



The Law Society

The importance of insurer solvency

May 2013



Contents

Purpose of this guide	3
Status of this guide	3
Insurers' financial security is important	4
The true cost of a cheap quotation	4
You may end up paying more.....	4
You may have to close your practice	4
You may have no insurance to pay or defend claims.....	4
You may have to pay a claim out of your own pocket	5
Other obligations	5
Market instability affects the entire profession.	6
Case studies	6
Other issues to consider	7
Transparency requirement	8
Why doesn't the SRA regulate insurers?	8
Financial security ratings	9
What do the ratings mean?.....	9
How should I use this information?	9
Availability of compensation	10
What is the FSCS?	10
Is my insurer covered?	10
Am I covered?	10
Appendix A: Main rating companies	11
Further PII help & support	12

First there was Quinn. Then there was Lemma.

Is your insurer next?

The financial security of your insurer is important.

The recent financial collapses of these unrated insurers should make solicitors think twice before accepting a quote without checking an insurer's financial stability.

The most objective measure of a firm's financial security is their rating. The existence of a rating indicates that the firm has been assessed by an independent rating agency. Unrated insurers are an unknown quantity. They have not been subject to independent scrutiny from a ratings agency. Are you content to make one of the most important purchasing decisions for your practice blindfolded?

Purpose of this guide

This guidance is designed to raise solicitors' awareness of the importance of considering whether their insurer will be able to meet claims under their professional indemnity insurance (PII) policy.

Some members of the profession continue to believe that insurers listed as 'qualifying' by the SRA are vetted in some way. This is not the case. The SRA does not undertake any solvency checks on insurers and does not require a minimum level of financial security for participation in the solicitors' PII market. Indeed, the SRA has decided to change 'qualifying' to 'participating' insurers from 1 October 2013 to more accurately reflect [its role](#).

The SRA has, however, introduced a transparency requirement for all participating insurers. Insurers must now disclose whether or not they have a financial security rating and the provider of this rating. You should use this information when assessing PII quotations. This guide contains some general information about [what these ratings mean](#) to help you assess insurers' financial security. Information about specific insurers and whether they are rated or unrated is contained in the Law Society's [Insurers' Guide](#).

Your broker should also be able to offer advice on an insurer's financial security. They should provide tailored advice on the suitability or otherwise of accepting a quotation from a particular insurer. Solicitors should, however, consider whether their broker is providing an execution only service and whether the advice might be tied to an arrangement with a particular insurer. For more information about choosing a suitable, independent broker see the Society's [PII Buyers' Guide](#).

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.

Insurers' financial security is important

An insurance policy is only as good as the paper it is written on. In other words, the financial strength of the company that issues the policy will determine whether a claim can be paid. Given the long-term nature of solicitors' PII, particularly run-off cover which must be provided for six years, it is important to know that your insurer is financially secure and will be able to meet any claims made on the policy.

You need to be confident that an insurer will meet its obligation to pay claims. This means that an insurer's ability to pay should be foremost in your mind when selecting an insurer.

The true cost of a cheap quotation

While we understand that there may be commercial pressures on firms to choose the 'cheapest' quote for their PII, the true cost of this can be grave. If an insurer becomes insolvent, there may be a steep price to pay in both a personal and business capacity. The Law Society strongly advises its members to think about the true cost of 'cheap' insurance.

You may end up paying more

If your current insurer becomes insolvent in the middle of your policy term, you must find alternative cover within 4 weeks.

Once you have obtained cover from a new insurer, you will effectively have paid a double premium. As your new premium may be more expensive, you may end up paying more than double the cost of that 'cheap' quote.

A senior partner within a 1-4 partner firm reflecting on the experience of dealing with an insolvent insurer, said: "I didn't pay too much attention to whether the insurer was rated or not, but now I understand the difference and fully appreciate what is at risk. You pay too much in premiums to find out that you have got no cover at the end of the day."

You may have to close your practice

If your insurer becomes insolvent after 1 October 2013 and you cannot obtain alternative cover within 4 weeks, you will have to cease practice.

For this reason, the financial security of your firm's insurer should be a matter of importance for everyone within the firm, not just the partners or the person who deals with PII.

You may have no insurance to pay or defend claims

In the unfortunate event that a claim is made against your firm, you will need an insurer with sufficient resources to rigorously defend it. If your insurer is in administration, claims handling will, at best, suffer delays. There is also a high probability that your outstanding claim will not be met in full by the insolvent estate.

