulatory body and the professional association for lawyers. By the early 1970's, they had all established mandatory professional liability insurance programs. Initially, a commercial insurer would issue a master policy to the law society for the benefit of its members (i.e. all practising lawyers) and certificates of insurance would be issued by the societies. The premium was recovered by the levy on the membership.

Gradually, the law societies entered into self-insurance by retaining risk through a society deductible on each claim. This was funded by the reserve accumulated from the difference between the levy on members and the premium paid to the insurer. Through this, the societies established reserve funds and virtually complete information on claims against lawyers within their jurisdiction.

Whilst these plans had served the profession well, their overall effectiveness was severely limited due to the following:

1. Insurance markets particularly for the initial C$5,000,000 to C$10,000,000 of coverage were very limited, often to a single insurer. This, in turn, resulted in extremely volatile and at times excessive premium requirements.

2. From time to time insurance was not available either at all or at affordable prices to certain Law Societies (e.g. during the liability market crisis of the mid 1980's)

3. Due to this uncertainty and volatility in both availability and cost of insurance, Law Societies were not able to modify their programs to keep pace with the changing environment (e.g. the need to increase the coverage limits in order to ensure that the public interest is being adequately protected).

4. The inability of the Law Societies to modify their programs had a particularly adverse effect on the level of protection carried by members of the profession who were practising in smaller firms or as sole practitioners.

As a result of the foregoing and the demands of the Profession at large for more stable and effective professional liability coverage, a study was conducted by the Federation of Law Societies of Canada and the Canadian Bar Insurance Association ("CBIA"). The former is an association of the Law Societies. The latter is a national not-for-profit organisation formed by the Canadian Bar Association to establish and manage insurance programs for the legal profession.

The purpose of the study was to explore and seek a more effective alternative to the status quo. CLIA was formed as a result of this study.

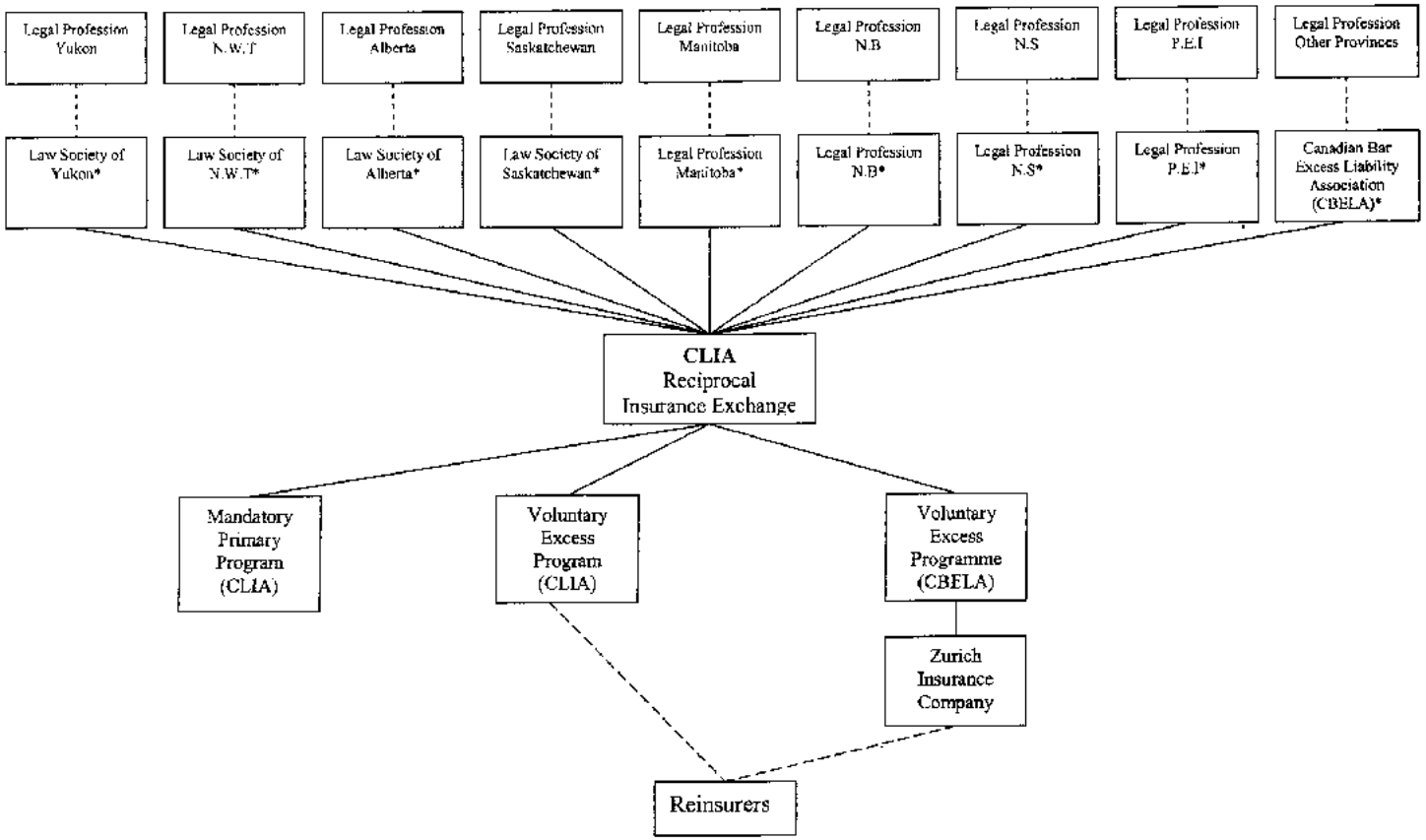
CLIA was established as a reciprocal insurance exchange, and it issued its first policies on July 1, 1988. The subscribers now include Nova Scotia, Prince Edward Island, New Brunswick, Manitoba, Saskatchewan, Alberta, Yukon and Northwest Territories. The participating Societies agree on standard limits and policy terms, and each select a Member Society retention appropriate to their circumstances. CLIA continues to issue a master policy to each Member Society for the benefit of its practising, including claims management within their retained limits. CLIA administers claims which exceed the Society deductibles, and performs a co-ordinating role.

All lawyers in private practice in Canada who offer legal services at a fee to a client must purchase standard liability insurance cover. The minimum compulsory coverage for each lawyer is C$1,000,000. The insurance does not cover the misappropriation of funds by a lawyer. It mainly covers errors and omissions by the lawyer for which the client suffers a financial loss. All Canadian law societies manage a compensation fund to compensate a client for misappropriation of funds by a lawyer.

The States of Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, Yukon, North West Territories and Nunavut are members of the reciprocal insurance exchange. CLIA was established on 1st July 1998 the participating Societies agreed on standard limits and policy terms and each member selects a retention level appropriate to their circumstances. CLIA continues to issue a Master Policy to each member's society for the benefit of its practising insured members. Most of the member societies manage their own programmes including claims management within their retained limits. CLIA administers claims which exceed the society's deductibles and forms a coordinating role.

This arrangement is therefore a series of small mutual funds each within of whom lacked the size and critical mass to have any market force or to efficiently negotiate and administer a scheme.

Initial members of CLIA



iv. British Columbia

The Law Society of British Columbia has a captive scheme. The Society collects and administers a group deductible of C$250,000 each occurrence with a C$500,000 aggregate. The balance is reinsured. Solicitors are rated identically by dividing the necessary premium pool by the number of solicitors which is approximately 8000. The LSBC Captive Insurance Company Ltd provides errors and omissions insurance coverage of C$1,000,000 per error and C$2,000,000 aggregate per year subject to deductibles of C$5,000 for the first claim resulting in payment of damages and C$10,000 for second and subsequent claims reportable in three years resulting in claims of damages. The insurance premium payable by insured solicitors is calculated as 60% of an actuaries projection of expected losses for the year. Added to this are administrative and claims handling costs, the reinsurance premium and premium taxes. The premium pool is then divided amongst the number of members. There is no variation according to type of practice size of practice geographic location or gross fees. A 50% discount is given for part time practitioners.

l. South Africa

The Attorneys Fidelity Fund provides a scheme of professional indemnity cover to all Attorneys in South Africa.

The profession in South Africa comprises approximately 15,000 attorneys, practising in some 6700 firms. The Attorneys Fidelity Fund is a client protection/compensation fund, established by statute to reimburse persons who have suffered pecuniary loss consequent upon the theft of trust money/property by attorneys in the course of their practices as such.

As a secondary function, the Fund provides funding for a scheme of professional indemnity insurance cover provided at no cost with respect to all practitioners in firms throughout South Africa. The provision of cover is automatic, rather than compulsory, in that all principals in every firm in South Africa receive the benefit of such cover. The limit of indemnity is R 1 million for a sole practitioner increasing by firm size to a maximum of R2 million. Costs equal to 25% of the indemnity limit are additional.

The scheme is run through a separate registered insurer (the Attorneys Insurance Indemnity Fund), a non-profit company which is wholly controlled by the Attorneys Fidelity Fund.

APPENDICES

Appendix 1 - The Review Team

Review Team

ANDREW FRYER (Team Leader)	Executive Director Global Markets International Willis Limited (London)
GRAHAM VASILEFF	Manager Professional Risks Practice Willis Australia
CAROLYN RICHARDS	Consultant, Willis
STEPHEN DAVEY	Account Executive Global Markets International Willis Limited (London)
MARTIN GIGGINS	Regional Director Financial & Executive Risks Asia Willis China (Hong Kong) Ltd

Appendix 2 - Description of Assigned Risk Pool (from Law Society of England & Wales QIS)

The Assigned Risks Pool

(Clause 2.2)

An Assigned Risks Pool ("ARP") shall be established and operated and the ARP Manager shall carry out its functions in accordance with the following paragraphs of this Schedule 2 and the Rules.

1 Participation

1.1 The Insurer shall participate in the ARP throughout each Indemnity Period in accordance with the terms of this Agreement, for so long as it remains a Qualifying Insurer.

2 ARP Manager

2.1 The ARP shall be managed and administered by the ARP Manager. The Law Society shall act as ARP Manager, provided that it may appoint one or more third parties to carry out some or all of the functions of the ARP Manager as set out in this Agreement or in the Rules on its behalf. Any third party so appointed may directly enforce any rights granted by or under this Agreement to the ARP Manager in accordance with the Contracts (Rights of Third Parties)Act 1999 for the purpose of giving full effect to such appointment. The consent of any such third party shall not be required in respect of any variation or termination of this Agreement.

2.2 The Insurer agrees that the ARP Manager may issue an ARP Policy incepting during the relevant Indemnity Period to a Firm where:

2.2.1 the Firm has applied to be insured through the ARP; or

2.2.2 the Firm is a Firm in Default; and

2.2.3 (in either case)the Firm is eligible or is to be regarded under the Rules as being eligible to be so insured; or

2.2.4 the Law Society has granted a waiver in accordance with the Rules from the requirement to meet some or all of those criteria.

2.3 The Insurer irrevocably appoints the ARP Manager as its agent to:

2.3.1 set the premium payable by each ARP Firm in accordance with the Rules;

2.3.2 bind the Insurer to the terms of the ARP Policies issued to each ARP Firm in accordance with its Percentage Participation;

2.3.3 calculate and adjust (in accordance with paragraphs 3.9 and 9.4)the Insurer's Initial Participation, Percentage Participation and Percentage Liability;

2.3.4 issue ARP Policies and related documentation to ARP Firms on behalf of all Qualifying Insurers participating in the ARP, including the Insurer;

2.3.5 if agreed in writing by the Insurer and subject to the terms of any agreement made with HM Customs and Excise for this purpose, collect and account to HM Customs and Excise for Insurance Premium Tax;

2.3.6 receive notice of, negotiate, settle and pay claims on behalf of all Qualifying Insurers participating in the ARP, including the Insurer;

2.3.7 provide data to the Law Society relating to ARP Policies and ARP Firms; and

2.3.8 do all things incidental to any of the above and generally to do all such other things as may be necessary or expedient from time to time to facilitate the operation of the ARP.

2.4 The Insurer further irrevocably appoints the ARP Manager as its agent to:

2.4.1 conduct any claim, advance defence costs and, if appropriate, compromise and pay any such claim in the normal course on behalf of each relevant Qualifying Insurer (including where applicable the Insurer in its own right or by virtue of its participation in the ARP), in accordance with clause 12.1.2; and

2.4.2 to commence, be a party to and be bound by the decision of an arbitration in accordance with clauses 12 and 13.

2.5 Where a Firm in Default makes an application to the ARP Manager to enter the ARP, the ARP Manager shall:

2.5.1 establish whether that Firm in Default is eligible or regarded under the Rules as being eligible to be insured through the ARP under the Rules or by virtue of any waiver of any provision of the Rules by the Law Society and, if so, issue one or more ARP Policies to that Firm in Default in accordance with the Rules or such waiver (as the case may be); and

2.5.2 (except where any such waiver has been granted)notify the Law Society, within 1 business day after the issuing of such ARP Policy/ies, of the identity of the Firm in Default, the fact that it has been or appears to have been carrying on business as a Firm in Default, and whether it has issued the Firm in Default with one or more ARP Policies.

2.6 Any ARP Policy issued in accordance with paragraph 2.5.1 shall be treated as incepting on the first day of the Indemnity Period to which it relates or, if later, the first day on which the Firm became a Firm in Default under the Rules.

