



The Law Society

A guide to top-up or excess layer insurance:

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Introduction

The Solicitors Regulation Authority (SRA) requires all firms to take out a minimum level of professional indemnity insurance (PII) cover. However, the principals of each firm will need to form an individual assessment about whether this minimum level of cover is sufficient for their practice.

This guide is intended to assist solicitors by outlining a non-exhaustive list of factors that should be considered when assessing the adequacy of their PII arrangements and the potential exposure of the firm to risk.

The guide highlights situations where it may be prudent to purchase top-up or excess layer cover and the potential pitfalls for firms and individual principals if they fail to select the right level of PII.

It is not intended to replace a firm's individual assessment of the adequacy of its individual PII policies or advice provided by insurance brokers.

You should read this advice in conjunction with the [PII practice note](#).

Status of this guide

While care has been taken to ensure that the information in this guide is accurate, up-to-date and useful, the Law Society will not accept any legal liability nor warrant the accuracy of the information within.

Factors to consider in choosing an appropriate level of PII

Is the minimum level of cover sufficient?

The mandatory level of insurance required under a minimum terms and conditions (MTC) policy is £3,000,000 for relevant recognised bodies and relevant licensed bodies (ie ABSs and partnerships that are limited companies - see [glossary](#) definition) and £2,000,000 for all other entities, including sole practitioners. This is sometimes referred to as 'primary layer' cover.

While all firms are required to take out primary layer cover, it is prudent for principals to consider whether additional layers of cover should be purchased to protect the firm, and, [depending on the firm's structure](#), its individual principals, from liability in the event of a large claim that is not covered by the monetary limits of the primary layer policy.

The total amount of PII needed will depend on the firm's size, structure and exposure to risks. For some firms, the mandatory level of cover may be sufficient. However, all firms should undertake a risk assessment to determine their appropriate level of cover.

Situations where the minimum level of cover may not be sufficient

1. A single claim exceeding the indemnity limit

If a single claim is for an amount over the indemnity limit of your policy (for example, £4m) then your primary layer insurer is only required to pay out a sum up to the indemnity limit less any policy excess.

The insured will be liable for the remaining amount, unless additional insurance has been purchased.

2. Aggregation

The mandatory limits apply to each and every claim, meaning that any number of separate claims arising from separate matters can have the full limit of cover applied to each.

Any one claim which exceeds the limit of indemnity, if successful, would mean a shortfall in cover, leaving the insured liable for the uninsured loss.

Insurers are able to aggregate claims in accordance with MTC clause 2.5, which allows the following to be regarded as 'one claim':

(a) all claims against any one or more insured arising from:

- (i) one act or omission
- (ii) one series of related acts or omissions
- (iii) the same act or omission in a series of related matters or transactions
- (iv) similar acts or omissions in a series of related matters or transactions and

(b) all claims against one or more insured arising from one matter or transaction.

Example 1

A number of claims arise from a series of related acts or omissions. The individual claim values are £200,000; £1.3m and £600,000 respectively. The firm is an unincorporated partnership with primary layer cover (ie £2m for each and every claim).

The insurer is entitled to aggregate the claims in accordance with the policy terms and pays out £2m. The firm is liable for the £100,000 shortfall. The structure of the firm means that if the firm itself is unable to meet this obligation, the firm's partners are jointly and severally liable for this amount.

Solution: The firm could have purchased top-up cover. For example, provided the aggregated claims did not exceed the level of top-up cover purchased, the top-up cover insurer (instead of the firm and its partners) would have been liable after the primary limit had been reached and would have paid the additional £100,000.

Conduct a risk assessment

Given the potential situations where the minimum level of cover may not be sufficient, each firm should form an assessment of the likely risk and magnitude of uninsured client loss.

At a minimum, an assessment of the adequacy of the firm's indemnity limits should be undertaken before each PII renewal. However, good practice would be to form an assessment prior to accepting any retainer that that may expose the firm to a risk that is greater than its current indemnity limits.