The SRA relies on the availability of the Financial Services Compensation Scheme (FSCS) to provide protection against uninsured loss. The FSCS only covers small businesses and does not pay the entire claim.

Practices that are not eligible for protection could find themselves wholly uninsured.

Real life experience

“We shouldn’t have to feel this way [uncertain about the future] because if there was an insurance policy in place it would be the insurer that would be on the line and have to pay out. We hope that we are partially covered by the FSCS but that is by no means certain. You do not want to find yourself having to rely on your eligibility for FSCS compensation. It is really important to get the right cover in the first place.”

Quote from a partner at a 1-4 partner practice insured with Lemma

See: [Am I covered by the FSCS?](#)

You may have to pay a claim out of your own pocket

Depending on your firm’s business structure, uninsured loss can have devastating personal consequences. Principals of a partnership are jointly and severally liable for uninsured losses, while sole practitioners are personally liable.

This can lead to bankruptcy and closure of your practice.

Real life experience

“If Lemma had not been insolvent, the insurer would have had to pay these costs instead of me and my partners...Selecting an insurer is a decision that all partners within the firm should make collectively because they are all on the line if things go wrong.”

Quote from a partner at a 1-4 partner practice insured with Lemma

Other obligations

The Law Society’s [practice note](#) on insolvency of insurers provides further details about your rights and obligations if your insurer becomes insolvent.

Market instability affects the entire profession.

All solicitors will pay if a PII insurer with a large number of policyholders becomes insolvent. There is likely reputational damage if clients with valid claims against firms are not compensated. There may also be an increased demand on the Compensation Fund.

The Irish Compensation Fund which is meeting claims arising out of Quinn's failure, has paid out €1,058 million (as at 15 December 2012). Given the high level of claims, there is now a 2% levy imposed on all insurance policies.

The UK equivalent, the FSCS, is funded by FCA-regulated entities. Your insurer will pay a levy towards this scheme. If there are substantial amounts levied, insurers may pass these costs onto policyholders, which may impact on premiums.

Case studies

Depending on your firm's business structure, uninsured loss can have devastating personal consequences.

Example 1

Insurer A goes into liquidation. Firm B is a three partner firm with an annual turnover of £1.5m. Firm B had been insured with an A-rated insurer from its commencement in 2000 until 2009. It switched to Insurer A, an unrated insurer, in the 2010-11 indemnity period because the premium quoted was substantially lower than its renewal quotation. When Insurer A becomes insolvent in 2012, there are two outstanding claims notified on the policy for the 2010-11 year that are yet to be paid.

C is a former partner of Firm B who left the firm in 2008. C did not have any input into the decision to switch insurers in 2010. The alleged negligent act that forms the basis of one of the claims notified in 2010 relates to work undertaken in 2005 when C was a partner.

The partners of Firm B 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 claim. There is no recourse to the FSCS because the firm's annual turnover exceeds £1m and so it does not meet the eligibility criteria.

C, as a former partner, is covered under Insurer A's policy. If the liquidators of Insurer A are unable to fully meet the claim, C is jointly liable with the firm's partners for any shortfall in the claim that arises from work undertaken while C was a partner in the firm. C has retired and is forced to sell his house in order to meet this personal liability.

Example 2

D is a sole practitioner who retired in 2010 with an annual turnover and net assets of £500,000. D did not have a successor practice and therefore entered into run-off. Insurer E was D's last insurer and must cover the mandatory six years run-off cover policy as required under the minimum terms and conditions. Insurer E goes into liquidation in April 2012. A £2m claim is made on the run-off policy in May 2012.

D is eligible for compensation from the FSCS. The FSCS will only cover 90% of the claim. D is personally liable for the remaining £200,000. As D has retired, D has limited income to meet this claim and faces bankruptcy.

Example 3

Insurer F becomes insolvent on 2 November 2013. There are 1,000 firms insured by Insurer F for the 2012-13 indemnity period. Each of these firms have four weeks to find alternative open market insurance. There is no recourse to the assigned risks pool as it was closed on 1 October 2013.

Insurer G is willing to insure 900 of these firms. It will, however, charge a higher premium than firms were paying under Insurer F because it considers that F's 'under-pricing' of risks was the reason for its collapse. These firms must pay this additional premium to become insured with G for the remainder of the indemnity period or else face closure.

The 100 firms that were unable to obtain alternative insurance are required to be closed by the SRA. If this requires intervention by the SRA, the cost to the firm and its principals can be substantial. Any PII claims that are made while the firm is in the first six years of run-off will fall on the insolvent estate of the insurer. Principals may be eligible for partial compensation under the FSCS if the practice is a small business, however, they still may be personally liable for any uninsured shortfall.

