

Solicitors: – ARP, Aggregation, and ABS's:

New challenges or same as always?

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## Content

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1. The Assigned Risks Pool ("The ARP") – the "perverse disincentive"?
2. Aggregation – Catastrophe Risk, Innovator One and Willmetts
3. Alternative Business Structures – Business models, financial analysis, higher risk practice areas



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## 1 The ARP

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### Background

The Open Market for Solicitors Professional Indemnity

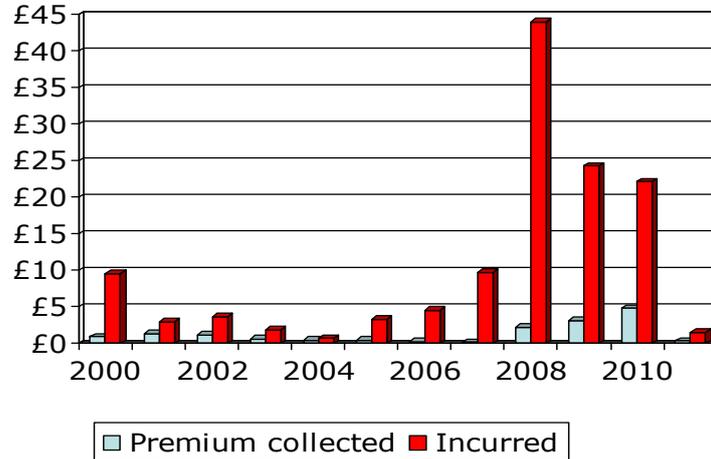
The ARP

Once upon a time...



## 1 ARP – what have firms and insurers paid?

Millions



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Data: ARP Manager June 2012

## 1 The ARP changes

From October 2011: Duration reduced to 6 months

Plan for getting cover or closure

October 2012: Funding split Insurers/Profession

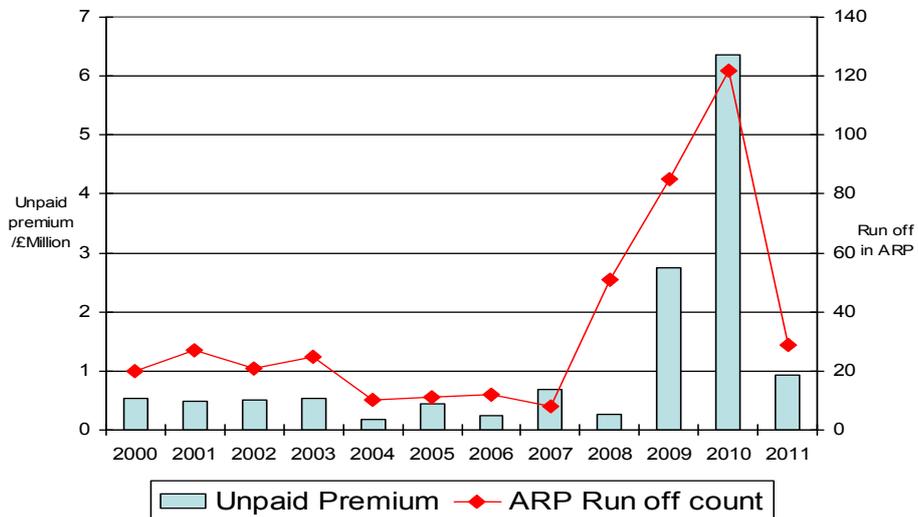
October 2013: ARP shuts

Non-Applied Firms to the Compensation Fund

“Extended Reporting Period”

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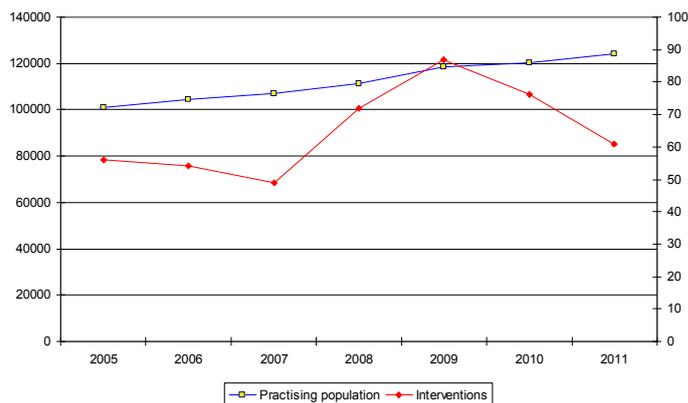
## 1 The ARP hangover – Unpaid premiums and run-offs



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Data: ARP Manager June 2012

## 1 No more ARP – Population and Interventions



2007 - 2009 interventions grew rapidly – faster than practising population

Is the PI policy being used as a substitute for capital adequacy?