2.7 Where the ARP Manager becomes aware of a Firm which is or appears to be a Firm in Default, but which either:

2.7.1 has not made an application to enter the ARP in accordance with the Rules; or

2.7.2 has made an application to enter the ARP but is not eligible or regarded as being eligible under the Rules to enter the ARP (including by virtue of any waiver made under the Rules), the arrangements referred to in paragraph 2.8 shall apply.

2.8 The ARP Manager shall (and is hereby authorised to)agree on behalf of all Qualifying Insurers arrangements with the Law Society for the purpose of providing professional indemnity insurance in respect of Firms which do not obtain a policy as required under the Rules. These arrangements shall include provisions to ensure that:

2.8.1 insurance through one or more policies issued by the ARP Manager on behalf of all Qualifying Insurers is provided in respect of such Firms;

2.8.2 such insurance is in compliance with the Minimum Terms, subject to any variation that the ARP Manager and the Law Society may agree; and

2.8.3 premiums and other sums due under the terms of each such policy are recoverable from the relevant Firm.

3 Basis of participation in the ARP

3.1 The Insurer shall provide to the ARP Manager within 10 business days following the start of each Indemnity Period a declaration in the form set out in Part 1 of Schedule !i

providing a figure for the Relevant Premium Income of the Insurer on a "best estimate" basis.

3.2 In the event that the Insurer fails to provide a figure within the time limit in accordance with paragraph 3.1, the ARP Manager may in its absolute discretion make its own estimate of the relevant figure for the purposes of this paragraph 3.

3.3 The ARP Manager shall calculate in accordance with paragraph 3.7 the Initial Participation Of the Insurer on the basis of the information provided in accordance with paragraph 3.1 or estimated in accordance with paragraph 3.2 and shall notify each Qualifying Insurer of its Initial Participation by no later than 20 business days after the start of the relevant Indemnity Period.

3.4 The Insurer shall provide a declaration of its Relevant Premium Income to the ARP Manager by no later than 31 January in each Indemnity Period in the form set out in Part 2 of Schedule 5, for the purpose of determining its Percentage Participation in the ARP for that Indemnity Period.

3.5 The ARP Manager shall calculate in accordance with paragraph 3.7 the Percentage Participation of the insurer on the basis of the information provided in accordance with paragraph 3.4 and shall notify:

3.5.1 each Qualifying Insurer of its Percentage Participation; and

3.5.2 each ARP Firm of the Percentage Participations of each of the Qualifying Insurers to the extent that they exceed 0 per cent by no later than 10 business days following the date in the relevant Indemnity Period on which the ARP Manager receives the last of the declarations required under paragraph 3.4 (the "Notification Date")from any Qualifying Insurer.

3.6 The Percentage Participation notified on the Notification Date shall be applicable in respect of all ARP Policies incepting in the relevant Indemnity Period and under any arrangements made pursuant to paragraph 2.7 in respect of that period both up to that date and thereafter, except to the extent that it may be adjusted from time to time in accordance with paragraph 9.

3.7 Each calculation made under this paragraph 3 shall be made in accordance with the formula:

$$\frac{A}{B} \times 100, \text{ where}$$

A = the Relevant Premium Income as declared by the Insurer in accordance with paragraph 3.1 or 3.4 or as estimated by the ARP Manager in accordance with paragraph 3.2 (as the case may require);

B = the total Relevant Premium Income declared by all Qualifying Insurers for that Indemnity Period;

"Relevant Premium Income" means the Premium Payable to a Qualifying Insurer in respect of Policies (excluding ARP Policies)incepting in the period 1 September 2003 to 31 December 2003, to the extent that such premium relates to cover required in accordance with the Minimum Terms for that Indemnity Period, as calculated in accordance with generally recognised professional indemnity underwriting methodologies; and

"Premium Payable" means the premium due from each Firm to a Qualifying Insurer (excluding any amount in respect of Insurance Premium Tax), whether or not actually received by that Insurer, less (only)any amount due to any intermediary acting as agent of that Firm for the purpose of obtaining professional indemnity insurance.

Provided that the ARP Manager may, at its absolute discretion, round the percentage resulting from the above formula, up or down to not less than three decimal points.

3.8 Without prejudice to paragraph 9.4 the Insurer warrants and represents to the ARP Manager for itself (and as trustee for all Qualifying Insurers participating in the ARP in any relevant Indemnity Period) that:

3.8.1 the estimated Relevant Premium Income declared pursuant to paragraph 3.1 **is its best** estimate of its Relevant Premium Income for the relevant Indemnity Period; and

3.8.2 to the best of the knowledge information and belief of the Insurer the Relevant Premium Income declared pursuant to paragraph 3.4 does not materially understate the Relevant Premium Income for the relevant Indemnity Period as at the date of such declaration; and

3.8.3 it has taken all reasonable steps to verify the accuracy of the declarations of its Relevant Premium Income made pursuant to paragraphs 3.1 and 3.4 and that such declarations have been made in good faith.

3.9 In the event that the ARP Manager can establish that the Insurer is in breach of the provisions of paragraph 3.8 and that in consequence the Percentage Liability of the Insurer has been materially understated (that is to say understated by more than 0.1 per cent)then the Percentage Liability of the Insurer (but not the Percentage Participation)shall be adjusted to the level it would have been, but for any such breach, and the Percentage Liability of all other Qualifying Insurers shall be adjusted accordingly.

4 Quarterly reporting

4.1 The ARP Manager shall at intervals of not less than 3 months following the Notification Date in respect of each Indemnity Period provide a bordereau to each insurer participating in the ARP in that Indemnity Period setting out premiums received and claims made or notified in respect of that Indemnity Period, and the administration and management costs and expenses incurred by the ARP Manager relating to that Indemnity Period.

4.2 The obligation of the ARP Manager under paragraph 4.1 shall continue until 3 months after the end of the Indemnity Period in question or, if later, for so long as any claims made on ARP Policies incepting in that Indemnity Period or under any arrangements made pursuant to paragraph 2.7 in respect of that period remain outstanding.

5 Share of premium

5.1 The Insurer shall be entitled to share in all premiums received by the ARP Manager in respect of all ARP Policies incepting in the relevant Indemnity Period or under any arrangements made pursuant to paragraph 2.8 in respect of that period in accordance with its Percentage Participation from time to time, subject to:

5.1.1 deduction of administration and management charges (including any applicable Value Added Tax)by the ARP Manager;

5.1.2 (where the Insurer has agreed that these may be paid on its behalf by the ARP Manager under paragraph 2.3.5 or where the obligation to pay such amounts falls on the ARP Manager as a matter of law)deduction of any amounts payable by the ARP Manager to HM Customs and Excise by way of Insurance Premium Tax;

5.1.3 any set-off against the liability of the Insurer from time to time under paragraph 6;

5.1.4 any set-off against the liability of the Insurer from time to time in respect of claims arising on ARP Policies or in respect of any arrangements made pursuant to paragraph 2.8 incepting in any previous Indemnity Period;

5.1.5 any adjustment required under paragraph 6.5;

5.1.6 any adjustment to the Insurer's Percentage Liability in accordance with paragraph 3.9;

5.1.7 any adjustment to the Insurer's Initial Participation Percentage Participation or Percentage Liability in accordance with paragraph 9;

5.1.8 the addition of any income earned (net of any taxation in respect of that income)on

premiums received by the ARP Manager; and

5.1.9 deduction of any sum due pursuant to paragraph 8.1,

such share after taking into account each of the above adjustments being referred to in this Agreement as the 'ARP Amount".

5.2 If, on the date 3 months following the end of the relevant Indemnity Period, the ARP Amount in respect of any Indemnity Period is greater than zero, the ARP Manager shall pay such sum to the Insurer within 20 business days thereafter, but without prejudice to its rights under to make any subsequent demands under paragraph 6.

5.3 The ARP Manager shall keep all premiums received in respect of ARP Policies or under any arrangements made pursuant to paragraph 2.8 in a separate account and held by the ARP Manager on trust for the Qualifying Insurers which participate in the ARP at any time during the relevant Indemnity Period.

6 Share of liability

6.1 The Insurer shall be liable to make payments under each ARP Policy incepting in the relevant Indemnity Period or under any arrangements made pursuant to paragraph 2.8 in accordance with its Percentage Liability.

6.2 The Percentage Liability of the Insurer in respect of each ARP Policy or under any arrangements made pursuant to paragraph 2.8 shall (subject to paragraphs 3.9 or 9.3 or 9.4) equal its Percentage Participation applicable on the date on which that ARP Policy or any such arrangements incepted.

6.3 The ARP Manager may at any time and from time to time demand from the Insurer an amount as specified by the ARP Manager for the purpose of making payments on behalf of the Insurer in accordance with its Percentage Liability.

6.4 The ARP Manager may at any time and from time to time demand from the Insurer an amount as specified by the ARP Manager for the purpose of meeting the administration and management costs and expenses (including any applicable Value Added Tax)of the ARP Manager, including without limitation in respect of all costs and expenses howsoever incurred (including where applicable, but without limitation, the amount of any claim paid and associated claimant's costs)in respect of any claim handled by the ARP Manager in accordance with clause 12.1.2, provided that in each case any such demand is made at the same time from all Qualifying Insurers participating in the ARP at the date of the demand in accordance with the Percentage Liability of each such Insurer on the date of the demand.

6.5 If any demand under this paragraph 6 is made before the Notification Date in any Indemnity Period before the relevant Percentage Participation (or, as the case may be, the relevant Percentage Liability)of the Insurer has been determined, then any such demand may be made in accordance with the Initial Participation of the Insurer, provided that the ARP Manager shall make any adjustment necessary to the ARP Amount in respect of the Insurer to reflect any difference between the Insurer's Initial Participation and the Insurer's relevant Percentage Participation (or, as the case may be, the relevant Percentage Liability)within one month of the Notification Date.

6.6 The ARP Manager shall not make any demand from the Insurer under this paragraph 6 where:

6.6.1 the Insurer has paid the ARP Manager in full following all previous such demands; and

6.6.2 the ARP Manager holds sufficient premiums on trust for the Insurer from which to pay known and anticipated claims and defence costs and/or meet any administration and management costs and expenses (including any applicable Value Added Tax).

6.7 The Insurer shall pay to the ARP Manager all sums demanded by the ARP Manager under this paragraph 6 within 10 business days of such demand being made by the ARP Manager. Interest shall accrue at a rate equal to the base rate from time to time of Barclays Bank plc plus three per cent to any sums that remain unpaid within 10 business

days of such demand being made by the ARP Manager.

6.8 The ARP Manager shall, on request in writing from the Insurer, provide evidence of its administration and management costs and expenses where any sum in respect of such costs and expenses has been demanded under paragraph 6.4.

7 ARP Indemnity Period

7.1 Each ARP Policy issued and any arrangements made pursuant to paragraph 2.8 by the ARP Manager on behalf of the Qualifying Insurers shall expire at the end of an Indemnity Period, irrespective of the date on which the ARP Policy is written or incepts or any such arrangements are made or incept.

7.2 The ARP Manager may not issue an ARP Policy or effect any arrangements pursuant to paragraph 2.8 with an expiry date before the end of the Indemnity Period in which that ARP Policy incepts or in relation to which those arrangements are made.

7.3 Paragraphs 7.1 and 7.2 shall apply in respect of an ARP Policy subject to the eligibility under the Rules of the ARP Firm in question to remain in the ARP until the end of the Indemnity Period, and an ARP Policy shall expire upon the ARP Firm holding such Policy ceasing to be entitled under the Rules to be insured through the ARP.

8 Additional charges

8.1 The ARP Manager shall pay on behalf of Qualifying Insurers the costs and expenses of the Law Society in respect of any special measures as notified to it by the Law Society imposed on an ARP Firm. The ARP Manager shall be entitled to seek reimbursement of any such costs and expenses from the relevant ARP Firm.

9 Adjustments to Percentage Participation and Percentage Liability

9.1 If any Qualifying Insurer becomes a Run-off Insurer during any Indemnity Period (but not thereafter then:

9.1.1 the Percentage Participation of each of the other Qualifying Insurers in respect of the unexpired part of the relevant Indemnity Period shall be recalculated in accordance with the formula set out in paragraph 3.7 but excluding the Relevant Premium Income of the Run-off Insurer in question; and

9.1.2 the Percentage Participation of the Run-off Insurer in question in respect of the unexpired part of the relevant Indemnity Period shall equal zero.

9.2 The Percentage Participation adjusted under paragraph 9.1 shall apply from the date on which the Run-off Insurer in question became a Run-off Insurer.

