

Insurance Matters

JANUARY 2010 ISSUE 1

A Challenging Year?

Targeting stable pricing
for Solicitors' PI

Can your risk management
system cope in a recession?

In association with

Aon



The Law Society



The Law Society

WELCOME TO THE FIRST EDITION OF THE LAW SOCIETY AND AON LIMITED'S INSURANCE MATTERS

Inurance Matters will give all of our members market intelligence on solicitors' professional indemnity insurance (PII). Many firms do not have the resources to research and understand market trends or to retain specialist advisers. Furthermore, in recent years there have been a number of instances where lack of communication between market participants has left many firms unaware of and unprepared for changes to the qualifying insurers and their underwriting approaches. We perceived there to be a clear need to provide our members with a service to close this gap.

Insurance Matters will be provided free of charge to every firm in England and Wales three times per year to provide the latest information on the insurance market generally and the PII market specifically.

As in 2008–09, the 2009–10 PII renewal period was very difficult for some members. Whilst the majority of the profession experienced no problem obtaining cover

with little or no increase in their premium, others received greatly inflated quotes or struggled to obtain cover at all.

The Law Society is determined to assist its members to obtain PII at the lowest possible price. In 2009, the Society developed a comprehensive Practice Note offering advice on managing the renewal process and presenting a firm to insurers in the best way possible, and provided a PII Buyer's Guide in association with the insurance industry. The Society also staged an extensive free PII seminar series across the country and provided a dedicated PII Helpline for solicitors during the renewal period.

In response to the 2009–10 renewal period, the Society will be conducting a survey of the renewal experiences of members to better inform how we can best support members, as well as assessing all aspects of the current arrangements. We will also continue to provide as much information to members about the PII

market as possible – starting with this publication.

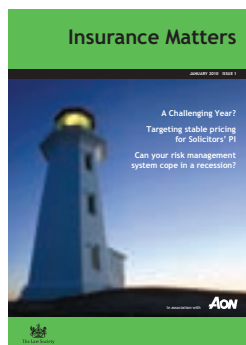
I am confident that by keeping members informed of key issues, changes and trends in the PII market, all firms will be in a stronger position to present their business in a favourable light to insurers and to submit the best possible PII application.

Desmond Hudson
Chief Executive, The Law Society

Do you have any comments on Insurance Matters?

We would welcome your comments on the content or any other aspect of this edition of Insurance Matters. Please email us at: insurancematters@lawsociety.org.uk

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A CHALLENGING YEAR?

“If the frequency can be reduced by better management of risk, it would follow that premiums can be controlled.”

The dust has settled on the professional indemnity (PI) insurance placements for 2009/10, which have taken place during a challenging period for all involved with the market.

There was an expectation that prices would increase significantly during 2009. At the end of September, the Law Society wrote to every PI insurer and the Association of British Insurers stating its concern that premiums would be significantly higher

than last year. The society said that it was aware of some insurers quoting premium prices which were 300% higher than the 2008 costs with no change in circumstance.

There were a number of reasons for the expected increase, not least of which was the recession and fear of a rise in related claims. This year also followed a number of years of relatively soft rates, although there were signs in 2008 that prices were already beginning to harden for the smaller end of the market. ➤

Preliminary data

Although the data for 2009 is still very preliminary at this stage, it does appear that prices have not increased by as much as suggested. Initial results suggest that the overall premium pot increased by only 7% to £241m, which is certainly not as high as originally feared.

There is still competition in the market for Solicitors' PI insurance. There were three new Qualifying Insurers that brought capacity to the sector and who entered into the top seven insurers providing cover to the profession and at Aon we are very pleased to have been able to work with

one of these entrants, XL Insurance. Despite taking a measured approach to winning business, they have attracted a healthy number of clients for their first year of writing for the profession.

Larger insurers have continued to consolidate and smaller players have not shown an appetite for growth but the slack has been taken up by the new entrants.