The entire profession may end up paying for these claims if clients turn to the Solicitors Compensation Fund as a last resort.

Other issues to consider

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

You should also consider whether the indemnity limit of your policy is sufficient to cover the potential liability of your firm.

The Law Society has prepared [additional guidance about top-up and excess layer cover](#).

Transparency requirement

The Solicitors Regulation Authority (SRA) has made it mandatory for insurers to disclose credit and financial strength ratings. Insurers must state any rating and the name of the agency that has provided the rating on any quotations provided to you.¹ Insurers must also state if they are unrated and notify the SRA within 5 business days of any changes throughout the indemnity year.

The Law Society supports increased transparency within the solicitors' PII market.

The Law Society's [Insurers Guide](#) details information about insurers prepared to cover different segments of the profession, including their financial security rating.

Why doesn't the SRA regulate insurers?

Neither the SRA nor the Law Society vets, approves or regulates insurers. The SRA has only required transparency of financial security ratings without mandating that insurers must have a certain rating or indeed any rating at all.

Regulation of insurers is undertaken by the Financial Conduct Authority, or, where an insurer from another jurisdiction is passported into the UK system, the financial regulator of that jurisdiction. The SRA only requires that these insurers agree to provide solicitors' PII policies.

¹ See clause 10.3 of the Qualifying Insurers Agreement.

Financial security ratings

What do the ratings mean?

It is important to check an insurer's rating when seeking PII cover.. However, ratings do not guarantee an insurer's financial solvency.

A rating means that an insurance company has been through an independent process by which a rating agency has assessed its financial strength. The two major rating agencies for insurers are Standard & Poor's (S&P) and AM Best (see **Appendix A** for an explanation of the individual ratings provided by each of these agencies). The insurance industry generally regards S&P to be the stronger agency.

While the SRA requires transparency from insurers about whether they are rated, it does not stipulate that insurers meet a minimum level of financial stability. Brokers can advise on whether an insurer is suitable for a particular client; indeed, some brokers will refuse to deal with insurers that they consider to be at risk of financial insolvency. Other brokers will deal with these types of insurers, but only after providing clients with detailed disclaimers.

How should I use this information?

You should use these ratings as a guide to help you assess an insurers' financial security.

If an insurer is unrated, it is difficult for you to assess its financial security as it has not been assessed by an independent rating agency.

The potential for grave personal consequences for individuals in the event of insurer insolvency is [outlined above](#). You should consider this risk when assessing quotations. Unlike rated insurers, the financial stability of unrated insurers is unknown and untested.

Availability of compensation

What is the FSCS?

The Financial Services Compensation Scheme (FSCS) is a compensation scheme provided by the Financial Conduct Authority (FCA) in the event that a financial services provider becomes insolvent or ceases trading. The purpose of the FSCS is to assist individuals and small businesses who are consumers of financial services.

The FSCS only covers small businesses.

Is my insurer covered?

All participating insurers are covered by the FCA's scheme, however, there are limits and restrictions on the types of customers that are covered.

The FCA requires that all insurers must participate in the FSCS; this includes those firms from the European Economic Area (EEA) that are passported into the UK by the FCA.²

The FSCS does not apply to reinsurance contracts.

Am I covered?

It is important to remember that even if your insurer is covered, there are limits on eligibility and amount payable under the scheme. The purpose of the FSCS is to assist individuals and small businesses who are consumers of financial services. It will only pay 90% of an eligible claim.

The FSCS rules are complicated and there are several important restrictions on the scheme in so far as insureds under a solicitors' PII policy are concerned. The key points to note are:

- Partnerships (other than limited liability partnerships) are only eligible to bring a claim if their annual turnover does not exceed £1m and their net assets do not exceed £1.4m.
- Corporate bodies (including limited liability partnerships) are only eligible to bring a claim if their annual turnover does not exceed £1m, and either they have not more than 50 employees or their balance sheet net assets (as defined in section 247(5) of the Companies Act 1985 and section 382(5) of the Companies Act 2006) do not exceed £3.26m.
- Individuals are eligible to bring a claim irrespective of their turnover, net assets or number of employees. This will include sole practitioners and individuals whose practice has ceased and whose policies are in run-off.
- Compensation from the FSCS is limited to 90 per cent of the total amount claimed.
- If there is any shortfall or you are not eligible for the FSCS, you may be personally liable to meet claims.