For example, you should conduct a risk assessment before accepting new clients, or new work from existing clients. As part of this assessment, you will have considered the possibility of being sued should anything go wrong and the possible amount of such a claim, having regard to whether the work is ongoing or one-off.

You should assess the maximum potential exposure of the client and other interested parties, such as its shareholders and creditors. Some clients, such as lenders and local authorities, may ask higher limits on certain transactions.

Larger contracts involving sums greater than the primary cover's indemnity limits need to be carefully reviewed. If you decide that work done for any client creates a potentially higher than average risk, additional premium for excess layer insurance needs to be factored into your decision about whether or not to accept the retainer.

Due to the 'claims made' nature of PII, this is not simply a one-off purchase. The extra cost of top-up cover will extend to future years in order to maintain the increased level of cover, see [how much top up cover should I purchase?](#)

You should evaluate your ability to mitigate the risk (for example, initiate a review by another principal to ensure quality control). After taking any limiting action you must then assess the remaining risk before deciding upon the level of professional indemnity insurance required.

Having carried out an initial risk assessment of procedures when deciding whether or not to accept clients or matters, as part of your annual PII review, you should decide the level of cover required, considering:

- the size of your firm
- the minimum of cover level required by the MTC
- the nature of activities undertaken which impact on your firm's risk exposure, including the nature and level of undertakings accepted
- the likely level of exposure of your firm to claims
- the firm's claims history
- whether it is necessary to be insured for the exact value of the transaction given the likelihood of any negligent act resulting in 100 per cent client loss
- whether your current cover is consistent with that of similar firms, using available resources, such as, industry benchmarking by your broker to assist in this analysis
- the advice from your broker on what cover is available and its cost, and
- the level of the firm's own resources to meet claims. This includes the availability of both firm and personal assets of principals and the reserves held to meet known claims.

This assessment will largely depend on the risk appetite of your firm and its principals.

Consider your options

If your assessment determines that there is a risk that a potential client loss may be wholly or partly uninsured, there are a number of potential options:

- Purchase additional excess layer (also known as 'top-up') cover
- Refuse to accept instructions for a particular transaction that will present an unacceptable risk of uninsured loss, or
- Consider appropriate referral options.

If the risk is due to a particular transaction, consider whether the cost of additional insurance outweighs the benefit of accepting the retainer.

You may also have to consider the impact of any existing client relationship if you decide to turn down the retainer that you consider has an unacceptable level of risk of resulting in uninsured loss. Some lenders, for instance, will insist on practices having insurance cover to the value of the loan.

What is top-up insurance?

Top-up or excess layer insurance is insurance cover above or in excess of the primary layer of insurance. For example, if the primary coverage is £2m and the excess insurance is £8m, there is a total of £10m of cover, because after the losses exceed £2m, the excess insurance will pay for the losses up to a total of £8m.

