

**The Professional Indemnity Scheme (PIS)
and
the Qualifying Insurers Scheme (QIS)**

1. Under PIS indemnity is provided to solicitors against civil liability incurred in connection with Practice (as defined in the Solicitors (Professional Indemnity) Rules) (the Indemnity Rules).
2. Under PIS indemnity is provided by a fund established under the Indemnity Rules (the Fund) which all “principals in Practice” (as defined in the Indemnity Rules) have to “maintain” as provided in the Indemnity Rules.
3. PIS indemnity is provided to the extent of HK\$10 million per claim, subject to the Exclusions and Conditions in Schedule 3 of the Indemnity Rules.
4. The Fund is managed and administered by Hong Kong Solicitors Indemnity Fund Limited (SIF), a company limited by guarantee formed for the sole purpose of such management and administration.
5. If a claim is made against a solicitors’ firm, the firm will notify SIF, which will normally take over the management of the claim and defend or settle the claim as the case may be, with the assistance of the Claims Manager and solicitors. SIF will provide indemnity against liability under the claim to the extent of HK\$10 million per claim, inclusive of defence costs.
6. It is proposed to replace PIS with QIS.
7. Under QIS the same amount of indemnity in respect of the same type of liability will be provided to a solicitors’ firm.
8. The main difference between PIS and QIS is that under QIS indemnity will be provided by one or more Qualifying Insurers selected by the firm and not by the Fund to which the principals in Practice contribute.
9. The proposal to change from PIS to QIS arose out of dissatisfaction with the fact that under PIS solicitors were in effect insurers for each other and also insurers of last

resort, because of their statutory obligation to “maintain” the Fund. Under QIS, if a Qualifying Insurer is unable to pay a claim because of insolvency, the firm which the policy was originally intended to cover will have to personally pay the claim.

10. However, QIS does not mean that solicitors could obtain professional indemnity insurance in any manner they like. As a condition of their being qualified to practise, solicitors’ firms must have in place “Qualifying Insurance”.

11. Qualifying Insurance means a policy issued by one or more of a group of “Qualifying Insurers”. To become a Qualifying Insurer, an insurance company must agree to be contractually bound by a set of “Minimum Terms and Conditions” which must be in each policy and which will override any other term or condition in the policy.

12. The Minimum Terms and Conditions are part of the QIS Rules and are designed to protect the interests of solicitors’ firms and their clients. For example, they provide that the insurer is not entitled to avoid or repudiate the insurance on any grounds whatsoever including, without limitation, non-disclosure or misrepresentation, whether fraudulent or not.

13. The intent of such a provision is that whatever happens between the firm and the Qualifying Insurer, a successful claimant against the firm will be paid by the Qualifying Insurer.

14. As mentioned above, a firm which does not have Qualifying Insurance will not be permitted to practise. There is however a provision to provide Qualifying Insurance for firms which, for one reason or another, are unable to obtain Qualifying Insurance. This is the Assigned Risk Pool (ARP).

15. The Qualifying Insurers have the responsibility for offering cover under the ARP. The premium for ARP cover is high: the current estimate is 27.5% of gross income of a firm. No firm is entitled to remain in the ARP for more than 24 months in a 5-year period. The intention is that if a firm is unable to obtain Qualifying Insurance outside the ARP after the 24 month period, it must cease to practise.

16. The ARP can be said to have a punitive and deterrent effect and members of the Law Society have expressed concern over its effect. The system is copied from England and Wales but it did not produce a catastrophic effect. A report issued by the English Law Society is attached as Appendix A.

17. A total of 8 meetings have been held between the Law Society and the Department of Justice since the Government indicated acceptance in principle by letter dated 16th February 2006. Further meetings have been scheduled with a view to finalizing the QIS Rules by early April. Subject to resolution of all outstanding issues the Law Society proposes to put the entire QIS proposal as embodied in the QIS Rules to its members for approval at an EGM to be held on 27th April 2006.

18. If QIS is implemented, PIS will remain in existence until all claims notified to PIS up to and before QIS is implemented are dealt with. Certain consequential amendments will have to be made to the Indemnity Rules, including a provision for a call for further contribution, in the event that the Fund is insufficient to meet all claims notified. The Fund has made full provisions for all claims notified and the existing re-insurance arrangements of the Fund are that re-insurers will be responsible for all amounts in excess of the first HK\$100 million of the liability of the Fund for the indemnity year ending 30th September 2006. Nevertheless, it is prudent to provide for a power to call for further contributions if required because it will be a number of years before all claims are finalized.

