Indemnity insurance: the sting in the tail

Overselling the firm's financial stability may turn out to be a high-risk strategy, **John Gould** warns

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A professional indemnity policy is a contract of utmost good faith. This means that an insured solicitor must disclose to the prospective insurer all the material circumstances before the policy is put in place. This is not limited to simply being truthful and avoiding misrepresentation, it means volunteering information if it is material. A solicitor may be expected to know quite a lot about their own practice and firm. If it is something that might affect the setting of the premium or the insurer's willingness to take the risk, it is likely to be material.

For many years, the minimum terms of insurance for solicitors have provided protection for clients against the risk of a policy being avoided. The policy must provide that the insurer is not entitled to avoid or repudiate the insurance on any grounds whatsoever including, without limitation, non-disclosure or misrepresentation, whether fraudulent or not.

This is not, however, the end of the story because an insurer who pays out in such circumstances may seek reimbursement from each insured who committed or condoned (whether knowingly or recklessly) non-disclosure or misrepresentation. That could be very expensive.

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Sometimes dishonest solicitors provide false information to insurers to obtain lower premiums. They may misrepresent fee revenue or incorrectly characterise work types to increase lower risk areas. Sometimes solicitors conceal negligence claims from their colleagues as well as insurers. It must be fairly obvious to them that they are taking a considerable risk, but not all cases are so clear.

Insurance renewals are likely to be delegated not only to brokers but also to particular individuals within a firm. A busy principal may sign documentation placing great reliance on administrative staff in relation to, for example, financial information.

Over-reliance on others and a failure to make reasonable checks could lead to very serious regulatory and financial problems for the unfortunate partner who volunteered to sign.

If problems arise there may be no record of the steps taken to show that errors were not made recklessly. Other partners may (correctly) say that they were not asked and did not endorse what was provided. Poor record-keeping may also introduce uncertainty as to what information has been provided to brokers and whether or not they passed it on. Multiple applications may lead to a lack of uniformity in information provided to different insurers. Material differences will make omissions very hard to justify.

The characterisation of information as relevant may not be straightforward. Inadequately trained staff and partners may have an overly restrictive view of when "circumstances" before a claim has been received require notification to insurers. At present the financial stability of a firm is very material to insurers and overselling the firm's financial stability may turn out to be a high risk strategy. **SJ**

AVOIDING REIMBURSEMENT CLAIMS

Busy practitioners must take renewals and notifications very seriously. The temptation to seek lower premiums by gilding the truth should be avoided:

- Ensure that the internal responsibilities for the provision of information are documented.
- Make sure that information is checked carefully against sufficient evidence.
- Ensure that everyone is asked by email to contribute any relevant information.
- Obtain a specific approval for the content of the insurance proposal and authority to sign it from all partners or any executive board.
- Disclose any material facts concerning financial stability.