

Special report

# Risk Management & Professional Indemnity



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# A Different Perspective

Personal Insurance for Solicitors

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By Richard Brent



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## TL Risk Solutions Professions

# Solicitors' Professional Indemnity Insurance (PII): the market in 2007

**Trevor Moss** is an experienced and qualified insurance practitioner, specialising in the provision of solicitors' Professional Indemnity Insurance (PII).

This time last year I was asked to write a similar article predicting the appetite of the insurance market for solicitors' PII business for the 2006 renewal season.

At the time, several insurers and brokers were 'talking rates up', suggesting possible premium increases of around 30 per cent. This seemed unrealistic bearing in mind the competitive state of the professional-indemnity market for other classes of risk and the desire of most insurers to increase premium revenues by engaging in competition for new business. The outcome for those firms who demonstrated good claims records and a well managed business was a competitive renewal season, with most enjoying a rate reduction and certain smaller to medium-sized firms seeing premiums reduce by as much as 40 per cent on the previous year's premium spend.

Issues arising from the legal actions following the demise of The Accident Group (TAG) and other 'claims farmer' disputes in the run up to the 2006 renewal had a lesser impact than first predicted. They may be even less of an issue in 2007, especially if insurers are competing for business in the knowledge that previous arrangements/insurers will carry the can in terms of any liability, damages and costs from the outcome of litigation resulting from such issues.

Early indications for 2007 are that certain insurers on the current



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Qualifying-Insurer panel are keen to write more profitable risks. However, it is too early to say whether others will throw in the towel if it is felt that low rates and profit margins are unsustainable. Furthermore, insurers want to see a 'balanced book', and some will need evidence that the percentage of solicitors' risks are not out of kilter with the overall premium revenue derived from

In general terms, firms with between two and 15 partners tend to view price as the key determinant in the selection of their professional-indemnity provider. Top 150 and upper mid-tier firms, albeit conscious of the need to keep expenses low to maintain competitive advantage, put greater emphasis on service standards and other value-added propositions when deciding on their choice of insurer and broker.

Although it is too broad an assumption to typecast firms by size, there are some general patterns that tend to emerge from the demands, needs and buying processes of firms across the size scale. For the purposes of this article, I have used the term Top 150 as the point where

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other professional classes for which professional indemnity insurance is underwritten. Having said this, there is a limit to the extent of premium discounting, and those firms that enjoyed significant savings last year will have less of a margin for further reductions this year.

segmentation of these needs and processes take place, but this is of course a generality with exceptions throughout the range.

Larger firms have been taking advantage of softening insurance rates by investing in higher indemnity limits. It is predicted that some further

reductions in the cost of higher layers of cover may again manifest themselves this year. Increasing investment in risk management is also being funded by lower premiums and this is a logical approach to take. These observations are supported by research undertaken by PriceWaterhouseCoopers in its Law Firms Survey 2006. At some stage the market will become far more volatile and investment in claims avoidance through good practice management now, aided by an imbedded risk-management culture, should reap rewards when the market cycle turns from soft to hardened conditions in the future.

On the broad subjects of risk management and best practice, firms with fewer than 25 partners are signing up for Lexcel accreditation in greater numbers, and this will mean willingness from insurers to focus on those applications that demonstrate embedded claims-avoidance procedures in 2007. The essence of PII is the transfer of risk from the insured to insurers, but any underwriter worth his or her salt is looking to 'invest' in those businesses offering the potential for the highest return.

A firm offering claims-free credentials over a period of time can represent a gross profit ratio of between 80 and 100 per cent to insurers depending on whether broker remuneration is a factor, and excluding general administration expenses. However, it only takes a few bad apples to have a serious impact on profitability when rates are so competitive. With risk exposure on primary cover currently set at £2-3m per claim, a lot of business has to be written to cover a single maximum loss.

It is often difficult to correlate the tangible financial benefits of risk management in terms of premium rating. Lack of investment in risk prevention will automatically limit the number of insurers willing to offer terms to firms with poor claims

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records, resulting in the absence of risk management controls.

