THE LOOK OUT

PROFESSIONAL RISKS NEWS

A QUESTION OF SUCCESSION

In This Issue...

Jim Brindley looks at the importance of Succession Planning for law firms and the impact of Professional Indemnity Insurance (PII) and run off insurance requirements have when developing a Succession Plan strategy.

We also discuss the ongoing developments in the PII market and why 2019 may trigger the end to historically low insurance premiums for the legal industry.

I recently attended the Solicitors Regulation Authority (SRA) Compliance Officers conference at the ICC in Birmingham and in one of the breakout sessions “Succession Planning” was hotly debated.

In recent years the question of succession planning and run-off insurance is being asked of me more and more, particularly by law firms with four partners or less. The question of succession planning and how law firms are preparing for succession is likely to be scrutinised more closely by insurers in the coming months, especially if talk of a hardening market comes to fruition.

If we do see a reduction in insurer capacity and stricter acceptance criteria, it is inevitable that insurers will be reviewing firms management plans and risk management procedures in more detail, as we saw in the last hard market of 2008 and 2009 following the credit crunch.

Jim Brindley
Account Executive
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In my experience, partners in this sector (four partner or less) are of a similar age with many nearing retirement. Often in recent years, firms have found it more difficult to promote or bring in younger partners. There are various reasons for this but research clearly suggests that millennials have different life aspirations to the previous generation. So how does a lack of succession planning have an impact on a firms Professional Indemnity Insurance (PII) and how should a firm prepare for the eventuality of retirement?

RUN OFF INSURANCE

Under the PII minimum terms set out by the SRA, a firm when closing is obliged to take out run off insurance for a period of six years. Once an insurer accepts cover they are under an obligation to provide run off insurance for six years should a law firm close its doors, if they are the insurer at the time of closure. The cost of run off insurance typically varies from 250% to 400% of the last annual premium, which can be a substantial cost to smaller law firms. I have seen examples of partners being unable to retire due to the cost of run off insurance and soldier on, hopeful that at some point they can afford to retire! Despite the cost of run off insurance insurers do not like the possibility of providing run off cover due to the six-year policy period, and they are also particularly concerned if a firm enters a disorderly closure.

SIF CLOSURE

In just two years' time, the Solicitors Indemnity Fund (SIF) will close resulting in no future claims being handled or paid. This will have an impact on firms after their six year run off insurance expires. As a result, partners will seriously have to consider purchasing additional run off insurance beyond the mandatory six-year period when contemplating closure and retirement. At present, the insurance market has not reacted to this additional exposure; unlike the mandatory requirement to provide run off, they are currently not obliged to provide additional cover beyond the six years. Any additional cover will be at the discretion of insurers who will apply the appropriate additional charge should they choose to offer run off insurance.

PREPARATION IS KEY

At the conference, panel experts provided good advice on succession planning and how firms can best prepare for closure, and what steps are needed for an orderly closure. One panel member suggested reducing income and high-risk work, such as conveyancing to put themselves in the best position to have more affordable run off insurance. Whilst this seems logical and good advice, we must remember that insurers underwriting professional indemnity insurance calculate premium on, and ask for previous year's incomes and legal work undertaken. For this strategy to bear fruit, a firm would need to start reducing fee incomes and high-risk work up to five years before closure, and wouldn't take into account that some types of work have a limitation period beyond six years.

If a firm is stuck between not being able to afford run off insurance and being unable to attract younger blood, what other options are there? The obvious answer is a sale of the law firm and the acquiring law firm taking on the run off insurance responsibility and becoming a "successor practice". If this is the intended plan, a firm must prepare early and put themselves in the best possible position to be acquired. They should revisit and review their risk procedures and implement, where possible, stronger more robust procedures. Gaining risk accreditations such as Lexcel should be considered. Implementing a stronger risk strategy prior to a sale will put the firm in a better position and result in the new firm and their insurer being more comfortable in accepting your risk and taking on the run off liability exposure. Whatever your preferred option is, it's clear that a long-term succession plan is vital to any firm. Do not leave it to fate.

PII - IS CHANGE COMING?

The October Professional Indemnity Insurance (PII) renewal season saw the first signs that the PII market is beginning to harden. Whilst the majority of law firms still obtained favourable renewal terms, some law firms found they had to move insurers. Firms who purchase cover beyond the minimum limits of £2M and £3M found their excess layer premiums increasing due to a number of insurers exiting the market or reducing their underwriting capacity and acceptance criteria.

In recent years, the insurance market for solicitors PII has become more reliant on MGA based schemes where a Managing General Agent (MGA) underwrite on behalf of a number of insurers and syndicates. MGA backed schemes such as Omnyy, Maven or Pelican can have a number of insurers on the scheme who each take a percentage share of the risk. Many MGA schemes are reliant on the London market.

LLOYD'S OF LONDON REVIEW

Lloyd's undertook a review last year following a £2 billion loss. Part of the review showed poor underwriting performances. Professional Indemnity Insurance was highlighted as one of the worst performing insurance classes and required urgent review. Following this review, a number of syndicates either withdrew from offering PII or reduced their capacity significantly. Libra, who wrote a number of the top 50 law firms withdrew from the market in that summer and a number of the MGA markets have found they have to replace syndicates on their schemes which resulted in different underwriting approaches to certain classes of work undertaken by law firms – hence the need for some law firms to move insurers last October.

FUTURE LANDSCAPE

The next important date is April 2019. A number of law firms are due for renewal during this month and brokers will certainly have more clarity on how the market is responding to the reduced underwriting capacity. Whilst I expect many law firms will still be an attractive proposition to a number of insurers there will be some firms who could find themselves in a more difficult position. It is advisable to prepare earlier this year to put yourself in a better position to react to any change in the insurance market.

PII RENEWAL: IS YOUR INSURANCE DUE?

Following the removal of the common renewal date by the Solicitors Regulation Authority back in 2013 many law firms chose to move away from the traditional date of the 1st October. April and June have now become key months of the year for PII.

If you are looking to review your insurance arrangements for 2019 and are interested in finding how TLO Risk Services can assist your firm, or wish to discuss the above matters, please contact James Brindley on 0121 2121 9090 or james.brindley@tlorisk.com for more information.

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