

Mandatory professional indemnity insurance & a mandatory insurer:

A global perspective



The recent lawyers' malpractice insurance crisis in the United Kingdom offers a stark reminder of the value of Ontario's scheme of universal access to professional liability insurance.

Crisis in the UK

In the spring of 2010, UK bar associations warned members that the fall insurance renewal deadline was expected to be "difficult."¹ As many lawyers already knew from their dealings with insurers over the previous year, this warning would turn out to be a colossal understatement. Lack of access to affordable professional indemnity insurance for the 2009/2010 and 2010/2011 insurance years has since forced dozens of law firms in England, Ireland and Wales to shut their doors.

Like Ontario lawyers, UK lawyers are required, as a condition of remaining licensed, to obtain a malpractice insurance policy with set minimum terms. Coverage limits are

prescribed for UK firms as a whole, not for individual lawyers: a firm that is not a corporation must have coverage of at least £2,000,000 (almost \$3.3 million CAD) per claim; and an LLC must have £3,000,000 (more than \$4.8 million CAD) coverage per claim. Defence costs must also be covered, and no aggregate limit is permitted.² Unlike their Ontario counterparts, UK lawyers must look to the open insurance market (actually, to a list of approved providers) to obtain this coverage.

The UK mandatory insurance requirement dates to 1975. Between 1975 and 1986, UK lawyers purchased insurance from commercial providers through a specialized broker. By 1984, only one provider was offering

coverage. In 1987, to ensure access to insurance for the profession, the open-market system was replaced by the Solicitors Indemnity Fund (SIF). The SIF was the exclusive provider of insurance to the profession until 2000, but it struggled, running up a potential £450 million (roughly \$720 million CAD) shortfall by 1997, and imposing an expensive seven-year top-up to stabilize itself. Disillusioned with the fund, members of the profession voted in 2000 to decide its fate: A 70 per cent majority supported a return to buying insurance in the open insurance market.³

That market proved volatile. In the wake of the recent global recession, property values plunged, and there was a spike in mortgage fraud and money laundering activity. The insurance market responded by hardening dramatically. Estimates were delayed; the window of time for accepting insurance offers contracted; and premiums swelled, in some cases to over 400 per cent of 2007 levels.

Leading up to the fall 2009 mandatory insurance renewal deadlines, it became clear that a large number of UK firms – especially small and mid-sized – would be forced to shut their doors even if permitted to join the national Assigned Risks Pools (ARPs) – facilities offering punitively-priced coverage for the hard-to-insure. And then the Irish ARP folded.

While the English ARP continued coverage for existing clients for the 2009/2010 insurance year, it capped contracts at 12 months and closed the door to new applicants. The English ARP will be discontinued in time for the 2013 renewal. When the dust finally settles, it is likely that the loss of ARP coverage in Ireland and England will have dealt a fatal blow to at least two hundred firms.⁴ The rest of the profession and the commercial insurance market will share responsibility for the claims orphaned by the loss of the ARPs, with insured lawyers on the hook for the first £10 million in aggregated claims. Going forward, when firms that would have been destined for the ARP are forced to cease operations due to lack of access to coverage, each defunct firm's last insurer will be required to provide tail coverage for six years.⁵

For the firms that have managed to weather the storm, survival has come at a high price. In a September 2009 article in the *English Law Gazette*, a London lawyer working in a two-partner firm reported that he would be closing his practice after receiving a quoted premium of £110,000 (nearly \$200,000 CAD, and equivalent to 25 per cent of the firm's annual turnover).⁶ Premium increases were triggered in part by the need to subsidize the ailing ARPs, and were especially galling in the face of reductions in the scope of coverage. Insurers have also become less generous in their acceptance of claims, refusing coverage in situations where lawyers other than the insured (but working in the same firm) have been dishonest. In the September 2010 edition of its newsletter, English insurance law firm Legal Risk LLP took a bleak view of the developments, lamenting that "the small high street firm may be all but gone forever."⁷

Lessons for Canada

Could a similar fate ever threaten Canadian firms?