One factor that deters firms from investing in certain risk management solutions available from specialist providers is that these often include the 'risk profiling' of partners and fee-earners, which can often be viewed as too intrusive both in terms of time and the potential highlighting of a lack of knowledge or adherence to procedures by key individuals within the firm. These considerations are particularly relevant to those senior partners responsible for the purchasing of risk-management services where their own personal adoption of best practice may be somewhat outdated. However, there are specialist risk-evaluation tools available that provide a snapshot of exposure to risk without being overly invasive or putting partners and staff through the mangle of online testing or in-depth interviews.

Last year there were only a few new entrants to the list of Qualifying Insurers (QI), and undoubtedly those insurers currently on the Law Society panel will be waiting to see whether any new entrants will emerge from the wings this year. New entrants always pose a real danger to those more established markets as they are invariably looking to 'buy in' premium income at discounted rates. They can afford to do this in the short term, as unlike those insurers who have previously subscribed to the QI panel, they have no legacy claims issues to reserve against.

During the course of the renewal season, it is customary for the Law Society to list those insurers who have agreed to renew or enter the QI panel. This information can be found at [www.lawsociety.org.uk/professionalinsurance/qualifyinginsurers/currentlist/law](http://www.lawsociety.org.uk/professionalinsurance/qualifyinginsurers/currentlist/law).

In 2006, even the majority of the Top 100 firms left their decision to renew until the closing stages of the renewal season. In a survey conducted by specialist risk-management law firm Legal Risk, 45 per cent of respondents from the Top 100 firms did not give instructions to their brokers to renew cover until the last week of September. Although this may have desired outcomes in terms of buying cover at the most competitive price, brokers will struggle to get full cover in place by renewal date, particularly for firms buying more than £100m of cover.

For 2007 it is predicted that more early renewal options will be made available by the market than ever before, and some insurers will endeavour to employ a carrot and stick approach by offering discounts but with a deadline of acceptance by a stated date. Firms should make their own decisions as to whether such early renewal options are in their favour and should not be pressurised into making any decisions if it is believed they offer greater benefit to the provider than the purchaser.

In my predictions for 2006, I mentioned that the dynamics of the market were about to change, mainly

as a result of personnel changes at the major brokers specialising in solicitors' PII. Some teams and individuals have set up new professional indemnity businesses, or have created new divisions within current brokers not previously attuned to the class. Others have migrated from one major player to another, hoping to take personal connections with them. As it transpired, not many firms moved as a result of loyalty to individuals. This may have been due to non-compete covenants being in place. However, this did not preclude some changes taking place, with business mainly switching between the three main brokers operating in the sector. There was an inherent concern for the financial stability of new broking houses in the sector, particularly those that had taken on high start-up costs with little or no revenue to support it. It will be interesting to see if such buying considerations will prevail this year.

Most major firms seem to put value on continuity of insurer, having stayed loyal to their insurance provider, but not before shopping around for cheaper terms from other risk carriers. From the Legal Risk Top 100 survey, nearly 17 per cent of firms switched broker whereas the same survey shows only three per cent changing the insurer(s) of their primary cover.

The SME segment of the market has seen brokers inundate the target market, initially with mail-shots - where firms can expect to receive up to 30 non-solicited letters from almost as many brokers. In more recent times, telesales marketing campaigns have resulted in keeping 'gatekeepers' on the firm's telephone switchboard particularly busy.

A large number of brokers profess to have requisite expertise and exclusive markets only available to them, and such statements should be scrutinised. Solicitors would be wise to request details of the respective

strength of broker relationships with insurers and levels of service support, as these could be quite different from previous years. Brokers employing high-caliber staff and sector knowledge will be only too pleased to provide full details of their credentials.

