THE LAW SOCIETY OF HONG KONG
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# THE LAW SOCIETY OF HONG KONG

Following the adjournment of the Extraordinary General Meeting of the Society on 21 April 2004, the Law Society Council wishes to obtain the views of members of the profession on the preferred structure of the future Professional Indemnity Scheme. It is seeking a clear direction from the profession as to the type of future scheme which would be acceptable to the majority of members. The Council will then conduct detailed discussions with the Administration, the Legislative Council and potential insurers in relation to the preferred scheme and will revert to members with the outcome of those discussions for formal resolution.

Members are therefore requested to answer the following questions by fax to 2877 2069 or by post to the Law Society (marked for the attention of the Secretary General) not later than **30 June 2004.** The short time period is necessary in view of the need to settle within the course of this year the new insurance arrangements and any required changes to the Solicitors (Professional Indemnity) Rules) ("Rules"). A brief explanation of the alternative schemes and the advantages and disadvantages of each is attached.

1. Please number in order of preference the form you wish the future Professional Indemnity Scheme to take (with no.1 being the most preferred and no.3 being the least preferred):

☐ Solicitors Indemnity Fund Scheme (the current scheme)

☐ Master Policy Scheme

☐ Qualifying Insurers Scheme

2. How important is it that the Professional Indemnity Scheme is structured so that solicitors have no future mutual liability for negligence claims:

☐ Fundamental

☐ Preferable

☐ Not important

3. Are you prepared to accept a degree of liability in respect of claims made by fellow practitioners if this will achieve the objective of changing the current Solicitors Indemnity Fund Scheme?

☐ Yes

☐ No

**My particulars are as follows :**

**Name :** ______________________________

**Firm :** ______________________________

**Tel :** ____________________ **Fax :** ____________________

**E-mail :** ______________________________

## EXPLANATORY NOTE

## DESCRIPTION OF MAIN ELEMENTS OF ALTERNATIVE SCHEMES

### Solicitors Indemnity Fund Scheme ("SIFS")

- A mutual fund is established by contributions from members. The fund has primary liability to its members for HK$10,000,000 for each and every claim (inclusive of the insured's deductible) ("SIF Maximum Liability").

- The mutual fund:

  - retains all its liability for HK$1,500,000 for each and every claim (net of the insured's deductible) ("SIF Retained Level") and may take out stop loss insurance which limits the total aggregate amount payable at the SIF Retained Level (if this is commercially available); and

  - reinsures its liability for HK$8,500,000 for each and every claim with one or more insurers ("SIF Reinsured Liability").

- A percentage of the SIF Reinsured Liability is assumed by each of the insurers to a total collectively of 100% of the difference between the SIF Retained Level and HK$10,000,000. The insurers are not jointly and severally liable for the SIF Reinsured Liability so each is only liable for its specified share.

- In the event of insurer failure, either of an SIF Reinsured Liability insurer or a stop loss insurer, the mutual fund has primary liability for the amount that would have been covered by that insurer.

- The detailed operation of the current SIFS may be subject to amendments to the current Rules in terms of the SIF Retained Level, the division of contributions in accordance with the formula, the amount of deductibles, the treatment of specific risks such as conveyancing, and other matters.

### Master Policy Scheme ("MPS")

- A Master Policy Agreement is entered into between the Law Society on behalf of all practising members and a minimum of three insurers for HK$10,000,000 for each and every claim less the MPS Retained Level, if any (see below). The Master Policy premium is paid for by contributions from members.

- A mutual fund may be established by contributions from members. Any such fund would only have liability to its members for any agreed level of retained mutual liability ("MPS Retained Level") (which it is proposed should not exceed HK$1,500,000). There is no mandatory MPS Retained Level as this would only be agreed if it is commercially required or desirable.

- A percentage of the insured liability is assumed by each of the Master Policy insurers to a total collectively of 100% of the difference between any agreed MPS Retained Level and HK$10,000,000. The insurers are not jointly and severally liable so each is only liable for its specified share.

- In the event of insurer failure, members of the profession do not have any liability as insurers of last resort for the amount that would have been covered by that insurer. The responsible solicitor will however be solely liable for that amount left uncovered by the failed insurer. If a mutual fund has been set up by the members to cover the MPS Retained Level, then members will only be liable as insurers of last resort if any deficit arises in that fund.

- The detailed operation of the current SIFS will be subject to significant amendments to the current Rules in terms of mutuality, any MPS Retained Level, the division of contributions, the amount of deductibles, the treatment of specific risks such as conveyancing, and other matters.

**Qualifying Insurers Scheme ("QIS")**

- Minimum terms of insurance and qualifying insurers ("Qualifying Insurers") (which may potentially include insurers of specific risks such as conveyancing) are determined by the Law Society.

- Each individual law firm obtains insurance by direct negotiation with qualifying insurers.

- If a firm cannot obtain insurance from a Qualifying Insurer, it will be placed in an "Assigned Risks Pool" whereby all Qualifying Insurers agree to insure jointly such firms. If a firm is still within the Assigned Risk Pool within a specified time, expected to be 2 years, then that firm will no longer be insurable and must cease practice.