Will OFR change that? Will the changes help?

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Data: ARP Manager June 2012  
+ SRA statistics

## 1 The ARP – development current year and next

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### Key drivers for development:

- Inflation, unemployment, mortgage arrears, interest rate
- lender's public image and sensitivity to review of their activity
- 2007 peak for lending limitation expires 2013 could drive activity
- is exposure linear with number in pool? approx 25% of the firms in the pool generate claims - 75% had no claims
- Will the COLP COFA requirements drive retirements and run-offs?

**Will the Law Society's £10 million be enough?**

## 1 The ARP – “the perverse disincentive”

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### Longevity assessment:

- Underwriters have always had exposure to run-off
- Bad debt from unpaid run-off premiums
- High level failures: Halliwells; Dewey & LeBoeuf
- ARP will no longer take the hit
- Underwriters will assume all the consequences of their own risk selection
  - Exposure to negligence
  - Exposure to fraud
  - Exposure to failure
- Increased importance of financial analysis

## 2 Aggregation – a constant issue

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- World Trade Centre
- Definition of event critical for property insurers
  - Losses driven by significant weather “events”
  - Focus for underwriting, reinsurance purchasing, and capital adequacy
- What about Professional Indemnity?
  - How do we assess sideways exposure?
  - Within policies and across policies?
  - How do you rate for it?
  - What cover are we providing?
  - Lloyds v Lloyd’s TSB
  - Series clause change – has it increased certainty?
  - Innovator one
  - Willmetts

## 2 Aggregation and the Minimum Terms

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- Definition of any one claim
- SIF

“All claims arising from the **same** act or omission...shall be regarded as one claim”
- Minimum Terms & Conditions 2000

“all claims arising from the same act or omission **or from one series of related acts or omissions** will be regarded as one claim”

## 2 Aggregation and the Minimum Terms

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- Lloyds TSB v Lloyds Bank
  - “related series of acts or omissions”
  - Combination of acts which resulted, causally, in the claim.
  - Scope for aggregation restricted
- Minimum Terms & Conditions 2005

“all claims...arising from...

  - the same act or omission in a series of related matters or transactions;
  - **similar acts or omissions in a series of related matters or transactions;**
  - **one matter or transaction”**

## 2 Aggregation and the Minimum Terms

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- Considered at the time likely to lead to more aggregation
- Minimum limit of indemnity increased to £2m/£3m
- Often relate to fraud/dishonesty matters
- Open to interpretation. Law Society?

## 2 Aggregation – is underwriting action needed now?

- Outcomes from litigation will have to emerge
- Earliest likely dates around 2014
- What are suitable limits for law firms now?
- Are different practice areas more likely to see aggregation than others?
- What will the effect on reinsurance be?

## 3 ABS – what are the issues for underwriters?

- Are the managers likely to be any better or worse at managing than the average solicitor?
- How involved are they going to be? Who is managing quality?
- What is the investment strategy – quick win or long term - Time horizon and strategy of investors can be very different to traditional law firm
- Who are the real owners of the business? (Remember despite representations to SRA, little can be done if they change mid-term)
- What linkages or referral sources are expected to provide work to the ABS?
- Is the work area prone to industry wide issues – personal injury, financial services, conveyancing, tax

### 3 ABS – example structures so far

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**Classic vertical integration:** existing in house legal function converts to ABS

- increased ability to conduct reserved activities
- in-house department can become a profit centre
- reduce external legal spend – work done at cost

Risks: OFR compliance; conflicts of interest; capacity to cope with emergencies and variation in service demand

### 3 ABS – example structures so far

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**New Services to existing customers:** “Co-op” law, AA etc

- process control and efficiency – standardised services
- customer base large and knowledge high, superior service possible, targeting services at appropriate age ranges/spend patterns

Risks: history demonstrates costly teething problems e.g. financial services, cost reduction not obvious.

### 3 ABS – example structures so far

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**Niche specific service:** “Will-Mart”, “leases 4 U”, “Divorces R US”,

- process control and efficiency - standardised service + expertise
- low interaction
- no different from niche law firm so what is external investment adding?

Risks: contagion – one wrong all wrong, ensuring (wrong) service is not given to customers;