One further issue requiring clarification is that of broker remuneration. Brokers do add value and the cutting out of the middleman could result in the absence of experience and advocacy and result in some add-on services simply not being available when purchasing directly from insurers. However, at what price should broker services be charged? The vast majority of Top 100 firms remunerate brokers by way of fees added to net premiums rather than brokerage paid by insurers out of gross premium. The level of fee is as difficult for brokers to formulate as it is for firms to verify and agree. However, it is unlikely that a fee will represent a figure greater than that which the broker would earn from brokerage paid out of gross premium.

The acid test when it comes to fees is the competitive tender process. Although there can be low-balling in any industry, the legal profession is

based, the broker is totally transparent in terms of earnings. Despite FSA regulation making brokers more responsible for earnings disclosure, not all apply the same levels of transparency. If you have negotiated a fee, make sure that all premiums throughout the programme are placed with insurers on a net basis. The failure to do so could be compared with paying for a meal at a restaurant and then finding, on closer inspection of the bill, that you have paid a tip on top of a service charge.

Many Top 100 firms would prefer to see a reassuringly expensive fee subject to exemplary service standards being set and adhered to. Some firms will pay their brokers an annual bonus fee where it is determined that the service standards have been met or are above expectations. On the subject of client expectation, in my experience, brokers to Top 150 law firms rarely win new business unless the incumbent loses the business by not meeting its client's delivery expectations.

The 'value' proposition tends to diminish and be replaced by a 'price' proposition as the size of firm reduces. For this reason, the

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also prone to such activities when bidding for tenders, and most firms are able to assess the sustainable from the unsustainable and recognise that a low fee will, sooner or later, result in delivery issues in terms of service levels.

Do be sure that whether remuneration is fee or brokerage

greatest level of change of broker and insurer tends to take place in the SME segment of the profession. To a certain extent, this model is supported by the fact that larger firms do value continuity of insurer. The rationale behind this may be that, by their very nature, larger firms have larger claims and there is a general desire not to

leave an insurer who is on the hook for a sizeable loss, particularly if that loss takes the form of a claim where the settlement remains outstanding.

So why is all this relevant in April, in a soft market, when the renewal date is not until October? The answer is that those Top 100/150 firms contemplating broker review will be putting together plans of action now and starting the tender process. For other firms, the early renewal offers from incumbent insurers and brokers are only days away, as are the relentless new business campaigns of market competitors.

So what else will be relevant during the 2007 renewal process? Minimum indemnity limits are likely to remain unaltered from the current £2m (increasing to £3m for LLPs) but with more firms making the transition to LLP status there will be greater demand for Personal Asset Protection policies (otherwise known as lifeboat policies), the intention of which is to provide contingency cover to individual members and their estates in the event that the main PI programme fails to respond in whole or in part to actions against individual members and their estates. Likewise, the executive boards of LLP firms will be more aware of the management liabilities incumbent upon them and will look to take out management liability policies akin to the directors and officers insurance available to commercial corporate entities.

Here are my ten top tips for 2007:

- Complete your submission early, or if putting the PII out to tender, start the process now. It is one job less to do when the pressure piles up either pre- or post- summer holidays;
- Make sure that the renewal submission includes all relevant information, including full claims details for the past five indemnity

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**Do not flood the market with submissions. Two brokers, carefully selected should be able to cover most of the market. Only use a third broker where you are satisfied they have an exclusive scheme which is not available elsewhere;**

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years. Some insurers and brokers are reluctant to provide this information in the knowledge that it will be used to seek alternative terms from the market. You may have to be persistent in your requests for such information. And take time to look at levels of claims reserves. You could be surprised and may wish to dispute the level of reserves attached to certain matters. Bear in mind that any competing insurer will pay close attention to the number of reported matters to which reserves and payments attach. Therefore if any of these can be closed off, make sure that insurers do so at the earliest opportunity;

