



***GUIDE FOR NEW START-UP
PRACTICES PURCHASING
PROFESSIONAL INDEMNITY
COVER***

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Our initial article on this subject appeared in the Messenger last August. Since then the insurance market has changed somewhat and the number of would-be start-up practices has increased significantly.

Previously the profile of most new practices was that they would comprise one or two twenty-something individuals with 5 or so years' experience, wanting to do their own thing and make their mark. Over the last couple of years but accelerating over the last 6-9 months, that profile has changed out of recognition.

The new driver is the economic downturn and the effect it has had on practices large and small. There is no longer any common profile, although certain categories of new firm have emerged.

Another influencing factor is the appetite of insurers and the big hikes in PI insurance premium for many practices in the 2009 renewal cycle. Insurers have been monitoring the change in profile of potential start-up practices and frankly have not made it very easy for those practices to obtain cover at a reasonable level of premium.

Although it's not our role to represent the interests of insuring firms, I do have some sympathy for the insurers- but only a little!

The current rules, created originally by the Law Society in the form of the Minimum Terms, now regulated and enforced by the Solicitors Regulatory Authority, place onerous liabilities on the Approved Insurers, even for new practices apparently presenting relatively low insurance risk. Under the Minimum Terms, insurers are obliged to provide:

- a full civil liability policy wording (wider than any wording currently enjoyed by other professions);
- a market of last resort for failing practices, i.e. the Assigned Risk Pool;
- payment of claims including the policy excess, which they may or may not be able to recover from the insured practice;
- a full year's cover even if little or no premium has been collected subsequent to assuming cover;
- continuing cover for up to 6 years in the event of firms ceasing to practice, i.e. the Run-Off provision.

The above exposures break down into two principal factors:

- the credit risk – this is a problem for

insurers and is now a major issue due to the deteriorating financial adequacy of many practices;

- the claims risk – it is virtually impossible for insurers to refuse cover for a claim made against a practice, even when fraud by the practice is involved.

As a consequence, and for sound business reasons, insurers need start-up practices to provide very detailed information, comprising:

- full CVs of partners and senior employees: insurers will take an in-depth look at the capabilities and experience of key individuals and consider whether those individuals have the expertise to deliver what is promised in the business plan;
- a full business plan including financial and cash-flow projections: insurers will consider the plan and the financials to establish whether in their view the plan is achievable. In addition insurers will want evidence of the availability and the adequacy of capital.
- a start-up firm's Proposal Form which will drill down into the detail of the professional activities the new practice intends to undertake. Insurers will form a view, again based on the experience of the key individuals but also on their claims experience emanating from those activities.

It is essential that would-be start-up practices adopt the right tactics from the beginning. It is important that individuals embarking upon this significant step obtain appropriate advice from a variety of professional advisers, i.e.:

- Accountants
- Compliance Consultants
- Insurance Brokers.

With specific regard to Professional Indemnity Insurance, it is important that this is fully explored before any bridges are burned or significant money is spent. The SRA will not process any application until the applicant can provide written evidence of the availability of compliant insurance cover.

Therefore, this should be tackled early in the process, not the final piece of the jigsaw to try to slot in hurriedly at the end.

An insurance broker with the right credentials will guide the practice through this essential stage and establish quickly whether the insurance market will offer cover. Key individuals should be prepared to meet prospective insurers: a face to face meeting can have a beneficial effect.

Some hot tips:

- Provide full CVs;
- Provide a simple and concise business plan;
- Curb the natural enthusiasm to over-egg the financial projections: Insurers are nervous of over ambitious projections;
- Stay within your existing areas of competence: again, insurers get nervous when business plans rely on expertise the key individuals do not possess;
- Be up-front about the funding of the venture;

Include a compliance plan as an extension to your business plan.

The key to success is to provide comfort to insurers in the areas mentioned above: good financials and compliance procedures are crucial, and you need to demonstrate low credit risk and manageable claims risk. Continuing:

- Obtain insurance advice early and deal with that part of the process, allowing you to progress other aspects of the new venture safe in the knowledge that the unavailability of cover will not become an obstacle;
- Do not ask insurers why they need a business plan!
- Do not attempt to negotiate 6 months' credit with insurers!
- Do not say you are really setting up this business for your daughter who is a first year trainee and part-time pole dancer!

We hope the above will assist would-be new practices in understanding the insurance requirements and the process for meeting them.

In the next technical bulletin we will examine the Successor Practice and Assigned Risk Pool issues in more detail, and the likely impact on the insurance market of potential changes in those areas.

MFL can provide the assistance required by new start up practices

Visit our website:

www.m-f-l.co.uk/mls-newstartups

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