Assessing and purchasing the appropriate level of cover: 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 in accordance with the Minimum Terms and Conditions (MTC) of the Insurance Indemnity Rules 2012 of at £2 million (or £3 million in the case of a limited liability firm).

In April 2015, the SRA introduced a new Outcome into the SRA Code of Conduct 2011 which requires firms to assess and purchase the level of professional indemnity insurance (PII) that is appropriate for the firm.

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. It 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.

The guide is not intended as a check-list which can be mechanically ticked off. The mix of work a firm does and has done in the past and therefore its risk profile will be specific to that firm. The 'claims made' nature of solicitors' PII means that a higher level of cover once taken out, is likely to be needed in subsequent years. Also, when considering the limit of cover, claimants' costs will need to be taken into account.

This guide 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.
The new self-assessment Outcome

The new Outcome in the SRA Code of Conduct 2011 states:

'O(7.13) you assess and purchase the level of professional indemnity insurance cover that is appropriate for your current and past practice, taking into account potential levels of claim by your clients and others and any alternative arrangements you or your client may make.

'We expect firms to be compliant with this obligation by the earlier of:

- the date on or after 1 April 2015 of the commencement, renewal, replacement or agreed extension of the policy period of any qualifying insurance; and
- the start of the new indemnity period on 1 October 2015.'

What does the new Outcome mean for my firm?

Prior to the introduction of the new Outcome, firms were responsible for ensuring that they avoided the potential risks for the firm and for individual principals of failure to select the right level of PII.

The new Outcome makes it a regulatory requirement for firms not only to ensure they have purchased the right level of PII. Firms are now expected to be capable of demonstrating how they have formed an assessment of whether the compulsory minimum level of cover is sufficient for their practice and that they have purchased cover appropriate to their business.

The SRA has stated\(^1\) that when assessing compliance with the Outcome, it may take into account a range of factors including evidence that the firm has made a reasonable and rational assessment of the appropriate level of its PII cover. If a firm is able to demonstrate to the SRA's satisfaction that it done so, the SRA states it is very unlikely that it would challenge that decision.

\(^1\) SRA Ethics guidance Professional Indemnity Insurance cover issued on 14 July 2015

http://www.sra.org.uk/solicitors/code-of-conduct/guidance/guidance/Professional-Indemnity-Insurance-cover.page
Factors to consider in choosing an appropriate level of PII

The compulsory minimum level of cover

All firms have an obligation to take out and maintain a mandatory layer of PII (rule 4.1 of the SRA Indemnity Insurance Rules 2012).

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.

These limits do not apply to defence costs. There is no monetary limit on defence costs under the minimum terms and conditions (clause 2.2).

You must purchase a PII MTC policy from an SRA participating insurer. A list of all participating insurers is available on the SRA website. The Law Society has produced a guide to insurers selling MTC policies, which is updated by reference to the SRA's list of participating insurers and which indicates the practice sizes the insurers have stated that they are willing to consider providing PII cover for. It also lists any other restrictions they apply and states how you should approach the insurer.

Is the minimum level of cover sufficient?

The SRA has stated that the current minimum levels are likely to be sufficient for many small provincial firms.

The Law Society takes the view that for some firms, the mandatory MTC level of cover, at £2 million / £3 million may be sufficient in view of the policy’s breadth and scope of cover.

The case examples provided in this document illustrate the importance for firms not to rely purely on the MTC minimum level of compulsory cover.

Nor should firms rely on the level of additional cover they might have purchased until the next renewal. Reviewing risk management and practice by reference to cover needed should be an ongoing exercise.

When considering the compulsory minimum level, firms need to bear in mind that:

- The level of premium paid for MTC cover does not reflect whether the individual firm has purchased appropriate level of cover.

- It is the type of work that a firm undertakes, not the fee level or transaction volume, that will help inform the assessment of appropriate cover. For example, a sole practitioner might have a gross fee of below £250,000 for undertaking commercial work of a significant value. The current compulsory minimum may not be adequate for that firm. In contrast, a firm doing only criminal work which is low risk, will attract low premiums but if it takes on conveyancing work as well, its risk exposure will be increased.

