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**Panel on Administration of Justice and Legal Services**

**Background brief prepared by Legislative Council Secretariat**

**Professional Indemnity Scheme of the  
Law Society of Hong Kong**

**Purpose**

This paper highlights the past discussions of Members of the Legislative Council (LegCo) on the Solicitors Professional Indemnity Scheme of the Law Society of Hong Kong (the Scheme).

**Background**

The Scheme

2. The Scheme is a mandatory scheme which provides indemnity against negligence claims made by the public against members of the Law Society. In accordance with the requirements of the Legal Practitioners Ordinance (Cap. 159), a Solicitors Indemnity Fund (SIF) was established and maintained by the Council of the Law Society for administering the indemnity scheme.

3. Previously, the Scheme had a three-year reinsurance programme expiring on 30 September 2001. Under the Scheme, SIF provided indemnity cover to all members of the Society, up to a limit of \$10 million for each and every claim. Of this amount, SIF retained the first \$1 million of every claim and reinsured the remaining \$9 million.

4. In view of the substantial increase in claims payments, the Law Society commissioned a benchmarking exercise in April 2000, which predicted an enormous reinsurance premium increase after 30 September 2001. At a forum attended by members of the Law Society in September 2000 to discuss the options available, the decision was taken to cancel the three-year programme and re-write a five-year programme which allowed an increase in reinsurance premium phased in over a period of five years on a progressive basis. The five-year programme commenced on 1 October 2000.

5. However, the new reinsurance programme required an increase in SIF's retention for the self-insured layer from \$1 million to \$1.5 million per claim from 1 October 2001 to 30 September 2005. Based on projections made by actuaries, the costs of the premium and SIF's retention over the five years were found to have exceeded the income which SIF could have received from members' contributions based on the then existing contribution assessment formula. It was therefore necessary to amend the formula to raise the amount of contributions from the membership of the Law Society sufficient to administer the total coverage.

Solicitors (Professional Indemnity) (Amendment) Rules 2001 (The Amendment Rules)

6. Under sections 73 and 73A of the Legal Practitioners Ordinance, the Council of the Law Society is empowered to make rules concerning professional indemnity insurance for solicitors in Hong Kong with the prior approval of the Chief Justice.

7. The Amendment Rules were tabled in LegCo on 11 July 2001 and came into operation on 1 October 2001. A major object of the Amendment Rules was to amend the Solicitors (Professional Indemnity) Rules (Cap. 159 sub.leg.) to increase the contributions to SIF by 150%. A subcommittee was formed by the House Committee to study the Amendment Rules.

8. The subcommittee noted the concerns expressed by the profession about the marked increase in contributions. Many solicitors firms, particularly the smaller firms operating with marginal profits, feared that under the poor market conditions they would be forced out of business because of inability to pay the contributions. As many solicitors requested the Law Society to conduct an immediate and independent review of the existing Scheme with a view to adjusting or replacing it with other alternative schemes, the subcommittee had asked the Law Society to undertake such a review and consult the membership on the way forward in the light of the recommendations of the review, and to report to LegCo on the progress in due course.

9. The Law Society agreed that it would carry out a review and consider whether at the expiry of the five-year reinsurance contract the Society should maintain the existing mutual Scheme with or without amendment, or to demutualise the Scheme and put into effect such other options as might be proposed as a result of the review. In a letter dated 22 October 2001 to the subcommittee, the President of the Law Society assured that it would seek a mandate from its members to conduct expeditiously an independent review, and would inform LegCo of the progress of the review on or before 30 September 2003. Any recommended arrangements would have to be acceptable to its members, approved by the Chief Justice and transformed into amendments to the statutory rules to be approved by LegCo before the expiry of the five-year contract at the end of September 2005.

10. While the subcommittee agreed to support the Amendment Rules, it had recommended that the review of the Scheme should be followed up by the Panel on Administration of Justice and Legal Services (AJLS Panel).

## **Discussions of the AJLS Panel**

### Review Report on Insurance Arrangements of the Hong Kong Solicitors Indemnity Scheme prepared by Willis China (Hong Kong) Limited (the Willis Report)

11. The Willis Report provided by the Law Society was discussed by the AJLS Panel at its meetings on 18 December 2003, 26 April and 14 June 2004. According to the Law Society, the purpose of the review was to re-examine the current insurance arrangements and report on what arrangements were in the best interests of the legal profession and the public, having investigated into the problems with the existing professional indemnity scheme for solicitors in Hong Kong. In its consideration of the Report, the Panel had discussed with representatives from the Law Society, the Administration and the Professional Indemnity Scheme Action Group (the PIS Action Group), and considered the written submissions received from individual solicitors and solicitors firms on the indemnity scheme.

12. The major findings and recommendations of the Willis Report are summarised as follows –

- (a) solicitors were generally dissatisfied with the existing Scheme under which solicitors were made the insurers of last resort for each other in the event of failure of the insurer, as in the case of the collapse of the HIH Group. The arrangements were considered unfair, giving rise to grave problems as solicitors were required to meet calls for extra contributions to SIF to make up for any deficit of the fund. The issue about balance of risk between solicitors who were responsible for the negligence claims and solicitors who were not should be addressed;
- (b) the Willis Report had looked at possibilities of adopting different types of schemes and altering the current arrangements, so that in the event of insurer failure the liability would not fall on members of the profession as a whole. Such new arrangements, however, represented a fundamental and significant policy change and would involve legislative amendments for implementation;
- (c) two major schemes alternative to the existing Scheme were proposed, i.e. a Master Policy Scheme (MPS) and a Qualifying Insurers Scheme (QIS). The features of the two alternative schemes are highlighted in paragraphs 14 and 15 below; and
- (d) the Willis Report also proposed risk banding so that solicitors who practised in areas of law that could more likely result in claims should contribute more, as well as increased claims loading for firms making claims.

Law Society's consultation with its membership

13. The Law Society informed the Panel of the progress of consultation with its members on the way forward for the Scheme as follows –

- (a) following the adjournment of an Extraordinary General Meeting of the Law Society on 21 April 2004, the Law Society issued a questionnaire on 12 June 2004 to seek its members' views on and preference for the future scheme. The questionnaire included an explanation on the elements of and advantages and disadvantages of three alternative schemes (i.e. the existing Scheme, an MPS and QIS). The Law Society had requested responses to the questionnaire by end of June 2004;
- (b) on the basis of the responses received, the Law Society would recommend an option for the future scheme to be put for formal resolution at a future Extraordinary General Meeting, with a view to seeking a mandate from its members to pursue the preferred scheme; and
- (c) the Law Society would then proceed with drafting of the relevant legislative amendments in consultation with the Department of Justice for implementing the agreed changes.

Alternative schemes

*MPS*

14. As advised by the Law Society, the major features of the proposed MPS are as follows –

- (a) a Master Policy Agreement is entered into between the Law Society on behalf of all practicing members and a minimum of three insurers for \$10 million for each and every claim less any agreed level of retained mutual liability ("MPS Retained Level"), if any, borne by a mutual fund;
- (b) a mutual fund may be established by contributions from members. Any such fund would only have liability to its members for the agreed MPS Retained Level (which it is proposed should not exceed \$1.5 million);
- (c) liability for the balance of \$8.5 million would be assumed by the Master Policy insurers, which are not jointly and severally liable so each is only liable for its specified share; and
- (d) in the event of insurer failure, members of the profession do not have any liability as insurers of last resort. The responsible solicitor will be solely liable for that amount left uncovered by the failed insurer. If a mutual fund has been set up to cover the MPS Retained Level, members

will only be liable as insurers of last resort if any deficit arises in that fund.

### *QIS*

15. Under the proposed QIS, –

- (a) minimum terms of insurance and qualifying insurers (which may include insurers of specific risks such as conveyancing) are determined by the Law Society;
- (b) each individual law firm obtains insurance by direct negotiation with the qualifying insurers; and
- (c) if a firm cannot obtain insurance from a qualifying insurer, it will be placed in an Assigned Risks Pool (ARP) whereby all qualifying insurers agree to insure jointly such firms. If a firm is still within the ARP within a specified time, expected to be two years, that firm will no longer be insurable and must cease practice.

16. It is noted that in England, QIS is backed up by a Policyholders' Protection Fund (PPF). In the event of a failure of an insurer, the insured might turn to the PPF for the amount which the insurer in default would have paid.

### *Captive insurance model*

17. A member of the PIS Action Group suggested the adoption of a Captive insurance which was similar in nature to a mutual scheme, conducted through the medium of a licensed insurer which was subject to similar regulations as that of other licensed insurers but with lower capital requirements. A Captive insurance insures only the profession which owns it and operates for the benefit of its owner.