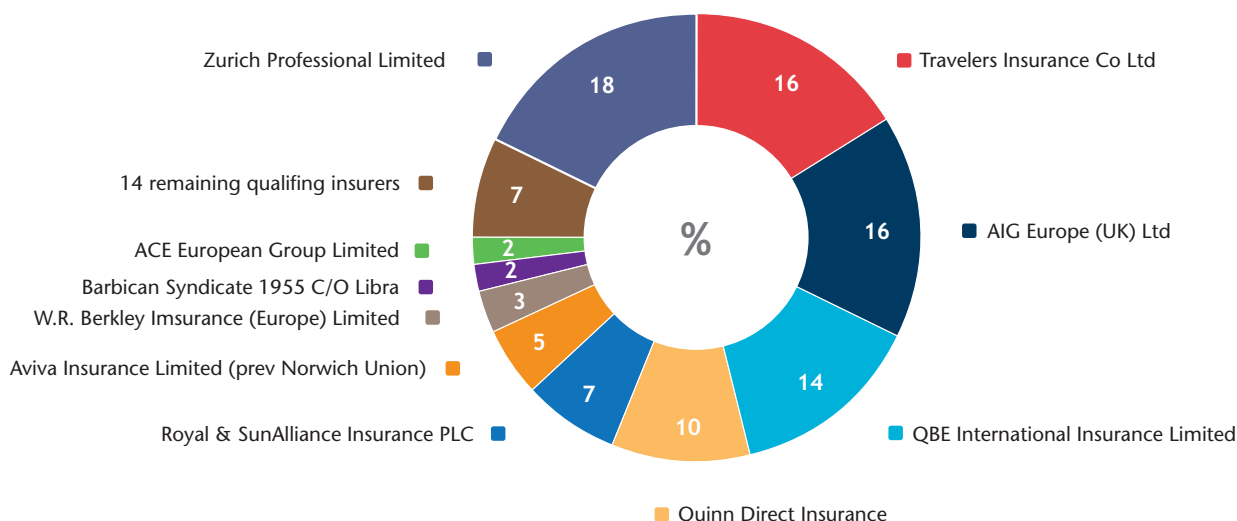
Please see two charts below to show the top 10 insurers who have provided this insurance for the last two years. This is based on the premium in respect of the compulsory part of your cover and does not include the assigned risks pool premium.

Hard, not terrifying market

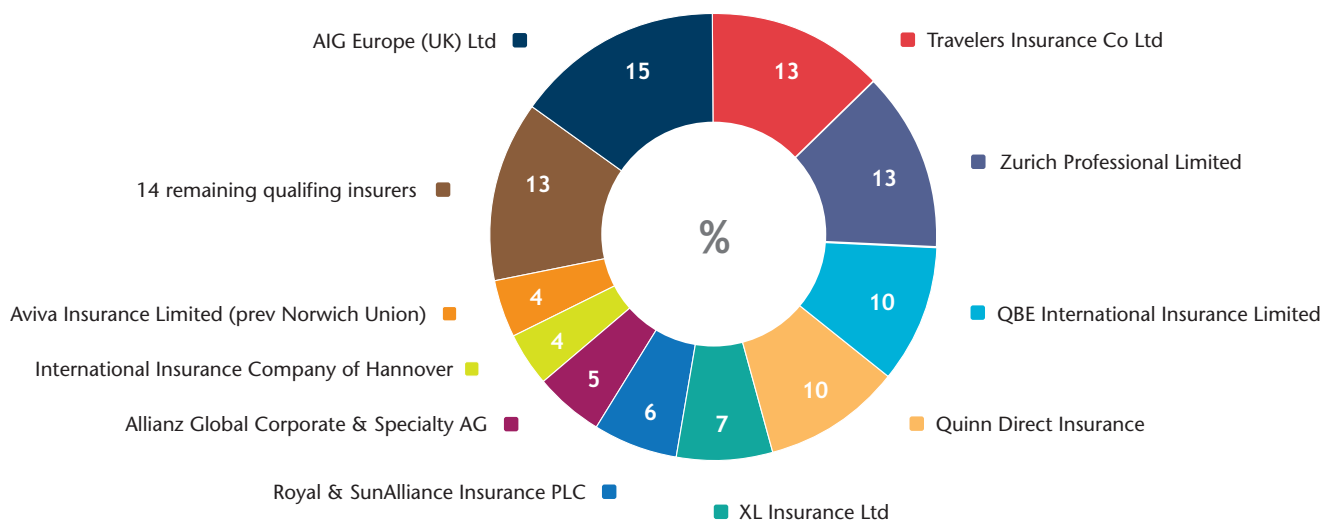
There certainly appears to have been a number of firms that have paid more this year, but a good claims history and individual factors mean that some price rises were not too onerous for some organisations. Underwriters have access to quality data about the sector, which has provided them with the ability to set prices very precisely.