It's easy to point out that if it were not for the UK's mandatory insurance scheme, some of the defunct firms could have foregone unaffordable insurance and soldiered on. This suggestion, however, ignores the reality that the insurance crisis was not fabricated, but rather was triggered by a recession-driven spike in fraud, falling real estate values and associated claims. A more rigorous post-mortem analysis makes it clear that problems with access to coverage – and not the coverage mandate itself – led to the calamity in the UK. Without the compulsory coverage, many of the same firms would likely have collapsed under the weight of claims, leaving the public unprotected and a spreading stain on the reputation of the surviving bar.

It would be irresponsible not to view the UK situation as a reminder to reflect on our choices here in Canada and more particularly, in Ontario. Should lawyers here be required to carry professional indemnity insurance? And if so, what kind of professional indemnity insurance arrangement should be in place to accommodate legal practitioners?

These are questions considered around the world by regulators and law associations.

In most common law jurisdictions, professional indemnity insurance for lawyers is made mandatory by law or by law society or bar association regulation.⁸ Besides requiring that practising lawyers have liability insurance, these law societies typically prescribe and/or implement various types of insurance arrangements to help lawyers comply. This article provides a global perspective on the benefits of a mandatory professional indemnity insurance program and a mandatory insurer regime for lawyers.

Mandatory professional indemnity insurance: background

A review of approaches elsewhere shows that requiring practising lawyers to buy professional indemnity insurance with minimum terms is popular among many jurisdictions. Some of the reasons that have prompted regulators in different jurisdictions to implement the compulsory insurance programs include:

Protecting the public interest

Many law associations have faced the challenge of balancing their duties to the public and to the legal profession. In doing so, many noticed that some lawyers were either not purchasing errors and omissions insurance, or were under-insured, resulting in clients being unable to collect on losses they suffered as a result of successful lawsuits against lawyers.

Legal regulatory leaders have also expressed concern about the varied policy terms available in a voluntary insurance market. Even where lawyers obtain insurance on their own initiative, differences among policies can expose some lawyers and their clients to potentially dangerous gaps in coverage.

Mandating that lawyers hold professional indemnity insurance that incorporates a minimum set of terms has been promoted as one way to provide some protection to the public. In offering this protection,

mandatory insurance helps maintain public confidence in the legal profession.

Mandatory insurance also helps redress certain inequities in the insurance status of lawyers practising in the same jurisdiction. Critics have suggested that those lawyers who might otherwise remain uninsured but for the requirement that they carry professional indemnity insurance would "free-ride" on the profession's reputation and liability standards.

When "caught" with a claim that these lawyers could not satisfy, these "free-riders" could negatively affect the reputation of the profession. Scandinavian regulators, for example, cited this as a problem for the profession, offering it as one reason for requiring that members be insured.⁹

Protecting lawyers' financial interests

Of course, protection of lawyers' financial interests is another important benefit of compulsory insurance. It is important to provide some protection against forcing a lawyer into bankruptcy, either due to the financial burden of judgments or settlements or from the cost of defending meritless claims. In a litigious environment and with an increasing number of self-represented claimants, this is of particular importance to lawyers. Fostering a financially healthy and diverse bar is also promoting – indirectly – access to justice.

Legal profession as group risk

In deciding to introduce compulsory insurance, the Malaysian law society explained that mandatory insurance allowed Malaysian lawyers to view themselves as a cohesive profession, and not as stand-alone risks. The Law Society of Malaysia found that before malpractice insurance became compulsory, insurers offering this form of insurance favoured the larger firms – a problem because, in 2010, 66 per cent of the lawyers in the country practised either as sole practitioners or in two-lawyer firms. In addition, lawyers practising in high-risk areas such as conveyancing would have difficulty obtaining and sustaining professional indemnity insurance if it were not made mandatory.¹⁰

Even playing field regardless of firm size

The Malaysian bar has also asserted that mandatory insurance helps level the playing field as it helps sustain a range of firm sizes, giving clients more choice in the marketplace.¹¹ There is a suggestion that before the mandatory insurance requirement, clients were more likely to gravitate toward larger, more established, and more often insured firms, resulting in small-firm lawyers having difficulty competing for business.