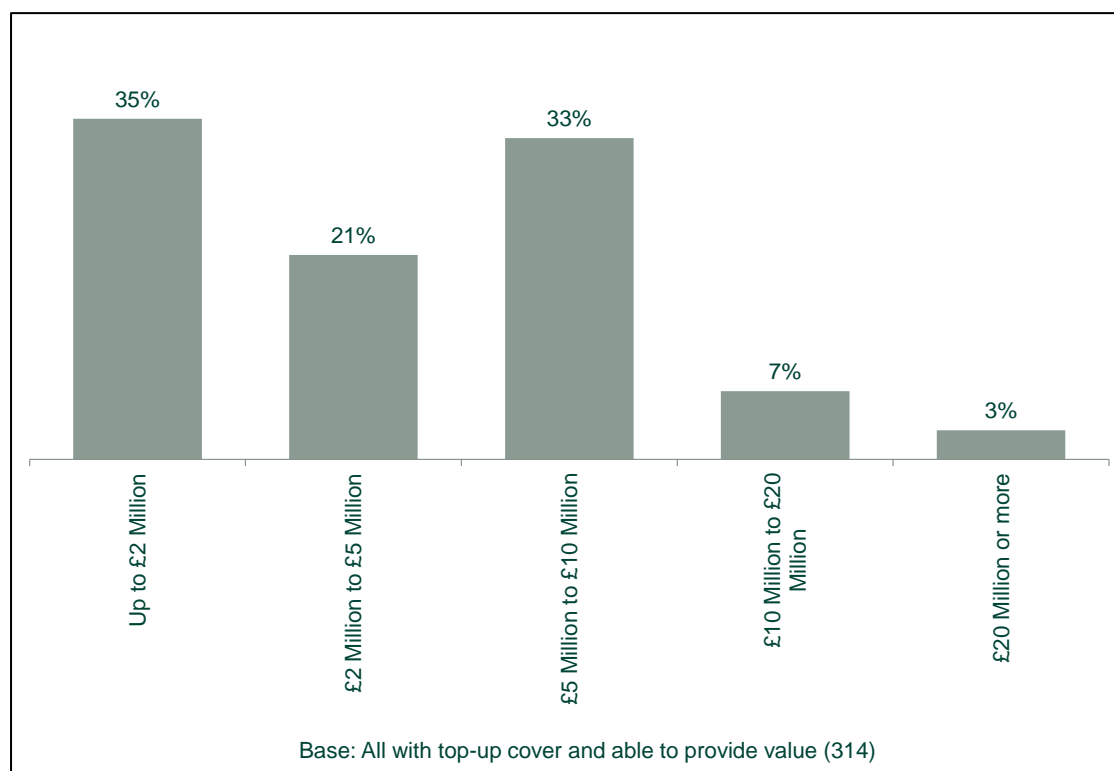
Excess layer insurance should not be confused with a policy excess, that is, the amount payable by the firm under an insurance policy in the event of a claim.

How much top-up cover should I purchase?

Factors to assist you determine the level of top-up cover required are outlined in the section on risk assessment.

According to the Law Society's 2012-13 PII survey, more than one-third of firms (36%) elect to take top-up cover. The likelihood to invest in top-up cover varies with size of firm from a small minority of sole practitioners (7%) to almost all 11-25 partner firms (94%). The level of cover purchased also differed. The median level of cover purchased was £2m for sole practitioners; £4m for 2-4 partner firms; £7m for 5-10 partner firms and £9m for 11-25 partner firms.

The value of top-up cover purchased by those firms surveyed in 2012 is set out below.



IFF research, PII survey 2012, available at: www.lawsociety.org.uk/pii

For how long should top-up cover be maintained?

It is not simply a matter of topping up cover for a single transaction or for a single indemnity year. The 'claims made' nature of the PII system means that it is important to maintain that level of cover whilst a claim can still be brought in relation to that work.

Therefore, in order to be protected, your firm may face higher premiums for a number of years. Six years after the completion of work undertaken is usually the *minimum* amount of time that excess layer cover is kept in place.

This is a factor to consider when accepting retainers for high risk work.

How much will top-up cover cost?

While excess layer insurance are less exposed to the frequency of claims experienced by the primary layer cover, severity of claims reaching into higher limits can impact on pricing generally. Excess layer premiums, although less volatile than primary cover premiums, may still fluctuate and the cost today may not be the same cost in five years time.

This cost should be considered when negotiating a fee on a new large contract requiring increased levels of cover. Although it may be cheaper to sort out higher layers of cover at renewal rather than mid-way through a policy period.

Your broker or insurer will provide you with further information about cost of top-up cover. Many qualifying insurers will offer up to £10m in additional cover. Often higher limits can be purchased for not much more than primary layer premium.

Do I need to purchase top-up cover from a qualifying insurer?

No. The SRA only requires that primary layer cover be purchased from a qualifying insurer (ie an insurer that has signed the SRA's agreement to provide the MTC listed on the [SRA website](#)).

While some qualifying insurers give firms the option of purchasing excess layer insurance, it is not a requirement that your top-up cover be placed with the same insurer as your primary layer or, indeed, even with a qualifying insurer.