The bottom line is that the PI insurance market is like any other during a hard market: well run practices with good risk management and good or improving loss records will get a fair hearing. In the end,

INITIAL PARTICIPATION 2008 - 2009



INITIAL PARTICIPATION 2009 - 2010





while some parts of the profession have done better than others, the fundamentals remain in place. The prevailing market conditions are a factor, but the health of an individual business also plays a large part in setting the price of insurance.

Looking ahead

While the hard market conditions in 2009 do not appear to have been as painful as some predicted, the factors that encouraged the negative predictions are still very much apparent. It looks like 2010 could be another challenging year. There is an expectation that because we are still in recession there will be an increase in claims, and that will have an impact on how underwriters approach the market.

Even if the UK economy emerges from the downturn early in the New Year, the PI market will continue to be at risk from increased claim levels for some time, particularly as a result of mortgage defaults leading to the potential for claims against solicitors. The legal process behind these claims can take some time to work through the system and the expectation that there are more claims to come could continue to drive prices up for 2010/11.

No matter what direction the wider economy takes, the price of PI insurance will continue to reflect the risk that a firm represents. The same rules apply: if an organisation is well managed and if it contains its claims then this should be reflected in the cost of PI insurance.

We all know that the majority of claims are not as a result of poor legal advice but are normally due to a lack or failing of a system to control risk. This is something

firms can tackle themselves which will make a difference in the long term.

Very few claims tend to exceed the £1m mark, but insurers suffer with a frequency of smaller claims where the combined costs are making certain insureds unprofitable. If the frequency can be reduced by better management of risk, it would follow that premiums can be controlled. At Aon, we have engaged with our clients since 2000, to provide risk management advice and also worked with Local Law Societies to assist as many firms as possible.

It is never too late to consider risk management. It can take some time for the results to reflect in claims records, bearing in mind previous work may not have been carried out up to the same standard. Even if a firm is concerned about their past claims experience, it is important to work with their broker or insurer to find any patterns. In many cases trends can be identified and action taken that can help to give insurers comfort that these claims will not reoccur.

Renewal discussions

Around 10,000 UK-based law firms place their PI insurance on October 1. The frenetic pace of activity during the first weeks of the autumn each year has led to some questioning whether the industry would be better served by staggering the renewal date. The Law Society's council recently voted in favour of abolishing the single renewal date and is moving to put pressure on the Solicitors Regulation Authority (SRA), who have responded that any change is improbable. There are practical reasons why the system was put

in place like this in 2000. We feel that there are positives and negatives to the current structure.