9.3 If at any time after the start of any Indemnity Period any Qualifying Insurer or Run-off Insurer which is or was a participant in the ARP during that Indemnity Period is the subject of an Insolvency Event, then:

9.3.1 in the case of an insurer which was a Qualifying Insurer immediately prior to the Insolvency Event, paragraph 9.1 shall apply; and

9.3.2 for the purposes of any claim first made, or arising from circumstances first notified to the ARP Manager before the date of the relevant Insolvency Event, no adjustment shall be made in accordance with paragraph 9.3.1. However, the Percentage Liability of each of the other Qualifying Insurers in relation to Defence Costs and any associated costs and/or expenses incurred by each of the other Qualifying Insurers in respect of each ARP Policy on or after the date of the relevant Insolvency Event may be recalculated by the ARP Manager (in its absolute discretion)in accordance with the formula set out in paragraph 3.7 but excluding the Relevant Premium Income of the Qualifying Insurer or Run-off Insurer which is the subject of the Insolvency Event; and

9.3.3 the Percentage Liability of each of the other Qualifying Insurers in respect of each ARP Policy and any arrangements made pursuant to paragraph 2.8 in force immediately prior to the date of the relevant Insolvency Event shall, with effect from the date of the relevant Insolvency Event, for the purposes of any claim first made, or arising from circumstances first notified to the ARP Manager, on or after the date of the relevant Insolvency Event, equal their respective Percentage Participation on that date after adjustment (if applicable)in accordance with paragraph 9.3.1; and

9.3.4 the Percentage Liability of the Qualifying Insurer or Run-off Insurer in question in respect of the unexpired part of the relevant Indemnity Period shall equal zero.

9.4 Without prejudice to paragraph 3.9 the ARP Manager may, in its absolute discretion, at any time during or after the end of any Indemnity Period adjust the Initial Participation, the Percentage Participation and/or the Percentage Liability of each Qualifying Insurer prospectively or retrospectively in the light of information relating to the Relevant Premium Income of one or more Qualifying Insurers obtained or received by the ARP Manager which indicates that the Relevant Premium Income of such Qualifying Insurers is greater than that previously declared to the ARP Manager.

9.5 The ARP Manager shall notify in writing:

9.5.1 each Qualifying Insurer of its revised Percentage Participation; and

9.5.2 each ARP Firm of the revised Percentage Participations of each of the Qualifying Insurers, by no later than 10 business days following any adjustment being made in accordance with any of the provisions of this paragraph 9.

10 Supplementary provisions

10.1 Clauses 6, 7, 9, 10, 12, 13, 14, 15 and 16 shall apply to the ARP Manager in respect of its dealings with ARP Firms, Qualifying Insurers and the Law Society in the same way as they apply to Qualifying Insurers, except that the ARP Manager shall be obliged to notify the Law Society in the circumstances described in clause 6.2.

10.2 The Insurer undertakes and agrees with the ARP Manager and the Law Society that it shall:

10.2.1 if called upon to do so, ratify and confirm any lawful act or omission of the ARP Manager on behalf of the Insurer and/or all Qualifying Insurers in the proper performance by the ARP Manager of its duties under this Agreement; and

10.2.2 indemnify the ARP Manager and keep it indemnified fully at all times against all liabilities, claims, actions, proceedings, damages, losses, costs and expenses which are made or brought against or incurred by the ARP Manager in the proper performance by the ARP Manager of its duties under this Agreement,

10.3 The ARP Manager (and its agents and advisors from time to time)shall be entitled to access any Records of the Insurer at all times on reasonable notice during normal business hours for the purpose of verifying or obtaining any information provided or required to be provided by the Insurer to the ARP Manager.

Appendix 3 - List of Interviews undertaken (excluding Hong Kong law firms)

- Hon Margaret Ng, Leg Co
- Elsie Leung, Secretary for Justice, Department of Justice
- Bob Allcock, Solicitor General, Department of Justice
- Kitty S.F. Fung, Senior Government Counsel, Department of Justice
- Pamela Chan Wong Shui , Chief Executive, Consumer Council
- Li Kai-ming, Deputy Chief Executive, Consumer Council
- Wong Wan-ming Rosa, Legal Counsel, Consumer Council
- Kim Salked, Land Registrar, The Land Registry
- H.Y. Mok, Assistant Commissioner of Insurance, The Government of the Hong Kong Special Administrative Region, Office of the Commissioner of Insurance
- Isabelle S.Y. Tsang, Legal Counsel, Legal and Compliance Department, Bank of China
- See Lai Ngar Silvia, Manager, Loans Division, Bank-wide Department, Bank of China
- Christopher To, Secretary-General, Hong Kong International Arbitration Centre
- Andrew Bellers, Director, Essar Insurance Services Limited
- Vivien Lee, Assistant Director, Professional Indemnity Scheme, The Law Society of Hong Kong
- Tony Harrod, Director of Compliance, The Law Society of Hong Kong
- Donald S. Breakstone, Attorneys' Liability Assurance Society, Inc. (ALAS)
- Margaret Moran, Manager, Solicitors' Mutual Defence Fund Limited, Northern Ireland
- David Cullen, Director, The Law Society of Scotland
- Andrew Darby, Head of Professional Indemnity Section, Regulation Directorate, The Law Society of England & Wales
- Peter Farthing, Clyde & Co, Chairman PI Committee of The Law Society of England & Wales
- Paul Cusition, St Paul International Insurance Company
- Edward Coulson, Robin Simon Solicitors, (Law Society of England & Wales Review Group member)
- Katharine Mellor, Elliotts, (Law Society of England & Wales Review Group member)
- Mark Hick, Wragge & Co.
- Miranda Milne, Chief Executive of the Legal Practitioners Liability Committee (Victoria)
- Sue Clark, Chief Executive of Lawcover (New South Wales)
- Larry King, Executive Director of the Law Society of the Australian Capital Territory
- Ann Durack, Manager of Law Mutual (Western Australia)
- Martin Keith, Chairman, Lawguard (South Australia)
- Jan Grundy, Director, Law Claims (South Australia)
- Ron Ashton, Vice-President, The Law Society of Queensland
- Margaret Bryson, Deputy-CEO of the Law Society of New Zealand
- Yashodhara Dhoraisingham, CEO The Law Society of Singapore
- Quentin Loh, Chairman, The Law Society of Singapore Professional Indemnity Committee

Appendix 4 - List of current qualifying insurers for Law Society of England & Wales QIS (2003/04), including their current participation

Qualifying Insurer	Initial Participation
Ace Global Markets	0.000%
Ace INA Limited	3.104%
AIG Europe (UK) Ltd	5.807%
Alea London Limited	3.198%
AON Professional Risks on behalf of London General Insurance Co Ltd	0.000%
Brit Insurance Limted	0.584%
Brit Syndicates Ltd (Lloyd's Syndicate 2987)	0.000%
Chubb Insurance Co of Europe SA	0.556%
DA Constable (Lloyd's Syndicate 386)	1.240%
HCC Global Financial Products	0.000%
Hiscox (Lloyd's Syndicate 33)	0.110%
Hiscox Insurance Company Limited	5.154%
M J Harrington (Lloyd's Syndicate 2000)	1.926%
Newline Underwriting Management Limited	1.215%
Norwich Union	8.164%
QBE International Insurance Ltd	16.551%
Royal & Sun Alliance	4.369%
Saturn Professional Risks for MMA Insurance Plc	0.000%
St Paul International Insurance Company Ltd	19.946%
SVB Syndicates Limted	0.393%
TWK (Lloyd's Syndicate 839)	0.000%
W R Berkley Insurance (Europe) Ltd	4.327%
Zurich Insurance Company	0.000%
Zurich Professional Limted	25.356%
Total	**100.000%**

Appendix 5 - Assigned Risk Pool Rules for the Law Society of Ireland

ASSIGNED RISKS POOL PARTICIPATION AGREEMENT

AGREEMENT made the day of 1995 BETWEEN the LAW SOCIETY OF IRELAND of Blackhall Place in the City of Dublin (hereinafter referred to as "the Society"), of the First Part AND ..... of .....
.....
in the County/City of ..... (hereinafter called "the Qualified Insurer") of the Second Part.

WHEREAS

(a) The Society has made regulations (hereinafter referred to as the "Indemnity Regulations")pursuant to Section 26 of the Solicitors (Amendment)Act 1994, as comprised in Statutory Instrument No._of 19_).

(b) The Indemnity Regulations provide (inter alia) as follows:

(i) **"Assigned Risks Pool"** means the insurance pool participated in by each qualified insurer through which a solicitor who is refused the minimum level of cover or run-off cover, or in respect of whom there has been a constructive declinature, by three or more qualified insurers (one of which to be the mutual fund known as the "Solicitors Mutual Defence Fund Limited") may, in accordance with these Regulations, obtain the minimum level of cover or run-off cover.

(ii) **"Constructive declinature"** means the quotation to a solicitor by a qualified insurer of terms or conditions or of a premium for providing the minimum level of cover or run-off cover, the effect of which is tantamount, in the opinion of the PII Committee in the particular circumstances of the case, to a refusal to provide the minimum level of cover;

(iii) **"Council"** means the Council of the Law Society of Ireland.

(iv) **"Indemnity against losses"** means indemnity against losses and claims in respect of civil liability incurred by an insured in respect of any act or omission of the insured arising from his practice as a solicitor;

(v) **"indemnity cover"** means indemnity cover in force relating to a solicitor in respect of his practice as a solicitor, whether or not provided by a qualified insurer and whether or not equivalent to the minimum level of cover;

(vi) **"insured"** means a solicitor or a partner, clerk or servant (or former or deceased partner, clerk or servant)of a solicitor, and includes a solicitor who is a member of the mutual fund known as the "Solicitors Mutual Defence Fund Limited";

(vii) **"insurer"** means

(A) the mutual fund known as the "Solicitors Mutual Defence Fund Limited"; or

(B) an insurance company or insurance underwriter. authorised pursuant to the

Insurance Acts, 1909 to 1990 to carry on general insurance business in the State; or

(C) an insurance company or insurance underwriter which has either its head office or a branch office within a member state of the European Union other than the State and which is authorised by law to carry on general insurance business within the State;

(viii) **"minimum level of cover"** means the minimum level of cover (including retroactive cover)for indemnity against losses pursuant to approved indemnity terms from a qualified insurer in respect of any practice year and shall be

(A) the amount of £350, OOO for each and every claim (including claimants 'legal costs)unlimited in the aggregate in respect of any act or omission of the insured which gives rise to a claim or which the insured considers may give rise to a claim and is duly notified to the qualified insurer concerned during the practice year in question, together with the insured's own legal costs up to a maximum of not less than f 100,000 incurred with the consent of the qualified insurer concerned, or such other increased amounts as may be specified by the Council from time to time (after consultation with the PII Committee)and as shall be notified to each qualified insurer and to each solicitor holding a current practising certificate by not later than six months prior to the commencement of the next following practice year from which such increased amounts would become applicable; or

(B) in such particular and exceptional circumstances (whether in relation to the Assigned Risks Pool or otherwise)as the PII Committee in its discretion may accept and subject to such terms and conditions as the PII Committee may specify as appropriate, such amount in the aggregate not being less than f350, OOO (including claimants' legal costs), together with the insured's own legal costs up to a maximum of not less than f 100,000 incurred with the consent of the qualified insurer concerned, for claims in respect of any act or omission of the insured which gives rise to a claim or which the insured considers may give rise to a claim occurring during, or within a period of six years prior to the commencement of, the practice year in question, and is duly notified to the Pool Manager or to the qualified insurer concerned during the practice year in question;

(ix) an insurer to be designated by the Society's Professional Indemnity Insurance Committee (hereinafter referred to as the "PII Committee")as a **"qualified insurer"** is required to enter into an Assigned Risks Pool Participation Agreement (in the form of this Agreement), which shall include an agreement with the Society to provide to solicitors acceptable to the qualified insurer at least the minimum level of cover pursuant to a contract of insurance, or pursuant to written terms of membership of a mutual fund, including at least the minimum provisions as set forth in the Appendix to the Indemnity Regulations and as may be specified by the PII Committee from time to time (in the Indemnity Regulations referred to as **"approved indemnity terms"**);

(x) **"PII Committee"** means the Professional Indemnity Insurance Committee appointed pursuant to Regulation 3;

(xi) **"Pool Manager"** means the person (including a body corporate) appointed from time to time by the PII committee to manage the Assigned Risks Pool;

(xii) **"Practice"** means a solicitor's practice carried on by one or more solicitors engaged in the provision of legal services;

(xiii) **"Retroactive cover"** means indemnity against losses arising from the provision of legal services engaged in by a solicitor prior to the practice year in which a claim in respect thereof is duly notified to the qualified insurer concerned or to the Pool Manager;

(xiv) **"Run-off cover"** means indemnity against losses equivalent to the minimum level of cover in respect of an act or omission of a solicitor arising from his practice as a solicitor and occurring prior to the solicitor ceasing for any reason to engage in practice as a solicitor, which is duly notified within a period of six years from the end of the practice year in respect of which there was last in force relating to the solicitors the minimum level of cover;

(xv) the **"self-insured excess"** applicable to each and every claim in any practice year shall

not exceed

(A) in the case of a practice comprising one solicitor only, the amount of £5,000 and in the case of a practice together (whether or not the relationship between them is based on partnership), the amount of £5,000 multiplied by the number of solicitors in the practice;

(B) such other amount as may be specified by the Council from time to time (after consultation with the PII Committee)and as notified to each qualified insurer and to each solicitor holding a current practising certificate by not later than six months prior to the commencement of the next following practice year from which such other amount would become applicable;

(xvi) **"solicitor"** means a person who has been admitted as a solicitor and whose name is on the roll; and a reference to a solicitor includes, unless the context otherwise requires, a reference to

(A) a solicitor who is engaged in practice as a solicitor, whether as a sole practitioner or as a partner in a practice or as an employee of a practice or of any other person or body, and who is prohibited by section 56 of the Solicitors (Amendment)Act 1994 from so engaging in practice unless a practising certificate in respect of him is in force;

(B) a solicitor who is employed full-time within the State to provide conveyancing services only to and for his employer (provided that such employer is not a solicitor);

(C) a former solicitor or a deceased solicitor;

(xvii) a solicitor shall not be issued with a practising certificate unless the solicitor has furnished (or caused to be furnished)to the Society written confirmation from a qualified insurer of there being in force relating to that solicitor the minimum level of cover for the duration of the practice year to which such practising certificate so applied for relates.