Even playing field regardless of jurisdiction

The Hong Kong and Singapore bars both view compulsory professional indemnity insurance for their lawyers as essential to maintaining competitiveness in financial, trade and commercial services, and to being on equal footing with firms in other mandatory insurance jurisdictions. Since most common law jurisdictions require mandatory insurance for lawyers, clients will expect the same level of protection for inter-jurisdictional trade and commerce.¹²

The U.S. experience

Calls for the introduction of mandatory malpractice insurance for lawyers arise regularly in jurisdictions without the requirement, including in many areas of the United States. Opinions about the issue are typically divided, with critics warning that compulsory insurance would drive fees higher, and that other programs (for example, funds to compensate the victims of lawyers' criminal acts) provide adequate protection.

For example, in an article in the *Connecticut Law Tribune*, lawyer and blogger Susan Cartier-Liebel, a business consultant for solo and small firms, warned that malpractice insurance is designed to protect the assets of the (lawyer) policyholder as much as it is for the protection of the public, and that having insurance will not curb the insured's criminal behaviour: "[i]f you have a criminal mind, you have a criminal mind." In Cartier-Liebel's view, especially where a lawyer has few assets to protect, making an independent decision about the purchase of insurance is "the right and privilege of each attorney

and business owner based upon their own risk-tolerance."¹³

However, when Cartier-Liebel posted her article to her blog, visitors countered that client claims are often based not on a lawyer's criminal acts, but rather on innocent errors. (Many professional indemnity insurance policies exclude coverage for losses caused by a lawyer's dishonest or fraudulent acts anyway.) While the Connecticut bar has a fund in place to compensate victims of lawyer dishonesty, clients with claims based on innocent error are unprotected. When clients find themselves unable to collect in these cases, the reputation of the entire bar suffers.

Just as controversial in the U.S. is the question of insurance status disclosure requirements. Many states have passed legislation requiring uninsured lawyers to disclose, in writing, that they do not have insurance coverage.¹⁴ Critics of this requirement argue that the rule draws unwelcome attention to insured lawyers' coverage, which these critics suggest is tantamount to inviting the client to sue in negligence any time a legal action is unsuccessful. However, there is scant evidence, either in the U.S. or in any other jurisdiction, that this threat has actually materialized in the form of an increase in frivolous claims.

American bar associations will likely continue to grapple with the issue of mandatory insurance. However, the trend toward requiring disclosure of lack of insurance (disclosure is now required by law, either at the outset of the retainer or in response to client inquiry, in approximately 50 per cent of states) suggests that interest in mandatory insurance is growing in the U.S.

While only the state of Oregon has so far made insurance coverage mandatory, other states are looking seriously at the issue, including New Jersey, where certain kinds of legal service providers – professional corporations, limited liability companies, and limited liability partnerships – must carry a minimum of \$100,000 worth of coverage for each member. In an article in the *New Jersey Law Journal*,¹⁵ legal analysts Bennett

J. Wasserman and Krishna J. Shah urged that the New Jersey mandatory insurance provisions be extended to all lawyers, not only for the protection of the public, but to make malpractice insurance more affordable: “[M]ore lawyers covered by insurance would mean more premium dollars to the insurance industry and thus lower premiums overall. If ever there were a ‘win-win’ situation, this is it.” The typical range for U.S. legal malpractice premiums in many states is currently \$5,000 to \$10,000 per year.

With mandatory insurance, who will be the insurer?

In compulsory insurance jurisdictions, regulators generally designate, endorse or establish an insurance scheme to achieve the objectives of the program. Law societies in many common law jurisdictions have moved toward self-insurance schemes for the primary compulsory layer. The structure and the operating procedures for these programs vary depending on the circumstances of each jurisdiction and the terms of the governing legislation under which the lawyers and the law societies operate.