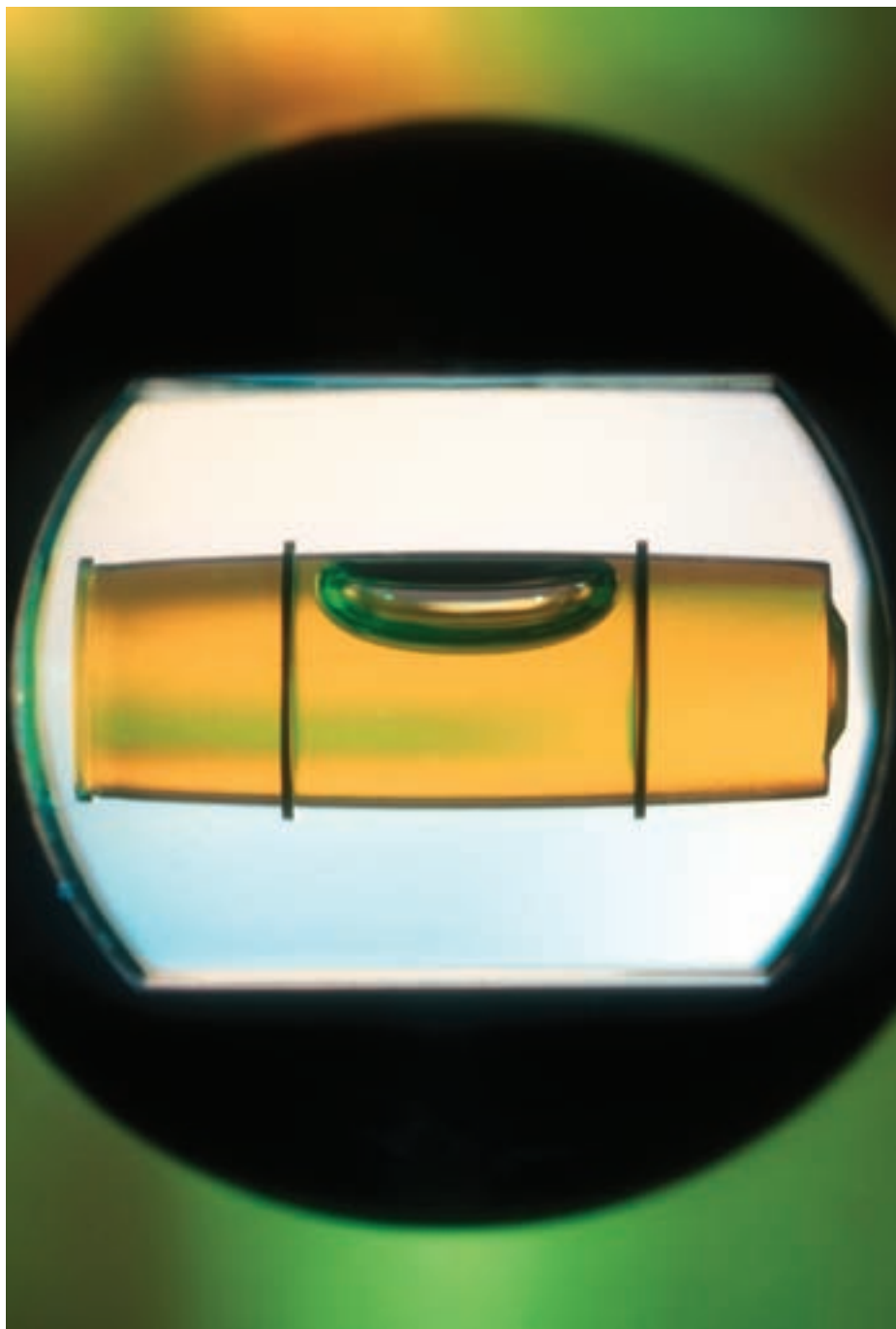
Changing the renewal date will not resolve all the issues, which are as much as a result of wording and coverage as a single renewal date. The profession needs to consider what insurers would do with regard to pricing if firms could choose their renewal date. At the moment one of the reasons that the market remains competitive is that each insurer does not know what the other one will charge and as a result, they risk losing their share of the premium if they overprice the risks presented to them. With a smaller percentage of the profession going to market at any one time insurers may be encouraged to test the market at higher pricing as they would only be putting a small proportion of their book at risk rather than it all.

In addition, the insurance market moves from a soft to a hard market in a cycle and premiums can fluctuate depending on the renewal date. At certain dates there will certainly be capacity in the market and therefore competitive pricing but later in the year as renewals come up there may be less capacity with fewer insurers remaining in the market and less potential for lower prices. Choosing the best date to go to market would become a consideration; one that solicitors don't have to think about at the moment.

There are other issues that will not be resolved by changing the renewal date. The review of the Successor Practice Rules and the Assigned Risks Pool will certainly help. This year the insurer Travelers showed on their quotations that 3% of their quoted premium goes towards their contributions to the Assigned Risks Pool which is an indication of the cost to both Qualifying Insurers and in turn the profession.