### *Levy system*

18. A member of the AJLS Panel suggested that the possibility of establishing a fund financed by levy on certain types of transactions to settle claims which were ultimately left uncovered should be considered. The fund so established could be used to meet claims, including claims against solicitors for fraud which were not covered under the present indemnity scheme. The level of levy might be set in proportion to the fees which solicitors charged their clients for specific types of transactions.

### Views of the Administration

19. The Administration had explained to the Panel its position as follows –

- (a) the Administration was strongly of the view that a mandatory professional indemnity insurance scheme should remain in place for the protection of users of legal services. An assurance that all solicitors were insured would enable small firms to compete with the larger firms for business, and a thriving legal profession was essential for promoting Hong Kong as an important legal services centre;
- (b) any new scheme should offer the same protection to both the profession and the public as the current Scheme. The Administration did not support the proposed MPS or QIS unless the schemes were backed up by mechanisms such as a PPF or “insurance on insurance”. With regard to “insurance on insurance”, the Solicitor General had requested the Law Society to explore the possibility of introducing such arrangements; and
- (c) the Administration did not support the option of a scheme funded by levy imposed on certain transactions. In its view, the practical effect of a levy system was that the burden of the levy would be borne by users of legal services. The Administration considered it unfair to make the users legally liable for the payment of insurance in respect of their solicitors’ default.

#### Views of the Law Society

20. The Law Society supported mandatory indemnity insurance for solicitors. It had pointed out that although some of its members considered that indemnity insurance should not be compulsory and that clients should be given an informed choice as to whether or not to engage an insured or uninsured solicitor, these views did not represent the overall position of members of the profession. The majority of practitioners were in support of mandatory insurance, as borne out by the survey results shown in the Willis Report. Nevertheless, the Law Society shared the concern of its members that unlimited mutual liability for the wrongdoings of individual practitioners was fundamentally unacceptable, and that the existing system, which had put solicitors at risk in the event of failure of the insurer, would have to be changed.

21. The Law Society informed the Panel that it had considered the possibility of removing mutuality of liability altogether. However, it was recognized that to do so might result in prohibitively high insurance premium, or insurers refusing to provide cover at all.

22. The Law Society also referred to the observation in the Willis Report that the majority of the respondents in the surveys preferred to arrange their own insurance. In its view, however, there were law firms, particularly the smaller firms, which would find it extremely difficult to purchase their own insurance in the present hard insurance market where there was a high demand for insurance. They would be charged with hefty premiums. Also, there would be the risk that the insurance might be placed in undesirable insurers, and public interests might be prejudiced. The Willis Report did not consider this to be to the benefit of both solicitors and the public.

23. The Law Society did not accept the Administration's view that the proposed MPS would result in a large reduction in the protection presently available to clients. According to the Law Society, under the proposed MPS, the only conceivable reduced protection in the event of insurer default was the share of the claim that would have been covered by the particular insurer who failed. In such a case, the responsible solicitor would be solely liable for that amount which was left uncovered. The other co-insurers, on the other hand, would be liable for their specified shares.

24. The Law Society did not agree with the Administration that the alternatives of an MPS or QIS should not be supported unless they were backed up by a PPF or "insurance on insurance". It had pointed out that a PPF, even if approved, would need three to five years to come into existence. The Law Society considered that the Administration should provide more details such as how a PPF would operate and how it would be funded. "Insurance on insurance", on the other hand, was an unusual concept. The general view of professional insurers was that such arrangement was not readily available, and even if such insurance cover could be obtained, the cost would be prohibitively high.

25. Regarding the proposal to set up a fund financed by a levy imposed on certain types of transactions proposed by a member of the Panel, the Law Society explained that the proposal had previously been considered and issues including whether the levy should be imposed on all types of transactions or only limited to conveyancing transactions had been looked into. A major problem which had been identified was the drastic drop in property related transactions resulting from the fall of the property market, hence limiting the viability of a levy system.

#### Views of members of the profession

##### *PIS Action Group*

26. Members of the Action Group attended the Panel meeting on 14 June 2004. They pointed out that while there was general consensus within the profession that the Scheme should provide reasonable protection to the public, this did not mean zero risk to the public. The existing Scheme, which made solicitors the insurers of last resort for each other and for unlimited amounts in the event of insurer insolvency, was totally unjust and unfair. It was also unfair for the solicitors' profession to be the only profession whose members were mutually liable for the negligent acts of other members where claims arose.

27. On the proposed MPS, a member of the Action Group suggested that further safeguards might be introduced, such as –

- (a) having three or four participating co-insurers for the spreading of risks; and

- (b) limiting the single largest share of a co-insurer and introducing provisions to deal with merger of the co-insurers, and setting requirement for a minimum credit rating of the participating co-insurers.

28. Regarding mutuality of liability under MPS, a member of the Action Group expressed the view that an MPS Retained Level of \$500,000 might be acceptable.

29. A member of the Action Group proposed a Captive insurance model set out in paragraph 17 above to replace the existing Scheme. In her view, a Captive insurance scheme was in line with policy objective, with the added benefit of limited liability and being regulated. The member also expressed concern about conflict of interests and mis-management of the SIF resulting in increased management costs.

30. Another member of the Action Group pointed out that the high proportion of claims against practitioners in the profession resulting from conveyancing matters was an important factor contributing to the hardship facing solicitors. In her view, the problem was related to the absence of a comprehensive land title legislation and the absence of a minimum fee for conveyancing. The member considered that means to reduce the potential risks to practitioners connected with conveyancing transactions would need to be examined in addressing the problems related to professional indemnity.

*Survey conducted by Hon Margaret NG in October 2003*

31. Hon Margaret NG, in her capacity as the LegCo Member representing the legal functional constituency, conducted a survey on solicitors' views on the Scheme in October 2003. She reported the findings of the survey to the Panel at its meeting on 18 December 2003. The survey related to two calls on law firms in 2003 for extra contribution to SIF in order to make up for the shortfall caused by the collapse of the HHH Group, which was the reinsurer of SIF.

*Individual solicitors and solicitors firms*

32. About 270 solicitors and solicitors firms had submitted an identical letter on the Scheme to the Panel. They strongly urged the Panel to take urgent steps to stop solicitors acting as insurers of last resort for each other. They considered that any future scheme would be readily acceptable to the profession once this had been achieved.

Views of the AJLS Panel

33. A member of the Panel opined that an element of mutual liability should be retained, without which the smaller-sized solicitors firms would face difficulties in obtaining insurance cover at affordable costs. However, mutuality should be limited to a certain level without the requirement for solicitors to make top-up contributions to meet any unexpected shortfall of the mutual fund. The member was in favour of the



MPS option which featured an agreed level of retained mutual liability. However, he considered that the merits of adopting a Captive model and a fund established from levies should also be studied.

34. Members of the Panel were generally dissatisfied with the lack of constructive advice offered by the Administration on means to help solicitors to deal with the problems and difficulties encountered in relation to professional indemnity. They urged the Administration to adopt a helpful attitude and take urgent steps to assist the profession in appropriate ways, particularly in matters involving policy and law drafting. Members considered that a consensus on the future scheme should be reached as a matter of urgency, and legislative amendments to implement any agreed changes should be proceeded with as soon as possible.

35. As agreed by members, the Chairman of the Panel had written to the Secretary for Justice on 16 June 2004 urging the Administration to –

- (a) consider whether it was essential for any proposed schemes to be backed up by a PPF or “insurance on insurance” arrangement; and
- (b) respond without delay to any decision reached by the Law Society after its consultation with members of the profession.

### **Relevant papers**

36. A list of the relevant papers considered by the AJLS Panel is in **Appendix I**. Members are invited to note that these papers are available on the LegCo website at <http://www.legco.gov.hk>.

37. Relevant extracts from the minutes of the Panel meetings on 18 December 2003, 26 April and 14 June 2004 are in **Appendices II, III and IV** respectively.