(C) The Qualified Insurer has been furnished by the Society with a copy of the Indemnity Regulations.

(D) The Qualified Insurer is desirous of becoming a qualified insurer within the meaning of the Indemnity Regulations and of complying with the Indemnity Regulations in that regard by entering into an Assigned Risks Pool Participation Agreement (in the form of this Agreement)with the Society.

NOW THIS AGREEMENT WITNESSETH AS FOLLOWS:

1. That the Qualified Insurer shall provide to solicitors acceptable to the Qualified Insurer at least the minimum level of cover pursuant to a contract of insurance or pursuant to written terms of membership of a mutual fund, including at least the approved indemnity terms, to enable the solicitors concerned to comply with Regulation 4 of the Indemnity Regulations.

2. That the Qualified Insurer shall, when requested by the PII Committee to do so, furnish to the PII Committee and to the Pool Manager, in respect of any practice year in which the Qualified Insurer is a qualified insurer, the name and address of each solicitor to whom the Qualified Insurer provides the minimum level of cover; provided that where the minimum level of cover is provided to a practice comprising five or more solicitors (whether partners or employees)there shall be sufficient compliance with this clause if the Qualified Insurer furnishes to the PII Committee and to the Pool Manager written confirmation that each and every solicitor who is or becomes a partner, or who is or becomes an employee, of the practice during the practice year in question is covered by the minimum level of cover provided to that practice.

3. That the Qualified Insurer shall, when deemed appropriate and reasonable and so

requested by the PII Committee, refer to arbitration (by an arbitrator who shall be a solicitor or a member of the Irish Bar either mutually agreed or as nominated by the President of the Society for the time being)any dispute involving the Qualified Insurer relating either to which of two or more qualified insurers (or other insurer(s) providing indemnity cover)should indemnify a solicitor or relating to the manner or extent to .which two or more qualified insurers (or other insurer(s)providing indemnity cover)should indemnify a solicitor.

4. That the Qualified Insurer shall participate in the Assigned Risks Pool and shall share the premium therefore and shall contribute, in conjunction with all other qualified insurers for the time being, to the provision of the minimum level of cover or run-off cover through the Assigned Risks Pool pursuant to the Indemnity Regulations, such sharing and contribution to be ascertained in accordance with clause 5 hereinafter set forth.

5. That the proportion of the sharing by the Qualified Insurer of the premium therefore and the contribution of the Qualified Insurer to the provision of the minimum level of cover or run-off cover through the Assigned Risks Pool pursuant to the Indemnity Regulations shall be the proportion which the number of individual solicitors to whom the Qualified Insurer provides the minimum level of cover in the relevant practice year bears to the total number of individual solicitors to whom all qualified insurers provide the minimum level of cover in the relevant practice year.

6. That the Qualified Insurer shall, when deemed appropriate and reasonable and so requested by the PII Committee, furnish to the PII Committee and to the Pool Manager relevant information relating to an alleged refusal or constructive declinature by the Qualified Insurer in relation to a solicitor applying for admission to the Assigned Risks Pool.

7. That the Qualified Insurer shall when deemed appropriate and reasonable and so requested by the PII Committee, furnish to the PII Committee data relating to the category of claims in respect of civil liability incurred by solicitors insured by the Qualified Insurer and arising from their practice as solicitors, where the PII Committee require such data to provide to the solicitors 'profession as a whole advice relating to risk management; provided that the Qualified Insurer shall not be required to furnish such data where to do so would identify an individual insured and would give rise to a breach of the duty of confidentiality owed by the Qualified Insurer to that individual insured.

8. That in the event of any dispute, howsoever arising, between the Qualified Insurer and any other qualified insurer(s)in connection with or concerning the operation of the Assigned Risks Pool, the Qualified Insurer (following consideration by the PII Committee of written submissions invited from each qualified insurer concerned, including the Qualified Insurer, on the issues in such dispute)shall abide by the decision of the PII Committee on the means of resolution of such dispute.

9. That the Qualified Insurer shall give to the Society and to each solicitor to whom the Qualified Insurer provides the minimum level of cover at least three months notice expiring on the 31st day of October in any practice year of the Qualified Insurer's intention as and from the 1st day of January in the following practice year to discontinue providing the minimum level of cover to solicitors and to cease to be a qualified insurer.

10. That the Society shall, when requested by the Qualified Insurer to do so, provide all information relating to a solicitor that the Society would be entitled under the Solicitors Acts, 1954 to 1994 or any regulations thereunder (including the Indemnity Regulations)to provide on request to any member of the public or to any other solicitor.

IN WITNESS WHEREOF the parties hereto have hereunto set their hands and affixed their seals this day and year first herein WRITTEN.

SIGNED AND SEALED BY
the Law Society of Ireland
in the presence of:

SIGNED AND SEALED BY
(Qualified Insurer)in
the presence of:

Appendix 6 - Royal Institute of Chartered Surveyors – Assigned Risk Pool guidelines

Section 1

Purpose of the guidance notes

1 Purpose of the guidance notes

1.1 This guide is for RICS members and covers:

- The assigned risks pool (ARP)concept and purpose
- The procedure for admission into the ARP
- How to contact the APR managers

1.2 The rules of admission to the ARP are set out at Appendix A. The rules govern admission to the ARP for those firms that find themselves unable to get professional indemnity insurance in accordance with the requirements of RICS.

1.3 In this guide and rules of admission the following definitions have been adopted:

a. **RICS** means The Royal Institution of Chartered Surveyors

b. **Expiring premium** is the notional gross premium (excluding IPT) paid in the last insurance year in respect of the limit of indemnity required under the professional indemnity insurance requirements. 'In the event that the firm purchased an expiring policy with a limit of indemnity greater than the limit of indemnity provided by the ARP (GBP 500 000 in the aggregate), the 'Deposit Premium' will be calculated in accordance with the schedule agreed with the Panel insurers. '

c. **Firm** means:
i. A fellow, member or technical member of RICS who is or who is held out as offering surveying services to the public as a sole principal/sole practitioner

or
ii. A partnership offering surveying ser vices to the public where at least one partner is a fellow, member or technical member of RICS or is held out as a partner in a partnership offering surveying ser vices to the public

or
iii. A body corporate or a company, whether incorporated with limited or unlimited liability, offering surveying services to the public where at least one director is a fellow, member or technical member of RICS or is held out as a director of a company offering surveying services to the public

iv. A limited liability partnership offering surveying services to the public where at least one member is a fellow, member or technical member of R ICS or is held out as a member of a limited liability partnership offering surveying services to the public

d. **Listed insurer** means:
An insurer who:

i. Is authorised by the Department of Trade and Industry in the United Kingdom, or the Department for Enterprise and Employment in the Republic of Ireland, to under write general liability insurance business; or is in some other w ay recognised by the Department of Trade and Industry or the Department for Enterprise and Employment to provide professional indemnity insurance business in the United Kingdom or the Republic of Ireland respectively

and

ii. Is rated within AM Best at least b+ or Standard & Poors at least category BBB or have specific written approval from RICS to waive this requirement

Iii . Agrees to write a policy that is no less comprehensive than the form of the R ICS policy wording [subject to any derogations for firms within the assigned risks pool in force at the time when the policy of insurance is taken out]

iv. Agrees to underwrite, for the period of the contract, the ARP lineslip contract on terms as set out in the prospectus for listed insurers and to be bound by the terms thereof

v. Is listed by RICS for the purposes of the assigned risks pool.

e. **Deposit Premium** a premium to be paid by a firm before gaining entry to the AR P for the initial three months cover which will be based on 200%of the 'Expiring premium 'paid by the firm f or its expiring PII cover, pro-rated for three months, or such other rate as from time to time be prescribed by the ARP Panel. In the event that the firm purchased an expiring policy with a limit of indemnity greater than the limit of indemnity provided by the AR P (GBP 500 000 in the aggregate), the 'Deposit Premium' will be calculated in accordance with the schedule agreed with the panel insurers.

f. **Professional Indemnity insurance requirement** means the RICS compulsory professional indemnity insurance bye-law and regulations.

Section 2

The assigned risks pool concept

2.1 RICS requires professional indemnity insurance to be carried by every firm which is providing or offering surveying services to the public. There are a number of reasons for this:

- To comply with RICS' public interest duties
- To comply with RICS 'obligations for self regulation under the terms of the Royal Charter and/or the relevant bye-laws and regulations
- To provide compensation for those members of the general public who have suffered loss as a result of the negligence of a member of RICS
- To ensure that members themselves are protected in the e vent of a professional indemnity claim.

2.2 It is envisaged that the majority of firms will usually be able to obtain insurance, however, the ARP facility exists to provide temporary insurance cover for those who are unable to obtain insurance as a result of claims 'history or other factors.

2.3 RICS recognises that sometimes members suffer claims which result in their insurance arrangements not being renewed, or being renewed on terms that may, in effect, put the firm out of business. In some cases firms suffer insurance problems through no direct fault of their own, perhaps as a result of the activities of a former partner or employee. In this event the member or members may not be able to comply in full with the professional indemnity insurance requirement of RICS. The ARP facility is a member service provided by RICS to enable members to comply with the insurance regulations whilst they take action to rectify such problems that have led to them being declined insurance.

2.4 It is essential that firms and their advisers understand the function and purpose of the ARP. It is available in the following two sets of circumstances. Admission to the ARP will be considered only if:

a. There has been declinature (as defined in the rules of admission)

b. There has been constructive declinature (as defined in the rules of admission this takes account of levels of premium, or other terms, which are so punitive as to be deemed an unaffordable proposition for the firm). Refer in addition to the guidance notes at appendix E.
2.5 Being in the ARP is not a soft option. Premium costs, paid by banker's draft, or equivalent, will be higher than the 'expiring premium' and the quality and level of cover less

than the expiring policy cover. You will also be required to pay, again by banker's draft, or equivalent, for the cost of an investigation and business review. It is therefore for your broker, acting on your behalf , to explore all options for renewal of your cover and to obtain the necessary extensions to your policy in order that you remain insured in accordance with the professional indemnity insurance requirements.

2.6 The cover provided in the ARP will comply with the professional indemnity insurance requirement of RICS. Although RICS requires, in the public interest, professional indemnity insurance to be on an each and every claim basis, cover in the ARP will be 'in the aggregate'. This is a derogation from the normal professional indemnity insurance requirement. The alternative would be no cover at all which puts the public and the firm at greater risk.

2.7 In every case where a firm enters the ARP, the panel, on behalf of RICS, and at the firm 's own expense, will undertake a detailed investigation and future monitoring of the firm to:

a. Discover the reasons for insurance notbeing available

b. Direct the firm towards undertaking appropriate remedial action

Sections 2 to 5

Applications to the ARP

c. Assist the firm to prepare for re-application to the standard market for insurance cover

2.8 The panel will after considering the outcome of the firm's business review, meet to confirm the firm's continuing membership of the ARP or its exclusion.

2.9 Where warranted, disciplinary action may be taken which may lead to the individual member or members of RICS from discontinuing to be members of RICS. This will be pursued through the disciplinary powers and procedures of RICS. While membership of the ARP is not itself a disciplinary matter, if the business review highlights breaches of regulations these may be referred for disciplinary action.

2.10 Through the ARP, risk management advice will also be provided. This advice will be paid f or by the firm. It will be based on an independent view of the difficulties that have occurred and which will set out recommendations for remedial action for the future. As a result it should then be possible to bring the firm's insurance arrangements back within the standard market. If this cannot be achieved within the timescale laid down by the ARP, RICS will take disciplinary action. Moreover if the ARP arrangement is not taken up by the firm RICS will take disciplinary action as a breach of the professional indemnity insurance requirement.

3 Applications to the ARP

3.1 A firm may apply to enter the ARP in the following circumstances:

a. Where a firm has been declined professional indemnity insurance cover by all the prescribed listed insurers (i.e. declinature). The prescribed listed insurers for the purposes of the ARP are set out at appendix D to these guidance notes and rules of admission

or

b. Where a firm is able to provide satisfactory evidence that it has been quoted a premium and/or other terms by the prescribed listed insurers such that they jeopardise the firm's ability to carry on its business (i.e. 'constructive declinature').

4. Management of the ARP

4.1 The ARP is managed by Miller Insurance Services Ltd. If a firm finds itself in the situation of being declined professional indemnity insurance cover or feels that it has been 'constructively declined', it should contact Miller Insurance Services Ltd immediately for the relevant documentation, including details of what information is required to make an application to enter the ARP and the contractual documentation.

