

**PROFESSIONAL PRACTICES ALLIANCE WORKSHOP
RISK MANAGEMENT AND PROFESSIONAL INDEMNITY FOR PROFESSIONAL SERVICES
FIRMS**

1. INTRODUCTION

On Tuesday 29 July 2014, Howden Windsor kindly hosted a Professional Partnerships Alliance workshop looking at risk management and professional indemnity insurance for professional services firms. This report summarises the issues discussed.

2. THE INSURANCE BROKER'S VIEW

Solicitors firms

The last two years has seen a number of key changes relating to professional indemnity insurance cover for solicitors firms, in particular the abolition of the Assigned Risks Pool and the introduction of variable renewal dates.

The SRA is currently consulting on a number of proposals relating to the scope of cover under the Minimum Terms and Conditions, particularly a reduction in the minimum level of cover to £500,000. Firms will be required to assess the level of cover that is appropriate for their business beyond the new minimum. The proposals are intended to assist law firms in providing the right level of protection to their clients without the need to incur unnecessary expense having regard to their mix of work. It is hoped that any cost savings will be passed on to consumers. The SRA intends to seek final approval for these proposals by early August 2014, which would only allow six weeks before the new terms come into effect on 1 October 2014.

The introduction of these proposals may have a number of (unintended) consequences:

- (a) Whilst the introduction of these proposals may lead to a reduction in premiums of between 5-15% for some firms (depending on the size of firm and level of cover), savings are unlikely for firms which need higher levels of cover (e.g. £3 million), PI insurance may even become more expensive.
- (b) For firms with early renewal dates, it is likely that brokers will quote on the basis of the previous years' cover. However, as the new Minimum Terms and Conditions are yet to be finalised, it may not be clear what level of cover these firms are purchasing.
- (c) There are concerns in the market that the reduction in the minimum level of cover for solicitors may be insufficient for balance sheet protection. By way of comparison, IFAs and insurance brokers have a mandatory minimum level of cover of €1.6 million (or sterling equivalent). Similarly, accountancy firms have a minimum level of cover of £1.5 million.

Accountancy firms

Historically, accountancy firms have benefitted from a benign market, with average rates being 0.4% compared with > 4% for solicitors firms. However, underwriters are acutely aware that, with changed attitudes to tax mitigation and the new introduction of a new General Anti-Abuse Rule, accountancy firms may need to rely more heavily on their PI insurance to cover any claims brought against them in relation to tax advice. As a result, accountancy firms are now required to complete more detailed questionnaires in relation to their PI insurance and are paying higher levels of excess.

Surveyors firms

The recent economic downturn has led to a huge increase in the number of claims relating to secured lending valuations (both residential and commercial), exacerbated by the availability of Conditional Fee Arrangements and After the Event insurance. As a result, insurers covering valuation surveying are exposed to large losses.

Undoubtedly, a number of claims have arisen as a result of poor quality work undertaken in the boom years of 2005 to 2007. What are the main reasons for this?

- Surveyors were undertaking too many jobs in one day Fees were too low.
- Pressure on turnaround times – mortgage lenders were imposing penalties on surveyors who did not turn around valuations quickly enough.
- Poor quality, or in extreme cases, non-existent files. As a result, claims become hard to defend resulting in a higher proportion being settled.

The availability of PI cover is driven by the insurers and in the future, RICS will need to engage more fully with the insurers to ensure that surveyors have adequate PI protection.

3. MANAGING RISK

3.1 There was a broad discussion of the range of risks faced by professional service firms, and the controls needed, including the risk of claims. Insurance risk is likely to increase for professional services firms. As part of the SRA's wider reforms for compulsory professional indemnity cover, it has been suggested that an external auditor should produce a report on each firm. From an audit perspective, the key consideration is how large any claims are and whether the firm has made sufficient provision for those claims. Reputational risk is often the biggest risk facing many firms but it is not a factor which auditors are required to consider. Similarly, auditors do not assess the quality of a firm's work which will often be a key factor when claims arise.

Some financial risks can be mitigated by strengthening controls over bank transfer authority levels, having a frequently updated cash flow forecast and maintaining a robust review process over monthly management accounts.

4. THE LITIGATION LAWYER'S VIEW

Limitation periods

Limitation periods are particularly important in professional negligence claims, not least because limitation periods are something professionals can and do get wrong. When they do, it tends to have draconian consequences for their clients. At worst, an entire claim could be time barred. If missing the limitation period is due to the negligence of an adviser, this can give rise to substantial claims against them and their firms. Conversely, limitation arguments can also be used as a successful weapon in defending and limiting professional negligence claims. For example, Maurice Turnor Gardner LLP has recently defended Mercer in relation to a professional negligence claim in respect of their role as benefit consultant to an occupational pension scheme. MTG successfully argued that not only had the primary limitation period in relation to a tortious claim (i.e. six years from the date the cause of action accrued) under section 2 of the Limitation Act 1980 expired, the limitation period under section 14A of the Act (i.e. three years from the date on which the material facts were known or ought reasonably to have been known to the claimants) had also expired. As a result, the whole claim (with an approximate value of £7 million) was time barred, although the decision is being appealed (*Seton House Group Limited and Britax Pension Trust Limited v Mercer Limited*).

Limiting Liability

Contractual provisions limiting liability are now a fairly standard way in which parties try to limit their exposure to claims for damages. However a recent decision (*AB v CD [2014] EWCA Civ 229*), the Court has fired a warning shot against relying on such clauses. The Court of Appeal has recently held that the existence of a contractual clause limiting the damages recoverable will not preclude the Court from granting an injunction on the grounds that damages would be inadequate. Clauses limiting liability may still be valid but such a clause will not prevent the court using its discretion to grant equitable remedies.

5. WHAT NEXT FOR THE PROFESSIONAL SERVICES FIRM?

There is a high level of risk of cross-contamination from the property industry to other professional services firms (for example, law firms, banks and accountants involved in securitisation transactions will all be exposed to valuation errors). The risk of cross contamination from other sectors is more acute for the legal profession as solicitors will have acted on both sides of any transaction. This may exacerbate current professional indemnity insurance issues (availability of insurance, levels of cover and premiums etc.).

In general, it was felt that the professional services sector is not making use of technology to improve best practice and mitigate risk. It is likely that in the future we will see the increased “commoditisation” of services. For example, some lower risk property valuations may be carried out by a computer led process. Risk management systems and appropriate levels of monitoring will therefore become increasingly crucial and it is likely that the PI insurers will begin to discount PI cover if firms have formal monitoring systems as part of their compliance regime, e.g. COMPLETION Monitor or Lexcel accreditation.

6. STOP PRESS

Since the workshop, it has been announced that the proposed changes to the Minimum Terms and Conditions will not come into effect prior to 1 October 2014. The Legal Services Board has formally requested that the SRA provide further information on the proposed changes and has extended the time in which to consider this information until 17 August 2015.

Emily O'Donnell
Associate
Maurice Turnor Gardner LLP
15th Floor
Milton House
Milton Street
London EC2Y 9BH
Switchboard: +44 20 7786 8710
www.mauriceturnorgardner.com