**Professional Indemnity Scheme of the  
Law Society of Hong Kong**

**Relevant papers/documents**

**LC Paper No.**

**Papers/Documents**

Papers provided by the Law Society of Hong Kong

- CB(2)1092/03-04(01)  
(*English version only*) -- Review Report on Insurance Arrangements of the Hong Kong Solicitors Indemnity Scheme prepared by Willis China (Hong Kong) Limited
- CB(2)773/03-04(01)  
(*English version only*) -- Letter dated 18 December 2003 from the Law Society setting out some of the salient features of the report by Willis China (Hong Kong) Limited
- CB(2)2800/03-04(01)  
(*English version only*) -- Copy of questionnaire issued by the Law Society to its members seeking their views on the preferred structure of the future scheme

Papers provided by concerned solicitors

- CB(2)725/03-04(01)  
(*English version only*) -- Letter dated 13 December 2003 from Rene Hout & Co. acting on behalf of the Action Committee on Professional Indemnity Scheme Reform
- CB(2)725/03-04(02)  
(*English version only*) -- Copy of letter dated October 2003 from Mr Larry KO to the Registrar of Companies
- CB(2)725/03-04(03)  
(*English version only*) -- Paper dated 26 October 2003 prepared by Mr John KU on the Professional Indemnity Scheme
- CB(2)2129/03-04(03) &  
CB(2)2303/03-04(01)  
(*English version only*) -- Sample of a letter submitted by solicitors/solicitors' firms for the Panel meeting on 26 April 2004 expressing concerns about the Scheme, and an updated list of the names of the solicitors/firms
- CB(2)2724/03-04(01)  
(*English version only*) -- Written submission dated 8 June 2004 from Mr HO Kai-cheong, a member of the Law Society

- CB(2)2701/03-04(03)  
(*English version only*) -- Presentation at the Panel meeting on 14 June 2004 by Mr Larry KO on behalf of the Professional Indemnity Scheme Action Group (PIS Action Group)
- CB(2)2775/03-04(01)  
(*English version only*) -- Written submission dated 14 June 2004 from Ms Phyllis KWONG Ka-yin, a member of PIS Action Group
- CB(2)2775/03-04(02)  
(*English version only*) -- Copy of letter dated 9 June 2004 from Mr Benny YEUNG to the Solicitor General and the Solicitor General's reply to Mr YEUNG

Papers provided by the Administration

- CB(2)2582/03-04(01) -- Paper dated May 2004 provided by the Administration on "Review of Professional Indemnity Scheme of the Law Society of Hong Kong"
- CB(2)2700/03-04(01) -- Letter dated 8 June 2004 from the Administration on the operation of the Unified Exchange Compensation Fund and the Investor Compensation Fund

Correspondence between Hon Margaret NG and the Administration

- CB(2)2185/03-04(01)  
(*English version only*) -- Letter dated 24 March 2004 from Hon Margaret NG to the Commissioner of Insurance on the proposed Policyholders' Protection Fund
- CB(2)2701/03-04(01)  
(*English version only*) -- Letter dated 29 May 2004 from Hon Margaret NG to the Solicitor General on review of the Scheme
- CB(2)2701/03-04(02)  
(*English version only*) -- Written response dated 7 June 2004 from the Solicitor General to Hon Margaret NG's letter dated 29 May 2004

Minutes of meetings of Panel on Administration of Justice and Legal Services

- CB(2)1104/03-04 -- Minutes of meeting on 18 December 2003
- CB(2)2425/03-04 -- Minutes of meeting on 26 April 2004

[CB\(2\)3321/03-04](#)

-- Minutes of meeting on 14 June 2004

Others

[CB\(2\)731/03-04\(03\)](#)  
(*English version only*)

-- Results of an opinion survey conducted by Hon Margaret NG in October 2003 on the Solicitors Professional Indemnity Scheme

**Extract from minutes of meeting of Administration of Justice  
and Legal Services Panel held on 18 December 2003**

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**IV. Professional Indemnity Scheme of The Law Society of Hong Kong**

(LC Paper Nos. CB(2)692/03-04(01); 725/03-04(01) - (03); 731/03-04(03) and 773/03-04(01))

8. The Chairman informed members that she had conducted an opinion survey in October 2003 to seek views from practising solicitors on the Professional Indemnity Scheme of The Law Society of Hong Kong (the Law Society). She had provided the results of the survey for the Panel's information and discussion at the meeting (LC Paper No. CB(2)731/03-04(03)).

9. The Chairman further informed members that the Law Society had written to her before the meeting and expressed concern about whether she could lead the discussion of the item with due objectivity on the ground that she was representing the views of solicitors who were in opposition to the Scheme. The Chairman said that on knowing the Law Society's concern, she had asked the Deputy Chairman of the Panel whether he could chair this part of the meeting in her stead. Nevertheless, the Deputy Chairman was unable to attend the meeting. The Chairman sought members' views on whether she should chair the meeting for this item.

10. Mr Martin LEE said that to avoid the possible perception of conflict of role, it might be preferable for a non-lawyer member of the Panel to chair the meeting for the item.

11. The Chairman said that the question of a role conflict did not exist as she was holding no personal interest in the matter. She said that the survey carried out by her was for the purpose of gathering opinions from practising solicitors, having regard to the serious concerns expressed by the solicitors who had approached her about the heavy burden imposed upon them by the Professional Indemnity Scheme. She had presented the findings of the survey with a view to ensuring that the widest possible views were presented before the Panel to facilitate discussion on the matter.

12. Ms Miriam LAU, Ms Emily LAU and Mr CHAN Kam-lam said that they held no objection to the Chairman chairing the meeting.

13. In response to the Chairman, Mr Chris HOWSE said that he did not object to her continuing to chair the meeting.

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Review Report on Insurance Arrangements of the Hong Kong Solicitors Indemnity Scheme prepared by Willis China (Hong Kong) Limited (the Willis Report)

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(LC Paper Nos. CB(2)692/03-04(01) & 773(01))

14. Mr Chris HOWSE outlined the background to, and the salient features and findings of, the Willis Report as follows -

- (a) the review was conducted in accordance with the Law Society's undertaking made to the Legislative Council that it should review the current insurance arrangements and report on what insurance arrangements were in the best interests of the legal profession and the public, having investigated into the present problems with professional indemnity insurance of solicitors in Hong Kong;
- (b) a fundamental concern widely shared by solicitors in Hong Kong was that under the present arrangements, solicitors were the insurer of last resort for each other in the event of failure of the commercial insurer. This had given rise to grave problems for the solicitors when the commercial insurer turned insolvent, as in the case of the collapse of the HIH Group, resulting in calls on solicitors for extra contributions to the Solicitors Indemnity Fund (SIF) to make up for the shortfall. Another major concern was that the present insurance scheme had failed to address the balance of risk between solicitors who were responsible for claims and those who were not. The Willis Report had looked at possibilities of adopting different types of schemes or amending the existing scheme. A major proposal was to alter the current arrangements so that in the event of failure of the commercial insurer, the liability would be on the particular law firm responsible for the claim. If the law firm concerned was unable to meet the claim, the claimant would have no further recourse and no calls would be made on the rest of the membership of the Law Society. This proposed new arrangement represented a fundamental and significant policy change involving transfer of risk from members of the Law Society ultimately to the general public making claims against solicitors; and
- (c) the Willis Report proposed increasing the level of deductible (i.e. a determined amount payable by an insured firm in respect of any claim) from the present maximum level of \$200,000, which had remained unchanged since 1986, to \$500,000. It also proposed risk banding in determining the contributions to be paid by members of the Law Society on the principle that high risk work should account for a greater amount of contribution. Moreover, there should be increased loading for firms making claims on SIF on the principle that a user paid more.

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15. The Chairman drew members' attention to the letter dated 18 December 2003 from the Law Society, which set out the major proposals put forward in the Willis Report (LC Paper No. CB(2)773/03-04(01)). According to the Law Society, it would put the proposals to its members for comment and discussion. The Council of the Law Society had yet to discuss the Willis Report or form a view on the proposals contained in it.

16. Regarding statistics on claims made in the past, Mr Chris HOWSE informed members that it was observed, as set out in Table 7 of the Willis Report, that although the absolute number of claims had increased in the past 15 years, the proportion of the number of claims to the number of solicitors in Hong Kong had remained stable when compared with the situation in 1986/87. In the last 13 years, the number of solicitors firms with multiple paid claims was 16. One third of the total firms had notified claims.

Survey conducted by the Chairman

17. The Chairman briefed members on the background to and findings of her survey conducted in October 2003 on solicitors' views on the Professional Indemnity Scheme. The results were set out in detail in her paper circulated to the Panel under LC Paper No. CB(2)731/03-04(03).

Submission from Rene Hout & Co.

18. The Chairman referred members to a paper prepared by Mr John KU (LC Paper No. CB(2)725/03-04(03)) and a letter from Mr Larry KO dated October 2003 (LC Paper No. CB(2)725/03-04(02)) submitted by Rene Hout & Co. acting on behalf of the Action Committee on Professional Indemnity Reform. As advised by Rene Hout & Co., the two papers set out the major concerns expressed by solicitors on the Professional Indemnity Scheme. The Chairman informed members that Rene Hout & Co. had provided a large bundle of documents and correspondences on the subject. She said that members could approach the Clerk if they wished to make reference to the other papers submitted.

