

Summary of the Willis Report on the Hong Kong Solicitors Indemnity Scheme

Willis were instructed to consider whether at the expiration of the current insurance arrangements on 30th September 2005 the Law Society should maintain the existing mutual Scheme (with or without amendment) or demutualise the Scheme and replace it with other options.

Willis reported on 28th November 2003. The report, which runs to 200 pages, is detailed and comprehensive, and has been made available to all members of the Law Society.

Members will shortly be asked to decide whether to maintain the existing Scheme or to replace it. The purpose of this summary is to provide a brief synopsis of the main conclusions reached in the Willis Report in this respect. It is not intended as a substitute for reading the Report itself. For ease of reference however, the points mentioned below are cross-referenced to the corresponding parts of the Report itself.

Willis were also instructed to consider related issues (Report, page 6, paragraph 1.1). These issues and the points made on them are also briefly summarised in the Appendix to this Summary.

Whether to maintain or replace the existing Professional Indemnity Scheme.

1. Willis recommended that the Solicitors Indemnity Fund be retained from 2005 subject to certain amendments. This was on the basis that sustainable lower cost was the paramount factor consistent with appropriate public protection. However, if freedom of choice for individual firms and lower short term cost for some firms despite adverse consequences to other firms were the paramount factors, then a Qualifying Insurer Scheme might be preferable. The reason for Willis's choice between these two alternatives was that in their opinion a Qualifying Insurer Scheme would not offer the same protection to the profession and the public as the current Scheme. Were it possible to guarantee that such protection would exist, these two alternatives would be finely balanced. (Report, page 34, paragraph 2.1.1).
2. In reaching their conclusion, Willis considered the pros and cons of the following alternatives:-
 - (a) Master policy scheme. (Report, pages 128-129, paragraph 4.5.1).
 - (b) Mutual fund. (Report, pages 130-131, paragraph 4.5.2).
 - (c) Captive insurer. (Report, pages 131-133, paragraph 4.5.3).
 - (d) Licensed insurer. (Report, page 133, paragraph 4.5.4).
 - (e) Qualifying insurers (Report, page 133, paragraph 4.5.5).
 - (f) Open market (Report, page 135, paragraph 4.5.6).
 - (g) Co-existence of Qualifying Insurers and a Mutual Fund (Report, page 137, paragraph 4.5.7).

Examples of most of these alternatives exist in other common law jurisdictions, and are summarised, with details of their benefits (and some of their problems) in section 5, pages 138-156 of the Report.

3. The grounds on which Willis reached their main conclusions are set out in the Report at pages 42-57.
4. The significance of the public interest is noted at page 42, paragraph 2.2.1. This is amplified and explained at page 121, paragraph 4.2. The diverse nature of the interests of the legal profession is mentioned at page 42, paragraph 2.2.2. Willis concluded that "with regard to the past history, statistics, management and operational structures, claims experience, characteristics of the profession, the business environment and risks to the legal profession in Hong Kong", although there was no single arrangement that Willis considered "to be the most suitable, feasible and acceptable; which struck a balance between the interests of the public and the legal profession; and potentially provided adequate levels of protection likely to be available and affordable in the long term", Willis were able to reduce the options to two - a Qualifying Insurer Scheme or the Solicitors Indemnity Fund, subject to various changes.
5. Willis pointed out at pages 43-44 that the main reason for the higher level of premiums was the high level of claims and that the inescapable conclusion from the experience of the Fund was that the profession in Hong Kong had "had its insurance on credit" since about 1996. See also page 98 paragraph 3.6 of the Report.
6. Paragraph 2.2.4 deals with the reasons why the Fund assumed the exposure of "lead insurer" in 1989 and the changes in market conditions since then.
7. Broadly speaking, pages 44-52, paragraphs 2.2.5 and 2.2.13 of the Willis Report deal with measures that could be deployed to manage risk in terms of the existing Scheme. What would be required legally and otherwise in respect of these measures is summarised in the Appendix to this Summary.
8. Page 53-56, paragraphs 2.2.14 - 2.2.18 contain a number of comparisons of the various alternatives in descending order of preference:-
 - (a) Willis concluded although a mutual fund and qualifying insurer scheme offer the least freedom of choice, the alternatives would be harmful to the public (Report, p.53, paragraph 2.2.14).
 - (b) On the other hand, protection to the public is maximised by a mutual fund (Report, page 54, paragraph 2.2.15). Next most protection comes from a qualifying insurer scheme.
 - (c) The mutual fund also scores well on lowest long term pricing, second only to an open market arrangement. A qualifying insurer scheme is the most expensive in this classification. However, the cheapness of the "open market" approach arises only because the price can be maximised by reducing the risk covered by the insurer, increasing deductibles and so on, thereby harming the public (page 55, paragraph 2.2.16 of the Report and see also page 53, paragraph 2.2.14).

- (d) The mutual fund also represents the best opportunity of insurance being available to all members of the profession, ranking equally with a Qualifying Insurer Scheme provided the latter has an "assigned risks pool" to cover the otherwise uninsurable (pages 55-56, paragraph 2.2.17 of the Report).
- (e) As regards liability of the profession as a whole, a qualifying insurer policy, a master policy or open market arrangements are the best options although a captive and a mutual scheme set up as a fund to pay a deductible under a single commercial policy also offer almost complete protection. A mutual fund as currently constituted in effect passes on the risk of reinsurer insolvency to its members (pages 56-57, paragraph 2.2.18 of the Report).
- (f) Lastly, Willis make the point that whatever course is adopted, the existing Scheme will need to continue for some years until existing claims are "run off" (page 57, paragraph 2.2.19 of the Report).