19. Members of the Law Society will be reminded to notify all claims and circumstances giving rise to a claim to PIS before QIS comes into effect, so that they may enter QIS with a clean slate.

20. Members who have ceased practice before QIS comes into effect will also be reminded to notify all claims and circumstances giving rise to a claim to PIS before QIS comes into effect, because unless so notified, they will have no indemnity cover for such claims after PIS is replaced by QIS.

21. There are a number of “domestic” issues which need to be resolved by members of the Law Society. These are set out in the President’s Message for the April 2006 issue of Hong Kong Lawyer. A copy of the Message is attached as Appendix B.

Dated 27 March 2006.



The Law Society

AC 03 2006 04 Item 4

ASSIGNED RISKS POOL

Summary

The purpose of this paper is to give the Audit Committee information about the Assigned Risks Pool (ARP), which the Committee may not be familiar with. The paper includes an assessment of the risks associated with the ARP, and concludes that no further action is needed.

Recommendation

The Audit Committee is invited to note this report.

Financial and Resourcing implications

There are no financial and resourcing implications arising directly from this paper.

Equality and Diversity implications

There are no equality and diversity implications.

Freedom of Information

This paper is public.

Consultation

This paper has been prepared for the Audit Committee directly.

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Date of Report	9 March 2006

Background

1. The Assigned Risks Pool (ARP) was created to provide professional indemnity cover for a limited period to those firms that find it difficult to obtain cover from the commercial market. Without this, firms would be forced to close, perhaps as a result of short-term difficulties which had led to problems in obtaining insurance.
2. Firms are covered by the ARP for a limited period only, because it would not be acceptable for those who cannot obtain cover on the commercial market to be protected indefinitely. Firms are allowed to stay in the pool for a maximum of 24 months in any 60 month period. If they cannot obtain cover on the commercial market by then, they will have to close. Firms in the ARP are subject to monitoring visits by the Forensic Investigations Unit of the Society's Compliance Directorate.
3. Qualifying insurers are required to participate in the ARP in proportion to their share of the market for mandatory insurance by reference to premium income. Each qualifying insurer bears its due proportion of the ARP losses.

(All insurers authorised to conduct business in the UK can become a qualifying insurer provided they sign a Qualifying Insurer's Agreement under which they agree to:

- *Issue policies that comply with the minimum terms and conditions.*
- *Participate in the ARP.*
- *Report suspected dishonesty to the Compliance Directorate of the Law Society.*
- *Agree to arbitration arrangements for disputes between insurers.*

In the 2005/06 indemnity year there are 25 qualifying insurers.)

4. The ARP is managed by managers appointed by the Law Society, currently Capita London Market Services. They supply regular reports to the Regulation Unit on each firm in the ARP, and to the Indemnity Insurance Committee and the Market Liaison Committee. The Indemnity Insurance Committee meets approximately once a month to oversee the indemnity scheme and make any necessary policy and technical changes. The Liaison Committee meets approximately once every two months and is the forum by which the market and the Society exchange views and discuss indemnity insurance issues.
5. The table on the next page provides information about the number of firms in the ARP and the premiums paid/due.

Assigned Risk Pool - Five year trend

	firms paid in full	firms paid in part	Firms not paid	Total	£'000 premium due	£'000 premium paid	£'000 premium unpaid
2004/5	21	7	8	36	716	350	366
2003/4	30	15	10	55	1,498	596	902
2002/3	39	4	13	56	2,188	1,144	1,043
2001/2	115	6	13	134	2,035	1,336	699
2000/1	48	5	15	68	1,578	869	709
Five year total	253	37	69	349	8,015	4,295	3,719
Average	50	7	14	70	1603	859	744

Discussion

What risks does the ARP pose for the Society?

- The Society simply appoints the managing agent, who is FSA regulated. The agent holds the funds on the insurers' behalf in client accounts. The client is not the Law Society but the insurers who commit themselves to the ARP. The financial risks are theirs.
- The participants' premiums, topped up by the qualifying insurers' contribution constitute the ARP's income; the expenditure is the claims paid out and the managing agents' costs. The Society has no beneficial interest in the money.

Governance

- The ARP is not a legal entity. The Regulation Board's Indemnity Insurance Committee is responsible for overseeing the performance of the managing agents. There is no need, nor would it be appropriate under the General Regulations, for the Council or its Corporate Governance Board to have any involvement in the ARP's governance.
- The Council has a representative interest in the ARP as it has on a range of indemnity insurance issues - for example, in maintaining the ARP's availability to the profession and in the level of premiums and cover required.

Role of Law Society staff

- There is no need for Society Finance staff to have a role in ensuring that proper Treasury controls are in place. Law Society staff should not be authorised cheque signatories and should not authorise transactions.

