



THE

LAW SOCIETY

OF HONG KONG

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26 January 2006

Department of Justice
Legal Policy Division
Queensway Government Offices
66 Queensway
Hong Kong

By Fax and By Post
(Fax: 2869 0720)

Attention: Ms. Kitty Fung, Senior Government Counsel

Dear Sirs,

Professional Indemnity Scheme

I refer to the Administration's comments and issues raised in its paper to Legco dated 23 January 2006, LC Paper No CB(2)935/05-06(02).

Using the same numbering as the paper:

- 3(i) All the local professional indemnity insurers and reinsurers, as well as close to forty other Authorised Insurers in Hong Kong who do not currently write professional indemnity insurance were approached by the Law Society through its broker, Aon Hong Kong Ltd. Out of these, seven professional indemnity insurers and three reinsurers have expressed interest to participate in a Qualified Insurance Scheme ("QIS") in Hong Kong, and confirm that they can follow the latest draft of the minimum terms and conditions. Except for one reinsurer (who acts as a reinsurer for another prospective qualifying insurer), all of them are Authorised Insurers in Hong Kong. In addition, a number of Lloyds' syndicates have expressed interest in participating in a QIS in Hong Kong, although they have not yet confirmed whether they can follow the minimum terms and conditions. These Lloyd's syndicates are not

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The Law Society of Hong Kong

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Hong Kong insurers, but they are authorised to conduct insurance business in or from Hong Kong.

If one of the major selection criteria is that qualifying insurers be authorised by the Office of the Commissioner of Insurance to conduct business in Hong Kong, Lloyd's syndicates ought to be able to be qualified subject to confirmation that they are willing to follow the minimum terms and conditions. The Law Society does not wish to reduce competition by restricting qualifying insurers to Hong Kong Insurers only.

3(ii) Other major selection criteria include agreement to comply with the minimum terms and conditions, and experience in writing professional indemnity insurance. Most of the qualifying insurers who have accepted the minimum terms and conditions have long standing expertise in the field of writing solicitors' professional indemnity insurance either writing top up cover above the existing Professional Indemnity Scheme arrangements or for similar QIS schemes internationally.

3(iii) The Law Society will be selecting the qualifying insurers.

4. The interested insurers and reinsurers have been asked whether they are willing to include what is known as a "cut through" clause in their reinsurance contract. To date, the majority of them advise that they are unable to agree. Apart from the legal technical issues surrounding cut through clauses, it seems doubtful whether they would be effective in practice in that, insurers normally maintain treaty reinsurance, which protects an insurer for losses (above a particular threshold) arising from all books of business underwritten by that insurer in a particular class of business, eg, professional indemnity insurance, in a particular year. As such, it is difficult in practice to include a cut through clause in a treaty reinsurance contract but only with respect to one account, that is, QIS, and not others. Furthermore, some insurers have advised that they may opt to absorb losses within QIS themselves, and may not access treaty reinsurance at all.

The Law Society understands that the Government's prime concern is consumer protection. In this respect, the Law Society notes that the Insurance Company Ordinance sets in place a system of prudential supervision of authorised insurers in Hong Kong, aimed to ensure the provision of an adequate level of security and services to the public. The Office of the Commissioner of Insurance, headed by the Commissioner of Insurance, is appointed as the Insurance Authority for administering the Insurance Companies Ordinance, as well as authorising and regulating

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insurers. Authorized insurers in Hong Kong are required to comply with prescribed minimum requirements on paid up capital, solvency margin, fitness and propriety of directors and controllers, and adequacy of reinsurance. Further, we understand that the Insurance Authority is empowered under the Insurance Company Ordinance to take interventionary actions to protect the interests of actual and potential policy holders. Lloyd's syndicates are authorised to carry out insurance business in or from Hong Kong, and are subject to similar regulatory requirements as authorized insurers, as well as the interventionary powers of the Insurance Authority. It is for this reason that one of the major selection criteria for a qualifying insurer that is being considered and likely to be adopted is that an insurer must be authorized by the Office of the Commissioner of Insurance to conduct insurance business in Hong Kong.

- 5 & 6. The Law Society agrees that it is in the interest of the Insured and Insurer that risk management guidelines are introduced to help reduce future claims. However, the Law Society does not feel that it can compel or require qualifying insurers to impose risk management guidelines for the insured.

In any event, the Law Society has a mandatory risk management education programme that is aimed at minimising and managing the risk of a firm's exposure to claims and reducing the extent of loss which may arise from such claims. In addition, there is already in place a professional code of conduct for members.

On the question of reinsurance, we would inform you that seven out of the ten insurers and reinsurers who have expressed an interest in participating in a QIS have indicated that they would not agree to a "cut-through" clause. One has indicated that it could accept a cut through clause provided it received a premium from the insured (rather than the insurer as is normally the case).

In these circumstances we do not consider reinsurance to be a requirement that could reasonably be imposed on qualifying insurers or our members.

We are advised that individual insurers may enter into reinsurance arrangements in respect of their obligations, but parties who contract with the insurer do not have direct access to the same.