4.2 Once all the required information has been provided the managers will look at the application and provisionally accept or refuse it. If the application is provisionally approved, the managers will advise the firm of the terms of admission they propose to recommend to the panel. The firm is admitted for a provisional period of three months. During this period the business review must be under taken and the required declinatures sought from insurers. It will then be for the panel to approve the manager's decision and admit the firm for the full 12 months membership of the ARP and to set the terms of membership , or to exclude the firm from the ARP. If a firm is dissatisfied with any provisional decision or recommendation made by the managers, it has the right to raise this matter in writing with the panel.

4.3 The managers are remunerated by way of a fee and will not charge brokerage based on the risks covered by the ARP.

5. Assigned risks pool panel

5.1 The assigned risk s pool panel (the 'panel')is appointed by the governing council of RICS. Its functions are set out at appendix B to these guidance notes and rules of admission.

Section 6

Admission to the ARP

6. Admission to the ARP

6.1.1 The managers are unable to confirm provisional admission to the ARP until the firm has completed the formal written acceptance of the terms of admission and these have been received by the managers along with the deposit premium for the first three months of membership. This formal written provisional acceptance will not be available until a minimum of two insurers represented on the panel have been consulted.

6.1.2 It is the sole responsibility of the firm to ensure that continuity of coverage is maintained in accordance with the professional indemnity insurance requirement of RICS. A firm and/or its broker shall be and remain at all times responsible for maintaining continuity, by way of an extension to the existing policy, of insurance cover until the time of written notification by the managers confirming provisional admission to the ARP.

6.1.3 The managers have no duty or responsibility to the firm for insurance coverage prior to formal admission to the ARP and they have no powers to 'hold cover' pending completion of the admission formalities. Cover may be backdated however upon approval of the ARP panel.

6.1.4 Admission to the ARP for firms where the provision of surveying services are not a significant part of the firm's turnover will be at the sole discretion of the panel.

6.1.5 A firm where professional indemnity insurance cover has not been in place continuously before declinature or constructive declinature will be admitted to the pool only at the sole discretion of the panel.

6.2 On applying for provisional admission to the ARP the firm must:

a. Agree to submit to the panel, through the managers of the ARP, a proposal form, any supporting information (particularly from the existing insurer)as the panel or the managers might require and evidence of declinature from all prescribed listed insurers or evidence of constructive declinature

and

b. Sign the relevant documentation (generally this must be signed by a sole principal or two partners on behalf of a partnership or two directors on behalf of a company)

c. Pay to the managers, by banker's draft, or equivalent, a deposit premium of 200%of the expiring 'premium' pro-rata'd for three months of cover immediately upon acceptance to the AR P and agree to pa y, immediately upon request, the additional premium as will be determined by the panel, upon the completion of their investigations. Where there is no 'expiring premium 'the amount of the 'expiring premium 'shall be that determined by the panel

d. Agree to pay any excess under the policy whilst in the ARP. The excess shall be such amount as stated in the expiring policy or such other amounts as may be required by the panel upon completion of their investigations. Where there is no expiring policy the amount of the excess shall be as determined by the panel

e. Agree to submit a formal investigation and business review, at the firm's own expense, as required by the panel. The fee will be payable, by banker's draft, or equivalent, in advance of the review being undertaken

f. Agree to comply with the recommendations of the panel

g. Agree that their compliance record with RICS will be disclosed to the panel

h. Agree that the fact of the firm's presence in the ARP can be disclosed to interested third parties

Sections 6 to 9

Quality of cover

i. Agree to give 28 days' notice to the managers of any intention to resign from the ARP whether or not cover is available in the standard market.

The required information and the business review will all be completed during this three month provisional membership of the ARP.

6.3 The panel will meet towards the end of the three month period to consider the outcome of the business review and other investigations. Provided the firm has complied with the above conditions of en try, and has agreed to comply with an y panel recommendations, the panel will then formally accept the firm in to the ARP for a 12 month period. The firm will be required to pay the final premium, by bankers draft, or equivalent. In exceptional cases the three month period ma y be extended with the panel's agreement.

6.4 The procedure for admission is summarised at Appendix C.

6.5 While in the ARP a firm will be subject, at its own expense, to a compliance check regarding other RICS rules, the results of which will be made available to the panel.

6.6 The ARP will not pay any claim, or any part thereof, where any element of the relevant premium payable by the firm remains outstanding.

7. Quality of cover

7.1 The limit of indemnity within the AR P will be in accordance with that prescribed by the compulsory professional indemnity insurance regulations of the RICS subject to a maximum limit of indemnity of £500 000. This envisages that cover in the ARP will be in the 'aggregate' rather than on an 'each and every claim' basis. In all respects other than the limit of indemnity the panel will set the terms and conditions of the policy and the wording is likely to be less comprehensive than the wording of the RICS policy.

7.2 The panel may review the limit of indemnity within the ARP should the aggregate limit be eroded or extinguished by paid or outstanding claims whilst the firm is still within the ARP.

8. Resignations and departures

8.1 The principals in the firm who are members of RICS may not resign from or in any other way depart from the ARP without first giving the managers 28 days written notice of their intention to do so.

8.2 It will be at the complete discretion of the panel as to whether the cover in the ARP will continue beyond the notice period following notification of an intention to resign from the ARP.

9. Leaving the ARP

9.1 Subject to giving 28 days written notice, a firm must leave the ARP once it can demonstrate to the satisfaction of the managers that it is able to obtain insurance cover in the standard insurance market.

9.2 A firm 's length of stay in the ARP will be set by the panel and will initially be for up to 12 months from the date of admission.

9.3 A t the sole discretion of the panel this period might be extended f or a period of up to a further 12 months, which shall be the maximum extension available, making a total of up to two years in the ARP.

9.4 The panel will have absolute discretion to determine any entitlement to a return of premium upon resignation or departure from the ARP.

Sections 10 to 13

Guidance

10. Disciplinary action

10.1 Where a firm is unable to obtain professional indemnity insurance cover in the standard market after the expiry of its term in the ARP the principals in that firm will be subject to a disciplinary investigation by RICS under its professional indemnity insurance requirement.

10.2 For the a voidance of doubt whilst the presence of a firm in the ARP will not, of itself and in relation to its current professional indemnity insurance position, constitute a matter on which disciplinary action will be taken, this would not prevent RICS undertaking an investigation and disciplinary action in respect of other matters or, indeed investigating past breaches of the professional indemnity insurance requirement. Members will not therefore be immune from disciplinary action in respect of other alleged contraventions of RICS rules (see also section 2.9 above).

11. Guidance

11.1 Further guidance can be obtained, as necessary, from the following:

Mr Mark Southwell
Insurance Advisor
Professional Regulation and Consumer Protection RICS
Surveyor Court
Westwood Way
Coventry CV4 8JE

11.2 An action schedule on the various steps necessary in relation to the ARP setting out responsibilities for each step is attached at Appendix C to these guidance notes and rules of admission.

12. Listed insurers

12.1 A complete list of listed insurers is available on request from the compliance section, professional regulation and consumer protection.

13. Changes

13.1 The panel reserves the right to change these guidance notes and rules of admission at any time without prior notice subject to approval of the changes by the ethics , conduct and consumer protection committee. Firms who seek admission to the ARP will be notified of any revisions to the guidance notes and rules of admission and, following such notification, will be bound by them. The revisions, however, will not apply to firms already admitted to the ARP.

13.2 In the event that a matter is not covered by these guidance notes and rules of admission the panel shall have the ultimate discretion as to what action should be taken.

Appendix A

Assigned risk pool - rules of admission

A firm applying for admission to the assigned risk s pool must satisfy the following rules:

Rule 1 at least the following:
The firm must be a sole principal or have at least one partner/director who is a member of RICS. a. Agreeing to these rules

Rule 2
The firm must have either:

a. Been declined professional indemnity insurance cover by all the prescribed listed insurers (i.e. declinature)

or

b. Provide satisfactory evidence that it has been quoted a premium and/or terms such that its ability to carry on its business is jeopardised (i.e. constructive declinature)

c. And during the three month provisional membership of the ARP, obtain declinatures from all prescribed listed insurers (see Appendix D).

Note: in an y case where a firm wishes to rely upon 'constructive declinature', initially , the managers must be satisfied that the best terms available to the firm are, in the light of the information provided to the managers at that time, of such a degree as to constitute 'constructive declinature'. The firm will have the right to appeal to the panel against the manager's decision.

Rule 3
The firm must apply to the panel through the managers for admission to the assigned risk s pool. If evidence of declinature has been obtained, the firm must forward the relevant information immediately to the managers either direct or through the firm's brokers.

Rule 4

Before provisional admission to the ARP the firm*must sign a contract with the AR P managers undertaking at least the following:

a. Agreeing to these rules

b. Agreeing to meet any excess under the policy

c. Agreeing to have an investigation/business review by a person or persons appointed by the panel

*for the purposes of this rule, the following signatures will generally be acceptable:

i. A sole principal who is also a member of the RICS;
or

ii. Two partners in a partnership, at least one of whom is a member of the R ICS; or

iii. Two directors of a company, at least one of whom is a member of the RICS, on behalf of the other co-directors and the company; or

iv. Such other person as the managers in their absolute discretion shall determine.

d. Agreeing to pay by banker's draft or equivalent a fee as determined by the panel for the investigation/business review

e. Agreeing to notify the managers immediately if the firm is unable a t any time while applying f or admission to the ARP, or while in the ARP, to meet its financial obligations. Should such notice be received, it will be at the sole discretion of the panel as to whether continuing cover within the ARP will remain

f. Agreeing to comply with such recommendations as the panel shall from time to time decide

Appendix A Continued

Assigned risk pool-rules of admission

g. Agreeing that there will be full disclosure to the panel of the individual members disciplinary history and current compliance with RICS rules

h. Agreeing that the fact of the firm's presence in the ARP can be disclosed to interested third parties

and

i. Agreeing not to resign from the ARP without having obtained compliant cover within the ordinary insurance market and without first giving the managers 28 days notice of this intention

j. Agreeing not to resign from the RICS whilst applying for admission to the ARP and while in t he ARP.

*The signed contract must be accompanied by the deposit premium paid by banker's draft or equivalent (200%of expiring premium three months required for provisional admission. The rest to be paid for full acceptance into the ARP).

Rule 5
Any breach of the undertakings given by the firm or the giving of an y false or misleading in formation by the firm so as to gain admission to the AR P shall be a disciplinary of fence which will lead to action being taken by RICS and will lead to immediate cessation of ARP coverage, unless otherwise advised in writing, by the panel.

Rule 6
Subject to the undertakings referred to in rule four and subject also to rule seven, a firm may not leave the ARP without:

a. Being able to obtain qualifying insurance cover in the standard insurance market

and

b. Having discharged all its contractual obligations as described in these rules of admission

and

c. Having given 28 days' notice of its intention to leave the ARP.

Rule 7
A firm may remain in the ARP initially for a period of up to one y ear from the date of admission. This period may be extended for a further period or periods at the discretion of the panel but so that the maximum length of time in the ARP cannot exceed two y ears. If no extensions are granted then membership of the ARP will cease.

Rule 8
A firm may only remain in the ARP provided it is able to meet its ARP liabilities and financial obligations.

Rule 9
Notwithstanding that a firm leaves the ARP for whatever reason the individuals within the firm who are principals (i.e. sole principals, partners or directors or those held out to the public as such)will remain contractually bound to pay any outstanding amounts that may be or may become due as a result of its stay in the ARP.

Rule 10
When a member whose firm has been subject to the business review following provisional admission to the ARP, he shall be entitled to receive a copy of the report of the review if it leads to the rejection of his application.

Rule 11
All decisions of the panel will be binding on the firm in question.

A breach of an y of these rules will be grounds for expulsion from the ARP, and for disciplinary action to be taken by RICS.

Appendix B

Assigned risks pool panel

1. Composition and appointment

1.1 The assigned risks pool panel (the 'panel')is appointed by the governing council of the RICS, nominations having first been sought from listed insurers regarding their representation.

1.2 Members of the panel will generally serve for a three year period but will be eligible for re-appointment.

1.3 In the e vent that a member of the panel resigns from the panel the governing council or the officers of RICS will have power either to appoint a replacement to the panel or seek a further nomination from listed insurers. The person so co-opted or nominated will become a member of the panel and will serve for the remainder of the term of the person whom they have replaced.

1.4 The panel shall comprise:
°A chairman who will be appointed by RICS
°Persons who are RICS members
°Persons who are listed insurers.

A representative from the managers will attend but will not be a member of the panel.

2. Functions of the panel

2.1 In summary the functions of the panel will be:

a. To advise listed insurers about the nature of t he firms admitted to the ARP

b. To confirm the continuing status of the firm within the ARP or its exclusion if terms of entry are not complied with

c. To monitor firms 'progress within the ARP

d. To provide input into the business review and investigative process and advise listed insurers accordingly

e. To advise RICS on model terms within the 3.8 The panel will be supported by RICS staff.

ARP and interpret the rules of admission

f. To determine premiums, return premiums and other insurance terms and conditions.

2.2 The panel may delegate to the managers or to its nominated sub-contractor such of its functions as it considers appropriate.

2.3 If the panel is unable to reach agreement on the premium and/or other insurance terms , it shall adjourn until a future date which shall be at least five working days after the adjourned date.