Appendix

A. Other matters considered by Willis

General:-

1. The Solicitors Indemnity Fund cannot be wound up (Report, p.14, para. 1.4.2).
2. Possibility of limitation of liability (Report p.116-117, para. 3.10).

In relation to the Fund

1. Protection of the fund from insurer insolvency
 - (a) Limit exposure of the Fund to retained liabilities (i.e. the public and members of the profession facing claims bear the risk of insurer insolvency (Report, pages 44-45, paragraph 2.2.5)
 - (i) Captive insurer (Report, page 49, paragraph 2.2.8).
 - (ii) Single commercial policy (Report, page 56, paragraph 2.2.18(3)).

See also pages 58-59, paragraph 3.1.

2. Current level of protection (HK\$10 million)

This is appropriate (Report p.34, paragraph 2.1.2, see also p.98, paragraph 3.6).

3. Geographical cover

Willis recommend that liabilities from Branch offices outside Hong Kong are excluded from cover (Report, pages 34-35, paragraph 2.1.3, see also pages 113-115, paragraph 3.9).

4. No claims bonus

Willis took the view that the current system was fairer to firms with claims (Report, page 35, paragraph 2.1.4).

5. Risk Banding

Willis concluded that Risk Banding should be introduced. (Report, pages 35-36, paragraph 2.1.5, see also pages 99-102, paragraph 3.7, and pages 103-112 (conveyancing claims)).

6. Adjustment of loading and deductibles

Willis recommended that more penalty deductibles be introduced for those having claims (Report, page 36, paragraph 2.1.6, pages 51-52, paragraph 2.2.11) (loading); page 50, paragraph 2.2.10 (deductibles); pages 108-109, paragraph 3.8.3 (deductibles; conveyancing claims).

7. Risk management

Willis concluded that a level of risk management sufficiently effective to reduce the number and cost of claims across the profession was required. (Report, page 37, paragraph 2.1.7)

8. Qualifying insurer scheme

Willis deal at pages 37-41, paragraphs 2.1.8.1 to 2.1.8.7 with various matters relevant to a scheme of this type.

9. "Sideways protection". This is protection from a large number of claims in a particular year. Willis recommend that the contribution formula be adjusted to ensure that enough contributions are collected. (Report, page 46)

10. Management structure. Willis make various suggestions regarding modification to the management structure of the Fund at pages 47-49, paragraph 2.2.7.

11. Allocation of contributions (page 50, paragraph 2.2.10). Willis recommend the following:-

- (a) "Risky" areas of practice should pay higher contributions;
- (b) Certain claims should bear higher deductibles;
- (c) the cap on deductibles should be raised to HK\$500,000;
- (d) increased deductibles should be payable for claims resulting from work that was undercharged.

B. What would be needed in legal and other terms to implement Willis's recommendations.

- 1. The requirement for professional indemnity insurance is statutory. It is a pre-requisite for the ability to practise (Legal Practitioners Ordinance, sections 6 and 7).
- 2. The current scheme is operated under section 73A of the Legal Practitioners Ordinance, by which the Council is empowered to make rules relating to professional indemnity. However, such rules must be approved by the Chief Justice and are also in effect subject to a veto by Legco. It is thought that either the current scheme or a qualifying

insurer scheme could be implemented without change to the primary legislation.

3. The relevant body of rules is contained in the Solicitors (Professional Indemnity) Rules. The wording of the rules is appropriate to the current scheme. The rules themselves would require redrafting were a Qualifying Insurer Scheme to be implemented. Consideration of detailed changes to the rules in that context is therefore otiose.
4. There are 3 schedules to the Rules. Schedule 1 provides for contributions to the Fund. Schedule 2 provides for management and administration of the Fund, and does not require further comment in this context. Schedule 3 provides for the exclusions and conditions of indemnity.
5. The relevant requirements for the existing scheme as regards each of Willis's recommendations are thought to be as follows:-

| Item | Nature | Amendment required |
|------|---|--|
| 1. | Protection from insurer insolvency | Schedule 1, clause 2 (6)(c). Schedule 3, clause 2 (1). A new schedule dealing with the position of the captive/commercial insurer. |
| 3. | Geographical cover | Schedule 3, clause 1 (2)(c)(v). |
| 5. | Risk banding | General amendment to Schedule 1 and Schedule 2. |
| 6. | Adjustment of loading and deductibles | General amendment to Schedule 1 and Schedule 2 (loading). Schedule 3, clause 2 (deductibles). |
| 7. | Risk management | No amendment required. |
| 9. | "Sideways protection" | Could largely be addressed by limited "multiple claims" to a maximum of say 3 claims in a year (amendment to Schedule 3). |
| 10. | Management structure | Some recommendations would require general amendment of the Rules. Others could be implemented administratively. |
| 11. | Allocation of contributions (a) "risky" areas of practice. (b) certain claims pay higher deductibles. (c) raising "cap" to HK\$500,000. (d) undercharged work | General amendment to Schedules 1 and 2. Schedule 3, clause 2. Schedule 3, clause 2. Schedule 3, clause 2. |

The financial effect of various changes would depend on how they were implemented.