**The hidden cost of claims and why proactive risk management is so important.**

**Karen Eckstein October 2022**

Of course, firms want to avoid professional negligence claims and pay a lot of money for professional indemnity insurance to protect them in the event of a claim arising.

Firms put a lot of time and effort into putting risk management processes and systems into place (including training when onboarding staff, file audits, reminders on GDPR issues, together with file supervision and policies on emails, to name but a few ).

However, mistakes can happen and claims can arise. During the COVID-19 crisis and in the “new normal”, with remote working, in many cases being foisted upon people at very short notice, any weaknesses in the firm's monitoring, supervision, processes and systems will be highlighted, as well as an individual’s own weaknesses, self-motivation, ability to identify issues, organisational skills, and the learning skills absorbed almost by osmosis working with others more experienced by themselves are lost.

It is not surprising therefore, that claims are more likely now than before the COVID-19 crisis and that risk management has to have a higher profile .

However, many firms are just focusing on the financial implications of the crisis and the practical implications, how to return to work and how to stay in business. The hidden cost of claims has been, it seems, overlooked.

Given that claims are more likely, and given that the insurance market has hardened, and that insurers are taking a closer look at firms on renewal, a poor claims history is not going to assist firms in these difficult times. Firms who have taken a proactive approach to risk management may find this assists on renewal, but this is not the only reason to take a proactive approach. As I hope this article explains, the true cost of claims goes far beyond the payment of the excess. The old adage, “a stitch in time saves nine” is never truer than when applying it to proactive risk management .

So what is the hidden cost of claims?

In my view, there are seven impacts arising as a result of a claim against the firm, all of which have a cost which could be avoided if a proactive approach to risk management were undertaken.

**1 The excess**

The first of these is, of course the excess, the first amount of the claim which is payable by the firm . That might be, say, £2000. It might be £5000 or £20,000. That is a clearly easily quantifiable cost arising as a result of a claim.

**2 Increase in premium**

The second consequence is a potential increase in premium . I am not an insurance broker, so cannot comment on the likelihood of a premium increase as a result of one claim, but, in a current hard market, any adverse claims history is likely to have an impact.

 I have heard of an accountant who had a fraud some 6 or 7 years ago and it cost Insurers a seven figure sum. The firm has had no other claims or circumstances in their entire history since 2010. They have being paying for it ever since and it has precluded some insurers from even offering terms because of it.

**3 Wasted fee earning time**

The third consequence is the one that I think is often overlooked , but is the one that is potentially the most expensive. That is the wasted fee earning time. The time spent by the partner, and others, in dealing with the claim. This is time that could otherwise be spent on chargeable work, or in managing and running the firm.

Time will be spent by the partner in charge of dealing with claims . First of all he will have to deal with the notification to the broker and onto the insurer . He will then have to investigate the matter internally, which will require him to obtain the papers, deal with the solicitor appointed by the insurers, answer their queries , give instructions, attend perhaps conferences with counsel, give witness statements, deal with the fee earner involved in the matter , deal with insurer queries, deal with queries raised by the other side, deal with challenges, deal with strategy, consider proposals for settlement , attend a mediation, perhaps attend a trial. Even if the matter settles at a fairly early stage, without a mediation or litigation, the time spent by that partner is likely to be substantial.

Following settlement, he will probably have to report to the board, he will have to liaise with the insurers, the broker and the solicitors appointed by the insurers to deal with the claim. If there has been a delay and notification to the insurers , then he will have to deal with that aspect also, which causes further complications and delay, and may risk the firm not being insured, for at least part of the claim.

In addition, the board will no doubt have to discuss the claim at board meetings , that may not take up very much time, but when you take into account the number of people involved and their seniority, that could be a substantial cost.

Further, time will be spent by the staff in the firm. The staff will be involved at various levels. First of all any fee earners involved in the claim itself will have to spend time giving statements as to what happened in the transaction giving rise to the claim. They will have to review the papers. They may need to attend a conference with counsel, this may take considerable time.

Other staff might be involved, for example admin staff , in searching for papers, emails , past documents. Again that can be very time consuming.

I don't think it's an underestimate to suggest that, even in a straight forward, simple claim, which is settled before mediation , without litigation, could involve, say, 100 hours of time spent by the firm when you take into account all of the points above. At a notional rate of £200 per hour, that is a cost to the firm of £20,000 which could otherwise potentially have been spent on chargeable client work, or on running or otherwise being productive within the firm.

**4 Time spent on renewal**

The fourth impact again relates to time, but it's not time on the claim itself, it's time spent by the partner in charge of the PII renewal, and that is the time that the partner will have to spend with the broker in dealing with a potentially more difficult renewal because of the claims history of the firm. In this hard market, a firm with a clean claims history will find it easier than a firm with a chequered claims history to obtain renewal. The partner dealing with the renewal will have to spend more time with the broker working to obtain favourable terms, or in fact potentially cover at all .

