

# The professional indemnity insurance market for law firms

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The professional indemnity insurance (PII) market for solicitor firms has been hardening following a previous period of lower PII costs. As a result, anecdotal evidence suggests PII costs are becoming an increasingly significant cost centre for some firms. There are also concerns that some smaller firms may be poorly equipped to cope with rising costs.

This raised concerns that law firms might either pass on costs to their clients, be unable to obtain cover or go out of business, which could reduce access to justice.

We and the Legal Services Board (LSB) commissioned Frontier Economics to carry out research on the PII market using data already held by us both and by surveying nearly 300 firms. This would give us a better understanding and allow us to consider any regulatory action that might alleviate concerns about worsening outcomes for both firms and the public.

## *Key findings*

Key findings from the research included:

- The PII premiums paid by law firms in our sample were typically between 3% and 9% of annual turnover, with a median value of 5%.
- 80% of law firms in our sample pay a premium rate of less than 10% of turnover.
- Of the firms paying a higher rate than this, 90% are smaller firms.

We found smaller law firms pay a higher premium rate as a percentage of their turnover than larger firms, all other things being equal. Our modelling of the data found that firms with a turnover of £765,000 were likely to be paying twice the premium rate as a percentage, when compared to larger law firms with a turnover of £3.2m doing the same work.

Possible reasons for this include:

- Relative sophistication of cyber and wider security arrangements
- relative ability to absorb losses or to recompense clients from other work
- insurers potentially being more open to developing bespoke arrangements the higher the overall fee a firm is paying.

Area of work that firms operate in was also a key factor in differing premium ratings:

- Property work typically attracts higher PII premiums equivalent to 8%-12% of turnover – this means the average £900 legal cost for a property transaction includes £70-£120 to cover the PII costs.
- Divorce services typically attract lower PII premiums of 2%-7% - this means the average £815 cost of an uncontested divorce includes £10-£60 to cover PII costs.

All other things being equal, law firms doing 60% of their work in property would pay a 50% higher premium rate than a law firm doing 30% (which our data suggests is the median amount across all firms).

Wider factors which we found may contribute to a firm being charged a higher premium rate included:

- firms holding more or variable amounts of client money
- any history of regulatory findings against the firm
- more fee earners and more qualified fee earners per unit turnover.

We also found that law firms that have separate cyber insurance tend to pay a higher premium rate. The SRA's minimum terms and conditions for PII insurance already require all PII policies to cover third-party losses resulting from a cyber-attack. So, Frontier Economics indicate that this finding could be a result of the wider risk profile of firms typically taking out such policies, rather than any direct link to the cover itself.

## *Discussion and potential next steps*

Discussions with insurers suggested that although the pressures on PII costs from a hardening market cycle might begin to ease, costs are not expected to fall in the near term. The risks from an economic downturn or slowdown might put increased financial pressure on law firms and pressure on PII prices.

In this context, there might be some concerns about:

- high prices for PII impacting the price paid by consumers for some services, if these high prices are passed on
- in the extreme case, law firms being unable to afford cover at all and an increase in the number of law firms closing
- reduced competition in the PII market, meaning reduced choice for law firms in terms of insurance

- other impacts on law firms such as reducing resource for spending on innovation.

Frontier Economics suggest that future research could focus:

- whether or not PII costs are impacting law firms' operations or pricing decisions, or if there is a risk that this could be the case in the future
- the potential impact for consumers if PII costs affect firms' decisions
- potential policy actions to address any identified concerns about impacts on consumers.

This future research could involve additional data collection to more fully understand both supply and demand within the PII market.

Download report: Econometric analysis of professional indemnity insurance costs for legal service providers (PDF 73 pages 1.5MB) [<https://www.sra.org.uk/globalassets/documents/sra/research/econometric-analysis-of-solicitors-pii.pdf?version=4a5ff5>]