

# INSURANCE ISSUES:

## *Program Report*

A publication of the Law Society of British Columbia



Lawyers  
Insurance  
Fund

## The Lawyers Insurance Fund program

### THIS INSURANCE ISSUES:

- reports on the 2017 insurance program and policy revisions
- reviews statistics on claims and potential claims, and gives “one victim’s story” in relation to trust protection coverage
- introduces an expansion to trust shortage liability under Part C of the policy
- highlights resources to help protect you from trust shortage risks
- reports on the results of the 2016 claims audit

### The 2017 program and policy

THE LAWYERS INSURANCE Fund (LIF) manages the Law Society’s insurance program for BC lawyers. The program provides professional liability insurance for negligence (Part A), trust protection coverage for dishonest appropriation (Part B) and trust shortage liability insurance for reliance on fraudulent certified cheques or misrepresentations (Part C).

#### Insurance assessment

The 2017 insurance fee is \$1,750. Solid claims and risk management, combined with sound investment policies, have kept the fee at this level since 2011. Comparing the fee to other Canadian jurisdictions highlights the benefits that BC lawyers enjoy. Not only does it remain low in comparison to Ontario and Alberta (see chart on page 2), but this single fee is all that BC lawyers pay for both negligence (Part A) and theft (Part B) insurance.

### Compulsory policy wording

LIF issued a consolidated policy for 2017, which was included with the December 2016 *Member’s Manual amendment package*. Other policies and endorsements issued since 2000 are available on the Law Society’s website (Support and Resources for Lawyers > Lawyers Insurance Fund > Insurance Program Overview > [Policies and Endorsements](#)). In addition to some minor wording changes, the 2017 policy expands Part C’s coverage for trust shortages. Details of the expanded Part C coverage are set out on pages 2 and 3.

#### General

Condition 9 provides that there is no payment under the compulsory policy until any other insurance or recourse available is exhausted. The Condition is amended to clarify that the only exception to this provision is insurance specifically arranged to pay amounts in excess of the primary

limits. In the context of mobility, Condition 9 also avoids triggering additional limits of coverage simply because a claim involving lawyers at the same firm triggers coverage under both BC’s policy and that of another Canadian jurisdiction’s. The Condition is further amended to ensure that this provision operates as intended.

### Part A: Professional Liability (for negligence)

#### Trust shortages

Professional liability insurance (Part A) does not respond to claims that fall within trust protection coverage (Part B) or trust shortage liability insurance (Part C), nor does it respond to any other claims involving either dishonest appropriation or trust shortages caused by dishonesty or fraud. To clarify the policy’s intent, Exclusion 11 (previously 11.1) continues to exclude claims that fall within Part B of the policy or involve employee theft. Exclusion 12 (previously 11.2)

makes clear that there is no coverage for trust shortage claims, including claims that fall within Part C. A non-stacking provision, added as Condition 1.16, confirms that a claim payable under one Part of the policy cannot be paid under any other Part.

## Innocent insureds

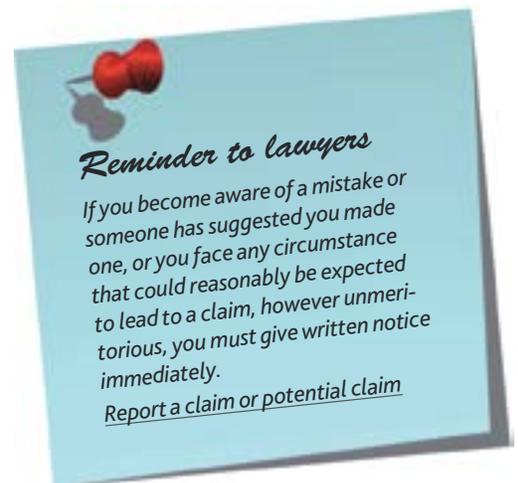
Condition 6.1, the “innocent additional insured” provision, is amended to clarify the Condition’s application only to individuals who had paid the insurance fee at the relevant time.