Accounting

- The ARP does not fall under FRS2 guidelines for the consolidation of accounts, nor is it a related party for the purpose of disclosure in the Law Society's accounts.

President's message for Hong Kong Lawyer April 2006

QIS Issues

In February 2006 the Department of Justice indicated that a Qualifying Insurers Scheme (QIS) was in principle acceptable to the Government. Since then there has been a series of intensive working sessions between the Law Society's Working Party and the Law Draftsman to finalize a draft of the Solicitors (Professional Indemnity) (Qualifying Insurance) Rules (QIS Rules). Two fora were held in March, one in English and one in Chinese, to explain the proposal for QIS to members and to answer their questions and to hear their views.

As a result of the working sessions and the fora, certain important issues have been identified which should be brought to the attention of all concerned. They arise mainly out of the effect of the proposed change on the cessation of practice by members both before and after the date on which QIS is implemented in replacement for PIS (the Implementation Date).

Run-off Cover

A principal concern is run-off cover. Where a firm ceases practice, there is a possibility that a claim may be made against the partners of that firm after cessation of practice. Indemnity against such claims is called "run-off cover". Under QIS, there is a requirement for run-off cover if a firm ceases practice after the Implementation Date. As regards firms that ceased practice before the Implementation Date, there will be no run-off cover except to the extent that claims notified to PIS before the Implementation Date will be covered by PIS. This could have an impact on firms which have already ceased practice or will cease practice on the Implementation Date.

Under PIS, "former solicitors" are provided with indemnity against claims arising after cessation of practice even though they no longer make contributions to the PIS Fund.

This provision is in Rule 10 (2) of the Solicitors (Professional Indemnity) Rules (the Indemnity Rules).

Under QIS, a firm which ceases practice is required to have run-off cover for a period of 6 years after cessation. Claims are generally time barred after 6 years because of the limitation period, but there are exceptions to this general rule. This is a complicated area of the law. However, the insurers who have indicated that they wish to be QIS insurers are only prepared to provide run-off cover for 6 years. By contrast, the position under PIS is that there is no time limit in respect of the cover, though indemnity may be refused in certain circumstances, such as where non-compliance with the Indemnity Rules has "involved or led to a substantial prejudice". This provision is in paragraph 1 (2) (vii) of Schedule 3 of the Indemnity Rules. For exclusions and conditions under PIS generally members should refer to the entire Schedule 3.

Members have asked how much run-off cover is going to cost under QIS. "Guesstimates" have ranged from 250% to 400% of the last premium paid. I emphasize that members should not rely on the guesstimates, because the amount of premium will depend on the assessment of the risk by Qualifying Insurers at the relevant time.

The run-off cover problem will only arise if a firm ceases business and there is no "Successor Practice" to a "Prior Practice" as proposed to be defined in the QIS Rules. The general idea is that the QI policy of the Successor Practice will cover claims which arise against the partners of the Prior Practice. This is again a complicated matter and the details and cost implications are being worked out.

Unnotified Claims

On the Implementation Date, PIS will cease to provide indemnity except in respect of claims or circumstances giving rise to a claim already notified. What will happen if an unnotified claim surfaces after the Implementation Date?

If a firm were in practice both before and after the Implementation Date claims or circumstances notified before that date would be covered by PIS and those notified on or after that date would be covered by QIS.

However, a firm that ceased practice before the Implementation Date would not have a QIS policy and claims or circumstances that were not notified to PIS before the Implementation Date would not be covered.

Assigned Risk Pool (ARP)

Under QIS, the ARP functions as a catch-all. Firms unable to obtain cover from Qualifying Insurers will be covered by the ARP, but at premiums which are punitive and deterrent. Members asked how much the ARP premium was likely to be. An indication based on the U.K. experience was 27.5% of gross fee income.

In the interest of public protection, the ARP will also provide cover in cases of default, such as where a firm that ceased practice did not obtain run-off cover. Again the actual arrangements are complicated and are being worked out.

A question which is causing concern to the Working Party is what impact the obligations undertaken by the ARP may have on premiums charged by Qualifying Insurers, as they have to finance the ARP. This matter is being discussed on an urgent basis with the proposed qualifying insurers.

What next ?

Every attempt is being made to finalize the draft QIS Rules, which will be the legal embodiment of QIS, with a view to putting QIS into effect on 1 October 2006. However, finalization means not just drafting, but finding solutions to problems. If all goes well, a complete package will be presented to members for approval at an EGM to be held late in April. Members will then have a final say as to whether we should replace PIS with QIS.

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