For more information about whether or not you are likely to be covered by the FSCS, see the FCA's [consumer information](#).

² See the definition of protected insurance contracts in COMP 5.4 of the [PRA Handbook](#)

Appendix A: Main rating companies

As at April 2013

AM Best

Secure	Vulnerable
A++ , A+ (Superior)	B , B- (Fair)
A , A- (Excellent)	C++ , C+ (Marginal)
B++ , B+ (Good)	C , C- (Weak)
	D (Poor)
	E (Under Regulatory Supervision)
	F (In Liquidation)
	S (Suspended)

Standard and Poor's

Long-term ratings

Investment grade

'AAA' Extremely strong capacity to meet financial commitments. Highest rating

'AA' Very strong capacity to meet financial commitments

'A' Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances

'BBB' Adequate capacity to meet financial commitments, but more subject to adverse economic conditions

'BBB-' Considered lowest investment grade by market participants

Speculative grade

'BB+' Considered highest speculative grade by market participants

'BB' Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions

'B' More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments

'CCC' Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments

'CC' Currently highly vulnerable

'C' Currently highly vulnerable obligations and other defined circumstances.

'D' Payments default on financial commitments

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Further PII help & support

www.lawsociety.org.uk/pii

Guidance on financial security

Importance of financial security <http://www.lawsociety.org.uk/advice/articles/pii-insurer-insolvency/>

List of insurers and ratings for 2012 <http://www.lawsociety.org.uk/advice/documents/pii-insurers--guide/> (PDF)

Insolvency of a qualifying insurer practice note <http://www.lawsociety.org.uk/advice/practice-notes/insolvent-qualifying-insurer/>

Information for solicitors with Lemma policies
<http://www.lawsociety.org.uk/representation/articles/firms-claims-outstanding-lemma/>

PII guidance

PII practice note <http://www.lawsociety.org.uk/advice/practice-notes/professional-indemnity-insurance/> – outlines the regulatory requirement to obtain PII and provides an introduction to the application process and market-related issues.

Excess layer / top up cover <http://www.lawsociety.org.uk/advice/articles/pii-excess-layer/> – This guide outlines what should be considered when assessing how adequate your PII arrangements are and highlights situations where it may be prudent to purchase excess layer cover above the minimum required by the SRA.

Setting up practice – regulatory requirements – a guide on the different types of legal practice (from sole practitioner to an alternative business structure) and PII tips for new firms:
<http://www.lawsociety.org.uk/advice/practice-notes/setting-up-a-practice-regulatory-requirements/>

Retirement calculator <http://www.lawsociety.org.uk/advice/articles/pii-retirement-calculator/> – a tool to assist solicitors to work out an indicative figure that should be saved each year as part of their retirement planning to prepare for the likely cost of run-off cover under the mandatory PII policy.

PII Buyers' Guide <http://www.lawsociety.org.uk/advice/documents/pii-buyers--guide/> – a useful guide that explains the different types of intermediaries in the market and has tips to help solicitors get the most out of their relationship with brokers.

Transparency campaign
<http://www.lawsociety.org.uk/representation/articles/broker-transparency-campaign/> – The Society encourages all solicitors to ask their broker what they are receiving in commission this renewal. This disclosure can be used as part of a 'conversation starter' about what level and type of service brokers are providing.

Insurers' Guide <http://www.lawsociety.org.uk/advice/documents/pii-insurers--guide/> – a non-exhaustive list of those insurers who are participating in the market each year. It sets out the segments of the market they are prepared to write and how solicitors can access them (i.e. directly or via a broker).

Insurance matters
www.lawsociety.org.uk/insurancematters – a free magazine with latest market intelligence

Information for firms ceasing to practice or having difficulties

Assigned risk pool & 2013 changes <http://www.lawsociety.org.uk/advice/articles/assigned-risks-pool/>

Closing down your practice: regulatory requirements
<http://www.lawsociety.org.uk/advice/practice-notes/closing-down-your-practice/>

Run-off cover <http://www.lawsociety.org.uk/advice/articles/run-off-cover/>

Latest news

<http://www.lawsociety.org.uk/representation/campaigns/pii/>

Other websites

You can obtain further information relating to brokers and PII in general from the following websites:

Association of British Insurers
www.abi.org.uk

British Insurance Brokers' Association
www.biba.org.uk

Financial Ombudsman Service
www.financial-ombudsman.org.uk

Financial Conduct Authority
<http://www.fca.org.uk/>

Solicitors Regulation Authority
www.sra.org.uk