## Part C: Trust Shortage Liability (for reliance on fraudulent certified cheques or misrepresentations)

If a fraudster tricks you into willingly paying funds out of trust through the intentional misrepresentation of some material fact, you’ve fallen victim to a “social engineering” fraud. In 2012, Part C was introduced to provide some assistance to lawyers targeted by one type of social engineering fraud, the “bad cheque” scam. This scam tricks lawyers into paying trust funds out to a fraudster on the strength of a phony certified cheque or similar instrument. Last Fall, the Benchers decided to expand Part C to provide some coverage for losses arising out of other social engineering frauds, as well.

These other social engineering frauds don’t involve someone trying to dupe you into believing that real funds have been deposited into trust. They often involve fraudsters pretending to be an existing client or someone genuinely authorized to give instructions on the client’s behalf:

- The “phony change in payment instructions” might involve a fraudster obtaining a client’s email address by hacking into the client’s computer system, then sending a “spoof” email that appears to come from the client — the client’s true email address may be used but with just one small change, such as an extra letter, so that any replies go to the fraudster. The fraudster then directs the lawyer to send the client’s funds to the fraudster’s account.
- The “phony direction to pay from a senior partner, staff member or other lawyer” scam, might involve email instructions to pay funds to a certain person that appear to come from a senior partner at the firm. The partner’s real email address is used, but the message is crafted to discourage a reply.
- Another scam might involve someone pretending to be a bank representative investigating a suspicious transaction,



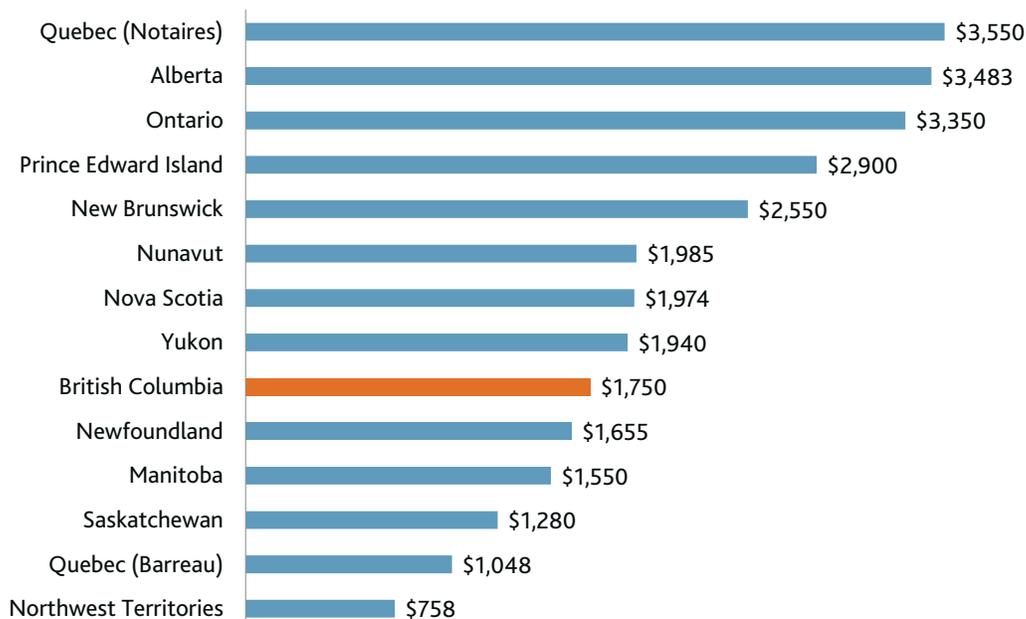
persuading the law firm to send cash payments to an account as a test.

However the fraud is perpetrated, it succeeds because the lawyer is misled into believing that the payment is in accordance with legitimate directions.

## Part C losses: Expanded

The Part C definition of “error” expands coverage so that Part C now also responds if a trust shortage is created by a payment to a third party that a lawyer believes — because of a fraudulent or dishonest act — is properly authorized. As Part C continues to provide coverage for a trust shortage created because a lawyer pays out on the strength of a fraudulent certified cheque, the

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expanded coverage responds only to payments unrelated to any mistaken belief that funds have been deposited into trust.

