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

**Background brief prepared by the Legislative Council Secretariat  
for the meeting on 23 January 2006**

**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 (CJ).

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. 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. At the request of the subcommittee, the Law Society agreed 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. 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).

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

#### Findings and recommendations by the Willis Report

10. 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. The major findings and recommendations of the Willis Report are summarised in **Appendix I**. 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.

11. The Willis Report had proposed two major schemes alternative to the existing Scheme, i.e. a Master Policy Scheme (MPS) and a Qualifying Insurers Scheme (QIS). The features of the two alternative schemes are highlighted in paragraphs 12 and 13 below.

#### MPS

12. 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

13. 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.

14. 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.

#### Views of the Administration

15. 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; and
- (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.

#### Views of the Law Society

16. The Law Society supported mandatory indemnity insurance for solicitors. 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.

17. 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.

### Views of members of the profession

#### *PIS Action Group*

18. 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.

19. Other views expressed by individual members of the Action Group attending the meeting are summarized below –

- (a) further safeguards might be introduced in the proposed MPS, such as having three or four participating co-insurers for the spreading of risks; and 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;
- (b) an MPS Retained Level of \$500,000 might be acceptable; and
- (c) the high proportion of claims against practitioners in the profession resulting from conveyancing matters was an important factor contributing to the hardship facing solicitors. The problem was related to the absence of a comprehensive land title legislation and the absence of a minimum fee for conveyancing. 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.

#### *Individual solicitors and solicitors firms*

20. 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 acceptable to the profession provided that this could be done.

*Survey conducted by Hon Margaret NG in October 2003*

21. 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 the 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 HIH Group, which was the reinsurer of SIF.

Views of the AJLS Panel

22. 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.

23. 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.

24. 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.

**The Law Society's option of a QIS**

25. At the Panel meeting on 22 November 2004, the Law Society informed members of its updated position on the future scheme as follows –

- (a) members of the Law Society voted in favour of a QIS at an Extraordinary General Meeting (EGM) in November 2004. The Society had commenced the drafting of a new set of rules for putting in place a QIS to replace the existing scheme;

- (b) it was expected that the rules could be approved by the Council of the Law Society in May 2005, and thereafter submitted for approval by CJ and scrutiny by LegCo. Meanwhile, the Law Society was discussing with the insurance sector concerning the practicalities of implementing a QIS; and
- (c) as the Administration had reservation about the proposal on QIS, the Law Society would continue discussion with the Administration with a view to achieving a compromise.

26. At the Panel meeting on 27 June 2005, the Law Society briefed the Panel on the proposed QIS and provided a copy of the 4<sup>th</sup> draft of the Solicitors' Professional Indemnity Qualifying Insurance Rules. The Law Society pointed out that a more realistic date for implementing a QIS would be 1 October 2006.

#### Views of the Administration

27. The Administration advised that it would not oppose the introduction of a new scheme to replace the existing scheme, provided that the new scheme could afford sufficient safeguarding of the interests of solicitors' clients in the event of insurer insolvency. The Administration had requested the Law Society to provide for its consideration further justifications as to why a QIS would be acceptable in the public interest. The Department of Justice (DOJ) had also identified a number of issues about the proposed QIS and would take them up with the Law Society. DOJ would review its position and revert to the Panel, once the response from the Law Society was received and considered.

#### Views of PIS Action Group

28. Members of the Action Group attended both Panel meetings on 22 November 2004 and 27 June 2005. The views of the Action Group were summarised as follows –

- (a) the Action Group was extremely disappointed that a QIS could not be implemented by October 2005, resulting in the present scheme having to be extended, and solicitors suffering the risks of mutual liability, for a further year;
- (b) the Law Society should take efficient action to obtain information from insurers, including the terms and conditions under the QIS and the likely costs of QIS to different types of solicitors firms. The Law Society should also require its appointed consultant to provide the market response and pricing information. Such information should be given to members of the Law Society as soon as possible to enable them to consider the viability of the QIS option;

- (c) a scheme without mutual liability, other than to a very limited extent if absolutely necessary, and without being subsidised with contributions should be adopted. The scheme should be affordable and viable over the long term, and should work with proper regard to risk containment. Title insurance would be the best means to achieve this; and
- (d) the Law Society should provide regular progress reports on the timetable and work plan for the implementation of the new scheme. The membership of the working committee of the Law Society should be expanded, and the Society should arrange forums to which representatives of the insurance industry and the Administration would be invited to discuss the QIS and the stakeholders' concerns.