3. Meetings, quorum and voting rights of the panel

3.1 The panel shall meet as and when required.

3.2 The panel shall appoint a vice chairman who is an RICS member to preside when the chairman is not present.

3.3 The panel may invite any person whom it believes is able to contribute to its decisions to attend a meeting to deal with an y particular case. Any person so invited will have no right to vote at meetings of the panel.

3.4 The quorum of the panel will be three persons and must include the chairman, or vice chairman plus one chartered surveyor and one insurance representative.

3.5 Decisions of the panel will be by a majority vote. When the votes are equally divided the chairman, or in his absence the vice chairman, will have a casting vote.

3.6 The panel ma y adjourn a t any time to enable it to obtain further information and may re-convene provided that at least five working days have elapsed.

3.7 The panel shall keep minutes of its deliberations and decisions.

Assigned risks pool panel

4. Powers of the panel

4.1 The powers of the panel will be as delegated acceptable risk to the insurance market once more to it by the governing council of RICS and may be amended from time to time.

4.2 The powers of the panel shall include the following:

a. To decide matters relating to firms admitted to the ARP

b. To confirm the continuing status of firms within the ARP or their exclusion, if terms of entry are not complied with

c. To monitor firms' during their period within the ARP

d. To require the firm to answer such questions in addition to matters covered in the proposal form as the panel considers appropriate and to invite the firm and/or its insurance or legal advisers to make such written representations as they may wish to the panel

e. To consider the compliance checklist prepared by the RICS in respect of the firm's compliance with RICS rules

f. To cause to be commissioned a business review, and any follow up visits, of the firm requesting admission. In the event of such a report having to be commissioned as a matter of urgency, the authority of the chairman or vice-chairman and two other members of the panel, at least one of whom must be a chartered surveyor will suffice

g. To decide the final premium to be paid by the firm admitted to the ARP and other terms and conditions;

h. To decide the appropriate level of cover and excess for the firm whilst in the ARP

i. To consider the recommendation of the business review and any representations made by the firm on that report

j. To make directions to the firm of those actions it considers the firm should take to become an acceptable risk to the insurance market once more

k. To decide any return of premium to the firm

l. To agree the period that a firm shall be in the A RP and any extensions to that period. The total period within the ARP must not exceed two years

m. To have reported to them all claims that arise during the period within the ARP

n. To decide whether firms in financial difficulties should continue to be covered within the ARP

o. To agree departures from the ARP

p. To advise the RICS on the terms of business of the managers and la y down such rules as the panel consider appropriate for the conduct of the ARP (remuneration of the managers will be decided by the professional indemnity insurance working party in consultation with the RICS members of the panel)

q. To review the limit of indemnity of the firm should the aggregate limit be eroded or extinguished by paid o r outstanding claims whilst the risk is still in the ARP

r. To monitor the progress and effectiveness of the ARP and to report annually to RICS, on the business conducted through the ARP

s. To monitor and approve any other matters as appropriate in relation to a firm's admission and stay in the ARP

t. To amend the guidance notes and rules of

admission as required, subject to the approval of the governing council.

5. ARP managers

5.1 ARP managers will be appointed by RICS to advise on insurance matters , to manage the ARP and to implement decisions made by the panel. The managers will, unless other wise determined by the panel, be entitled to attend and speak at all meetings of the panel but will not be entitled to vote.

Appendix C

Admission to the assigned risks pool

1. The procedure adopted is as follows: By whom

Action required

A. Firm or broker notifies assigned risks pool (ARP)managers that firm has been declined or claims **Firm/broker** to be 'constructively declined', and applies to ARP for admission.

B. Managers notify RICS of possible applicant. **Managers**

C. Firm to sign provisional contract and pay three month depositpremium for provisional admission. **Firm/broker**

D. Managers to consult at least two insurers on the panel to getapproval of firm's admission to ARP. **Managers**

E. ARP managers advise firm, directly or through firm's insurance broker (as appropriate), of **Managers** provisional admission to the ARP.

F. ARP managers confirm to RICS that firm has entered ARP. **Managers**

G. Firm obtains required declinatures and submits proposal form. **Firm**

H. Business review completed. **Secretariat**

I. Details sent to ARP panel for review and panel meeting convened **Secretariat**

J. Upon receipt of business review submit copies to the panel for discussion at a meeting and **Secretariat** for recommendations to be made.

K. At panel meeting decide final premium, excesses and length of time firm will be permitted **Panel** to remain in ARP.

L. Notify firm of panel's recommendations. **Secretariat**

M. Notify final insurance terms to firm/insurance broker. **Managers**

Appendix D to E

Prescribed listed insurers

Appendix D

Prescribed listed insurers

Trenwick Managing Agents -Syndicate 839 At Lloyd's
RJ Wallace &Others -Syndicate 683 At Lloyd's
AF Beazley &Others -Syndicate 683 At Lloyd's and/or
E&O Professionals
Aviva plc
Royal SunAlliance Insurance plc
Admiral Underwriting Agencies
Hiscox insurance Company plc
And as advised from time to time by the Institution

Appendix E

Guidelines to constructive declinature

1. A firm may be quoted premium or other terms which are un-affordable to the extent that they may jeopardise the immediate financial security of the firm. This may be regarded as 'constructive declinature'.

2. There can be no absolute definition of 'constructive declinature 'but the following guidelines are to be observed by listed insurers. In each case the final determination of 'constructive declinature will be made by the ARP panel consisting of four representatives of RICS and three leading underwriters.

3. A firm should not be required to:

a. Pay a premium which in the objective opinion of the member:

i. Exceeds its ability to pa y in full within six months of inception of the insurance

And/or

12 Assigned Risks Pool

ii. So affects the financial security of the firm as to jeopar dise its ability to carry on its business provided always that the premium and terms are, In the opinion of the managers in excess of contemporary market rates

b. Carry a self -insured excess which exceeds the maximum permissible under the terms of the compulsory professional indemnity insurance regulations and where no waiver has been granted.

4. Criteria for admission to the ARP on the grounds of 'constructive declinature' are that the premium and terms are, in the objective opinion of the member, such as may jeopardise the firm's ability to carry on its business as more fully described in (3) above.

5. Procedure for admission is as follows:

a. The premium and terms quoted must be disclosed to the managers, together with a written statement from the firm that, in the member's opinion the terms offered by the listed insurers constitutes declinature because to accept them would jeopardise the firm's ability to carry on its business

b. The firm must provide such documentary evidence as may reasonably be requested by the managers to support the claim for 'constructive declinature'

Note: RICS and/or the ARP managers, on behalf of ARP panel, may call for such supporting evidence as may be required to substantiate the claim made for 'constructive declinature' and have the right to refuse admission to the ARP if such supporting evidence is unreasonably refused.

c. Upon receipt of the information referred to above and upon satisfactory completion of the application for admission to the ARP and upon the ARP managers receiving the signed contract of acceptance terms of admission [which includes the immediate payment of a deposit premium as more fully described in the guidelines for admission to ARP] then the managers will confirm cover in accordance with the terms of admission of the ARP

Appendix E continued

Guidelines to constructive declinature

d. Pursuant to admission to the ARP, the panel will appoint a chartered accountant and a chartered surveyor to investigate and review the circumstances leading to admission to the ARP. The professional advisers will report to the ARP panel who will recommend such action as may be required to assist the firm in progressing towards eventually leaving the pool and obtaining insurance once again in the traditional market

e. The chartered accountant professional adviser will be required to confirm to the ARP panel that in his professional opinion the premium and terms quoted by insurers are such that they would prejudice the firm's ability to continue in business

f. All reasonable co-operation will be required from the member in assisting the advisers in forming their opinion

g. The decision of the ARP panel with regard to admission to the ARP, under the heading of 'constructive declinature will be final'.

This document should be read in conjunction with the full terms and conditions of entry to the ARP as set out in the guidelines and the contract for admission.

Appendix 7 - Rules of LawPro (Law Society of Upper Canada captive) in respect of conveyancing levy surcharge

Endorsement No. 2

Real Estate Transaction Levy Surcharge

This POLICY, subject to all its terms and conditions not in conflict with this Endorsement, and further to Part IV Condition D (i), shall include the following:

A. DEFINITION OF REAL ESTATE TRANSACTION

For the purposes of this rule, "real estate transaction" means a transaction that directly or indirectly results in the transfer, charging or insuring of title to land in Ontario, and shall include any one or more of the following services by a solicitor: the receipt of instructions, preparation of documents, searches and/or the providing of one or more opinions or certificates with respect to the title, transfer or charge, and/or with respect to the issuance of any title insurance policy.

B. LEVY SURCHARGE PAYABLE

(i) Subject to subparagraphs B(ii), (iii), and (iv), and any exclusions contained within this Endorsement, each member required pursuant to By-Law 16 of the *Law Society Act*, R.S.O. 1990, c.L.8, to pay a professional liability insurance PREMIUM levy, shall pay to The Law Society of Upper Canada $50 inclusive of taxes, in respect of each real estate transaction in which the member acted for one or more of the following parties, namely the transferor, transferee, chargee, chargor or the title insurer, in respect of either or both of the transferee and chargee.

(ii) Where more than one member from the same LAW FIRM acted on behalf of the same party on the same real estate transaction, only one member is required to pay the $50 levy surcharge.

(iii) Where more than one transfer, charge or title insurance policy is given by or received by the same party in respect of the same real estate transaction, the levy surcharge shall be limited to $50.

(iv) Where a real estate transaction involves more than one transferor, transferee, chargor, chargee, or one or more title insurer(s) and two or more of any of them are represented by different lawyers in different LAW FIRMS, each lawyer shall pay the levy surcharge of $50.

C. EXCLUSIONS

No levy surcharge is payable by a member under this Endorsement in respect of a real estate transaction if:

(i) a person transfers land to his or her spouse or to himself or herself and his or her spouse;

(ii) a person transfers land to any other person(s) in consideration of natural love and affection;

(iii) a body corporate transfers land to another body corporate of which it is an affiliate within the meaning of "affiliate" in the *Business Corporations Act* R.S.O. 1990, c.B.16, as amended from time to time;

(iv) a personal representative or its, his or her successor acting as an executor, administrator or trustee, transfers land to a beneficiary or to a successor personal representative; or

(v) the real estate transaction closes on or after January 1, 1998, and a title insurance policy(ies) is(are) issued in favour of all of the transferees and chargees obtaining an interest in or charge against the land which is the subject of the real estate transaction, provided that:

(a) the member does not act for the transferor in respect of the transaction;

(b) the title insurer(s) issuing the title insurance policy(ies) has(have) in all cases (except for the member's gross negligence or willful misconduct):

(i) agreed to indemnify and save harmless from and against any claims arising under the title insurance policy(ies); and

(ii) waived its right to maintain a negligence claim against;

the member(s) acting as solicitor(s) for the transferee(s), chargee(s) and/or the title insurer(s); and

(c) the member(s) is(are) not obliged to pay any deductible amount to the title insurer(s) in respect of one or more claims made under the title insurance policy(ies) where the deductible amount is or may be the subject of recovery under the POLICY.

D. FILINGS AND PAYMENTS

(i) The real estate transaction levy surcharges payable by a member under this endorsement shall be accumulated, remitted, and paid, with the corresponding Real Estate Transaction Summary Form, quarterly within thirty (30) days of the quarterly period ending on the last day of March, June, September and December. The 2003 Exemption Form from the Real Estate Transaction Levy Surcharge shall be due and remitted to the INSURER by April 30, 2003.

(ii) The levy surcharge imposed by this Endorsement applies to a member in respect of real estate transactions in which files are opened on or after January 1, 2003.

Endorsement No. 3

Civil Litigation Transaction Levy Surcharge

This POLICY, subject to all its terms and conditions not in conflict with this Endorsement, and further to Part IV Condition D (i), shall include the following:

A. DEFINITIONS OF CIVIL LITIGATION TRANSACTION

For the purposes of this Endorsement "civil litigation transaction" means:

(i) the commencement of a proceeding in Ontario by way of notice of action, statement of claim, originating process, application, petition, notice of appeal, a form prescribed by statute; or

(ii) the response to a commencement of a proceeding in Ontario by way of statement of defence, defences to third party or subsequent party claims, answers to petitions, a response to an originating process, or notice of appearance in response to an application.

B. LEVY SURCHARGE PAYABLE

(i) Subject to subparagraphs B(ii), (iii), and (iv) and any exclusions contained within this Endorsement, each member required pursuant to by-Law 16 of the *Law Society Act*, R.S.O. 1990, c.L.8, to pay a professional liability insurance premium levy, shall pay to The Law Society of Upper Canada $50 inclusive of taxes in respect of each civil litigation transaction in which the member acted for a party in a proceeding as defined in subparagraph A(i) or (ii).

(ii) Where more than one member from the same LAW FIRM acts on behalf of the same party on the same civil litigation transaction, only one member is required to pay the $50 levy surcharge.

(iii) Where more than one proceeding is commenced as per A(i) or responded to as per A(ii) by the same party to a civil litigation transaction, the levy surcharge shall be limited to $50.

(iv) Where a civil litigation transaction involves more than one claimant, defendant, or other party, and two or more of them are represented by different lawyers in different LAW FIRMS, each lawyer shall pay the levy surcharge of $50.