To reflect the expanded coverage, the Part C heading is changed to "Trust Shortage Liability (for reliance on fraudulent certified cheques or misrepresentations)" and the Part C definition of "damages" is revised slightly to clarify that the loss to which Part C responds is the amount by which the trust account is short.

**Part C limits, deductible and other requirements: No changes**

Lawyers who exercise due diligence can avoid these other social engineering risks. As Part C's scope and terms are intended to encourage vigilance, they are unchanged. Part C continues with its lower claim limit (\$500,000 per claim, and per lawyer and firm annually), cap on payments (\$2 million profession-wide annual aggregate), higher deductible (35% of the trust fund shortage) and required compliance with the client identification and verification rules (Rules 3-98 to 3-109). These limitations reduce risk to the fund, and result in lawyers who are caught bearing a significant portion of any trust shortage personally. Part C continues to require that the lawyer is operating a trust account in accordance with the Law Society Rules, and payment will

only be made after the lawyer has replenished the trust account as required by Rule 3-74(1). Coverage is excluded if the claim is connected to or arises out of the wrongful or unlawful conduct of a firm employee or contractor. More detailed information about Part C was provided when it was introduced, and is available in the *2012 Insurance Issues: Program Report*.

**Part C resources**

To help lawyers protect themselves from the bad cheque and other social engineering scams, comprehensive risk management material is available on our website in Support and Resources for Lawyers > [Lawyers Insurance Fund](#) > [Fraud Prevention](#). Although Part C offers some protection for lawyers, it is not intended as a substitute for commercial insurance available through a broker. As set out in "Trust shortages: You are at risk – protect yourself" on page 5, if you need insurance, buy it.

**A review of claim and potential claim reports**

**Part A (negligence)**

The chart below shows the number of reports and their frequency (reports divided

by insured lawyers) over the past five years. The two charts on page 4 provide more information about the specific claims experience in 2016 by area of law. The first chart shows the percentage of reports generated by the different areas of practice. *Civil litigation – plaintiff* and *Motor vehicle – plaintiff* continue to account for roughly one-third of all reports, again reflecting the risk of a missed deadline and claims of "settlers' remorse." The second chart shows the areas of practice according to severity — the actual or expected cost of reports.

**Part B (theft)**

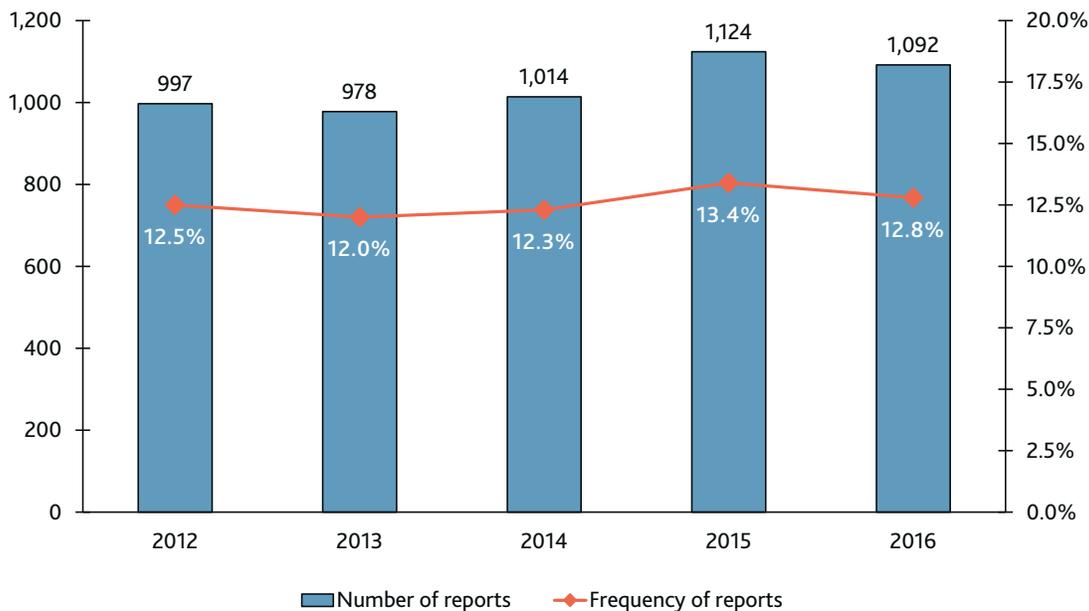
Since this coverage was introduced in May 2004, total compensation of \$1,110,000 has been paid relating to 73 claims involving 22 different lawyers. Given the 8,000 or so lawyers in private practice, our claims experience continues to demonstrate the very small number of lawyers involved in misappropriations.