- This may become more acute when the 'claims made' nature of solicitors' PII is taken

2 ibid
into account, whereby a historical transaction might give rise to a claim in the current (or future) policy year.

- The 'claims made' nature of solicitors' PII means that a higher level of cover, once taken out, will need to be taken into consideration when assessing adequacy of cover in subsequent years.

- Claimant costs should also be taken into account as the limit of indemnity provided by the policy is in respect of any damages awarded and claim costs. For example if a solicitor has £2m of cover and gets successfully sued for £1,950,000, he may be under-insured if costs exceed £50,000 because the combined total of damages and costs exceeds the limit of the cover.

- Aggregation of claims arising from the same incident will have an impact on whether a firm’s limit is exceeded. How this might happen is illustrated in the case examples.

So, while you must take out primary PII layer (MTC) cover, you should also consider whether additional layers of cover (often referred to as 'top-up cover', 'excess layer' or 'excess of loss cover') is required over and above the primary limit of indemnity. This additional cover should be purchased to protect the firm, and, depending on the firm’s structure, its individual principals and its exposure to risks, from liability in the event of a large claim that could exceed the indemnity limits of the MTC policy.

All firms should undertake and keep under ongoing review a risk assessment to determine their appropriate level of cover, in order to protect the firm and to be able to meet the regulatory requirements. All firms need to assess carefully and purchase the level of PII cover that is appropriate for current and past work.

If a firm has inadequate cover and a shortfall arises in relation to a claim, depending on the size of the shortfall, this could lead to an insolvency situation and regulatory action by the SRA.

**How much cover do I need?**

You should seek advice from your broker and/or insurer to ensure that you have a sufficient level of cover based on your assessment of your firm's work. Your PII proposal form might be a good place to start your assessment. However, you need to bear in mind that its purpose is to assess the appropriate premium for your firm's work for the compulsory MTC cover.

Your broker will not be able, for regulatory reasons, to advise you on the on sufficiency of cover appropriate for your firm. The broker will, however, be able to review the information you provide in your own assessment of the nature of your firm's business and the associated risk profile. The broker should be able to advise, on the basis of that information, whether you have considered you have sufficient cover, the limits of your indemnity and whether it is appropriate for your firm's exposure.

A good starting point might be to think in terms of how confident you are in being able to defend future claims based on a past and current business review. This should take into account quantifying your firm's risk profile and ensuring that there will be adequate cover for liabilities which your firm may incur to its clients or other parties to whom it may owe duties when performing its legal services.
Producing a checklist to use as the basis of regular documented reviews which can be shown to your broker or insurer might be helpful for this. A checklist will also demonstrate whether your self-assessment of cover *appropriate to your firm* has been carried out on a reasonable and rational basis. If it has, it could provide a degree of comfort in demonstrating that the correct level of indemnity has been purchased.

You should bear in mind that a checklist is a good framework but assessment of cover is not just a box ticking exercise but more of an art, as explained below.

The checklist should consider the following, non-exhaustive factors:

- Where do your largest fees come from? The types of clients (i.e. not your turnover) - this is where the exposure will lie.
- The types of contentious work you do, for example commercial, M&A, company corporate.
- Identify the value of the transactions that give rise to exposure.
- Identify your highest contract values over the last five years.
- Large conveyancing transactions with large potential losses.
- What are the reasons for buying the level of cover and why is this level sufficient? Has the client (for example, a building society or a public body) in its procurement contract stipulated a level of cover it is comfortable with?
- If the work undertaken went spectacularly wrong, could the losses be aggregated leading to a shortfall in cover?
- How would losses be mitigated? In a high-value property contract, how much might the loss be brought down by for example, through salvage from land sale?
- The maximum amount of money held in your client account on any given day.
- And don't forget that due to the ‘claims made’ nature of PII, contentious work in past years needs to be carried over year on year and when purchasing run-off cover.

### 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 may expose the firm to a risk that is greater than its current indemnity limits. Excess layer cover can be purchased at any time (but will usually align the next renewal date to co-incide with your MTC policy).