We also believe that the SRA should consider the entry requirements to practice law and, the timely intervention into the behaviour of high risk firms to improve regulation of the profession. Many of the issues that cannot be tackled by risk management, stem from poorly qualified professionals or delayed intervention. Positive action in these areas would make the market more attractive to insurers and in turn new competition from insurers could lead to more favourable premiums. ■

Nicholas Gilbert, *Director, Aon Limited*
Ryan Senior, *Director, Aon Limited*



TARGETING STABLE PRICING FOR SOLICITORS' PI

As one of the new entrants referred to in the previous article, XL Insurance had done its homework before teaming up with Aon to offer solicitors' PI in the UK. We knew there was demand and felt that we had the capacity as well as the underwriting expertise, having offered this product for many years as primary insurer in the US and on an 'excess basis' in England and Wales.

XL Insurance has extensive experience in tailor made solutions. However, we understand that in a market set around minimum terms and conditions designed

to protect the consumer should there be a valid claim against a solicitor, the flexibility of this insurance is somewhat limited. Consequently the price often drives the market with the focus being on the claims scenarios expected by insurers. We feel that this correlation can be broken as solicitors can significantly improve their own 'insurance profile' independently from the market through good risk management. As part of our long-term commitment to offering this insurance cover we feel that underwriters should also contribute to these improvements around risk management. By engaging with our clients and the Law Society to discuss best practice, we believe the volatility around claims can be reduced.

For this it is important to understand that we believe a large number of PI claims against solicitors are not based on poor legal advice by the solicitors, but on insufficient business procedures. Over time a solicitors' 'insurance risks' profile can be enhanced by improving their practice management, with a beneficial impact on the solicitors, including their insurance premiums, and their insurers. We are committed to working in partnership with Aon in getting this message to our clients. Sometimes the solutions in avoiding business claims can be as simple as ensuring deadlines are met, completeness of documents and proper file keeping. We understand that small offices don't have a large back office support, but the best legal practice can be let down by bad business basics.

Supporting solicitors in improving their risks will, in our view, over time remove some of the price volatility seen in this market. For some firms Solicitors' PI cover is the second largest cost next to staffing. Stable insurance premiums will help, especially smaller firms, in budgeting and planning for the years ahead, leaving them more time to conduct their business in a stable environment.

We are committed to work with solicitors and the Law Society to engage in risk management to ensure a negative claims forecast does not turn into an inevitability, whatever the economic times. ■

William Wharton

Chief Underwriting Officer, Professional Lines UK at XL Insurance "XL Insurance" is the global brand used by member insurers of the XL Capital Ltd (NYSE: XL) group of companies.



The Law Society

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Helen Bunker, Partner, Piper Smith Watton LLP

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Birmingham

contact **James Frost**
tel **0121 253 3227**
fax 0121 253 3083
email james.frost@aon.co.uk

Bristol

contact **Marco D'Ovidio**
tel **0117 948 5116**
fax 0117 948 5087
email marco.d'ovidio@aon.co.uk

Leeds

contact **Nigel Bennett**
tel **0161 910 5320**
(mobile 07507 870455)
fax 0161 910 5249
email nigel.bennett@aon.co.uk

London

contact **Toby King**
tel **020 7086 3507**
fax 020 7086 1087
email toby.king@aon.co.uk

Manchester

contact **Tony Brown**
tel **0161 910 5332**
fax 0161 910 5249
email tony.brown@aon.co.uk

Wickford

contact **Dean Perkin**
tel **01268 502028**
fax 020 7570 1755
email dean.perkin@aon.co.uk



Are you missing something?

AON



CLAIMS TRENDS - TOP FIVE CONTRIBUTORS TO CLAIMS NOTIFIED TO AON CLAIMS SOLUTIONS

During the last nine years from the inception of the open professional indemnity market, our experience at Aon Claims Solutions (ACS) has revealed a clear pattern of claims trends. This article focuses on the causes of the five main constituents of those claims that affect all firms.