The mandatory captive insurer regime

Some jurisdictions have implemented mandatory captive insurer regimes.

Australia

In New South Wales, Australia, all lawyers obtain insurance through LawCover Pty Limited, a wholly owned subsidiary of the Law Society of New South Wales.¹⁶ In Queensland, Lexon Insurance Pte Ltd is a wholly owned subsidiary of the Queensland Law Society, and is the captive insurer providing professional indemnity insurance to members of the Queensland legal profession.¹⁷ In Victoria, lawyers are required to maintain professional indemnity insurance with the Legal Practitioners’ Liability Committee.¹⁸

United States

Oregon is currently the only state that requires lawyers to carry liability insurance.

Oregon lawyers must purchase their primary insurance through the Oregon bar’s Professional Liability Fund.¹⁹ In an article for *Law Practice TODAY*, the newsletter of the Law Practice Management section of the American Bar Association, law practice management expert, Ed Poll praised the Oregon program for its affordable premiums and universal coverage, noting that the premiums paid by Oregon lawyers “are much less than the nationwide average [voluntary] payment for malpractice insurance,” and that universal coverage in Oregon means that “[t]he playing field between large and small firms is at least manageable. And the public is truly protected.”²⁰ Jeff Crawford of the Oregon bar’s Professional Liability Fund confirmed that the base premium for the current insurance year is \$3,500 (for coverage of \$300,000 per claim and \$300,000 in the aggregate, plus a defence costs allowance of \$50,000), a premium amount that, he notes, “if you consider inflation, has remained quite stable over the past several years.”

Canada

In British Columbia, a practising lawyer must purchase compulsory insurance through the LSBC Captive Insurance Company Ltd., a wholly owned subsidiary of the Law Society of British Columbia.²¹

In Quebec, the Professional Liability Insurance Fund of the Barreau du Quebec was established to provide insurance for the bar.²² LAWPRO is the mandatory insurer for practising lawyers in Ontario and is a subsidiary of the Law Society of Upper Canada.

Lawyers in all other Canadian jurisdictions effectively insure each other by participating in a reciprocal inter-insurance exchange called the Canadian Lawyers’ Insurance Association (CLIA).



Benefits of a single mandatory insurer

The advantages of requiring all practising lawyers in a jurisdiction to acquire errors and omissions insurance from a single mandatory insurer are significant.

Robert Andrew Scott, past president of the Law Institute of Victoria, Australia, once observed that if lawyers were forced to find insurance on the open market, commercial insurers would likely insure only those lawyers they considered worth the risk. Even where lawyers found coverage, small mistakes leading to a large claim might, he predicted, impact a solicitor’s premiums so substantially that he or she would no longer be able to practise law. Commercial insurers, he concluded, would *de facto* decide who may or may not practise law.²³

As explained at the beginning of this article, Scott’s warning has proven prophetic with respect to the UK insurance market. When factors such as the collapse of the housing market caused the professional indemnity market in Europe to harden,²⁴ many lawyers were forced out of practice when they became unable to obtain or afford coverage.

This result would likely have been avoided had the UK chosen instead to designate or create a single mandatory insurer. Reliance on

a captive insurer can protect the profession from adverse economic conditions and the vagaries of the cyclical insurance market. While captive insurers may be permitted to refuse insurance to a small percentage of lawyers with very poor claims histories, these programs generally are not at liberty to turn away lawyers considered higher-than-average risk from an underwriting standpoint.

In a mandatory insurance jurisdiction, being the insurance provider for all lawyers allows a captive insurer to rely on a predictable pool of clients. If the captive insurer is well-managed, that predictability, along with access to a critical mass of clients, can make it easier for the insurer to determine adequate funding levels, which helps to stabilize premiums.