29. In response, the Law Society pointed out that –

- (a) at the Law Society's EGM on 16 November 2004, the majority of members of the Society voted for the QIS option to replace the existing scheme;
- (b) after the EGM, a committee with representatives including the Action Group was authorised to draw up the minimum terms and conditions for the QIS, which were being negotiated by the Law Society with more than 40 prospective insurers. Expressions of interest had been received from the majority of them. The Law Society expected that the consultant appointed by it could complete a report by end of July 2005 on the response from commercial insurers, and the minimum terms and conditions could be finalised in August 2005. A Qualifying Insurers Agreement (QI Agreement) with the insurers would be drafted after the minimum terms and conditions were agreed and the qualifying insurers identified;
- (c) some of the solicitors firms that fit into the representative profiles would be invited to participate in a costing exercise with an intending insurer, with an understanding that the results of the exercise would be given to members of the Law Society for information on a no-names basis. It was hoped that the result of the exercise would give solicitors firms some indication of the likely pricing and the costs of the QIS. The costing exercise was expected to be undertaken in around September 2005; and
- (d) there would be interim meetings with members of the Law Society before finalisation of the whole structure of the QIS and arriving at a decision on the viability of the QIS, which was anticipated to be achieved in early 2006. It was expected that solicitors firms could then deal with the insurance arrangement under the new scheme between May to September 2006.

Issues raised by AJLS Panel members

*Claims Committee*

30. A member asked whether the Claims Committee of the Law Society would be retained under the QIS to continue to handle claims, and if so, whether this would be stipulated in the QI Agreement. The Law Society responded that the issue had not yet been resolved as there were arguments for and against the retention of a claims committee. The response of the insurance market would have a bearing on the ultimate decision on the matter. The Law Society considered that the benefits of a claims committee were as follows –

- (a) as members serving on the claims committee provided their services free of charge, there would be cost saving for the insurers as far as the handling of the claims was concerned; and
- (b) a claims committee could more competently discharge the function of reporting professional malpractices and misconduct which it found in the course of examining claims.

*Timeline for implementation of the proposed QIS*

31. A member asked about the timeline for implementation of the proposed QIS. The Law Society advised that the target of putting in place the QIS by September/October 2006 would be achievable. The pressing issue was the early finalisation of the minimum terms and conditions acceptable to both the members of the Law Society and the insurers. The Law Society would consider the views of all concerned parties and stakeholders as the negotiation progressed.

32. DOJ indicated that its Law Drafting Division would offer its best professional services on drafting matters after receiving the draft rules from the Law Society. It would take about three months for the Division to consider the draft rules before submission of the rules for CJ's approval.

33. Another member expressed concern about the ability of the Law Society to implement the new scheme before October 2006, as there were still complex and controversial issues to be resolved before the Law Society could actually proceed with the work on the draft rules, and taking into account the time required for completion of the legislative process. She urged the Law Society to expedite the work, and engage its membership in forum discussions with a view to reaching decisions on the way forward at the earliest opportunity.

*Possibility of retaining the existing scheme*

34. A member asked whether there would be possibility of retaining the existing scheme if the QIS in its final form was ultimately rejected by members of the profession. The Law Society responded that in the event of the insurers coming back and insisting on terms which the membership found unacceptable, or where the pricing and costs were found to be prohibitively high as shown by the costing exercise, it would be open to the membership to further decide whether the QIS option should be dropped. The Law Society would be responsive to its members' views, and would seek to apprise its members of the progress of implementing the new scheme through various channels, including posting the information on the Society's website. Where necessary, meetings of its membership would be convened to discuss matters. Another general meeting of its membership would have to be held if a decision to change direction was to be made and endorsed.