In 2016, seven claims were paid on behalf of five different lawyers, totalling approximately \$94,000:

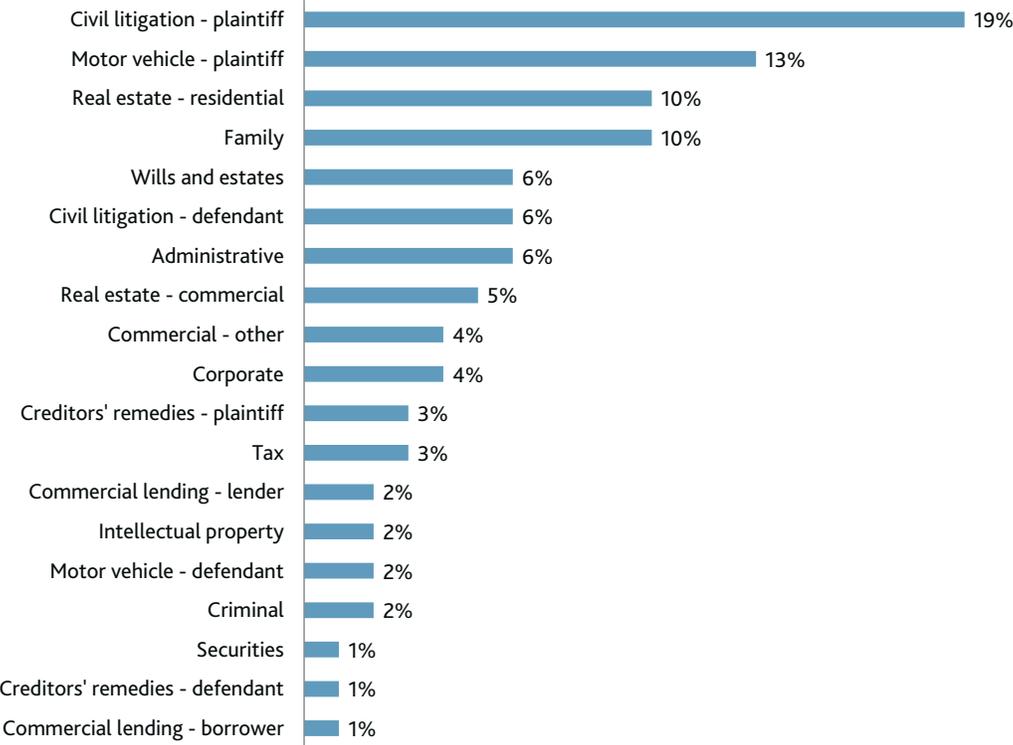
- A payment of \$1,450 was made on behalf of a lawyer who accepted retainer funds to commence a small claims