Issues raised by members

*Surveys conducted by Willis*

19. In response to the Chairman, Mr Chris HOWSE said that the brief given by the Law Society to Willis required that Willis should seek the widest possible consultation with the membership of the Law Society in undertaking the review. A number of members' forums had been held during the process in which Willis reported on the progress of the review and invited the membership to voice their views and make suggestions. Appointments were also made for Willis to meet with the solicitors firms to discuss concerns and measures to improve the

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existing arrangements. Many members of the profession had also written to Willis to express opinions. Mr HOWSE drew members' attention to pages 20 to 32 of the Willis Report, which set out the results of the two surveys conducted in November 2002 and October 2003 respectively.

20. In response to the Chairman's observation that the majority of the respondents in the two surveys conducted by Willis preferred to arrange their own insurance, Mr Chris HOWSE said that the responses should not be taken in isolation without considering other relevant factors, including the practicality of making such arrangement. He pointed out that firstly, there were law firms in Hong Kong, in particular the smaller firms, which would find it extremely difficult to purchase their own insurance in the present unprecedented hard insurance market situation, i.e a market with limited capacity to provide insurance cover and the existence of a very high level of demand. Hence, insured solicitors firms could be charged with hefty premium. Secondly, a major factor which governed professional indemnity was to protect the interests of the public. If firms were allowed to arrange their own insurance free from restrictions, there would be the risk that their insurance might be placed in undesirable insurers. The public's interests would then be prejudiced. Mr HOWSE said that in the view of Willis, the option for individual law firms to take out insurance cover on their own would not be to the benefit of solicitors and the public as a whole.

21. The Chairman pointed out that the surveys conducted by Willis showed that two thirds of the respondents agreed that professional indemnity insurance for solicitors should remain to be compulsory. Mr Chris HOWSE considered that the response was encouraging, given that compulsory insurance was appropriate for the protection of the public. That said, there was nevertheless a feeling amongst members of the profession that the balance had shifted too strongly in favour of the public and away from the solicitors, and that it was unfair under the present system to make solicitors as a whole the insurer of last resort. The situation therefore warranted consideration as to whether legislative amendments should be introduced to bring about necessary changes to the existing indemnity insurance arrangements.

*Options proposed by the Willis Report*

22. At the request of the Chairman, Mr Chris HOWSE briefed members on Option One and Option Two set out in Section 2 of the Willis Report. Option One was recommended by Willis to be adopted in 2005. In gist, the proposals in Option One included -

- (a) the retention of the existing limit of indemnity of HK\$10 million;
- (b) the insured should continue to be responsible for a deductible;
- (c) the SIF to be responsible for HK\$1.5 million to HK\$2 million in excess of the insured's deductible;



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- (d) the balance up to HK\$10 million to be covered by policy taken out with commercial insurers;
- (e) there should be risk banding so that solicitors who practised in areas of law that could more likely result in claims should contribute more; and
- (f) there should be increased claims loading for firms making claims.

23. Option Two was a qualifying insurer scheme similar to that adopted in the United Kingdom. Mr Chris HOWSE said that Willis had conducted a market research and concluded that the option probably would not work in Hong Kong. He referred members to paragraphs 3.4.8 to 3.4.10 of the Willis Report, which provided a detailed analysis on the research result.

24. In response to the Chairman on the other proposals in the Willis Report relating to modernisation of the decision making process and management structures, Mr Chris HOWSE said that any new measures to improve administration would be considered carefully by the Council of the Law Society. He opined that to appoint a professional manager from outside the legal profession to manage SIF was worth consideration, but the cost factor had also to be taken into account.

*Implications of the proposals*

25. Ms Miriam LAU said that the proposals on risk banding and increased claims loading, if implemented, might result in increased premium, hence affecting firms particularly the small and medium sized firms engaging in high risk work (e.g. conveyancing) which was more likely to result in claims. She expressed concern that with the present keen competition in the profession resulting in, e.g. drastic cuts in conveyancing fees charged by solicitors firms, practitioners would continue to face a difficult situation.

26. Mr Chris HOWSE said that he shared the concern that law firms were having a hard time under the present depressing economy. He pointed out that the extraordinary increase in the number of claims over the period from 1996 to 1999-2000 as well as the collapse of HIH Group had adversely impacted on the SIF. As the legislation now stood, the Law Society was obliged under the statutory indemnity arrangements to deal with the problem, and hence calls had been made on firms to make extra contributions. Going forward, nevertheless, there were ways to address the situation which hinged on, to a significant extent, how the balance of risk might be shifted from solicitors to the public. The Willis Report proposed that something should be done, including consideration of the option of introducing legislative measures, to improve the system so that the risk of hardship on the general membership of the Law Society could be significantly reduced. Mr HOWSE said that in his view, the proposals in the

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Willis Report regarding risk banding, increased loading and deductible etc were fair and sensible measures which could help address some of the major concerns of solicitors, such as imbalance in the distribution of risks amongst solicitors.

27. Mr Chris HOWSE added that he agreed that competition in the legal profession had caused problems. He opined that the reduction in conveyancing fees due to competition had reached a ludicrous level which prompted one to question whether the work could be properly done by solicitors for the price that they were receiving. Mr HOWSE pointed out that the Willis Report had in section 3.8.5 made reference to the pending introduction under the Land Titles Bill of a registered title system for interests in land in Hong Kong. It was hoped that the introduction of a registered title system would have benefits in reducing liabilities in the long term for conveyancing claims that were related to a solicitor failing to investigate or identify a defect in the title.

Way forward

28. Ms Emily LAU noted that the Law Society had advised in its letter dated 18 December 2003 that it had yet to form a view on the Willis Report and it would be putting forward the proposals to its members for discussion. She enquired about the timeframe for consultation and reverting back to this Panel on the progress.

29. Mr Patrick MOSS said that the Law Society was bound by the requirements under existing legislation on professional indemnity arrangements. It was also constrained by the fact the present contract with the reinsurers would not expire until September 2005. The Council of the Law Society had not yet studied the Willis Report in detail, but it would ensure that by April 2004 the Society would be in a position to agree on what options to adopt and the necessary legislative amendments. The Law Society would then proceed to liaise with DoJ on law drafting matters.

30. The Chairman remarked that despite that the Legislative Council had a veto power in relation to subsidiary legislation made by the Law Society, it would not normally exercise that power as it respected the role of the Law Society as a self-regulating body which had full knowledge of the operation of the profession and the needs of its members. The Chairman and Ms Emily LAU said that they hoped that the Law Society could come to a consensus view on the proposals and amendments with its members as soon as possible and revert to the Panel for further discussion.

Law Society

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**Extract from minutes of meeting of Administration of Justice  
and Legal Services Panel held on 26 April 2004**

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- V. Professional Indemnity Scheme of the Law Society of Hong Kong**  
(LC Paper Nos. CB(2)2129/03-04(03) and (04); 773/03-04(01);  
1092/03-04(01) and 2185/03-04(01))

Letters from solicitors on the Solicitors Professional Indemnity Scheme

8. The Clerk informed members that about 200 solicitors had sent letters to the Panel expressing views on the insurance arrangements under the present indemnity scheme. As the letters were identical in content, only a sample of the letters and a list showing the names of the solicitors had been issued to the Panel for reference (LC Paper Nos. CB(2) 2129/03-04(03) and (04) refer). The Clerk further advised members that identical letters from about 20 more solicitors had been received shortly before the meeting. An updated list would be provided for the Panel's reference.

*(Post-meeting note : An updated list was issued to the Panel vide LC Paper No. CB(2)2303/03-04(01) on 10 May 2004.)*

Letter from Chairman of the Panel to the Commissioner of Insurance on Policyholders' Protection Fund (PPF)

9. The Chairman referred members to a letter dated 24 March 2004 from her to the Commissioner of Insurance, a copy of which was tabled at the meeting (circulated to the Panel after the meeting vide LC Paper No. CB(2)2185/03-04(01)). The letter reflected the concerns expressed at a recent gathering held by the Chairman for legal practitioners and the Commissioner of Insurance to discuss the consultation document on the proposed PPF and the relevance of the PPF in tackling the problems encountered in the provision of professional indemnity of solicitors.