- Select the brokers that you propose to employ to approach the market on your behalf carefully. Due diligence at an early stage in this regard should prove to be profitable;
- Do not flood the market with submissions. Two brokers, carefully selected should be able to cover most of the market. Only use a third broker where you are satisfied they have an exclusive scheme which is not available elsewhere;
- Where a third broker is requested to seek a quote from an exclusive scheme, make sure that they are given explicit instructions not to approach primary insurers in the open market as this could have a negative impact;
- Do not feel forced to accept early renewal offers. In reality the incumbent insurer will be as

keen to secure your business on 25 September as they would on 25 June;

- Establish a dialogue with the brokers that you have instructed to act on your behalf. After all, your PII is your license to practice and your selection of cover and choice of broker and insurer should be based on more than price alone;
- Consider adequacy of indemnity limit and whether disclaimer clauses will assist in protecting the firm without having a negative impact on client relationships;
- Assess whether spreading premium payment by installments is cost effective. There are some very competitive options available and these may come from providers other than your insurers;
- Make enquiries as to when you can expect to receive policy documents. It should take days or weeks rather than months for these to be in your possession

Finally consider the firm's position in relation to risk management. Even though your PII policy is designed to offer protection, it is not a watertight solution and any practitioner who has experienced being on the wrong side of a negligence action will endorse the maxim that prevention is better than cure. ■

*TL Risk Solutions Professions is a broker specialising in Solicitors' Professional Indemnity Insurance and is a division of TL Risk Solutions Ltd, authorised and regulated by the Financial Services Authority*

## CRS Group

# Risking it all

**Simon Lovat**, Head of Professions at CRS Group, the international insurance and reinsurance broker, outlines how the Legal Services Bill will impact on the risk-management strategies of solicitors acting in the UK market.

“There are no clear objectives and principles which underline this regulatory system; and the system has insufficient regard to consumer interest” – Sir David Clementi, 2004.

The Legal Services Bill sets out the Government’s legislative proposals to reform the way legal services are regulated and delivered. These proposals are intended to put consumer interest at the heart of the regulatory framework, and as a result the introduction of the Legal Services Board (LSB) will change a number of aspects concerning how law practices are managed. The proposed reforms are a direct result of the Clementi report (published December 2004), which criticised the current legal system as too fragmented and uncompetitive.

In short, the Legal Services Bill has the potential to change the legal landscape significantly. Are we ready? What are the risks? How can they be managed? Much has been written about the opportunities and threats that will follow from these changes – but what are the risk-management challenges that legal practices need to be focusing on to ensure that they are well placed to meet these changes?

First of all, what changes should we expect? In essence, the LSB has three key aims:

- To reform the regulatory framework for the provision of legal services;

- To create a statute allowing the implementation of Alternative Business Structures (ABSs);
- To reorganise the way in which consumer complaints are handled.

This article deals with the second and third points only, leaving aside the challenges of the regulatory framework to focus on the commercial challenges and opportunities, as well as the key issue of much more effective dispute resolution for the consumer.

## Alternative Business Structures

In March 2001, the Office of Fair Trading (OFT) concluded that the legal market in the UK had, over time, developed a range of barriers to entry that had rendered the market unduly restrictive. As such, the OFT argued that quality and cost-effectiveness of legal services in England and Wales was being compromised.

The introduction of the Alternative Business Structure (ABS) – often referred to in the popular media as ‘Tesco’s Law’ – is intended to open up the market in a positive and constructive way. Practically speaking, ABS will mean that legal practices will be owned and managed by non-legal personal and provide non-legal services for the first time. For example, we envisage a situation where a firm of solicitors will also provide advice on financial services, accounting issues, and any other related discipline in professional services, as well as its core legal

practice. Any additional services would, of course, be subject to the usual regulatory checks and balances.

Any such ABS will be required to apply for approval from the newly created Legal Services Board, which will be required to report to and consult with the appropriate regulators (the Financial Services Authority would be an obvious example). Furthermore, each ABS will be required to nominate both a Head of Legal Practice (HoLP) and a Head of Finance and Administration. These individuals must be approved by the regulator, and will be required to undertake and pass a ‘fitness to own’ test.