*Title insurance scheme*

35. A member suggested that a title insurance scheme should also be considered as a fall-back alternative to a general indemnity insurance scheme, as it was found that most of the claims against solicitors firms arose from conveyancing work undertaken by the firms.

36. The Law Society responded that the law required the provision of indemnity insurance of solicitors against claims for civil liability arising out of practice. The possibility of adopting interim measures which fell short of the statutory requirement would be limited. Under title insurance, the person insured would be the owner of the property, not the solicitor. To use title insurance to absorb the liability of solicitors arising from civil claims would be a complex matter which required detailed consideration.

*Way forward*

37. The Panel requested the Law Society to update the Panel on developments in the implementation of the proposed QIS so that the Panel could continue discussion in the new legislative session.

38. The Panel also requested the Administration to provide a written response to explain its position on the proposed QIS and its views on whether the proposed QIS would offer reasonable and adequate protection of the public interest, taking into consideration the information provided by the Law Society.

**Latest development**

39. The Law Society will brief the Panel on the progress in the implementation of the proposed QIS at the Panel meeting on 23 January 2006.

**Relevant papers**

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

Council Business Division 2  
Legislative Council Secretariat  
18 January 2006

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

**Major findings and recommendations of the Review Report on Insurance  
Arrangements of the Hong Kong Solicitors Indemnity Scheme prepared by Willis  
China (Hong Kong) Limited (the Willis Report)**

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

- (a) solicitors are generally dissatisfied with the existing Scheme under which solicitors are 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 are considered unfair, giving rise to grave problems as solicitors are required to meet calls for extra contributions to Solicitors Indemnity Fund to make up for any deficit of the fund. The issue about balance of risk between solicitors who are responsible for the negligence claims and solicitors who are not should be addressed;
- (b) the Willis Report has looked at possibilities of adopting different types of schemes and altering the current arrangements, so that in the event of insurer failure the liability will not fall on members of the profession as a whole. Such new arrangements, however, represents a fundamental and significant policy change and will involve legislative amendments for implementation;
- (c) two major schemes alternative to the existing Scheme have been proposed, i.e. a Master Policy Scheme and a Qualifying Insurers Scheme; and
- (d) the Willis Report has also proposed risk banding so that solicitors who practise in areas of law that can more likely result in claims should contribute more, as well as increase claims loading for firms making claims.

**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
- [CB\(2\)2060/04-05\(04\)](#)  
(*English version only*) -- Paper on the proposed Qualifying Insurers Scheme (QIS) and summary of the principal provisions of the 4<sup>th</sup> draft of the QIS Rules
- [CB\(2\)1903/04-05\(01\)](#)  
(*English version only*) -- 4<sup>th</sup> draft of the Solicitors' Professional Indemnity Qualifying Insurance Rules

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
- CB(2)248/04-05(06)
- Paper dated November 2004 provided by the  
Administration on the Administration's updated  
position relating to the review of professional  
indemnity insurance

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
- [CB\(2\)386/04-05](#) -- Minutes of meeting on 22 November 2004
- [CB\(2\)2502/04-05](#) -- Minutes of meeting on 27 June 2005

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
- [CB\(2\)311/05-06\(01\)](#)  
*(English version only)* -- Letter dated 3 November 2005 from Hon Margaret NG enclosing a set of key correspondence provided by Mr Rene Hout concerning the Claims Committee of QIS
- [CB\(2\)338/05-06\(01\)](#)  
*(English version only)* -- Reply of the Law Society to Hon Margaret NG's letter in Appendix VII to LC Paper No. CB(2)311/05-06(01) concerning the Claims Committee of QIS