Smaller law firms must avoid falling into an unrated insurer cycle, warns Law Society

What are the implications for law firms buying insurance cover from unrated insurance companies? The Law Society has warned firms affected by the suspension of Latvian insurer, Balva, to carefully investigate their alternatives for their professional indemnity insurance (PII). Matt Davies and Brian Balkin, members of the Professions team at privately owned insurance broker and leading solicitors PII broking firm, Lockton Companies LLP, explain the background and advise law firms how to respond.

What has happened and what are the Law Society’s concerns?

Earlier this year the Latvian financial regulator, the Financial & Capital Market Commission (FCMC), stopped Balva from underwriting any new policies. Their licence has now been suspended by the FCMC. Balva were on the SRA’s Qualifying Insurer panel in 2012.

Last year, Balva, underwrote c.£16.5m of Solicitors PII business, 7% of the market, insuring approximately 1,300 firms. Balva do not carry any financial rating from any of the major rating agencies (AM Best, Standard & Poor’s or Fitch). The SRA are seeking advice on whether the collapse of Balva is an ‘insolvency event’ and in breach of the Qualifying Insurer rules.

The Royal Institute of Chartered Surveyors (RICS) has a similar Qualifying Panel arrangement for their members but they mandate that any insurer on their panel must carry a certain level of financial rating. Lockton has always believed that Qualifying Insurers should carry a minimum level of financial security. The SRA state that they do not regulate insurers, and that this is the responsibility of the Financial Conduct Authority in the UK. The SRA are changing the name from “Qualifying Insurer” to “Participating Insurer” to make sure that there is no suggestion that they have approved the insurer, undertaken any solvency checks or set any minimum level of security for participation in the solicitor’s PII market.
Over the last three years, a number of insurance companies, who did not have any financial security rating have appeared on the SRA’s Qualifying Insurer panel. A number of them, Quinn, Lemma, ERIC and now Balva have either withdrawn from the market, had their licences to transact business withdrawn or have gone into administration and/or liquidation.

The concerns are that a number of insureds, generally smaller practices, (1-4 partner size) may have been insured with a number of these insurers, because they have not been able to obtain cover from the larger, more established and more financially secure insurers. If an insolvency event is declared by the SRA, these firms will be forced to find a new insurer within 4 weeks and of course pay another premium. Failure to obtain cover will mean they will fall into the Assigned Risks Pool (ARP) where they will have to pay the punitive ARP rates.

Balva had an exclusive arrangement with one broker who has given firms an option to transfer to another unrated insurer - Berliner Versicherung Aktiengesellschaft ('Berliner'). Berliner, is a German insurer, that has no financial rating from any of the major ratings agencies and according to their accounts, only have €6m in capital reserves.

Berliner are offering to take on the Balva policies for four months from 1st June 2013, (i.e. through to the end of the current policy period) without the need for additional premium but we have been shown documents where longer term renewal options through to 30th April 2015 are being proposed.

What should firms affected by the suspension of Balva now do?

If you are currently with Balva, you do not have to take the option of transferring your cover to Berliner. You could seek help from a broker to try and find another insurer who would be prepared to cover you through to renewal and beyond. The Law Society have said that transferring policies across to another unrated insurer may be a short term option however they are recommending, that firms research the market available to them at this renewal.

There is no guarantee that you will be able to find an alternative insurer now. The easy option is to take the Berliner deal, which many are going to. If you do take that option, do not feel that you then have to take the extended renewal options which are being proposed from the period beginning 1st October 2013.

Lockton’s advice to all clients is start preparing for renewal early and to seek cover from an insurer with a good financial rating ("A-" is Lockton’s minimum requirement) who is going to be around for the long term and will be able to pay their claims. There is work involved in this course of action and there is a risk that firms may end up paying more premium, but it may well be worth it, to find a rated long term insurer.

We totally understand that if an unrated insurer is prepared to offer cover, at a lower cost, which does meet Minimum Terms set by the SRA, there will be a temptation to take it, rather than pay a higher premium to be with a more financially stable and secure insurer.

Is there a danger some firms may act rashly?

Yes. Policyholders who either aren’t aware of the issues or are not getting the most comprehensive advice from their insurance broker, might be tempted to take the option that’s on the table now.

Is there anything that firms could do to prepare for situations like this?

Nobody can predict the future, and whilst we do not guarantee the security of our insurer partners, Lockton goes to great lengths to ensure that the insurers we are placing our clients business with, carry a certain minimum level of financial stability. Lockton have an Internal Market Security Committee who constantly monitors the financial performance of our insurer partners and regularly issues updates and bulletins to our clients and prospects.

Do you have any best practice tips?

At the risk of restating what we’ve already said, our advice is to start preparing for renewal early, use a broker who has a track record in the legal sector and most importantly seek cover from an insurer with a good track record and a strong financial rating.

Interviewed by Nicola Laver. The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.