Verbal report by the Law Society of Hong Kong

10. At the invitation of the Chairman, Mr Peter LO briefed the Panel on the progress of consultation of the Law Society with its members on the report on Consultancy Study on Review of Insurance Arrangements of the Hong Kong Solicitors Indemnity Scheme (the Willis Report), since the item was last discussed by the Panel at its meeting on 18 December 2003. The latest position was summarized as follows -

- (a) at a recent Extraordinary General Meeting (EGM), two proposed resolutions were put to members of the Law Society by the

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Council of the Law Society (the Council) for consideration. The resolutions involved a choice between a Master Policy Scheme (MPS) and a Qualifying Insurer Scheme (QIS). The proposals, however, were considered by some members of the Law Society to be unsatisfactory. The EGM was adjourned pending a further meeting to be held to further discuss the matter;

- (b) the general sentiment expressed at the EGM was that members of the Law Society were strongly opposed to the existing mutual scheme arrangements with solicitors being the insurers of the last resort for each other. This had been identified in the Willis Report as the major dissatisfaction with the existing indemnity scheme. Some members of the Law Society also considered that compulsory professional indemnity for solicitors should be dispensed with altogether. Nevertheless, the Law Society had stated its stance that it was in favour of a compulsory scheme. The Willis Report had also recommended the retention of an indemnity scheme. According to the two surveys conducted by Willis, two-thirds of the respondents agreed that professional indemnity insurance for solicitors should remain compulsory;
- (c) the Council was seeking to address the issue by way of a MPS or QIS, the features of which had been explained to the members. The proposed MPS was an amendment to the existing scheme, under which the mutual fund (the Solicitors Indemnity Fund (SIF)) would absorb the first HK\$1.5 million of any claim. The balance of \$8.5 million would be borne by a syndicate of insurers, instead of by SIF in the event of the collapse of the insurer. Under the proposed QIS, the Law Society would set out standard reinsurance terms and invite insurers to participate on those terms. Individual members of the Law Society would, however, need to negotiate with the insurers on the insurance premium payable. A major problem with QIS was that some solicitors firms, because of the lack of a satisfactory track record, might encounter difficulties in obtaining insurance cover. The practice in England was that insurers who sold insurance to members of the profession agreed to issue insurance cover under an assigned risks pool (ARP) for those solicitors who were unable to find an insurer in the open market. These otherwise uninsurable solicitors then paid premiums, usually at high levels, for the indemnity cover provided under the ARP. The experience in England was that the premium could account for 25% to 30% of the gross income of the firms. In England, QIS was also backed up by a PPF, where in the event of a failure of an insurer, the insured might turn to the PPF for the amount which the insurer in default would have paid; and

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- (d) since the last EGM, the Council had further discussed with some of the members who had voiced objection to the proposals. It was hoped that another general meeting could be held within the next few weeks so that the Council could have a clear indication of the preference of the members and the direction in which to proceed.

Law Society's response to letters from solicitors

11. Mr Peter LO responded to the issues raised in the letters from solicitors on the indemnity scheme (LC Paper No. CB(2)2129/03-04(03)) as follows -

- (a) the Law Society shared the concern expressed by solicitors that solicitors as a whole should not be required to act as insurers of last resort for each other. The historical development was that a master insurance policy was put in place when the scheme was first introduced in 1980. Some years later, members of the Law Society felt that they were being "held to ransom" by the insurer by having to pay huge premiums. The option of a mutual indemnity fund to replace the master policy was subsequently approved by members. The possibility of the insurance company turning insolvent as happened in the case of the HIH Group, however, did not occur in the minds of members at that time;
- (b) the shortfall of \$416.8 million mentioned in the solicitors' letters had in fact been covered by the SIF. The call made to solicitors in 2003 for top-up contribution was to deal with the deficit of \$132 million as at 30 September 2002. Whether or not a further call for contribution would be made would depend on whether a deficit existed as at 30 September 2003. The position was not known at the present stage;
- (c) another factor which might affect the situation was the amount of insurance premiums to be paid towards the end of 2004. Under the existing arrangements with the insurers, if there were more than 340 claims at the end of the current indemnity year, the premiums payable would be about \$350 million. If the claims were in the region of 250, the premiums payable would be about \$250 million. Based on historical figures, the amount which the Law Society expected to collect from its members was about \$200 million to \$220 million. There would have to be adequate reserves in SIF to meet the payment of premiums, otherwise a call for contribution would have to be made. During the peak years in terms of claims against the insurers, the loss ratio of the insurers was higher than 300%, i.e. for every \$100 received in premiums, the insurers paid out more than \$300. As a result, the premiums had been sharply increased; and

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- (d) the Law Society appreciated the concern of its members that there was no other profession in Hong Kong which was required to operate a mutual indemnity scheme. However, in view of the present legislative requirements and the need to protect public interest, an appropriate balance would have to be struck in considering a transfer of risk away from the solicitors as a whole to other parties including the ordinary members of the public.

Issues raised by members

*The alternative options*

12. Referring to the letters submitted by solicitors, the Chairman said that the major concern raised was that solicitors should not act as insurers of last resort for each other and for unlimited amounts in the event of insurer insolvency. The solicitors considered that it was unfair that having already fulfilled the statutory requirement of paying their contribution to the SIF, they still had to pay extra contributions when unforeseen situations arose. The Chairman asked how the Law Society would address the concern.

13. Mr Peter LO said that under the option of MPS explained above, solicitors would not be liable for unlimited amounts. However, there would still be an element of mutuality so far as the retained portion of \$1.5 million per claim to be borne by SIF was concerned, in that a top-up contribution by solicitors might be called if the reserves of SIF were insufficient to meet claims up to the \$1.5 million limit. Under the proposed QIS, there would be no mutuality at all as individual solicitors would take out insurance cover on their own with an insurer. He said that it would be for the members to judge the advantages and disadvantages of the schemes and decide on which option to adopt.

14. Ms Miriam LAU said that in principle she supported a professional indemnity scheme as it could help protect the interests of the public. Nonetheless, the scheme, having run for more than 20 years, did not appear to have assisted members of the profession as a whole and a lot of problems had occurred. For example, the existence of a mutual scheme appeared to have encouraged certain undesirable practices in the profession amounting to negligence and less than satisfactory diligence on the part of some solicitors in carrying out their duties, despite that these still only happened in a minority of cases. Ms LAU said that she had doubts as to whether the proposed MPS and QIS could address the problems.

15. Mr Chris HOWSE said that he agreed that it was unfair that solicitors were the only profession in Hong Kong required to take out a compulsory indemnity scheme to mutually insure each other. He said that the

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overwhelming view expressed at the Law Society's recent EGM was that there should be a transfer of risk and that mutuality should be dispensed with. The fundamental element in both of the two options of MPS and QIS recommended in the Willis Report and the Council was the transfer of risk. Under QIS, the risk would be totally transferred away from the profession as a whole as each solicitor would choose his own insurer nominated by the Law Society. There would be no mutuality of liability at any level. If the insurer went into liquidation, the solicitor would be totally on his own. On the other hand, there would be no safety net for the members of the public as claimants, other than claims directly against the liable solicitors and whatever relief might be obtained from the PPF to be put in place. He added that there were other issues which needed to be carefully considered under a QIS, for example, the extent to which some solicitors and law firms might be disadvantaged because they would have to negotiate the best possible terms they could get from insurers in the market with less bargaining power than that of the Law Society.

16. Regarding the MPS, Mr HOWSE said that an amendment to the existing scheme was that an element of mutual insurance would be retained, but with the level of mutual risk reduced from \$10 million to \$1.5 million per claim. The responsible solicitor would be solely liable for the \$8.5 million if his insurer became insolvent, with no recourse to the other members of the profession. One of the advantages of MPS when compared with QIS was that it retained an element of assured public protection up to \$1.5 million. Moreover, the smaller law firms would be able to benefit from a relatively cheaper premium resulting from bulk-buying in the insurance market.

17. Mr Chris HOWSE further advised that members of the Law Society who attended the recent EGM did not unanimously reject the two options altogether, but they indicated that more time was needed to consider the proposals. A diversity of views had been expressed. For example, another proposal which had been put forward by some members was to abolish the professional indemnity insurance for solicitors. Some members also expressed the view that legislative amendments with retrospective effect should be introduced, if necessary, to relieve solicitors from the obligation to make further contributions to the SIF, which had already paid out an enormous amount of \$132 million to meet the shortfall. The predominant view of members, however, was that mutuality under the existing indemnity scheme should not be continued. Mr HOWSE added that whether mutuality should be allowed to end remained a policy issue to be resolved with the Administration, and the support from Members of the Legislative Council was needed.

