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*Kevin McParland, Managing Director of MFL Professional, details the insurers' take on new business start ups and how NBUs can secure insurance cover for their practice.*

The landscape of the legal profession is changing and doing so quite rapidly but how the land will lie after these earthquakes, eruptions and avalanches is uncertain. The more predictable areas of legal continental drift include:

- Mega-mergers: e.g. Clyde & Co and Barlow Lyde & Gilbert; Davis Arnold Cooper and Beachcroft;
- Alternative Business Structures: due to problems in setting up the licensing regime and of course the necessarily robust nature of the regime itself, there have been delays in applications. Some marriages will be fairly predictable but I suspect there will also be some unexpected "odd couples". Speculation is rife and we can but watch this space;
- Casualties on the High Street: already there are casualties, particularly in the more easily commoditised areas of practice. Plenty of the smaller practices are well run and I am pleased to say many of them are our clients. However, it is inescapable that a lot of small firms do run poor business models (not that they have a monopoly of this unwelcome practice) and, crucially, many of them simply are not financially robust enough to trade through the current difficult economic times.

## Increasing Number Of Start Ups

MFL acts for a number of Professional Institutes and their members and has done so for many years. It has long been found that the lifeblood of these various professions has been the willingness and ability of the more entrepreneurially-minded members to start new businesses. Whilst this sort of development has also been part of the evolution of the legal profession, the proliferation of new enterprises has historically been quite low when compared with other professions.

However, it is without doubt that the number of approaches we receive from would-be start-up practices has increased substantially over the last few years, and is continuing to do so.

We find that there is no particular stage in a career path prompting these lifestyle changes and nor does the age of the practitioner seem to be a driving factor. In some cases, the change has been forced on individual lawyers as a result of downsizing by firms during the upheavals in the legal marketplace over the past few years. But the reality is, without question, a desire by many lawyers to take charge of their own destiny and to be their own boss, despite the attendant trials and tribulations. There are some who wish to follow a more balanced lifestyle than is possible in the hothouse environment of a big firm and "work to live" rather than "live to work".

Whatever the motivation, many excellent practices have emerged whose business models are well thought through and are sustainable. Our belief is that there will always be a place for such businesses and the legal profession will benefit from their evolution.

## Minimum Terms Of Cover

Over the last few years, the insurance market has been very selective about offering cover to new start-up businesses. The root cause is the current rules, originally created by the Law Society and now enforced by the Solicitors Regulatory Authority (SRA), which place onerous liabilities on Approved Insurers in the form of Minimum Terms of Cover. These Minimum Terms currently oblige insurers to provide:

- A fully civil liability policy wording (wider than any wording currently enjoyed by other professions);
- A market of last resort (the Assigned Risk Pool or ARP);
- Payment of claims in full, including the policy excess which they may not be able to recover from the policyholder;
- Cover for a full 12 months, even if the premium remains unpaid;
- Cover for 6 years if the practice ceases, whether or not the premium due is paid.

Main exposures faced by insurers are:

- The credit risk: as you will gather from the above, insurers can be tremendously exposed to the non-payment of premiums and still have the obligation to pay claims in full. This dictates that insurers look very closely at the financial risk posed by new start-ups;
- The claims risk: new start-up practices have no track record; while this is good in the context of there being no legacy risk, it does not provide insurers with comfort that a new firm will be a good risk going forward. This can particularly be so if those involved in it have left firms that provided all the necessary commercial, professional development and administrative support, leaving the lawyers to concentrate on practising the law. The burden and distraction of taking on these essential back-up services should not be underestimated.

These considerations still apply today, albeit that there are changes afoot to reduce insurers' exposure, particularly with regard to the ARP.

From renewal in 2012, the legal profession will contribute to the upkeep of the ARP, which was previously the sole responsibility of the insurance market. The Law Society and the insurance market are still negotiating the exact terms. On a very positive note (of which there are not too many at the moment) the SRA is closing down practices in the ARP and by renewal 2012 it should be pretty clean (while still retaining the 6 year "run-off" liabilities of the closed practices). After the horrendous losses suffered by the ARP in 2008 to 2011, this is most welcome.

## Seek Advice Early

It is essential that any prospective start-up, whether a sole practitioner, partnership, LLP or limited company, obtains early advice, preferably before those concerned leave their existing employment and certainly before incurring significant costs or liabilities. The advice to be sought might include the following:

- accountancy;
- compliance;
- business consultancy;

- mentoring organisations;
- insurance brokers – from a firm suitably experienced in this specialised field.

For the purpose of obtaining PI insurance, you will need to provide detailed information as follows:

- 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 firm will be viable. In addition, insurers will want to see evidence of the availability and adequacy of capital;
- a professional indemnity insurance proposal form, which for a start-up business will drill down into the detail of the professional activities the new practice intends to undertake. In evaluating the firm, Insurers will have regard to the experience of the key individuals and also to the claims historically generated by the proposed spheres of operation.

The important message is that you should take the fullest of advice and get your strategy right from the very beginning.

Quite early on in the insurance process, an insurer can indicate whether it is prepared to provide cover and, if so, offer an indicative quotation, sufficient to satisfy the SRA that cover can be obtained. At that point, the possibility of creating the new business becomes more of a reality. In some cases, if the insurance broker can arrange a meeting between the insurer and the key individual(s) of the new start-up, the prospect of achieving better terms can be substantially improved.

Some crucial tips:

- Provide a full CV;
- Provide a simple and concise business plan;

- Curb any natural enthusiasm to over-egg the financial projections. Insurers become nervous when faced with the prospect of over-ambitious projects;
- Stay within your existing areas of competence. Insurers lose interest when business plans rely on expertise not evident in the key individuals;
- Be up-front about the funding of the venture;
- Include a compliance plan as an integral part of your business plan.

To ensure that your ambitions are not scuppered by difficulties in obtaining insurance cover, take early advice from suitably qualified brokers.

MFL Professional will be pleased to assist. Contact us using the details below:

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