You are free to seek quotes from any insurer prepared to write excess layer cover. Your broker should be able to provide you with further information on this process.

It is important to read carefully the terms and conditions of any excess layer insurance. The excess layer policy will not always exactly match the primary layer cover provided within the MTC.

It is important that you understand what is and is not included in the excess layer cover and the effect that this will have on any claims made.

You will also want to ensure the policy provides protection for:

- all of your firm's current staff
- all of your firm's activities, and
- past and new principals and prior practices.

For example, it is likely that the excess layer policy will allow insurers to avoid coverage in the event of non-disclosure or misrepresentation by the policyholder. This is not possible within the primary layer cover in the MTC.

You should also check to see if the cover offered includes legal costs in addition to, instead of within, the limit of indemnity. Defence costs are in addition to the indemnity limits in the MTC but this may not always be the case with excess layer insurance.

As it is possible to arrange excess layer insurance with a number of different insurers, it may be that there are different wordings applied to each level of cover, with some providing lesser cover than the primary layer.

Gaps in cover can then occur, again leaving the potential for the firm or individual partner to be directly exposed to the risk of uninsured loss (see [consequences](#) below). Your broker should be able to advise you on the insurer options available, including the cost, level of cover available and whether or not the excess layer cover follows the MTC wording.

Professional obligations relating to purchasing PII

You should also consider the professional obligations relating to purchasing PII, the scope of the MTC and your obligations to inform clients contained in the Law Society's [PII practice note](#).

Avoid the severe consequences of uninsured loss

The purpose of a PII policy is for insurers to pay claims, so that liability of the insured is limited to any policy excess.

There is a per claim monetary limit under the minimum terms and conditions primary layer cover, which means that unless the firm has purchased sufficient top-up insurance, if one claim exceeds the limit under the policy, the loss may be partly uninsured.

Depending on your firm's business structure, uninsured loss can have devastating personal consequences. The following are real life case examples.

Example 2

Firm A is an unincorporated partnership that has purchased the £2m minimum level of cover required under the SRA Indemnity Insurance Rules. A claimant successfully sues the firm for £2,500,000 in damages for professional negligence. The firm's insurer pays the first £2m in accordance to the terms of the PII policy.

The partners of Firm A are jointly and severally liable to meet losses that arise from wrongful acts or omissions arising from the ordinary course of business of the firm. This includes the uninsured component of the claim. This means the partners are jointly and severally liable to meet the outstanding £500,000.

Solution: Firm A should have purchased top-up cover to meet any claim that exceeded £2m.

Example 3

A medium sized firm purchased £2m in primary layer cover from Insurers A, £8m excess layer cover from Insurer B and £10m in excess layer cover from Insurer C. The wording of the aggregation clause between the primary and excess layer policies was different.

The primary layer cover contained aggregation clause as required by the MTC outlined above. The excess layer cover contained the following aggregation clause 'any one claim shall mean all claims against any one or more insured arising from the same act or omission or from one series of related acts or omissions'.

Unlike the primary layer cover, the excess layer cover did not permit 'similar acts and omissions in a series of related matters or transactions' from being aggregated as one claim.

The firm received 10 claims each £1m in value caused by similar acts and omissions in a series of related matters or transactions. The primary layer insurer aggregated the claims and paid out a total of £2m.

The first excess layer insurer, Insurer B, refused to pay out for any of the claims because, according to its policy wording, the claims could not be aggregated and therefore each individual claim was worth £1m, which did not exceed the £2m indemnity limit of primary cover. As neither the total or the individual claims exceed £10m in cover, Insurer C was not liable.

The firm was liable for the uninsured loss, that is, £8m. The firm was unable to meet this cost and was placed into liquidation.

Solution: to avoid costly litigation over policy wording and the severe consequence of uninsured loss, firms should check carefully whether different policy wording between excess and primary layers will create a gap in cover.

The safest course will be always be to purchase excess layer cover on the same terms as the primary cover. If that is impractical, then understand any differences and how that will affect your cover.