Professional Indemnity Insurance

How to lessen the impact of rising premiums and preserve cash flow

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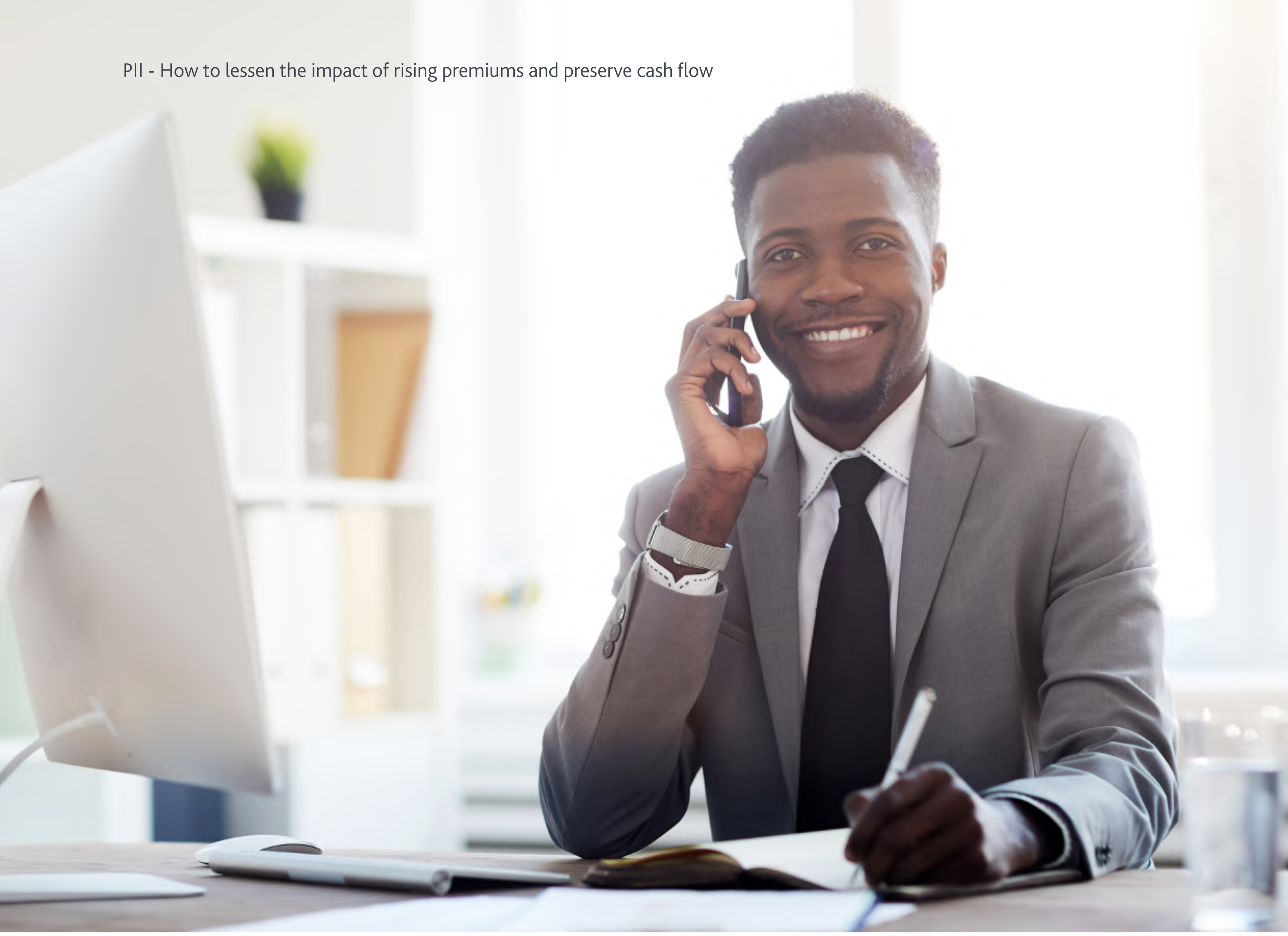

Finding the right and affordable Professional Indemnity Insurance (PII) policy is becoming an increasing challenge for law firms.

Insurance providers are placing more scrutiny on legal firms, due to economic pressures that have ensued since the start of the COVID-19 pandemic as well as the ongoing move to more flexible and remote working which has resulted in a perceived greater risk. This has coincided with higher premiums and some PII insurers withdrawing from the market altogether in the last 16 months.