Residential Conveyancing

The last policy year again gives testament to the fact that residential conveyancing is the largest contributor of all claims notified to ACS both in terms of severity and in terms of frequency. The number of notifications has steadily increased since 2004. The major problem areas in work undertaken in residential conveyancing remain as follows:

- ◆ repeated failures to undertake sufficient searches over properties;
- ◆ failures to advise on the difference between joint tenancies and tenancies in common and delays in registration of title, charges and restrictions within the priority period;
- ◆ failure to reserve services and easements over retained land on a sale of part;
- ◆ failure to identify restrictions over land preventing use, development or terms of alienation;
- ◆ failure to comply with notices to complete.

Practitioners need to have in place checklists to ensure searches have been undertaken, that restrictions are spelt out to the client and that registration is dealt with following completion. Not taking time to make these basic checks could save problems later on.

Personal Injury

Personal Injury litigation accounts for the second largest of all notifications. The majority of claims are caused by failure to issue and serve proceedings within the three year statutory limitation period. Rectification of missed primary limitation exists in the form of an application under Section 33 of the *Limitation Act 1980* (as amended). Until recently the courts were loathed to use their discretion in favour of a possibly negligent solicitor. However, the recent development in *Cain v Direct Line* (2009) now provides Insureds with some comfort as the courts will only decline to exercise discretion if the Defendant has been prejudiced by the delay. We have noticed an increase in successful rectification applications this year.

Litigious (Other)

The third most severe and frequent of all notifications over recent years is in the area of general litigation, making it a consistent high-risk area. The problems that arise are:

- ◆ inadequate management of client expectations;
- ◆ inadequate investigation and collation of evidence in support of a case;
- ◆ failure to name the proper parties as claimants or defendants to an action.

Trust and Probate

Trust and Probate law has given rise to the fourth largest of all notifications to ACS in recent years. Like conveyancing, this is an area of the law which is in constant demand by clients despite external economic factors, hence the consistent frequency of notifications. If problems arise in this area it is likely that the cost of restitution or the

cost of the claim is relatively high. Problem areas continue to be:

- ◆ failure to ensure that a witness to a testator's signature is not a beneficiary to the will;
- ◆ failure to check testamentary capacity and errors in the drafting of wills (possibly made years ago) affecting the gifts of beneficiaries;
- ◆ failure by an executor solicitor to account properly for the payment of inheritance tax on the distribution of assets in the estate.

Regardless of how long ago a will was drafted, the loss for the purposes of limitation only arises at the date of death of the testator. For practical purposes, all files should be retained for at least six years from the date of death of the testator.

Commercial Conveyancing

Commercial conveyancing is also a problem area due to the size of claims that can arise, although only being the fifth largest in respect of frequency of notifications. Typical problems are:

- ◆ failure to highlight to clients the existence or implications of rent review clauses in commercial leases;
- ◆ failure to identify the appropriate party on whom notices should be served;
- ◆ failure to identify restrictions within a commercial lease preventing the use of a property.

Over nine years, the areas generating the majority of claims have remained relatively consistent. The insurance market and the solicitors' profession alike have had to deal with group claims such as the The Accident Group litigation and miners' claims in 2004. Conveyancers have had to contend with external economic factors, which gave rise to a dramatic decline in the property market in 2008. The profession has also had to face the reality of mortgage fraud, with many scams being perpetrated in the boom years. Despite recent troubled times, lessons from the past serve us well going into the future. In the main, claims aren't due to a lack of understanding of the law, but as a result of poorly supervising staff and simple administrative mistakes. In most cases, a notification can be avoided by employing risk management procedures, and proper adherence to the Law Society's Practice Notes. ■

Stewart Muirhead, *Solicitor and Associate Director, Aon Claims Solutions*



PRESERVING COVERAGE - PARTICULARLY DURING A RECESSION

WHAT TO DO

Remember your policy's specific notification requirements which may be to notify circumstances as soon as possible ie days rather than weeks but to notify claims immediately. It also helps to be clear in what you are notifying and, where possible, try to identify the claimant or potential claimant, details of what you were engaged to do, why you think a claim may be made against you, including allegations or potential allegations, details of other parties involved in the work (and your views on their liability) and when you first became aware of the claim or circumstance. Also, bear in mind these do's and don'ts.