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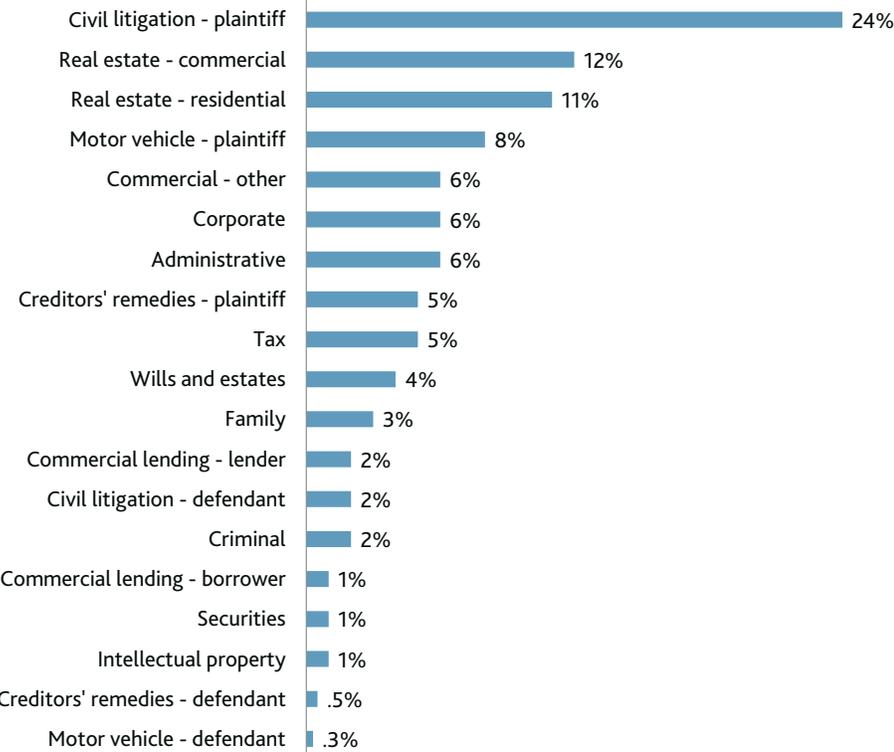
NUMBER AND FREQUENCY OF REPORTS



FREQUENCY OF REPORTS BY AREA OF LAW – 2016



SEVERITY OF REPORTS BY AREA OF LAW – 2016



action on behalf of two clients. The lawyer provided no services but kept the full amount of the retainer funds.

- A payment of \$50,500 was made on behalf of a lawyer who was retained to act in the distribution of estate assets. The lawyer misappropriated funds from trust that belonged to the estate.
- Three claims totalling \$29,000 were paid on behalf of a lawyer. In the first, the lawyer forged a direction to pay to allow double payment of the lawyer's accounts from trust. In the second, the lawyer acted in a sale of shares but did not pay all of the net sale proceeds to the client. In the third, the lawyer sued on behalf of a client, but failed to forward settlement funds to the client when the claim was settled.
- A payment of \$11,250 was made on behalf of a lawyer who received settlement funds in a motor vehicle claim, but did not pay those funds to the client or account to the client for their disbursement. A total of \$13,250 has now been paid on behalf of this lawyer.
- A payment of \$2,000 was made on behalf of a lawyer who accepted retainer funds to represent a client in a family

law matter. The lawyer provided no services but kept the full amount of the retainer funds.

None of the lawyers involved remain members of the Law Society.

Other claims in 2016 were either withdrawn or abandoned by the claimants or did not involve misappropriation. In the remaining reports, the claimants are not actively pursuing a Part B claim, or we are not yet in a position to determine if the claim is properly payable. In 2016, we recovered \$6,000 on behalf of two lawyers for whom we had paid Part B claims. We also sued two former members for amounts paid under Part B, although we have not yet made any recovery.

### Part C (trust shortage liability)

There were no Part C payments made last year, however one BC law firm was hit by the "phony change in payment instructions" scam. Let's stay safe in 2017. Avoid getting caught by reviewing the material published on both the "[bad cheque scam](#)" — including the [list of names and documents](#) used by fraudsters in BC and the different ruses used by scammers — and [other social engineering scams](#), and reading the Law Society's email fraud alerts.

### Trust shortages: You are at risk – protect yourself.

As some lawyers are unhappily all too aware, your trust account may be a fraudster's target. Just last year, one BC law firm was hit by a social engineering fraud that resulted in a \$1.2 million trust shortage. Another was allegedly the victim of theft by a bookkeeper who created a trust shortage in excess of \$7 million. Whether a fraudster tricks you into willingly paying funds out of trust through the intentional misrepresentation of some material fact (social engineering) or tricks your bank into transferring funds by hacking into your system, stealing your banking information and purporting to give instructions on your behalf (wire fraud), or a trusted bookkeeper crosses the line, you are at risk. Other than some potential coverage under Part C, as discussed above, the compulsory policy does not cover these losses.

