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Our Ref: BY/G/0005-PIS

Your Ref:

9th June 2004Mr. Robert Allcock
Solicitor General
Department of Justice
1st and 4th Floors, High Block
Queensway Government Offices
66 Queensway
Hong Kong**URGENT**
BY HAND*Dear Bob,***Re : Review of Solicitors Professional Indemnity Scheme (PIS)**

I find it disappointing that the Legal Policy Division of the Department of Justice has taken the view that neither schemes proposed, not even MPS, is acceptable unless they are backed up by a mechanism such as a policyholders' protection fund or "insurance on insurance".

While "insurance on insurance" may appear to be one possible back up, it will not be so when one takes into account the high insurance cost. Such cost will be part of solicitors' operating cost and will be, and quite rightly so, passed on to clients. Is it really necessary to inflate the cost of legal services with this type of insurance?

What "insurance on insurance" achieves is, in reality, a further spreading of risk. In my submission, the spreading of risk is already built in to the MPS now being proposed for the following reasons :-

1. In the proposed MPS, there will be 3 or 4 co-insurers ("the Direct Insurers") (there cannot be too many because, if so, large insurance company will not find the business attractive).

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2. Under the Insurance Companies Ordinance, the Direct Insurers have to maintain adequate reinsurance and this is monitored closely by the Insurance Authority.
3. Following the insolvency of the HIH Group, the Insurance Authority has tightened the control on reinsurance with related companies (which was one of the main causes of the liquidation of the HIH's Hong Kong subsidiary) and they have on 30th June 2003 published the "Guidance Note on Reinsurance with Related Companies" limiting the percentage of risk which a Direct Insurer can reinsure with related companies.

In my view, these are already sufficient measures to ensure the spreading of risk. If they are still considered inadequate, I suggest all parties to sit down and work out how to improve **within** the MPS rather than spending time and resources on exploring impractical things like "insurance on insurance". The following additional measures may be considered :-

1. Limiting the largest single share of a participating Direct co-insurer to, say, 30% or 40% (too small a share will disinterest large companies). To limit the risk associated with the share being increased through mergers, it can be made a condition of the Master Policy that if one co-insurer merges with another co-insurer such co-insurers should prove to the satisfaction of the Law Society that there is in place sufficient security by way of reinsurance or otherwise. These companies shall, upon the reasonable request of the Law Society, arrange at their own cost such additional security as the Law Society may reasonably require.
2. Stipulating a certain credit rating for participating insurers and their reinsurers.
3. Requiring the incorporation of a "cut-through" clause as a term of reinsurance. The effect of this clause is that in the event of a liquidation of a Direct Insurer, the reinsurer shall pay the claim to the insured direct instead of to the liquidator so that the payment will not be shared by other creditors.

I am sure that there are many other measures which can further improve on the protection afforded by MPS. However, it will not be desirable for the Government to set conditions in a rigid way. Such conditions have to be practical and reasonably achievable. It can be left to the profession to negotiate the best deal with insurers. It is clear that it is also in the interest of our profession to obtain terms which afford the best protection. The interests of the public and the profession do not conflict.

I find it difficult to understand the logic behind insisting solicitors to act as insurers of last resort by retaining the present scheme. Solicitors were in the first place required to effect compulsory insurance because they cannot be trusted to be financially able to satisfy claims by clients. Insurance Companies are then not trusted

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to be able to provide adequate protection because they may become insolvent so that the burden goes back to solicitors whose financial ability are in doubt in the first place to insure against the insolvency of insurers. Where will all these end?

The Government may say that they do not trust the financial ability of individual solicitors but they trust the collective financial abilities of solicitors. But this goes back to the crux of the injustices :-

- Why should a solicitor be liable for another solicitor's fault?
- Why should a person new to the profession be liable to contribute to pay claims for others which arose from mistakes made by others before he has even joined the profession?

Finally, I also attach herewith a plea for the abolition of SIF. I hope that you can find time to read it.

Yours sincerely



BENNY YEUNG

BY/kmc

Encl.