C. EXCLUSIONS

No levy surcharge is payable by a member pursuant to this Endorsement in respect of a civil litigation transaction if:

(i) proceedings are commenced in Small Claims Court;

(ii) proceedings are commenced pursuant to Residential Landlord and Tenant matters; or,

(iii) proceedings are funded by the Legal Aid Plan, Office of the Children's Lawyer/Office of the Official Guardian, the Public Trustee or the Family Support Plan.

D. FILINGS AND PAYMENT

(i) The civil litigation transaction levy surcharges payable by a member under this Endorsement shall be accumulated, remitted, and paid, with corresponding Civil Litigation Transaction Summary Form, quarterly within thirty (30) days of the quarterly period ending on the last day of March, June, September and December. The 2003 Exemption Form from the Civil Litigation Transaction Levy Surcharge shall be due and remitted to the INSURER by April 30, 2003.

(ii) The levy surcharge imposed by this Endorsement applies to a member in respect of civil litigation transactions in which files are opened on or after January 1, 2003.

Endorsement No. 4

Claims History / Levy Surcharge

This POLICY, subject to all its terms and conditions not in conflict with this Endorsement, and further to Part IV Condition D (i), shall include the following:

A claims history levy surcharge is payable by an INSURED in addition to the INSURED'S base levy and any other applicable surcharges in an amount as set out below:

(a) One CLAIM PAID in the last five years: $2,500

(b) Two CLAIMS PAID in the last five years: $5,000

(c) Three CLAIMS PAID in the last five years: $10,000

(d) Four CLAIMS PAID in the last five years: $15,000

(e) Five CLAIMS PAID in the last five years: $25,000

(f) Six CLAIMS PAID in the last five years: $35,000
plus $10,000 per CLAIM PAID in excess of six.

Endorsement No. 5

Innocent Party Coverage / Levy Surcharge

This POLICY, subject to all its terms and conditions not in conflict with this Endorsement, and further to Part I Coverages A and B as well as Part IV Condition D (i), shall include the following where so indicated in ITEM 8 of the INSURED'S Declarations:

A. COVERAGE

Subject to the SUBLIMIT OF LIABILITY, exclusions and other terms and conditions contained herein, any dishonest, fraudulent, criminal or malicious act or omission (hereinafter referred to as "OTHERWISE EXCLUDED ACT(S) OR OMISSION(S)") of an INSURED, or the INSURED'S vicarious liability for the OTHERWISE EXCLUDED ACTS OR OMISSIONS of others, arising out of the provision of PROFESSIONAL SERVICES for others, is deemed to be an "error, omission, or negligent act" as referred to in Part I Coverage A and throughout the POLICY, notwithstanding Part III Exclusion (a) of the POLICY.

(i) SUBLIMIT OF LIABILITY

The amount of coverage provided with respect to this endorsed coverage shall be as set out in ITEM 8 of the INSURED'S Declarations as the SUBLIMIT OF LIABILITY. For greater clarity, this SUBLIMIT OF LIABILITY is included within the LIMIT OF LIABILITY and AGGREGATE LIMIT OF LIABILITY of the INSURER, as set out in ITEMS 5 and 6 of the Declarations.

(ii) EXCLUSIONS

This endorsed coverage shall not apply to any CLAIM (or that part of any CLAIM) arising out of:

(i) those OTHERWISE EXCLUDED ACTS OR OMISSIONS which are actually committed by the INSURED prior to January 1, 1998, or such later date that this endorsement coverage first came into force with respect to that INSURED; or

(ii) those OTHERWISE EXCLUDED ACTS OR OMISSIONS of others of which the INSURED had actual knowledge prior to January 1, 1998, or such later date that this endorsement coverage first came into force with respect to that INSURED.

(III) NOTICE OF CLAIM AND WAIVER

In the event that the INSURED fails to give notice to the INSURER of a CLAIM or to cooperate with the INSURER in the investigation or defence of a CLAIM under this endorsed coverage, the INSURER agrees to waive its right to rely on the INSURED'S breach of POLICY condition for the purposes of this endorsed coverage. In either circumstance, the INSURER agrees to accept notice of such CLAIM under this endorsed coverage from the NAMED INSURED.

(IV) SUBROGATION

If the INSURER pays any part of any settlement or judgment arising directly or indirectly from any actual or alleged OTHERWISE EXCLUDED ACT OR OMISSION of an INSURED, the INSURER shall be subrogated to the CLAIMANT'S rights, including its right of action against that INSURED.

B. MANDATORY INNOCENT PARTY COVERAGE & LEVY SURCHARGE

Each INSURED, other than an INSURED acting as a SOLE PRACTITIONER who does not practise in circumstances where he or she is vicariously responsible for the acts or omissions of other lawyers with whom the INSURED practises, is required by The Law Society of Upper Canada to purchase innocent party SUBLIMIT OF LIABILITY coverage of $250,000 per CLAIM and in the aggregate and to pay the required Innocent Party Levy Surcharge in the amount of $250 per calendar year.

C. DEFINITIONS

For the purposes of this Endorsement only:

"CLAIMANT" means a person (or entity) who has or alleges to have suffered DAMAGES by reason of an INSURED'S OTHERWISE EXCLUDED ACTS OR OMISSIONS in the performance or failure to perform PROFESSIONAL SERVICES for others, where these OTHERWISE EXCLUDED ACTS OR OMISSIONS are alleged to be dishonest, fraudulent, criminal, or malicious.

To the extent that they do not conflict with this Endorsement, all other terms and conditions of the POLICY remain unchanged.

Appendix 8 - Details of Hong Kong Travel Industry Compensation Fund

Travel Industry Compensation Fund Management Board

The Travel Industry Compensation Fund Management Board (TICFMB) is a statutory body established under Section 32B of the Travel Agents Ordinance (TAO) (Cap.218). Its terms of reference are:

a. To hold, manage and apply the Fund in accordance with the provisions of the TAO

b. To provide ex gratia payment to outbound travellers who are aggrieved by the default of travel agents after their outbound fares have been paid, and to provide financial relief to outbound travellers who are injured or killed in accidents whilst touring abroad

c. To authorise the Travel Industry Council or any other person to require the payment of and to collect the Fund levy

d. To borrow money on such security or other terms and conditions as it considers expedient

e. To invest any money of the Fund in any investment authorised under the Trustee Ordinance (Cap.29) or approved by the Financial Secretary

f. To make rules in relation to the administration of the Fund

g. To arrange for the examination of the economy, efficiency and effectiveness with which the Travel Industry Council has used its resources if required by the Financial Secretary

Levy: The TAO requires that travel agents pay a percentage (currently 0.3%) of the outbound tour fares to the tief as Levy. The Levy is spilt into two parts: 0.15% as Council Levy. The Fund Levy goes to the tief while the Council Levy goes to Travel Industry Council of Hong Kong to help finance its self-regulatory efforts. As at 31 August 2003, the tief holds a reserve of about $352 million.

Ex gratia Payment in default case of travel agent: When a default case of travel agents occurs, outbound travellers holding tour receipts which show that Levy has been paid are entitled to an ex gratia payment. The maximum of such payment is 90% of the outbound package tour fare paid.

Package Tour Accident Contingency Fund Scheme: The scheme established on 16th February 1996 and is financed from the tief. It provides financial relief to outbound travellers who are injured or killed in accidents whilst touring abroad.

Appendix 9 - Qualifications and practice limitations – summary table not part of circulars

COMBINATION LIST ON JURISDICTIONS

	Firm	Lawyer	Work/Advice	PIS Cover
1	Hong Kong	Hong Kong Solicitor with no other overseas qualifications	Hong Kong Law & Law in other jurisdictions provided that they are competent°	Yes
2	Hong Kong	Hong Kong Solicitor with qualified overseas qualified	Hong Kong Law & Law in other jurisdictions provided that they are competent°	Yes
3	Hong Kong	Foreign Lawyer	Foreign Law but not Hong Kong Law	Yes
4	Foreign	Foreign Lawyer	Foreign Law but not Hong Kong Law	No
5	Foreign	Hong Kong Solicitor	Must surrender Hong Kong Practising Certificate in order to be registered as a Foreign Lawyer to practise Foreign Law (a rare situation)	No
6	Overseas Branch of Hong Kong Firm	Hong Kong Solicitor	Hong Kong Law*	No
7	Overseas Branch of Hong Kong Firm	Foreign Lawyer	Foreign Law*	No
8	Overseas Branch of Hong Kong Firm	Foreign Lawyer	Hong Kong Law	No
9	Overseas Branch of Hong Kong Firm	Foreign Lawyer	Foreign Law	No

Foreign Lawyer: Overseas qualified lawyer registered as a Foreign Lawyer with the Law Society
Hong Kong Solicitor: Solicitor admitted in Hong Kong

° See Circular 361/93(PA)
* See Circular 113/94(PA)

THE LAW SOCIETY OF HONG KONG
香港律師會
Practitioners Affairs
1403 - 1413 SWIRE HOUSE • 11 CHATER ROAD • CENTRAL • HONG KONG TELEPHONE: 846 0500 FAX: (852)845 0387

CIRCULAR 113/94 (PA) **28 March 1994**

PROFESSIONAL INDEMNITY SCHEME

In the concluding paragraph of Circular 361/93 (PA) members were asked to note that if they give advice on, or legal services in relation to non-Hong Kong law for which they are not competent and authorised to do, they will be treated by the Law Society as having committed a disciplinary offence.

A number of members have asked the Society to clarify what is meant by "competent and authorised".

The purpose of Circular 361/93 was to remove any uncertainty as to the limitations of the cover afforded to a solicitor's practice in respect of work undertaken by Hong Kong solicitors involving non-Hong Kong law. The Law Society does not wish to prevent Hong Kong solicitors advising their clients on non-Hong Kong law and, indeed, has encouraged them to expand their practices in this way. However it considered it appropriate in the context of that Circular to deliver a note of caution that those who venture into any area of work involving non-Hong Kong law should ensure that they are competent and authorised to do so.

In issuing the Circular the Council took the following view: -

A solicitor must not act or continue to act in circumstances where he cannot represent the client with competence and diligence. **Competence** in this context is not equated to formal qualification to practise law. It has to do with a solicitor's capability to handle the matter in question. It involves more than an understanding of legal principles: it demands an adequate knowledge of the practice and procedures by which such principles can be effectively applied and the ability to put such knowledge to practical effect.

A solicitor has a fundamental duty to act competently and promptly in carrying out any instructions from the client. He is therefore obliged to decline or cease to act when he has insufficient experience or skill to deal with the instructions.

However it does not prevent a solicitor from acting if he is able to do so competently by, for example, instructing suitable counsel or seeking advice from or collaborating with other lawyers or experts. Nevertheless if assistance is required a solicitor has a duty to select a competent person to assist and thereafter continues to be bound, ethically and legally, to exercise his independent judgment in the matter.

The word **"authorised"** was specifically included in the Circular when the matter was discussed by Council, because members considered that any solicitors in Hong Kong engaged in the transfer of real property in the People's Republic of China should only do so if authorised by the Ministry of Justice in China. No other form of authorisation was contemplated.

A solicitor who fails in his duty of competence may be prosecuted for misconduct. The adjudication will, of course, be an issue for the Disciplinary Tribunal.

THE LAW SOCIETY OF HONG KONG
香 港 律 師 會
Practitioners Affairs
1403 - 1413 SWIRE HOUSE • 11 CHATER ROAD • CENTRAL • HONG KONG TELEPHONE: 846 0500 FAX: (852)845 0387

CIRCULAR 361/93 (PA) **8 November 1993**

PROFESSIONAL INDEMNITY SCHEME

On 15th June 1993 by way of Circular 206/93(PA) the Law Society Council sought views from members on the question of PIS cover in respect of work undertaken by Hong Kong solicitors involving non-Hong Kong law and work undertaken outside Hong Kong. The Council is grateful for the views expressed by members.

Having considered these views carefully, the Council in conjunction with the PIS Manager, Essar Insurance Services Limited, has sought the views of underwriters and with their agreement sets out below Insurers' views on the extent of the relevant cover under the Scheme. It is important however that members note that the ultimate decision on cover in the event of a dispute will be determined by an arbitrator appointed to make such a ruling.

Subject to all the terms and conditions of the Solicitors (Professional Indemnity) Rules 1989 :

(1) cover will be provided where a partner or member of staff of the Hong Kong firm gives advice or undertakes work in Hong Kong which is governed by the laws of foreign jurisdictions, so long as that advice or work forms part of the firm's Hong Kong practice;

(2) subject to 3) below, cover will be provided for work undertaken outside Hong Kong by a partner or member of staff of a Hong Kong firm so long as any such work or advice forms part of the firm's Hong Kong practice;

(3) the Scheme does not provide cover in respect of practices "conducted wholly outside Hong Kong", including the following :-

.... / 2

a) a branch office of a Hong Kong firm outside Hong Kong;

b) an overseas practice of a Hong Kong firm, e.g. a practice wholly separate and independent from the Hong Kong firm which does not operate in Hong Kong but bears the same name as the Hong Kong firm;

c) an overseas office of a limited company opened by a Hong Kong firm providing consultancy services.