You, however, are obliged to make up any shortfall. Protect yourself:

- Take steps to mitigate risk. Our expansive risk management material (on our website at Support and Resources for Lawyers > [Lawyers Insurance Fund > Risk Management](#)) will help you learn about the risks and the steps you can take to manage them, and explain how to keep on top of new scams. Proper trust account management, internal controls and appropriate communication with your financial institution all mitigate against the risks.
- Buy insurance. Crime or fidelity insurance provides coverage for employee theft or fraud. Social engineering, wire fraud and other coverages will assist if you or your bank are the victim of a fraudster. And the application process may bring added value by helping you identify potential gaps in your own trust account management and internal processes. Find out more (Support and Resources for Lawyers > [Lawyers Insurance Program > Coverage > Commercial Liability Insurance > Other Commercial Liability Products](#)).

## One victim's story

After her marriage ended, Ms. G needed legal advice. She contacted a lawyer who recommended a separation agreement, and asked for a \$2,000 retainer. Ms. G sent the retainer as requested — an e-deposit to the savings account of the lawyer's spouse — and the lawyer later set up a meeting to review a draft agreement. Not only was the agreement the lawyer produced nothing more than boilerplate, but he told Ms. G that he was about to retire. Ms. G's subsequent efforts to reach him were unsuccessful. Emails were not returned and his phone was disconnected. No work had been done to earn the \$2,000 retainer and Ms. G's money, along with the lawyer, had disappeared.

In December, less than three weeks after receiving her statutory declaration setting out her loss, we delivered a cheque to Ms. G for \$2,000, plus interest and a witnessing fee. Ms. G's note of appreciation read, in part, "*Thank you, thank you, thank you. I can't thank you enough for this good news! I actually did a happy dance in my kitchen! It is heartwarming to see and feel that the little person does matter and there is justice in this world.*"

## Lawyers Insurance Fund 2016 claims audit

To assist the Benchers in monitoring the insurance operations, a claims audit is performed every five years. This helps the Benchers determine whether LIF is meeting its claims handling goal of resolving claims in an appropriate and cost-effective manner. The report of the most recent independent claims audit summarized the overall results as follows:

*"It is without question that the entire insurance program is operating in a cost-effective manner, balancing extremely well both the public interest and the interest of the Law Society insured membership."*

Based on a response to a request for proposals, two lawyers experienced in both insurance industry and lawyer malpractice defence work were retained to conduct the audit. The choice of Carter Hampton and Lester Lee not only ensured that the audit reflected a Canadian perspective, but brought an added level of consistency as

Hampton was on the team that conducted the last audit in 2011. The audit included a detailed evaluation of internal processes and an in-depth review of a representative selection of files. And as with the 2011 audit, the results were positive in relation to all of the aspects reviewed, from quality control measures to claim repairs. In addition to the summary quoted above, the auditors also noted:

*"Having the perspective of a previous review I can say that the professionalism, knowledge, skill, and overall excellent work of the Lawyers Insurance Fund has continued to be maintained at the highest level."*

*"[Lawyers Insurance Fund staff] exhibit an abiding sense of mission and purpose; the group as a whole earnestly desires to do their best and to continuously improve. We applaud them for their commitment and efforts."*

*"Overall, a stellar performance by all concerned was observed. All should be proud of the high standards set and maintained... this is an outstanding*

*group doing an outstanding job on what we consider the most complex files in the professional liability business."*

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## 2017 and beyond

2015 and 2016 both stand out as high watermark years for the program. In 2015, we received the highest number of reports of claims and potential claims in 30 years. In 2016, the amount that we paid in indemnity and expense hit a 31-year high — \$15 million. We hope that these years are anomalies, not the start of a different reality. There were, in fact, fewer reports in 2016, although the number was still higher than previous years. It is possible that we are dealing with an upward trend on both the volume of reports and payments that could negatively impact the fee in future years. Although we'll continue with the solid claims-handling on which the auditors have reported, your effective risk management is the most important factor in reducing the number and cost of claims. Let's keep both in check in the year ahead.

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