DO NOT:

- ◆ make any admission of liability to your client or third party. It sounds simple but when there is an unhappy client on the other end of the phone it is easier than it sounds to admit some form of liability, or even just to proffer an apology. Doing this in any form may affect the chances of your insurer providing a full indemnity for the claim.
- ◆ promise to make any payments or agree to any settlement. This can be interpreted as an admission of guilt or liability.
- ◆ incur any costs with regards to the claim without your insurer's prior written consent.
- ◆ make reference to your Professional Indemnity insurance. People are far more confident in pursuing a claim against you if they know an insurer is backing you.

Remember – all of the above may be conditions precedent to insurers granting an indemnity and a breach of even one of these conditions may result in indemnity for all or part of the claim being denied.

DO:

- ◆ provide all assistance to, and cooperate fully with insurers and their representatives as required in their investigation of the matter.
- ◆ be prepared to provide all background documentation including the terms of any contract between you and the claimant and all exchanges of communication between the parties subject to the contract.
- ◆ advise your insurer and/or their representatives of steps you think might remedy the situation before proceeding.
- ◆ contact your insurer, or your broker if you have one, to discuss the claim if you are unsure of how to proceed.

Following these steps should help ensure that a valid claim is paid. Of course, there is no better cure than prevention, so instituting a stringent risk-management process throughout your business, particularly by producing a formal engagement letter, which records exact details of your instruction, clearly sets out the scope of your retainer, defines the client relationship and sets out any responsibilities your client may have, should help reduce the likelihood of you getting to this point in the first place. It pays to be vigilant and your broker should be there to advise and assist. ■

Jill Gough
Claims Director
Aon Limited

During recessions, when businesses are failing, money is being lost and belts are being tightened, a perfect claims culture is created, with people looking to shift the blame and recover their losses. We are seeing an increase in claims against all professionals and solicitors are unlikely to escape.

Insurers are also looking closer at policy terms and conditions and whether circumstances exist to trigger cover under the policy. Recent case law has crystallised the importance of complying with the notification conditions of a PI policy and the dangers of late or incomplete notification, which can result in all or some of a claim being denied by an insurer.

The decision of the Court of Appeal in *HLB Kidsons v Lloyd's Underwriters (2008) EWCA Civ 1206* has been widely reported in the insurance press and has become the point of reference for practical guidance about what you should notify and when, in addition to such cases as *Aspen v Pectel* and *Kajima UK Engineering Ltd v The Underwriter Insurance Company*.

Solicitors' Professional Indemnity policies are based upon the Law Society minimum terms and conditions and have always given protection against late notification and non-disclosure. However, even with this protection, it is still important to bear in mind conditions that are precedent to indemnity and following a breach, indemnity may be reduced to such sum as insurers' believe would have been payable by them in the absence of such breach.

CAN YOUR **RISK MANAGEMENT** SYSTEM COPE IN A RECESSION?



Ever since the nationalisation of Northern Rock, those firms undertaking residential conveyancing will know that life has become increasingly difficult and may well have seen a reduction, possibly substantial, in their work load.

The legal press is reporting staffing reductions at various levels, with redundancies being announced from the largest to the smallest firms and with partners not being exempt from the risk of job losses. Even one of the largest firms in the UK has recently announced a capital call on their partners to bolster the firm's working capital. At least most firms are trying to protect their trainee solicitors from the damage that losing a job part way through a training contract would cause.

None of us can be sure where this is all going to lead and it needs those of some age and longevity to remember the last time economic conditions were as bad. Recent GDP figures were worse even than the early 1970s with the three day working week and power cuts, the recession of 1979 onwards, and the recession which began in the late 1980s which was accompanied by soaring inflation and 15% interest rates.

All of this means that practices need to be alert to the rapidly changing environment and be reviewing and planning, in so far as is possible, the way forward for their business.

When times are hard and costs are under pressure it can be tempting to take short cuts or achieve work load reductions wherever possible and one area that practices cut at their peril is that of risk management. Indeed, when times are difficult fraud is likely to rise, both from clients and unfortunately at times internally and there is a need, if anything, to be even more vigilant rather than less.