## Dispute resolution and risk management in legal services

The implementation of ABS is just one part of the story though. The current complaints system within the legal-services industry is fragmented. Each professional body has its own consumer complaints department – unlike financial services, for example, where the Ombudsman constitutes a single point of contact for consumers. Sir David Clementi notes that consumers expect and deserve a standardised system of service for dispute resolution. For instance, a complaint on a conveyance could potentially include dealing with a solicitor, a licensed conveyancer and a legal executive, with several different complaint mechanisms involved.

### Restoring consumer confidence

The proposed solution is to create a single body – much like the Ombudsman – that would take responsibility for managing all claims made against any party providing a legal service. The Office for Legal Complaints (OLC) would operate independently of any approved regulator (AR) such as the Law Society. It would not, however, abolish the ‘in-house’ claims-management process currently provided by the AR. Only if the claim could not be resolved would it be passed to the OLC, which would have the power to provide redress to the consumer directly up to a sum of £20,000.

The guiding principle behind the creation of the OLC is to restore consumer confidence in the legal profession. Consumers will have the right to know what to expect when purchasing legal services – something they have not previously enjoyed (partly as a result of the infrequent nature of the purchase of legal services).

### Mitigating the risks

The Clementi report argues that consumers are losing out through a lack of competition in the legal-services market, suggesting that the existing regulatory structures do not have the best interests of the consumer at heart. The legal industry does not display the characteristics of a free market and cannot, therefore, deliver efficient outcomes.

ABSs are being introduced specifically to increase competition within legal practice. By combining elements of law practices with other related businesses, economies of scale should prevail and those businesses that can structure their resources most efficiently will be able to pass savings on to consumers. Free market economics should ensure that inefficient practices will become uncompetitive and, eventually, not profitable enough to survive.

As law practices join forces with insurance brokerages, chartered surveyors, independent financial advisors (IFAs) or any external

evaluate their business, there is no doubt it will pay dividends in the long term, but if this is a struggle there are many organisations available that

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financers (now possible within the structure of an ABS), best-practice risk management will become key to how successfully the expanded business operates.

### Gearing up for effective risk management

So what does ‘best practice’ look like? Job titles are very revealing when it comes to assessing how seriously a firm takes a particular area of its business, and it is no different when it comes to risk management.

In the past ten years we have seen massive changes in perception. Instead of risk managers we are seeing chief risk officers. Instead of the role of risk manager being an adjunct to another job, it is a specific job; and instead of being viewed as an unwelcome cost, risk managers are now considered an integral part of business.

### The professionals

Firms of solicitors that start to use professional risk managers rather than job-sharing staff to help identify business risks will start to set themselves apart from their competition. Not least because these professionals are often better placed to take a step back and offer an impartial view of how the business is being operated.

While smaller practices often lack the capacity to employ a full-time risk professional, the concept of risk management can still be embraced. If the partners, or even the sole practitioner, can take time out to

can offer consultancy-based risk-management services.

### Conclusion

The Legal Services Bill seeks to change the way in which legal services are purchased. The industry is currently uncompetitive. As legal services are purchased infrequently, there is little opportunity to compare quality, and the same firm is often used over and over again, regardless of suitability or quality of service.

The introduction of the ABS is designed to take advantage of economies of scale and reward efficient practices that can reduce prices and source external investment. Superior risk management will improve the efficiency of the firm, enable it to source more investment and ultimately become more profitable. Potential mergers between legal practices and non-legal business will become common under the new proposals and only those practices that have adequate risk-management procedures in place will be considered attractive partners. A firm regulated by the FSA will not want to merge with a legal practice that requires a complete restructuring of the back-office systems, for example. Inefficient practices are not being ‘forced out’ – but they will not be able to compete in the new environment if they don’t take the initiative to invest in their risk-management and back-office systems now. ■

## Survey analysis

# PII survey 2007

*Managing Partner* conducted an in-depth survey of the professional indemnity insurance (PII) market, asking firms for their opinions and priorities in advance of the October renewal deadline. By **Richard Brent**

Professional indemnity insurance (PII) is a fact of life for law firms, but that doesn't mean it is something they can take for granted. With increasing regulatory pressure being exerted by the profession's watchdogs, and the path laid out for a new Office for Legal Complaints (OLC) in the Legal Services Bill currently making its way through parliament, effective risk-management procedures have never been more important. Firms need to arrive at a realistic assessment of their risk profile and ensure they have a level of insurance cover to match it.