This is a statement of the cover which is currently in force and upon which the premiums payable by members have been based. The Council has decided that it would be inappropriate at this time to seek to restrict this cover. The Council's decision will be reviewed before each yearly renewal of the PIS cover and is likely to be affected by the record of claims relating to advice with an extra-territorial element as in (1) or (2) above. To date no such claims have been notified to the Scheme Managers.

The Council has noted the concern of some members about the impact of possible claims arising out of PRC conveyancing work, but is also conscious of the undesirability of discouraging the growth of international legal practices within Hong Kong firms. It is hoped that the course which has been adopted is the one which will be of most benefit to members overall.

Members should note that if they give advice on, or legal services in relation to, non-Hong Kong law for which they are not competent and authorized to do, they will be treated by the Law Society as having committed a disciplinary offence.

Appendix 10 - Conduct rule for the New Zealand Law Society

Rule 1.12

[New Zealand Law Society. *Rules of Professional Conduct for Barristers and Solicitors. 6th Edition,* incorporating amendments to 11 April, 2003]

1. A practitioner must accept legal responsibility for his or her actions. Subject to the following provisions, a practitioner must be prepared to meet any liability arising out of any act, error or omission in the course of the practitioner's professional duties or business. A practitioner shall not exclude by contract his or her liability to a client except as provided by this rule.

2. In order for a practitioner to take advantage of the provisions of is rute permitting limitation of liability the practitioner must:

   (i) have in full force and effect valid professional indemnity cover for civil liability (apart from fraud or dishonesty of the practitioner or any partner) arising in New Zealand out of any act, error or omission in the course of the practitioner's professional duties or business:

      (a) to a minimum of two million dollars ($2,000,000) per claim per sole practitioner or firm (or such other amount as the Council of the Society may from time to time prescribe); "the stipulated minimum cover"; and

      (b) with a deductible (if any) up to a maximum amount of twenty thousand dollars ($20,000) (or such other amount as shall from time to time be prescribed by the Council of the Society) per claim in respect of each sole practitioner or each partner in a firm; and

      (c) "providing cover for the fraud or dishonesty of employees to a minimum of $250,000 per claim per sole practitioner or firm (or such other amount as the Council of the Society may from time to time prescribe)", and

      (d) providing that all claims arising out of any one act, error or omission are deemed to be one claim; and

      (e) meeting any other terms of cover as may be stipulated from time to time by the Council of the Society.

   (ii) ensure that the policy effecting the professional indemnity cover is obtained through a sound and reliable brokerage;

   (iii) use his or her best endeavours to maintain such cover (with the original or some other insurer) for at least the stipulated minimum cover for at least 6 years from the date of the contract of limitation;

   (iv) ensure that the limitation of liability will not be in respect of an amount less than the stipulated minimum cover;

   (v) fully advise the client of all aspects of the contract of limitation including:

      (a) the actual level of the practitioner's professional indemnity cover or, alternatively, confirmation that the level extends to or exceeds the stipulated minimum cover; and

      (b) the minimum terms of cover otherwise required under this paragraph of this rule; and

(c) the practitioner's obligations under this rule.

(vi) ensure the client is aware of the provisions of paragraph (13) of the commentary to this rule.

3. A practitioner must be able, on inquiry by the council of a District Society:

(i) to demonstrate that any contract of limitation is fair and conscionable, having regard to the parties involved, the nature of the transactions and any other relevant circumstances, which were or ought reasonably to have been known or in contemplation when the contract was made;

(ii) to demonstrate that the practitioner took all reasonable steps to ensure that the client understood and accepted the terms of any contract of limitation;

(iii) to demonstrate that the practitioner's professional indemnity cover complies with the provisions of paragraph 2 of this rule.

Commentary

(1) The provisions of paragraph 2(i) of this rule represent only the minimum terms of cover, which the professional indemnity policy must have, for the purposes of this rule. The cover can, of course, be wider. Details of any additional terms of cover stipulated under paragraph 2 (i) (e) will be published, or can be obtained from the Executive Director of the Society.

(2) Although not essential for the purposes of this rule (unless the Council otherwise stipulates at any time), the Council recommends that the terms of cover should preferably include as well:

(i) Cover for innocent partners against liability arising from the fraud or dishonesty (actual or constructive) of their other partners;

(ii) Specific cover in respect of activities and functions commonly or sometimes fulfilled by practitioners such as services as directors, secretaries, trustees, executors, personal representatives, receivers, liquidators and officers of charities;

(iii) Cover in respect of past partners;

(iv) Provision for a minimum period of notice of 90 days for the exercise of any right of cancellation of the policy, whether by the insurer or the insured;

(v) Provision that non-disclosure or misrepresentation by the practitioner or anyone else in his or her firm in the insurance proposal will not invalidate the policy in respect of innocent persons not committing or condoning the same.

(3) The broker who arranges professional indemnity cover should preferably be a member of the Corporation of Insurance Brokers of New Zealand.

(4) Paragraph 2 (v) of this rule requires that a practitioner must advise the client of the level of his or her professional indemnity cover or provide confirmation that this extends to or exceeds the stipulated minimum cover required under the rule so that the client is aware of this in the context of any contract of limitation. The rule allows, of course, a higher limitation of liability than the minimum cover stipulated in paragraph 2(i)(a), and also allows a practitioner to have a higher level of limitation than the professional indemnity cover. On the other hand, the limitation of liability may be for an amount less than a practitioner's professional indemnity cover. However, in all cases a practitioner must otherwise have the minimum terms of cover stipulated in paragraph 2 (i) and make the appropriate disclosure. Paragraph 2(v) also requires the client to be fully informed as to

the terms of the rule generally. Accordingly, the client should be made aware of paragraph 2(iii) for instance. Paragraph 2(vi) requires that the client is made aware of paragraph (13) of this commentary.

(5) If a practitioner wishes to take advantage of the provisions of this rule, it is recommended that he or she obtains a certificate or a written confirmation from his or her brokers that the terms of cover of the policy comply with the terms of paragraph 2 (i). Specific, commonly excluded civil liabilities, (e.g. for a practitioner's trading debts or for loss or damage to property or for death or personal injury) would be acceptable.

(6) The level of the prescribed minimum amount of insurance cover required in order to render limitation of liability by contract ethically acceptable is an indication that the Council considers the element of risk in a transaction must be substantial or unusual before liability for that risk may be limited by contract. Limitation of liability would not normally be appropriate, for instance, for everyday conveyancing or domestic transactions. Where, however, the risks are substantial or unusual or the transaction is likely to be difficult or complex or one involving a large sum of money or high value of property, it may be unreasonable to expect a practitioner to be in a position where the personal assets of the practitioner and his or her spouse or family could be at risk, without the ability to limit that liability. It is also permissible for a practitioner to limit his or her liability on an on-going basis, covering a series of transactions or all transactions.

(7) The reference in paragraph 2(i) of this rule to the requirement that a practitioner must have in full force and effect valid professional indemnity cover for the minimum prescribed amount is intended to ensure that such cover is effective, that the practitioner genuinely believes this to be the case and that he or she has taken all reasonable steps to ensure that such cover will not be denied because of, for instance, material non-disclosure or misrepresentation or non-payment of the premium.

(8) The reference to the requirement that a practitioner must use his or her best endeavours to maintain such cover for at least 6 years, is intended to ensure that cover is available for any claim made during the usual contract/tort limitation period for a claim and that practitioners will maintain such cover, until there are genuine or special reasons precluding this. Such cases are likely to be rare and would have to be justified on inquiry by the Council of a District Society It is, however, obviously desirable that the cover be maintained for longer than 6 years, especially since the breach giving rise to a claim may not occur and so the relevant limitation period may not commence until an indeterminate time after the contract of limitation has been entered into. Practitioners should also be aware that professional indemnity cover is invariably on a "claims made" basis (i.e. the cover applies to claims notified during the period of the cover, not to when the default giving rise to the claim occurred). Practitioners should also ensure that their obligations under the rule continue to be properly fulfilled consequent upon a dissolution of the firm or the retirement of a partner. The cover need not be effected continuously with the same insurer throughout the period but any policy replacing a previously held policy must be fully retroactive. More than one insurer may be used.

(9) The rule is subject to the general law relating to contracts being voidable or unenforceable as being unfair or unconscionable. The general law relating to the lack of capacity on the part of a contracting party will also be applicable. The rule will also be subject to the general fiduciary obligations of practitioners. A practitioner should also be mindful of other statutory provisions, including in particular the Fair Trading Act 1986, which applies to the provision of services. Further, no limitation will be effective where there has been fraud or theft, or other material dishonesty on the part of the practitioner

(10)The terms of any contract of limitation of liability must be brought clearly to the attention of the client and fully understood and accepted. It would be preferable that they are confirmed in writing. If a practitioner has any doubt about the degree of understanding of the client or the appropriateness of any proposed limitation then the practitioner should see that the client is independently advised. It would be preferable that any such independent advice was appropriately recorded and the acceptance or otherwise of it

confirmed in writing. If such independent advice is offered to and declined by the client, again it would be preferable that this be confirmed in writing. The onus will be on a practitioner, on inquiry, to satisfy the Council of a District Society that the client properly understood and accepted the terms of any limitation of liability.

Accordingly, it is suggested that the terms of a contract of limitation should expressly include:

(i) the amount of the limitation of liability;

(ii) the level of the practitioner's professional indemnity cover which is in full force and effect, or confirmation that the cover extends to the required minimum;

(iii) confirmation by the practitioner that the terms of the cover otherwise comply with the requirements of paragraph 2(i) of this rule;

(iv) confirmation as to compliance with the practitioner's obligations, both present and future, under paragraph 2(ii) to (iv) inclusive of this rule;

(v) confirmation that the client understands and accepts the terms of the contract and, if appropriate, that the client has received or has had the opportunity of receiving independent advice about the contract;

(vi) confirmation that the client is aware of and accepts the provisions of paragraph (13) of the commentary to this rule.

It may of course, be appropriate for other matters to be provided for in the contract in any particular case.

(11) Nothing in this rule affects a practitioner's right to seek to limit his or her liability to persons who are not clients.

(12) This rule is not designed to affect the normal ability of a practitioner to qualify any advice or opinion given on a particular matter such that it is made clear that the practitioner is not unreservedly accepting or cannot accept responsibility for the advice or opinion. That may be appropriate, for instance, where the relative law is genuinely uncertain or complex or where there may be unknown material facts.

(13) It should be clearly understood that neither the Society nor any District Society shall be liable for any matter relating to or arising out of this rule or commentary, whether in respect of any contract of limitation or professional indemnity policy or otherwise."

[This Rule 1.12 was adopted by NZLS Council resolution on 27 July 1990 and came into effect on 1 September 1990. It now incorporates the subsequent amendments made by NZLS Council resolution on 3 November 1995 which came into effect on 1 January 1996.]

Appendix 11 - Extract from New Zealand Government Bill (Lawyers and Conveyancers) relating to Professional Indemnity

Clause 86

(1) The New Zealand Law Society and the New Zealand Society of Conveyancers must each have practice rules concerning the indemnity of practitioners or any class of practitioners or any incorporated firms or any class of incorporated firms against claims made against them in respect of anything done or omitted by them in their professional capacity.

(2) Practice rules made under subsection (1)—

(a) may authorise the New Zealand Law Society or the New Zealand Society of Conveyancers or both to establish or maintain a fund or funds:

(b) may authorise or require the New Zealand Law Society or the New Zealand Society of Conveyancers or both to take out and maintain insurance:

(c) may require practitioners or any class of practitioners or incorporated firms or any class of incorporated firms to hold professional indemnity insurance:

(d) may require that professional indemnity insurance held for the purposes of paragraph (c) be held only with insurers approved by the New Zealand Law Society or the New Zealand Society of Conveyancers, as the case may require.

(3) Without prejudice to the generality of subsections (1) and (2), practice rules made under the provisions of those subsections---

(a) may specify the terms and conditions upon which indemnity is to be available, and any circumstances in which the right to it is to be excluded or modified:

(b) may provide for the management, administration, and protection of any fund maintained by virtue of subsection (2)(a) and require practitioners or any class of practitioners or incorporated firms or any class of incorporated firms to make payments to any such fund:

(c) may require practitioners or any class of practitioners or incorporated firms or any class of incorporated firms to make payments by way of premium on any insurance policy maintained by the New Zealand Law Society or the New Zealand Society of Conveyancers by virtue of subsection (2)(b):

(d) may specify the minimum terms and conditions that an insurance policy must satisfy for the purposes of subsection (2)(c):

(e) may specify circumstances in which practitioners or any class of practitioners or incorporated firms or any class of incorporated firms are exempt from the rules or any provision of them:

(f) may empower the New Zealand Law Society or the New Zealand Society of Conveyancers or both to take steps to ascertain whether the rules are being complied with:

(g) may make such incidental, procedural, or supplementary provisions as are necessary to give full effect to subsections (1) and (2).

(4) The New Zealand Law Society and the New Zealand Society of Conveyancers each have power to carry into effect any arrangements that it considers necessary or expedient for the purpose of indemnity under this section.
Compare: 1982 No 123 s 17(3), (4)(a), (b), (c), (h), (i), (j); Solicitors Act 1974 (UK) s 37(1), (2), (3)(a), (b), (c), (d), (g), (h), (i), (5)