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c.c. The Honourable Margaret Ng

Mr. Michael Lintern-Smith, President of The Law Society of Hong Kong
Council Members of The Law Society of Hong Kong

Mr. Patrick Moss, Secretary General of The Law Society of Hong Kong

Mr. Chris Howse

PIS Action Group

Plea for the Abolition of SIF

1. The present mutual scheme was not introduced for the purpose of giving further protection to the public. It was introduced at a time when the professional indemnity insurance market was hard against insureds. The premium on the Master Policy had been rocketing because of the bad claims experience and it was expected that it would continue to rocket if something was not done then. It was thought that insurance premium could be reduced by the setting up of a fund which retains liability in the amount of \$1 million (subsequently increased to \$1.5 million) before placing insurance for the balance.
2. It was marketed to the members on the above basis together with an additional ground i.e. the better participation in claims handling through claims monitoring.
3. It is correct that the protection of the public was one of the reasons given when compulsory insurance was introduced in 1980. However, the switch to the mutual scheme was for the reasons already stated and **it was not motivated by public protection.** The public already had protection under the Master Policy Scheme. **Nobody – the Government, the Law Society, its members or Legislative Councillors - can say with hand on heart that the mutual scheme was introduced because they had in mind the collapse of insurance companies.** In other words, the collapse of the HIH and the substantial shortfall was not in the mind of anybody when they introduced or approved the scheme. While the Solicitors Professional Indemnity Rules provides for the power to call for additional contributions in respect of shortfall, **it was never intended to mean shortfall created by the collapse of insurers.**

4. It is now realized that **something not anticipated by the Rules have occurred**. The question for the Legco to decide is whether they should allow that to continue or whether they should right the wrong.
5. I think that most of us practitioners do not disagree with the Administration that our clients should be adequately protected by insurance arrangements. **We support adequate protection but not absolute protection**. The present mutual scheme has not only made solicitors co-insurers with other solicitors (whom they have no control or influence over) in respect of their professional liabilities but have also, unintentionally, turned solicitors as co-insurers to provide "insurance on insurance" i.e. insurance against the insolvency of professional indemnity insurance companies. Is this fair? Do you think that there is a wrong here that we should right?
6. The decision on the extent of protection to the public always involves a balancing exercise - a balance between the protection and the cost therefor. Compulsory insurance already provides adequate insurance to the public. Extension of the protection beyond compulsory insurance to protect against insolvency of insurance companies and insolvency of solicitors is excessive protection. This is a luxury. The profession has been asked to pay too high a price to provide unlimited cover (\$1.5 million per claim x an unlimited number of claims = unlimited liability) -- this is too costly, solicitors simply cannot afford it. This affects their livelihood. It will have a long term adverse effect on the legal system if good people are forced out of the solicitors profession.

Supposing that I suggest that all motor vehicle owners shall be made jointly liable to pay claims which are not met because of a collapse of certain motor insurers, will you think that I am out of my mind?

7. Towards the end of 2001, direct insurance companies threatened to withdraw from the Hong Kong employees' compensation market altogether because reinsurers have refused, upon the renewal of employees' compensation treaties, to accept retrocession of liabilities in respect of terrorism (which liabilities the Government insisted should form part of the compulsory employees' compensation insurance).
8. How did the Government solve the problem? The Government set up a \$10 billion facility to cover such risk and signed an "Agreement for Provision of Facility" with Insurers in January 2002.
9. If the Government thinks that the public ought to have the luxury of protection against the collapse of insurance companies, the Government should not simply leave the burden with solicitors who clearly are not qualified to shoulder such risk.
10. We are not asking the Government to put up funds. All we ask of the Government is not to create a stumbling block to delay the righting of the wrong by insisting on changing the rules only after the establishment of PPF or some other mechanism to protect against insolvency of insurers.
11. The Commissioner of Insurance has now commissioned Price Waterhouse to carry out a consultation on the setting up of a general PPF. If this goes ahead, it will cover professional indemnity insurance. Why then bother to have our own PPF?

12. The abolition of the scale fees has totally upset the basis of the collection of indemnity contributions in that conveyancing work which, acceptedly, generates more claims and is thus classified as high risk work but attracts small contributions because of the cheap fees charged so that the contribution (or premium in the context of MPS) are not proportionate to the risk. It is indeed irresponsible of the Government not to change the contribution pattern when scale fees was abolished. It is also irresponsible not to change the rules and abolish the mutual scheme now when such scheme has proven to have produced liabilities not anticipated when the rules were enacted.
13. It is easy to decide to maintain the status quo. However, it requires courage to change, the courage to right the wrong.

Date : 9th June 2004

BY/G/0005-PIS/M0001

法律政策專員辦公室
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10 June 2004

By fax : 2810 5559 & By Post

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Dear *Benny,*

Review of Solicitors Professional Indemnity Scheme (PIS)

Many thanks for your letter of 9 June 2004 and its attachment, both of which I have read with interest.

If I may say so, you have raised some thoughtful points. This department will certainly consider them as this exercise moves forward. At the moment, we are awaiting the Law Society's further comments on the possibility of establishing "insurance on insurance."

Please be assured that this department is aware of the burden that has fallen on the solicitors profession in the aftermath of the HIH collapse.

With best wishes,

Yours sincerely,

(Bob Allcock)
Solicitor General

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