PII costs have seen significant rises across the recent renewal rounds. Autumn 2020 saw rises of between 20-50%[1] and Spring 2021 brought an average of 30% for firms with at least four partners. Even claim free firms are seeing increases of more than 20%[2].

With the Law Society estimating that the average PII premium represents around 5% of turnover[3], any increase is likely to have a significant financial impact at a time when the pressures of the pandemic are forcing law firms to examine their cash flow like never before. As every penny counts, it is imperative to be well-prepared to find the best policy for your firm as your renewal is approaching.

In Wesleyan Bank's latest guide, we set out the key aspects of PII policies, the factors likely to influence your premium and how law firms can alleviate concerns about paying for premiums upfront by spreading the cost.

1 Lawyers' insurance rates double amid rising claims – The Financial Times

2 'Bleak' picture of massive PII premiums set to remain for now

3 Potential options for SRA PII requirements – Economics, Policy and Competition Ltd

Challenging and changing times

One of the biggest influences in the market are the stringent obligations placed upon insurers by the Solicitors Regulation Authority (SRA). It imposes a set of "Minimum Terms and Conditions" (MTC) which must be offered by any insurer as the baseline for their policies.

The MTC means any policy must have:

- A minimum of £2,000,000 of cover for each claim rising to £3,000,000 for LLPs
- Payment of unlimited defence costs
- Excess to be paid by the insurer if it is not done so by the firm
- A six-year "run-off" period of cover should the firm stop trading during the policy period regardless of whether the run-off premium is paid.

The SRA's annual review for 2018/19 (published in December 2020) found that within that 12 month period 1,245 claims were made of which 488 were settled[4]. The largest agreed settlement was for £794,000. This can affect premium levels and policy settings as insurers anticipate heightened risks in a volatile trading environment.

Uncertainty about the longer-term impacts of the pandemic and the likelihood of a recession are naturally determining appetite within the insurance markets. Historically, an economic downturn is followed by an increase in professional liability claims[5].

There are also some business streams which attract more claims, so firms working in residential conveyancing, commercial property, commercial litigation and wills and probate tend to face higher premiums because of greater perceived risks based upon previous experience. Insurers will also take into account growth in particular sectors. For instance, the stamp duty freeze has led to an increase in conveyancing work and could cause concern about a proportional rise in potential claims because of higher case loads.

Claims management companies are also driving upward cost pressures as they are increasingly prepared to take advantage of the MTC provisions to contest issues in relation to advice given in personal injury settlements.

Getting the structure right

Understanding how a firm operates helps an insurer assess the level of perceived risk which influences premium levels. Since the first lockdown in March 2020, home and remote working are now a necessity for many and this inevitably leads to questions about how this affects a firm's risk profile.

Insurers want to know:

- What safeguards are in place for how client instructions are evidenced, managed and supervised?
- What are the procedures for the remote access of files and documents and how is that managed?
- What oversight do line managers and partners have of those working remotely?
- What apps or software do staff use outside of the firm's network to complete their work?
- What protections are in place for preventing data or system breaches and losses?
- What cyber threat training do staff receive and how frequently?

PII premium and run-off cover can notably increase if there is a lack of evidence of robust IT security and back-office systems and protocols as they can be more susceptible to unscrupulous criminal activity.

4 Client Protection Review 2018/19 – Solicitors Regulation Authority

5 Running for cover – The Law Society Gazette

Getting prepared

Two key PII renewal periods are April and October and it's important to begin the work required well before the due date. This will give you and your team the time to collate and then review the information, make additions and complete the proposal process.

As with any insurance policy it is important not to think that the lowest price is necessarily the best one.

As the Law Society says: "You're purchasing a claims service, so you need to consider carefully whether that service and the support you will need will be there for you in the event of a claim being made against your firm[6]."

To make this decision most firms rely on a broker with a knowledge of the market to identify the right insurer for your firm and negotiate the policy on your behalf.

Whether you have a retained partner or not, brokers should not just have fleeting contact when the renewal is due. More reputable operators should maintain an ongoing relationship and act as a trusted business advisor with a good understanding of your firm to help you through the renewal process.

Importantly, if a claim should ever be made, they should be ready and able to support you to manage the relationship with the insurer. You also need to know if your chosen broker is fully independent. If they are tied to a single or pre-agreed panel it may limit your options. If they have a restrictive panel, consider engaging with another broker to get a whole market view.