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 for 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 PII required.

**What level of cover is needed?**

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.
Level of cover considerations:

- 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
- likelihood and level of claimants’ costs
- 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 and any excesses and exclusions including in top-up cover. 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.

**How to buy excess layer / top-up cover**
If you need cover above the compulsory level, known as 'excess layer or top up cover', this cover is not subject to the requirement to purchase it from a SRA participating insurer. It is not necessary to buy all of your cover from one insurer. This means that you can obtain it from any insurer and on different terms and conditions to the MTCs. You are also not tied to purchasing it at the same time that you renew your MTC PII - you can purchase it at any time when the need arises, for example, if you are planning to take on additional work.

For some transactions the cost of top-up cover or excess layer is generally cheaper than the premium paid for the primary layer. This is because the cover only applies when the indemnity limit of the primary policy has been breached.

You should bear in mind that excess layer insurance will not be subject to the comprehensiveness of the MTC cover. It therefore might not benefit from the same level of protection as MTC cover and might contain exclusions which place risks on the firm.

The excess on the excess layer policy will be to the value of the primary policy (or underlying policies if more than one excess layer policy is purchased to achieve a desired indemnity limit).

**What about other types of insurance not concerned with professional liability?**

Outcome O(7.13) only refers to professional indemnity insurance. The MTC are not concerned with the latter type of liability. Whether and on what terms to seek to insure against such exposure is a commercial judgment for the firm. Firms will wish to ensure they are appropriately protected against losses incurred in respect of other types of liability (such as loss of business continuity or cyber insurance).
Situations where the minimum level of cover may not be sufficient - case examples

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 excess layer insurance has been purchased.

Example 1

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.

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

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.

This could be, for example, a series of accounting losses over 10 years.
Example 2

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 (equating to £2.1m in total). 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.

The firm should 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.

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 contains the 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.

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.
Top-up cover / excess layer cover - some frequently asked questions

What is top-up insurance?

Top-up (or excess layer or excess of loss) 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.

The Law Society's PII survey findings report purchasing trends among firms and amount paid for top-up. They do not tell us whether firms are correctly assessing their appropriate level of cover.

According to the survey findings for the last two years, around a quarter of firms reported purchasing top-up cover. Larger firms were more likely to do so, with 98 per cent of 11-25 partner firms reporting doing so, compared with 26 per cent of 2-4 partner firms and just 5 per cent of sole practitioners. Firms using rated insurers were more likely to do so than those using unrated insurers.

On value of top-up purchased, 36 per cent of firms purchased cover of up to £2 million; 21 per cent over £2 million and up to £5 million; 23 per cent over £5 million and up to £10 million; and 20 per cent over £10 million. Almost a quarter of 11-25 partner firms purchased more than £20 million of top-up. However, it is significant that turnover or firm size does not automatically indicate the necessity of top-up cover. For example, a sole practitioner might have a gross fee of below £250,000 for undertaking commercial work of a significant value.

IFF research, PII survey 2015, available at: www.lawsociety.org.uk/support-services/risk-compliance/pii/surveys/

When can I purchase top-up cover?

Top-up (excess layer) cover can be purchased at any time. However, once bought, it will usually align the next renewal date to co-incide with your MTC policy.

How will the SRA check and decide on sufficiency of cover?

The SRA has not said how it will go about checking compliance with the new Outcome. It has stated that when assessing compliance, it may take into account a range of factors including evidence that the firm has made a reasonable and rational assessment of the appropriate level of its PII cover. If a firm is able to demonstrate to the SRA's satisfaction that it done so, the SRA states it is very unlikely that it would challenge that decision.
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. For some transactions, that period should be longer.

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

How much will top-up cover cost?

While excess layer insurance is 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.

N.B. If you deal direct with an insurer for your MTC cover, they might not be able to provide the excess layer cover.

Do I need to purchase top-up cover from an SRA participating insurer?

No. The SRA only requires that primary layer cover be purchased from a participating 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.

Are the terms and conditions of top-up cover identical to MTC cover?

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.