18. Mr Albert HO said that he shared the concern that it was unfair to solicitors that they should act as insurers of last resort for each other and be mutually liable for unlimited amounts. He opined that solicitors should only be required to make a prescribed contribution to the indemnity scheme so as to satisfy the condition for practice. They should not, however, be called upon to

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pay further contributions from time to time to meet unforeseen shortfalls. Mr HO sought clarification on whether the existing legislation imposed a mandatory obligation on solicitors that they had to comply with any calls made by the Law Society Council for additional contributions.

19. Senior Government Counsel said that under the Legal Practitioners Ordinance, a solicitor for the purpose of practice was required to comply with the indemnity rules made by the Law Society. The Solicitors (Professional Indemnity) Rules made by the Law Society required, among other matters, that an indemnity fund should be established and maintained by contributions which should be made or caused to be made by solicitors.

20. The Chairman asked whether there had been any discussion between the Department of Justice (DoJ) and the Law Society on the implementation of a new scheme. Senior Assistant Solicitor General replied that the Solicitor General had discussed with the Law Society and the Commissioner of Insurance the options of MPS and QIS, as well as means to supplement the scheme such as by way of the PPF. He said that the parties would continue to discuss the issues that needed to be resolved.

21. The Chairman opined that professional indemnity of solicitors was a legal policy issue, and whether solicitors should continue to be required to take out professional indemnity insurance on a mutual basis should be reviewed in the context of policy. She said that the problems with the present mutual indemnity scheme were acknowledged by all parties. She urged DoJ to have discussion with the Law Society Council as soon as possible, taking into account the fundamental policy issues involved. She said that until the two parties could come to an agreement on those issues, it would be difficult for this Panel to offer views on any proposed changes and monitor the progress of implementation at every step. The Chairman added that she had requested the Solicitor General in writing to take urgent action on the matter.

22. The Chairman requested the Administration to respond in writing to the following matters -

- (a) the policy objectives of the existing legislative requirements, taking into account the concern expressed by solicitors that there was no other profession in Hong Kong whose members had to act as insurers of last resort for each other; and
- (b) whether under the existing legislation and the mandatory indemnity scheme solicitors had a liability to mutually pay for any shortfall in compensation of unlimited amounts, and if so, whether it was the intended policy.



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Indemnity under a levy system

23. Mr Albert HO said that the Administration and the Law Society should look at all possible options to address the problems identified. He suggested that the possibility of setting up a fund financed by a levy imposed on certain types of transactions to settle claims which were ultimately left uncovered by the indemnity fund should be considered. The levy collected could also be used to meet claims, including claims against solicitors for fraud which were presently not covered by the solicitors indemnity scheme. The level of levy could be set in proportion to the fees which solicitors charged their clients for specific types of transactions. Mr HO opined that this proposed scheme could serve the dual purpose of protection of public interest and upholding the integrity of the legal profession.

24. Mr Chris HOWSE said that the suggestion of a levy system had been considered previously and certain issues had been looked into, such as whether the levy should be imposed on all types of transactions or only limited to conveyancing transactions. A major problem which had been identified was the drastic drop in property related transactions resulting from the fall of the property market which limited the viability of a levy system.

25. The Chairman said that she had also heard of similar proposals from some legal practitioners. She requested the Administration to provide a written response to the option of a levy system as proposed by Mr Albert HO.

*(Post-meeting note : A paper from the Administration which responded to the issues raised in paragraphs 22 and 25 above was issued vide LC Paper No. CB(2)2582/03-04(01) on 31 May 2004.)*

Way forward

26. The Chairman said that the Panel should follow up the issue at a future meeting. She requested the Clerk to liaise with the Law Society on whether it would be in a position to revert to the Panel at the next meeting of the Panel on 24 May 2004 on the progress of the Law Society's consultation with its members.

*(Post-meeting note : A special meeting of the Panel to follow up the item was scheduled for 14 June 2004.)*

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**Extract from minutes of special meeting of Administration of Justice  
and Legal Services Panel held on 14 June 2004**

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**II. Professional Indemnity Scheme of the Law Society of Hong Kong**  
(LC Paper Nos. CB(2)2582/03-04(01), 2700/03-04(01), 2701/03-04(01) -  
(03), 2724/03-04(01) and 2775/03-04(01) - (02)).

2. The Chairman welcomed representatives of the Administration, the Law Society of Hong Kong and the Professional Indemnity Scheme Action Group (PIS Action Group) to the meeting.

Administration's views on issues raised at the meeting on 26 April 2004

3. Senior Assistant Solicitor General (SASG) introduced the Administration's paper (LC Paper No. CB(2)2582/03-04(01)) which responded to the issues raised at the Panel meeting on 26 April 2004. The Administration's overall position was as follows -

- (a) the Administration was strongly of the view that a mandatory professional indemnity insurance should remain in place for the protection of users of legal services. From the perspective of the profession, an assurance that all solicitors were insured would enable small firms to compete with the larger firms for business, and a thriving legal profession was essential for promoting Hong Kong as an important legal services centre;
- (b) under the existing legislation and the mandatory Professional Indemnity Scheme (PIS), and consistent with the policy objectives, solicitors had a liability to pay for any shortfall in compensation. At present, the Solicitors Indemnity Fund (SIF) was required to provide indemnity against specified loss up to a sum not exceeding \$10 million (less deductibles) in respect of any one claim. Therefore, the liability of solicitors to pay for any shortfall was not of an unlimited amount;
- (c) any new PIS should provide adequate protection for both the solicitors and the public in the event that an insurer became insolvent. With regard to the proposed Master Policy Scheme (MPS) and the Qualifying Insurers Scheme (QIS) which the Law Society had put to its members for consideration, the Administration considered that they should not be supported unless

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the schemes were backed up by a mechanism such as a Policyholders' Protection Fund (PPF) or "insurance on insurance"; and

- (d) the Administration did not support the option of a scheme funded by levy imposed on certain transactions. In its view, the practical effect of a levy system was that the burden of levy would be borne by users of legal services. The Administration considered it unfair to make users legally liable for the payment of insurance in respect of their solicitors' default.

4. SASG added that the Administration had not rejected outright either the MPS or QIS. The suggested back-up arrangement of "insurance on insurance" was a preliminary thinking and the Solicitor General (SG) had requested both the Commissioner of Insurance and the Law Society to explore the possibility of introducing such a mechanism.

Verbal report by the Law Society of Hong Kong

5. At the invitation of the Chairman, Mr Michael Lintern-Smith reported on the progress of the Law Society's consultation with its members on the way forward for PIS and the intended course of action. The latest position was summarized as follows -

- (a) in view of the concerns expressed by members of the profession at the Extraordinary General Meeting (EGM) held on 21 April 2004, the Law Society issued a questionnaire on 12 June 2004 which sought to obtain solicitors' views on the preferred structure of the future scheme. The questionnaire included an explanatory note on the main elements of and advantages and disadvantages of three alternative schemes (namely, the current scheme, an MPS and QIS). Members of the profession were asked to rank their preferences for the three schemes, and to comment on the aspect of future mutual liability in respect of claims made by fellow practitioners. The Law Society had requested responses to the questionnaire by 30 June 2004 (a copy of the questionnaire was tabled for the information of the Panel and circulated after the meeting vide LC Paper No. CB(2)2800/03-04(01));
- (b) on the basis of the responses received, the Law Society would recommend an option for the future scheme to be put for formal resolution at a future EGM, with a view to seeking a mandate from its members to pursue the preferred scheme; and
- (c) the Law Society would then proceed with the drafting of the relevant amendments to the Solicitors (Professional Indemnity)

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Rules in consultation with the Department of Justice, and implement the proposed changes. The amended Rules would be submitted for the approval of the Chief Justice and subject to the negative vetting procedure of the Legislative Council (LegCo).

6. Mr Lintern-Smith said that the Law Society supported mandatory indemnity insurance for solicitors. Although some of its members had expressed the views that indemnity insurance should not be compulsory and that clients should be given an informed choice as to whether or not to engage a solicitor who was insured or not insured, these views did not represent the overall position of practitioners in the profession. The majority view was in support of mandatory insurance. This was borne out by the survey results shown in the Willis Report. However, the concern which had been voiced by the majority of practitioners was that unlimited mutual liability for the wrongdoings of individual practitioners was fundamentally unacceptable. In their view, the present system, which made solicitors responsible for the defaults of other solicitors and hence put them at risk in the event of failure of the insurers, would have to be changed.