Commercial insurers, on the other hand, focus on maximizing profit and will charge their premiums accordingly.²⁵ The Queensland Law Society prides itself on its insurance

scheme that has protected its lawyers from increases in professional indemnity premiums of up to 1,000 per cent, as seen in other professions.²⁶

Perhaps the greatest benefit of a captive insurer, however, is that its management focus targets the needs of a specific profession within a particular jurisdiction. In serving all insurance clients in a jurisdiction, the captive professional liability insurer can have at its disposal a complete picture of the different types of claims experience in a particular jurisdiction and in all areas of law. This focus promotes accurate identification and analysis of claim trends. Data analyzed in this manner is invaluable in support of the development of carefully-tailored risk management strategies that can be communicated to the profession through education initiatives.²⁷ Implementing risk management strategies helps to reduce claims costs and to keep premiums relatively stable.

Successful profession-specific insurers do not focus only on historical claims trends, but also take a prospective view of future changes and challenges likely to affect the profession. Because their mandate is to make insurance accessible to all lawyers regardless of market conditions, captive insurers must show leadership and foresight if they expect to live up to their commitment to protect lawyers and their clients throughout the insurance cycle. Focused research and analysis allows these insurers to plan accurately and early for contingencies, to adapt quickly to developing problems, and to tailor products and services to client needs within a specific jurisdiction.

Mandatory insurance program and a mandatory insurer: Ontario lawyers, we've got you covered. ■

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¹ The Law Society (of England and Wales); "Practice Note: Professional Indemnity Insurance"; June 8, 2010; available at: <http://www.lawsociety.org.uk/productsandservices/practicenotes/piinsurance/4527.article>

² Solicitors Indemnity Insurance Rules 2010 (established by the Solicitors Regulation Authority; last updated October 2010); Appendix 1: Minimum Terms and Conditions of Professional Indemnity Insurance for Solicitors and Registered European Lawyers in England and Wales; available online at <http://www.sra.org.uk/solicitors/code-of-conduct/professional-indemnity/indemnity-insurance-rules.page#appendix-1>

³ See "History of Solicitors' Professional Indemnity Insurance" prepared by Lawyers Defence Group, available at: <http://www.lawyersdefencegroup.org.uk/solicitors-professional-indemnity-insurance/>

⁴ According to *Legal Futures*, a UK website and blog dedicated to educating lawyers about regulatory compliance and other issues, 138 English and Welsh firms closed after joining the English ARP between 2009 and 2011, and several other firms are considered to be at risk. An additional cohort of firms have failed in Ireland, where the ARP closed in 2009. See: <http://www.legalfutures.co.uk/latest-news/138-law-firms-in-the-arp-close-down-as-solicitors-face-bankruptcy-action>

⁵ See explanation of arrangements after ARP closure in Lockton Solicitors' Blog at: <http://solicitors-blog.co.uk/tag/arp/>

⁶ Dean, James "Firms shut down ahead of PII renewal", *The Law Gazette*, September 16, 2009

⁷ In "The Renewal" in *Risk Update*, September 2010 edition, a publication of Legal Risk LLP. *Risk Update* is available at: www.legalrisk.co.uk

⁸ Refer to Table 1: "Professional Indemnity Insurance Requirements Around the World" at www.lawpro.ca/magazinearchives

⁹ G. Skogh, "Professional Liability Insurance in Scandinavia: The Liability of Accountants, Barristers and Estate Agents" in *The Geneva Papers on Risk and Insurance*, 14 (No. 53,

1989), 360 at 364, online: [http://www.genevaassociation.org/PDF/Geneva_papers_on_Risk_and_Insurance/GA1989_GP14\(53\)_Skogh.pdf](http://www.genevaassociation.org/PDF/Geneva_papers_on_Risk_and_Insurance/GA1989_GP14(53)_Skogh.pdf)

¹⁰ R. Kesevan "Malaysian Bar PII: A Mandatory Scheme" (The Malaysian Bar, 2010), online: http://www.malaysianbar.org.my/professional_indemnity_insurance/malaysian_bar_pii_a_mandatory_scheme.html