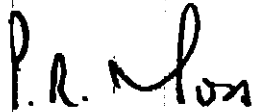
Further, some or all insurers may opt to absorb losses within QIS themselves, in which event such losses might not be covered by treaty reinsurance at all.

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In these circumstances we would invite you to inform us whether the Administration is willing to support a QIS in the absence of any reinsurance requirement being imposed on qualifying insurers, because such a requirement is incapable of being fulfilled.

Yours faithfully,



Patrick R. Moss
Secretary General

cc: Mrs. Percy Ma, Clerk to Panel, Panel on Administration of Justice and Legal Services

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7 February 2006

Department of Justice
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(Fax: 2869 0720)

Attention: Ms. Kitty Fung, Senior Government Counsel

Dear Sirs,

Professional Indemnity Scheme

I refer to my letter of 26 January 2006.

I write to clarify paragraph 3(i) of my said letter.

Under section 6 of the Insurance Companies Ordinance Cap. 41 ("the Ordinance"), 3 types of entities are not prohibited from carrying on insurance in Hong Kong, namely:-

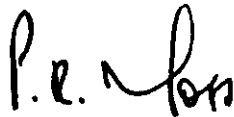
- (a) those authorized by the Insurance Authority under section 8 of the Ordinance to carry on insurance business in Hong Kong;
- (b) Lloyd's; and
- (c) an association of underwriters approved by the Insurance Authority.

The Law Society does not wish to reduce competition by restricting qualifying insurers to Hong Kong insurers (i.e. those incorporated in Hong Kong) only. However, one of the major selection criteria is that qualifying insurers shall be

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insurers permitted under section 8 of the Ordinance to carry on professional indemnity insurance business in Hong Kong.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'P. R. Moss', written in a cursive style.

Patrick R. Moss
Secretary General

→ cc: Mrs. Percy Ma, Clerk to Panel, Panel on Administration of Justice and Legal Services (Fax: 2509 9055)

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16 February 2006

Mr Patrick Moss
Secretary General
The Law Society of Hong Kong
3/F Wing On House
71 Des Voeux Road, Central
Hong Kong

Dear Mr Moss,

Professional Indemnity Scheme

Thank you for your letters of 26 January 2006 and 7 February 2006, responding to this department's paper of 23 January 2006.

As you know, this department has been concerned to ensure that any new scheme to replace the existing Professional Indemnity Scheme should be in the public interest. The manner in which a new scheme would deal with an insolvent insurer has been a prime concern. Over the past two years, we have suggested a number of ways in which consumers might be protected, the latest being a form of re-insurance. We note with gratitude that the Law Society has explored these various suggestions, but understand that none of them is a viable option.

We have therefore to decide whether or not to give support in principle to the Qualifying Insurance Scheme ("QIS") that the Law Society proposes to introduce. In coming to a decision, we have noted that –

- (1) the QIS is modelled on that in the United Kingdom, and so can be considered to be an advanced and competitive scheme;
- (2) the UK QIS does not provide protection in the event of insurer insolvency;

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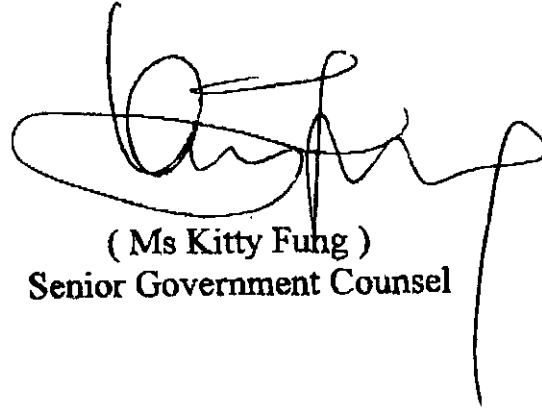
- (3) a QIS can be more beneficial to consumers than a mutual fund in that it tends to force negligent solicitors out of business;
- (4) although there are still a few schemes in other jurisdictions that make lawyers insurers of last resort, the large amount of funds in those schemes are such that lawyers are not likely to be badly hit by an insurer insolvency – the same cannot be said to be the case in Hong Kong;
- (5) it is not possible to justify the continued imposition on Hong Kong solicitors of the insurer of last resort concept;
- (6) the Law Society has explored ways of providing, under the QIS, some protection to consumers against insurer insolvency, but this is not viable.

In the light of these considerations, the Department of Justice considers that the Law Society has done its best to produce a scheme that will generally ensure that valid claims against solicitors will be met. It therefore supports in principle the implementation of the QIS, subject to the following conditions.

- (1) The Law Society should continue to give adequate consideration to the interests of consumers when finalizing the details of the new scheme.
- (2) The main differences between the existing and new scheme, so far as consumers are concerned, should be highlighted in the papers to be submitted to the Legislative Council when negative vetting takes place.
- (3) The Law Society should proactively publicize and explain the new scheme through the media and, possibly, through the Consumer Council.

We also suggest that the LegCo Panel on Administration of Justice and Legal Services should monitor the implementation of the new scheme.

Yours sincerely,



(Ms Kitty Fung)
Senior Government Counsel

cc : Hon Margaret Ng
LegCo (Attas Mrs Percy Ma)

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