7. Mr Lintern-Smith added that Hong Kong needed a strong and regulated legal profession, which was a highly important element in pursuing the Government's objective of promoting Hong Kong as a leading centre for legal services. A strong legal profession depended on talented new entrants into the profession, and experienced practitioners believing that there were sufficient rewards for them to remain in the profession. There were, however, worrying signs that this might not be happening. Mr Lintern-Smith pointed out that at present, about 33% of the solicitors firms in Hong Kong were sole-practitioners. This was a high figure compared to most of the other comparable jurisdictions. Out of 656 practising firms, 596 were firms of five partners or less. Traditionally, the smaller firms relied heavily on conveyancing work. With the downturn of the property market, and the abolition of the scale fees which resulted in sharp reduction in fees on conveyancing transactions, income of these firms had dropped significantly. Mr Lintern-Smith said that he was aware of examples of low income of solicitors. In one particular case, a practising partner of a firm received a monthly take-home pay of merely \$20,000.

8. Mr Lintern-Smith further said that low earnings, coupled with expensive overheads which included high insurance premiums, had posed serious questions to many smaller firms as to whether it was still economically worthwhile for them to continue practice. He cited his personal experience of practising in a medium-size firm of 20 lawyers, which had a no-claim record against the SIF. In 2000, the amount of the firm's contribution to the indemnity scheme was \$419,000. In 2001, the contribution went up to \$841,000. The amounts for 2002 and 2003 were \$834,000 and \$789,000 respectively. Nonetheless, the firm was required to make additional top-up contribution of \$507,000 in 2003 to meet the shortfall of the fund. Top-up contribution paid by his firm in 2000

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was \$241,000, and \$229,000 in 2001. Reduced cover was taken out in 2004 and the premium was \$32,480. A quote for comparable top-up cover to that in 2001 was for more than \$500,000. The amount of insurance premium paid by the firm had risen by about 300% in four years. Insurance premium, together with salaries and rent, now ranked as the major expenses of practice. For a large number of firms, the cost of insurance already exceeded the rent payment. The cost, however, could not be automatically passed on to the clients. Mr Lintern-Smith said that he had been told by many practitioners that it was unfair for the solicitors profession to be the only profession whose members were mutually liable for the acts of other members, and to be exposed to unlimited risk of indemnity. If the existing situation continued, they could hardly remain in practice and would have to move into other areas of work which were less regulated and less financially burdensome.

9. Mr Lintern-Smith further informed the Panel that the number of practising certificates issued for solicitors in 2001 and 2002 was 5 070 and 5 173 respectively. The figure for 2003 was 5 301. These figures actually represented a diminution in the number of existing practitioners, taking into account the fact that over 400 newly graduated students entered into the legal profession each year. He called upon the Administration to take heed of the warning signs and assist the profession in addressing the problems in order to pursue the objective of developing Hong Kong as a competitive legal services centre with professional excellence.

The Law Society's views on the Administration's paper

10. Mr Lintern-Smith said that the Law Society did not agree with the Administration on the retention of the element of mutuality of liability and the back-up mechanism of a PPF or "insurance on insurance". He said that the majority view of solicitors was that mutuality should be dispensed with, and that it should not be subject to a PPF which, if approved, would need three to five years to come into existence. "Insurance on insurance", on the other hand, was an unusual concept. The general view of professional insurers was that such arrangement was unknown, and even if such insurance cover could be obtained, the cost would be prohibitively high.

11. Referring to paragraph 15 of the Administration's paper, Mr Lintern-Smith said that the possible default by solicitors who held large amount of clients' money in performing their duties was not the reason for mandatory insurance for the protection of the clients. Instead, it was more the potential risk of exposure to liability faced by solicitors resulting from their handling of commercial interests of significant amounts which necessitated the need for insurance. In the view of the Law Society, obligation to the public was fulfilled provided that solicitors took out the statutorily required insurance, and it would be unfair to require solicitors to pay for additional cover such as in the form of "insurance on insurance".

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12. Referring to paragraphs 28 and 29 of the Administration's paper, Mr Lintern-Smith said that while the Law Society agreed that clients' interests should be adequately protected by insurance arrangements, it did not accept that the risk of compensation should be passed on to solicitors as a whole in the event of insurer failure.

13. Mr Lintern-Smith added that the Law Society did not accept the Administration's view that the proposed MPS would result in a large reduction in the protection presently available to clients. He said that under the proposed MPS, the only conceivable reduced protection in the event of insurer default was the share of the claim that would have been covered by the particular insurer who failed. In such a case, the responsible solicitor would be solely liable for that amount which was left uncovered. The other co-insurers, on the other hand, would be liable for their specified shares.

14. Regarding the proposed PPF, Mr Lintern-Smith said that the Administration should provide more details such as its operation and how it would be funded.

15. On the Administration's view that ways should be found to reduce the potential amount of claims against solicitors, Mr Lintern-Smith advised that the Law Society was in the course of organizing courses for its members which included a risk management course and a professional management course.

Views of the PIS Action Group

16. Mr Benny YEUNG introduced his letter dated 9 June 2004 to the Solicitor General, which contained a plea for the abolition of SIF (LC Paper No. CB(2)2775/03-04(02)). He appealed for LegCo's support for the plea.

17. Referring to the issue of adequate protection of clients' interests raised by the Administration, Mr Benny YEUNG said that adequate protection did not mean zero risk but the absence of a large degree of risk. There was general consensus within the profession that the indemnity scheme should operate in a manner which provided reasonable protection to the public. Both the existing scheme and the proposed schemes had mandatory insurance cover provided by licensed insurers who were monitored by the Insurance Authority. Hence, there was no reason to believe that there would be a substantially high degree of risk in the future scheme as far as protection of the interests of the clients was concerned. The existing mutual scheme, which made solicitors the insurers of last resort for each other in the event of collapse of the insurer, was unfair to the solicitors. In Hong Kong, no other profession, including doctors who took care of human lives, was subject to the same mandatory requirement.

18. Mr Benny YEUNG opined that the Administration's comment that an indemnity insurance scheme should protect clients from default by solicitors was

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wrongly applied, because the mandatory scheme required under existing legislation did not cover claims arising from frauds by solicitors. In fact, insurance to cover frauds by solicitors could not be obtained. Protection of solicitors' clients against moral hazard, therefore, was a separate issue.

19. Regarding the Administration's proposal on back-up arrangements of PPF and "insurance on insurance", Mr Benny YEUNG said that the former would not become operative in a few years' time even if it was to be implemented. The latter was not readily obtainable, and even if available, would be extremely expensive. On the proposed MPS, Mr YEUNG suggested that further safeguards might be introduced, such as -

- (a) having three or four participating co-insurers for the spreading of risks; and
- (b) limiting the single largest share of a co-insurer and introducing provisions to deal with merger of the co-insurers, and setting requirement of a minimum credit rating of the participating co-insurers.

20. Ms Hilary GORDELL expressed the view that apart from insurer insolvency, the high proportion of claims resulting from conveyancing matters was an important factor contributing to the present difficult situation faced by solicitors. She pointed out that during the period 1997 to 1999, 90% of the value of claims against SIF was related to conveyancing cases. The proportion had now dropped to 50% but the amount was still considerable. She remarked that the situation was related to the absence of land title legislation and the absence of a minimum fee for conveyancing. Of the total disputed cases, about 35% related one way or another to title issues. The situation in Hong Kong was that it was difficult to prove title conclusively, given the absence of a satisfactory land title system. An inadvertent error might give rise to a negligence claim. The present plan to introduce land title for primary properties only would not assist in a material way because the significant problem area was the secondary market properties, where solicitors were still facing great difficulties in obtaining proof of title. Therefore, the inherent risk to solicitors still had not been removed. The hardship of solicitors was further compounded by the very low conveyancing fees they charged for the transactions. Ms GORDELL considered that means to reduce the risks to solicitors connected with conveyancing transactions had to be examined in addressing the issue of professional indemnity of solicitors.

21. Mr Larry KO said that the bottom-line of the PIS Action Group was that it did not accept that solicitors should be made the insurers of last resort for each other and solicitors should be asked to make additional contributions to make up for any unexpected shortfall of SIF. He said that the PIS Acton Group might be prepared to accept mutuality of liability up to \$500,000 for each and every claim.

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22. Ms Phyllis KWONG briefed the Panel on her written submission (LC Paper No. CB(2)2775/03-04(01)). The paper highlighted the following issues -

- (a) the principles for a professional insurance scheme and the framework of the solicitors' indemnity rules;
- (b) the flaws of the existing PIS;
- (c) professional insurance arrangements in England and Wales, New South Wales, Ontario and Quebec;
- (d) features of an MPS, QIS and a "Captive" insurance model; and
- (e) suitability of replacing the existing scheme with a Captive model.