Practices need to ensure that their risk management procedures in all areas of work, but particularly in the reduced volume of residential and commercial conveyancing, are robust and properly implemented on a day-to-day basis by every member of the firm. It is especially important for conveyancing work as from our experience residential conveyancing attracts the highest incidence of claims and commercial conveyancing attracts the higher value claims.

The wider political economic scenario also needs to be included in risk management planning and needs to be kept constantly up to date. The Law



Society is doing what it can to help give guidance and in two consecutive days during early October 2008 issued and then amended a practice note regarding the banking crisis and the security of client funds and on 8th January 2009 issued a further update to its guidance. Boring as these documents may potentially appear, it is important that they are read as soon as they are issued and, if necessary, acted upon quickly, but in a considered manner, to ensure that the firm is protecting itself, its own assets and its clients' interests as best it can in the rapidly changing times in which we are working.

Practice Rule 5

Many practices will still be coming to terms with the July 2007 Code of Conduct and in particular the Practice Rule 5 on Business Management.

Comprehensive and possibly intimidating as this Rule may appear, careful and thorough implementation of all of the areas listed can help firms manage and cope with the pressures and challenges that we are facing, particularly if the planning has been done in advance and partners and other senior staff have had time to consider carefully all the possible options and the challenges and risks that practices may face and put in place proper plans to deal with and minimise the risks to the business.

Even if firms have not yet managed to address all areas of this Rule, it does act as a very good agenda and aide memoire for partners and managers to consider as they face the challenges that are likely to come in the future.

The clauses that may be considered particularly relevant at this time are:-

Ensure adequate supervision

Supervision is the key to good risk management and is no less important when workflows are low. Indeed it is even more important than usual to ensure that fee earners (and fellow partners) are not taking on work for which they are not properly qualified. This is a route to future problems as has been mentioned many times before.

Control of undertakings

The loss of control of undertakings can have a severe financial impact on a firm that may be experiencing a difficult enough financial climate anyway. The Law Society has pointed out that firms should not restrict or caveat their normal undertakings despite concerns over the financial stability of some banks.

Financial control of budgets, cash flow and expenditure

When cash is in short supply, good credit control and cash management is essential. Banks are less likely than normal to entertain sudden short notice requests for additional funding. Good planning is the key to identifying impending cash pressures and thus being able to approach the bank in good time.

Good control of expenditure to ensure that a firm lives within its budget is critical when income is in short supply.

The continuation of the firm

Whilst this clause normally primarily refers to the continuation of the firm due to external physical influences and is usually referred to as Business Continuity planning, it can in current circumstances also apply

to the economic forces buffeting firms. Thus for the long term sustainability of the business, the making of necessary, even if unpleasant, decisions is something that should not be left until too late.

The management of risk

As has already been said, good risk management increases in importance in difficult times. It is a prime duty of all principals to ensure that their firm has robust procedures in place and ensure that they are fully followed by everyone in the firm. As the economic climate is changing rapidly the wider risks to the firm – strategic, regulatory, economic and political should be kept under closer review than in normal times.

Amidst all of the rapid change and confusion there are signs that the harshest period of the recession may be behind us and the UK economy is stabilising, but it could be 2010 before there starts to be a slow and gradual recovery and that there is not going to be a quick return to what we have grown to believe to be normality. We are likely to face at least one, probably two or possibly even three years of severely straitened circumstances before we recover from the present situation and indeed it may be that we never return fully to the situation that we have grown used to particularly through 2006, 2007 and even into early 2008.

Strategic planning needs to take that into account whilst risk management at the procedural level also needs to recognise that things have probably changed and may never be completely the same again. Whilst circumstances remain stressed and difficult, there is an increased likelihood that clients or others relying upon work done by your firm will look to you and your insurers as a possible way of mitigating their own losses, seeing you as professional advisers with "deep pocket" insurers against whom claims can be made.

As always it is those who are aware of the risks and plan appropriately to manage them who will hopefully suffer the least problems, whilst those who do not keep their procedures up to date and properly and fully implemented will unfortunately pay the price.

The motto as always is – like the Boy Scouts – "Be Prepared". ■

Roy Slocombe, *Quality Assurance and Lexcel Consultant, QBE Insurance (Europe) Limited*

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