¹¹ R. Kesevan, "The Malaysian Experience: The Way Forward" (Address to the 1st Malaysian Professional Indemnity Insurance Workshop, 17 and 18 November 2005) [unpublished], online: (<http://www.jltinteractive.com/ecCover/Attachment/Malaysian%20Experience%20-%20The%20Way%20Forward.pdf>)

¹² "Hong Kong Solicitors Indemnity Scheme Review of Insurance Arrangements Review Report" (28 November 03), LC Paper No. CB(1)730/03-04(04), online: The Legislative Council of Hong Kong, <http://www.legco.gov.hk/yr03-04/English/panels/ajls/papers/aj0129cb2-1092-1e-scan.pdf> at 121

¹³ Cartier-Liebel, Susan, "Mandatory Malpractice Insurance Only Hurts Law-Abiding Lawyers", *The Connecticut Law Tribune*, February 12, 2007

¹⁴ See, for example, the January 4, 2010 press release titled "Legal Professional Liability Insurance Disclosure Required in Many States" from the Brunswick family of insurance companies, available at: <http://www.brunswickcompanies.com/pr-pl-legal-malpractice-insurance-disclosure-20100104.html>

¹⁵ Wasserman, Bennett J. and Krishna J. Shah, "Mandatory Legal Malpractice Insurance: The Time Has Come", *New Jersey Law Journal*, Vol CXCIX No.2 Index 58, January 14, 2010

¹⁶ online: <http://www.lawcover.com.au/topup/default.asp?ContentItemID=85>

¹⁷ online: <http://www.lexoninsurance.com.au/content/lwp/wcm/connect/Lexon/About+Lexon/>

¹⁸ online: http://www.lplc.com.au/policies_and_premium/about_your_insurance/

¹⁹ R. Acello, "Climate Change" *ABA Journal* (1 Nov 2009); online: http://www.abajournal.com/magazine/article/climate_change/

²⁰ Poll, Ed "Risky Business – Some Thoughts on Legal Malpractice Insurance", *Law Practice TODAY*, a publication of the American Bar Association, February 2007 edition

²¹ online: http://www.lawsociety.bc.ca/licensing_membership/membership/status_changes/insurance.html

²² online: <http://www.assurance-barreau.com/en/index.html>

²³ A. Scott, "Playing the ball not the man" (Law Institute of Victoria, President's LIJ Column, Jun 1998), online: <http://www.liv.asn.au/About-LIV/Media-Centre/President-s-Page/Playing-the-ball-not-the-man>

²⁴ Law Society of England and Wales, Practice Note (June 8, 2010); Online: <http://www.lawsociety.org.uk/productsandservices/practicenotes/piinsurance/4527.article>

²⁵ Law Council of Australia, Law Council Submission to the Potts Review, "Review of Regulation of Discretionary Mutual Funds and Direct Offshore Foreign Insurers" (2006) at 9, online: http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uid=8C755089-1C23-CACD-22CC-8316BEC40307&siteName=lca

²⁶ online: <http://www.qls.com.au/content/lwp/wcm/connect/QLS/Your+Legal+Career/Practice+Support/Professional+Indemnity+Insurance/>

²⁷ M. Gill, "Lawyers' Professional Indemnity: New South Wales", (Address to the 1st Malaysian Professional Indemnity Insurance Workshop, 17 and 18 November 2005) [unpublished], online: <http://www.jltinteractive.com/ecCover/Attachment/New%20South%20Wales%20-%20Lawyers%20Professional%20Indemnity.pdf>; see Law Council of Australia, supra note 14 at 9; see Scott, supra note 12; A. Flandrin, G. Durange, L. Halper, t. al., "Professional Indemnity for Lawyers - A Worldwide Review and Comment" (2005) PartnerRe at 6, online: http://www.partnerre.com/App_Assets/Public/4dd14bd9-48a6-4e32-820a-200c9bdb6c98/PIforLawyers.pdf