**5 Damage to client relationship**

The fifth impact relates to the client relationship . It is much easier to lose a client than to gain one. A claim brought by a client will clearly damage that client relationship. It is true that if a claim is sensitively and carefully handled, the relationship may be maintained, but that will take time, and the claim will clearly put the relationship at risk. It is likely that most claims will cause the client relationships to be irreparably damaged , giving rise to an inevitable loss of income for the firm.

**6 Impact on staff**

The sixth impact relates to the impact on staff within the firm. Dealing with a claim, and asking staff to focus on something that has gone wrong , causes them to focus on negativity, it can cause a lack of confidence, which impacts on productivity, it can generate bad will within the department and, in many cases, can hamper staff relationships. At a time when productivity and the ability to work remotely confidently is critical, this negative impact can be devastating. It can also spread to other staff members, particularly if the individual in question feels that he is being unfairly criticised.

**7 Publicity and loss of potential future income**

The final impact relates to publicity. Unhappy clients are far more likely to speak out about their bad experience than happy clients. They may well tell others, causing a “ripple effect” , again having an impact on an unknown future income stream.

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It is important to be aware of the wider negative impact that a claim can have and the reasons why it is important to proactively manage risk. It is likely that things will have gone wrong during the initial “crisis” period of working from home and now is the time, despite everything else that is going on, to look at what has happened, and to ensure that proactive steps are taken to ensure that processes and systems are in place and that staff are supported and managed appropriately to ensure that risk is managed in a positive and supportive way.

So what does proactive risk management look like? You already have your own processes and systems in place. Are they sufficient? What more can be done? Is now the time for a review? Some professional bodies require proactive risk management as part of their regulatory requirements . Are your processes and systems“ proactive”?

How can you be “proactive ” when you have so much else on your plate?

In my view, proactive risk management involves three elements, culture training and reporting .

So what does culture involve? Well you want to put in place and encourage a culture where staff feel enabled and encouraged to raise questions when they feel uncomfortable on a file at an early stage. Having a good culture is important, a poor culture can be hugely detrimental to a firm.

 So how do you do that?

Staff need to have a “safe” place to go to when they are concerned about a file, where they can raise a question without censure. Their concern might be just that they feel uncomfortable about a file and the way the client is behaving.

It might be that there is a complaint, a circumstance or a claim , but if the staff member does not have someone they can go to at that early stage, you may not identify the problem until it is too late. By having someone that they can go to to discuss issues (almost a “confessional” ) you encourage a culture where issues are raised at an early stage and problems are identified and dealt with before they become real issues.

It might be that the problem is just developing, and you're able to turn it round before it develops into a claim or a complaint.

If it is a complaint, you identify it as such early, perhaps before the client becomes entrenched in his position. If it is a circumstance or a claim, again you identify it as such early, avoiding a policy issue with the insurer, and ensure that the broker and the insurer are notified promptly, and that they are provided with full information (including sufficient to enable you to obtain confirmation that you can continue to act for the client, if you need to do so, promptly , preventing further client problems).

The second element is training. This needs to be bespoke, to all staff, and focusing on issues and problems relevant to the firm . It needs to be provided at least annually, and pick up on issues that have been identified during the year, and on any particular topics or aspects of the firm’s practice that are identified as high risk. In other words, the training is tailored to the issues that arise within the firm.

The final element is the reporting element. A report needs to be made to the board annually, at a relevant point in the year. My view is that the report needs to take place suitably in advance of pii renewal, so that the board can take into account the findings of the report and determine whether or not they are going to take any action prior to renewal. The report takes into account the issues identified during the year , reports on the training provided, reports on issues and improvements noticed following training and makes recommendations to improve areas where weaknesses have been identified following circumstances or claims. The board can then decide how much resource they want to spend to put right the weaknesses that have been identified in advance of renewal.

In that way, any adverse claims history or other issues within the firm can be addressed within the proposal form utilising the report and actions taken subsequent thereto .

The proactive risk management should mean that, year on year, the firm should improve in risk maturity, risk issues should be identified and dealt with, and the culture of the firm should improve so that risk management becomes embedded within the firm as a whole.

The “professional risks service” provided by Karen Eckstein Limited – see link below- <https://kareneckstein.co.uk/about> is one way of proactively managing risk within a firm, but there are others. But doing nothing may increase the risk of claims, and cost the firm dearly in terms of wasted time , lost clients and potential impact on insurance as mentioned above.

If you want to discuss any of the points raised in this article, then please feel free to contact me on karen@kareneckstein.co.uk.

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