One factor to remember is that there are a limited, and dwindling, number of insurers working in the legal market. There is little to be gained from seeking multiple quotes through different routes from the same insurer. It may even count against you as insurers may speculate why you have changed companies on a regular basis, potentially without good reason.

6 PII buyers' guide – The Law Society

Presenting the facts

Take the opportunity to assess your risk and compliance procedures and where you see any weaknesses take steps to strengthen your approach.

This will show insurers that you are serious about issues and will see you as more attractive option for them.

To assess the level of risk and set the premium, insurers want a clear and concise assessment of the firm and the business.

This is where working with a good broker is invaluable as they can work with you to help you provide the information required by the insurer to prepare the quote.

Standard requirements usually cover:

- Structure and finances
  - Outline the firm's profile and structure, practice areas and key achievements of the business, partners/ directors and staff
  - An overview of the client base – private or corporate clients and any perceived risks
  - Show the firm's financial position by providing the last two years' accounts and turnover, cash flow and fee income forecasts for the year ahead
  - Clarify any management or staff incentives/bonuses and state how those are awarded
  - Have you merged with any other firms in the last two years and, if so, are there any relevant issues to declare?
  - Explain any new business or value-added areas activities which may be part of the business plan and could pose exposure to risk
  - Outline any planned structural changes and include any expected senior management team changes and potential financial implications in the next 12 months
- Risk management
  - Demonstrate best practice within the firm and highlight accreditations
  - Emphasise how you manage and supervise staff working from home to ensure policies, procedures and case management systems are maintained
  - Outline your IT infrastructure and approach to security, which should include how you minimise cyber threats and the on-going training provision for staff, particularly for those working remotely
  - Provide clear evidence of your continuity planning, not only around COVID-19 but for other 'business as usual' threats
  - Be candid about any claims over the last five to 10 years, their outcomes and what has been learnt and changed to prevent a reoccurrence
  - Set out any dealings had with the regulator.

Insurance company underwriters will carry out due diligence on your proposal and the information supplied. Make sure there are no discrepancies in your disclosure as insurers can conduct a simple internet search or review the Law Society's listings to ascertain the facts. There have been cases of insurers repudiating insurance policies for non-disclosure, misrepresentation and even failure to pay the policy premium.

Be aware there is an increasing tendency for insurers to ask partners/directors for personal guarantees. If this is raised as part of the negotiation be sure to gain a full understanding of who is affected, what levels of guarantees are required and in what circumstances would they be called upon.

Set the plan

Tempting as it may seem when you're juggling heavy workloads, do not leave the work to prepare the proposal application until the last minute. Create a project plan and establish a critical path to know what, where and when tasks need to be completed.

Make sure you allow plenty of time to speak to your broker(s) to understand the current market and insurers' needs. Similarly, liaise with other management team members and partners at your firm whose input be required giving time to gather, prepare, analyse and amend the information.

In recent years, the proportion of firms moving away from traditional 12-month policies to 18 or even 24 months has been rising. A previous Law Society PII renewal report found that 34% of firms were now opting for policy with a longer duration – a 4% increase in a year[7].

PII funding preserves cash flow

PII can represent one of the single largest expenses that a law firm can face annually. With PII renewal dates often coming soon after HMRC tax deadlines, the funding of PII can fall at a time when cash is in short supply.

Due to the additional impact of coronavirus, many firms may be concerned about their ability to pay for premiums upfront. To avoid a significant impact on your cash flow and to ensure working capital is available for other vital areas of the business, an unsecured PII loan can mean not having to rely upon bank overdrafts or placing pressure on other credit lines.

Paying in monthly instalments can be beneficial, given that many law firms experience peaks and troughs in revenue throughout the year. Specialist finance providers, such as Wesleyan Bank, can offer flexible finance solution to enable the cost of PII premiums to be spread over a period of 10 to 18 months.

As a strategic partner of The Law Society, you can be assured that Wesleyan Bank has the expertise and knowledge to support your practice whatever your unique requirements.

To find out more and to speak to one of our dedicated and knowledgeable account managers today on **0800 980 9348** or visit **wesleyan.co.uk/commercial**.

7 Professional Indemnity Insurance Research Report 2017-18 (issue date 20th September 2018) – The Law Society

To enquire about these loans:

- bankcommercialsales@wesleyan.co.uk
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