As readers will know, the renewal date for PI insurance is in October every year, but for firms that may be tempted to change provider it isn't too early to begin formulating plans, assessing 'early renewal' offers and considering which brokers will be best placed to cover the market.

The annual *Managing Partner* PII survey canvasses the opinions of all sizes of firm, but the majority (76 per cent) of respondents had between five and 100 partners. Firms with more than 100 partners accounted for 12 per cent of responses – as did the very smallest of firms, ranging from sole practitioners to firms with four partners.

Firms also went for a wide range of cover levels in 2006, although 84 per cent took out less than £100m. Just over a tenth (12 per cent) – likely the larger firms – were covered for claims worth more than 200m, with 17 per cent taking out cover worth £5m or less. Around two-thirds (67 per cent) opted for cover between

£6m and £100m. A quarter of all firms also reported increasing their level of cover in the past 12 months to cater for the higher-value work they are attracting, in some cases for the same or lower premium.

Only one firm to respond did not use a broker to secure their insurance. A wide range of brokers were mentioned, but Aon, Marsh and Lockton dominated. A third of law firms (33 per cent) changed broker in 2006, however, with 14 per cent also planning to shop around for a better deal before October 2007. While it will come as no surprise that almost three-quarters (71 per cent) had switched broker looking for a lower premium, precisely the same percentage also claimed to be looking for a better personal relationship with their chosen broker. Over a quarter (29 per cent) reported being unhappy with their previous broker's level of service, and one specified a dislike for the 'hard sell' approach that was employed. More than half (58 per cent) said the relationship between firm and broker was "very important" for securing the best PI deal. The remaining 42 per cent thought this was at least "quite important".

To secure the lowest premiums PII providers will also be looking for evidence law firms routinely take risk-management seriously – by following clear procedures, monitoring activity and fostering a firm-wide culture of compliance. Asked about the most serious risk-management challenges facing the firm, a decisive 85 per cent said they were concerned by the threat

of negligence and libel claims or repercussions owing to a loss of client data – far and away the biggest issue. The second largest concern for firms was the impact of IT downtime, cited by a third (33 per cent).

Over a quarter of firms (26 per cent) had appointed a risk partner, and 13 per cent had brought in a non-lawyer such as a risk director, although for some two-fifths (39 per cent) it fell to the managing partner to take the lead on risk. Just under half of firms also had a formal risk-management training programme for lawyers to follow, involving a combination of classical, class-based learning, self learning, e-learning or reflective learning in the course of the firm's daily business. The majority of firms provided in-house training, however, with just eight per cent bringing in external coaches. In a sign that the trend towards LLPs continues, over a third of firms (35 per cent) had already adopted this structure to mitigate risk, and a quarter of those have purchased a specific insurance policy to protect against residual personal liability.

Overall, our survey shows firms are responding to the challenges of the changing legal landscape: the increased regulatory pressures, increased transparency demanded by clients, and the knowledge that if your firm can't deliver service excellence, there will be others that can. With pressure in the sector projected to get even fiercer post-Clementi and the expected market consolidation, responsiveness to risk is a key way for firms to demonstrate their fitness to compete. ■

A close-up, low-angle shot of a digital display, likely a stock market ticker or a financial instrument. The display shows the number "1.10" in white on a dark background. A blue square is visible between the two "1"s. The background is blurred, showing what appears to be a microphone or a similar object.

# *Decision Time?*

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