23. Ms Phyllis KWONG said that she had recommended the alternative of replacing the existing scheme with a Captive model. She explained that a Captive was similar in nature to a mutual scheme, conducted through the medium of a licensed insurer who was subject to similar regulation as that of other licensed insurers but with lower capital requirements. A Captive insurance insured only the profession which owned it and operated for the benefit of its owner. In the Willis Report, it was pointed out that -

*"A captive insurer licensed under the Insurance Companies Ordinance and incorporated in Hong Kong could provide to the public and to solicitors all the benefits of the current scheme with the added benefits 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."* (page 132 of the Report); and

*"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 with the Asian Region."* (page 133 of the Report).

Ms KWONG said that in her view, a Captive model was in line with public policy of protecting public interests and affording adequate protection to the profession, with the added benefit of limited liability and being regulated. She called upon the Law Society and the Administration to consider the merits of adopting the model to substitute the existing scheme.

24. Referring to the reference in Ms Phyllis KWONG's submission to practitioners' contribution to payment for defence costs to "Panel solicitors" defending claims against the SIF, Mr Peter LO drew members' attention to the information set out in the table in page 51 of the Willis Report. He explained that defence costs were incurred for defending and investigating claims.



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Average defence costs as a proportion of total losses from 1987 to 2000 was 29.2%. As at 30 September 2003, the amount of defence costs paid in relation to claims notified for the indemnity year ending September 2001 and September 2002 was about \$11.4 million and \$1.2 million respectively. Mr Peter LO advised that the figures would have to be updated when all the relevant claims had been decided.

Issues raised by members

25. Ms Miriam LAU said that she felt extremely disappointed after reading the Administration's paper and the responses provided therein. She criticized the Administration for being "blind to the problems and deaf to the pleas of solicitors", stating its own position merely from the moral high ground of public interest but offering no constructive advice on practical means to save solicitors from the dire situation. She said that as the Law Society had pointed out, there were serious implementation difficulties regarding the back-up mechanism of a PPF and "insurance on insurance". Ms LAU urged the Administration to get down to detailed discussions with the Law Society without delay, with the purpose of working out viable solutions to the problems. She added that in the end, it would be difficult for LegCo to support any new scheme if the scheme was not supported by the Administration.

26. Ms Miriam LAU further asked the Law Society and the Administration to study the feasibility of the Captive insurance model suggested by Ms Phyllis KWONG. The issue of conveyancing fees, mis-management of the indemnity scheme and conflict of interests etc should also be examined carefully.

27. The Chairman said that the primary legislation imposed compulsory insurance and required solicitors to comply with the relevant rules made by the Law Society Council. She opined that as the solicitors profession was a self-regulating profession and the Law Society was in the best position to assess the difficulties and the best means to deal with them, the Administration was not expected to work out with the Law Society the form of the future indemnity scheme. Nevertheless, the Administration should take a positive and helpful attitude in assisting the profession in appropriate ways, particularly in matters involving policy and law drafting. LegCo also played an important role as legislative amendments to implement any changes would be subject to its scrutiny.

28. The Chairman and Mr Martin LEE asked whether the Administration and the Law Society had plans to discuss with each other on the relevant issues. SASG and Mr Lintern-Smith responded that there had already been dialogue between the Solicitor General and the Law Society and the discussions would continue. SASG said that the views expressed at meetings of the Panel on the various options concerning the future indemnity scheme would be taken into consideration by the Administration.

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29. Mr Albert HO said that he hoped that members of the profession could soon reach a consensus on the future indemnity scheme and report the result to the Panel. Legislative amendments to implement any agreed changes could then be proceeded with as soon as possible. He opined that while it was accepted that the profession as a whole had a duty to protect the interests of the clients, whether or not the profession should continue to shoulder unlimited exposure to claims in the event of insurer failure was a separate issue which should be resolved urgently. Mr HO said that he personally supported the retention of an element of mutual liability, without which small solicitors firms might find difficulty in obtaining the insurance cover at affordable costs. However, for the protection of solicitors, mutuality should be limited to a certain level without the requirement for solicitors to make further contributions to meet any unexpected shortfall of the indemnity fund. Mr HO stated that he was in favour of the MPS option which featured an agreed level of retained mutual liability. He further opined that the alternatives of a Captive model and a fund established from levies should also be studied.

30. Mr Lintern-Smith advised that the Law Society had been looking into the matter of reducing mutuality of liability. At one stage, the possibility of removing mutuality was considered. However, it was recognized that to do away with mutuality altogether might result in prohibitively high insurance premium, or insurers refusing to provide cover at all. Under the MPS, there would be three to five co-insurers. Nonetheless, the risk of insurer failure would still exist. The possibility of making the co-insurers jointly and severally liable for that insured liability which was left uncovered by the failed insurer had been explored but such arrangement was found not viable. The current recommendation of the Law Society was that the agreed level of retained mutual liability under the MPS should not exceed \$1.5 million for each and every claim.

31. On the issue of limiting the liability of solicitors, Mr Lintern-Smith pointed out that there were statutory limits introduced in New South Wales. In England and Wales, a system existed under which limits on solicitors' liability for negligence claims by clients were set out in contractual agreements. He advised that the Law Society was currently studying the model of limited liability partnerships for solicitors practice and restriction of liability contractually in the light of the experience of England and Wales.

32. Mr Peter LO said that in considering the preferred future scheme, the Law Society had no pre-conceived views as to the level of retained mutual liability. The retention of \$1.5 million was proposed having regard to negotiation with commercial insurers and the reality of the insurance market. He further said that the previous shortfall in SIF resulting from the collapse of the HIH Group, the insurer, had been covered through top-up contributions to the fund made by members of the profession in 2003. At present, SIF was in a solvent state.

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33. Ms Phyllis KWONG expressed the view that the possibility of a shortfall in the reserves of SIF could be reduced by more effective management of the fund resulting in lower management costs, as well as reducing the costs of defending claims.

34. In response to the Chairman, Mr Lintern-Smith said that the suggestion of a Captive model of insurance would be further studied by the Law Society. With regard to the proposal on a fund financed by levy, Mr Patrick MOSS said that it was secondary to the three major options put forward by the Law Society in its questionnaire issued to solicitors but it could be factored into the future scheme for further consideration by members of the profession after the future basic scheme was decided.

35. Ms Hilary GORDELL said that in considering the future scheme to be adopted, it was necessary to look at whether the scheme was adequate for the protection of the interests of the public as well as whether it was affordable to practitioners of the profession. She hoped that the Law Society would adopt an open mind and analyse the different schemes so that solicitors could make an informed decision on the preferred scheme. In her opinion, once the basic structure of the new scheme was agreed and a mandate was obtained from members of the profession to pursue the scheme, the Law Society could proceed to work out the actual details of the scheme and the relevant legislative amendments with the Administration. She further commented that in view of the pressing timetable, it was important to get support of the Administration at an early stage for the development of a new scheme. The essential issues to be sorted out included whether mutual liability should be retained, or, given proper protection of the public interest, could be dispensed with.

36. Mr Sandara KRISHNAN said that public interest involved not only protection of the public but also the development and maintenance of a representative and vibrant legal profession comprising small, medium and large solicitors firms in Hong Kong.

Way forward

37. The Chairman said that the views expressed by the Law Society and solicitors had reflected the grave problems facing the profession which the legal community as a whole and the Administration should be seriously concerned about. She suggested and members agreed that she would write to the Secretary for Justice (SJ) on behalf of the Panel to bring SJ's attention the importance and urgency of resolving the problems. The Administration would be urged -

- (a) to consider whether it was essential for any proposed scheme to be backed up by a PPF or "insurance on insurance" arrangement; and

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- (b) to respond without delay to any decision reached by the Law Society after its consultation with members of the profession.

*(Post-meeting note - A letter from the Chairman to SJ was issued on 16 June 2004 (circulated vide LC Paper No. CB(2)2841/03-04(01)).*

38. The Chairman asked whether the Law Society could revert to the Panel on the updated position at the last regular meeting of the Panel in the current legislative session to be held on 28 June 2004. Mr Lintern-Smith replied that the Law Society might be able to give a broad indication on the preferred scheme, subject to the progress of its consultation with its membership. Members agreed that the Panel should follow up the issue, pending the response from the Law Society.

*(Post-meeting note - The Law Society replied to the Panel in writing on 28 June 2004 that it was awaiting the responses to the questionnaire issued to all solicitors, the closing date for which was end of June 2004. The Law Society considered that it was not likely that it could conclude discussions with the Administration and report to the Panel before the end of the current legislative session. The Law Society's reply was circulated vide LC Paper No. CB(2)2992/03-04(01)).*

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