- The detailed operation of a QIS will be subject to new Rules.

**COMMENTS ON ADVANTAGES AND DISADVANTAGES OF ALTERNATIVE SCHEMES**

**SIF and MPS**

The following comments are applicable to both the SIFS and an MPS:

- Insurance will be available for all firms irrespective of past claims experience.

- "Market power" is given to the profession to purchase insurance cover for all firms because of the large premium pool.

- Certain high risk areas of work may be taken into account when setting the contribution formula. This may take the form of:

- Increases of the deductible

- Increased contributions for certain work areas

- Increased contributions for firms making claims

Firms practising in high risk areas may have to pay higher contributions. They may also have higher indirect costs if the deductible is increased. The Willis Report suggested such areas of practice are primarily conveyancing and civil litigation.

**SIFS**

- Members will be able to look to the mutual fund for coverage up to the SIF Maximum Liability.

- Claims are handled at the direction of the Law Society Claims Committee which consists of fellow practitioners rather than insurers with a commercial interest in the outcome of a claim.

- Risk is retained within the profession in the event of a failure of an insurer or a large number of claims within the SIF Retained Level.

- The Law Society may in future be required to make calls for further contributions (beyond the basic contributions) to cover any actual or anticipated deficit in the fund in providing cover up to the SIF Maximum Liability.

**MPS**

- Members will only be able to look to any mutual fund for coverage up to a maximum of any MPS Retained Level.

- Claims may not be handled at the direction of the Law Society Claims Committee but may be dealt with by commercial insurers.

- In the event of failure of an insurer for any amount of a claim exceeding the MPS Retained Level the risk will pass from the fund as at present to the solicitors against whom the claim is made for that proportion of the claim for which the insolvent insurer is liable and thence to the claimant if the solicitors cannot pay.

- The Law Society may in future seek to make calls for further contributions (beyond the basic contributions) to cover any actual or anticipated deficit in any mutual fund in providing cover up to the MPS Retained Level.

**QIS**

- Solicitors will no longer be mutually liable for negligence claims. Risk of insurer failure and numerous claims is transferred entirely outside the profession to the insurance market although insurance is normally offered on an annual basis and therefore continuity of cover and predictability of premium costs will depend upon the market at the relevant time.

- Individual firms' freedom of choice would be maximised and as insurers could compete for firms' business within the parameters set by the Law Society for accreditation as a Qualifying Insurer.

- Each firm would be entitled to negotiate its own insurance cover in an amount not less than HK$10,000,000 each and every claim from any of the Qualifying Insurers. Assuming that a Qualifying Insurer is prepared to provide insurance cover, the premium that each firm would be charged would depend upon a range of relevant factors such as the claims record, risk profile, areas of practice and risk management systems rather than having to follow a formula set by rules.

- Firms with a poor claims record may have more difficulty in negotiating satisfactory terms with Qualifying Insurers; conversely, firms with a good or no claims record are likely to find it easier to do so.

- Depending on the type and size of the Qualifying Insurers approached, larger firms may find it easier than smaller firms to negotiate satisfactory insurance arrangements due to their stronger bargaining position and/or their ability to arrange for their excess insurers to cover the required insurance. Smaller firms may face particular difficulties in a hard insurance market.

- In any event, for many firms insurance from a Qualifying Insurer may cost more than insurance under the existing SIFS.

- Law firms who are unable to obtain insurance at all from a Qualifying Insurer would be placed in an Assigned Risks Pool. This may be because of practice area, perceived risk or the state of the insurance market at the time. Premium costs within any Assigned Risk Pool may be expected to be in the region of 25-30% of gross fee income. If a firm is still within the Assigned Risk Pool within a specified time, expected to be 2 years, then that firm will no longer be insurable and must cease practice.

- There is a possibility that the premium pool in Hong Kong will not be sufficiently large to attract enough Qualifying Insurers. Even if there are sufficient they may not wish to participate if they are required to accept liability for less attractive risks in an Assigned Risk Pool. In this case, the proposed scheme would need to be restructured without an Assigned Risk Pool in which case firms unable to obtain insurance would be unable to practise.

- In the event of the failure of a Qualifying Insurer, any firm insured by that Qualifying Insurer would be liable for the full amount of any and all claims made against that firm.

**NOTE**

1. The Administration will have to be persuaded by the Law Society whichever alternative the members choose.

2. The Administration has stated that neither the MPS nor QIS options would be acceptable unless backed by either a Policyholders Protection Fund ("PPF") or insurance against the failure of an insurer under the MPS or QIS. Enquiries are in hand to ascertain whether "insurance on insurance" is available and economically viable. The Administration has said that a PPF will not be established in Hong Kong for several years and accepts that a PPF exclusively for solicitors is impractical.

3. Whichever alternative members choose, it will only address the position after the current arrangements expire, in September 2005. Existing claims would still have to be dealt with in accordance with the existing regulations.

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