

SOLICITORS INDEMNITY FUND

**ANNUAL REPORT AND
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018**

SOLICITORS INDEMNITY FUND

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SOLICITORS INDEMNITY FUND

REPORT OF THE DIRECTORS OF THE ADMINISTERING COMPANY FOR THE YEAR ENDED 31 OCTOBER 2018

ADMINISTRATION OF THE FUND

Solicitors Indemnity Fund Limited (the “Company”) holds, manages and administers the Solicitors Indemnity Fund (the “Fund”). The Directors (the “Directors”) of the Company are responsible for the governance of the Fund.

THE BOARD OF DIRECTORS

The non-executive Directors of the Company are appointed by the Solicitors Regulation Authority (“SRA”) under delegated authority from The Council of The Law Society of England and Wales (“TLS”). TLS and SRA each nominate a non-executive Director to represent its interest on the Board. The appointment of the Chair is made following a joint selection process involving TLS and SRA. The remaining non-executive Directors are drawn from the legal profession or with relevant insurance expertise. The following were Directors during the financial year under review and up to the date of signing of the non-statutory financial statements (“the financial statements”):

J. T. Young - Chairman
D. A. McIntosh – (retired 28 February 2018)
W. R. Treen (retired 28 February 2018)
R. Collins (SRA nominated non-executive director)
T. Fothergill (TLS nominated non-executive director)
D. Neave (Appointed 1 March 2018)

Company Secretary – Andrew Darby

PURPOSE AND PRINCIPAL ACTIVITIES OF THE FUND

The Solicitors Indemnity Fund is a statutory fund established in 1987 governed by the Solicitors’ Indemnity Rules 1987 as amended from time to time. The Rules are presently made under sections 37, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, and paragraph 19 of Schedule 11 of the Legal Services Act 2007, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007. The Rules are now also known as the SRA Indemnity Rules.

The Fund provided indemnity in respect of the practices of solicitors, recognised bodies and registered foreign lawyers carried on wholly or in part in England and Wales, with up to £1 million of cover per claim (£1.5 million for recognised bodies) until 31 August 2000, when the Council of The Law Society decided to require firms to purchase indemnity insurance in the open market. The Fund therefore went into run-off from 1 September 2000. In 2004, the indemnity limit increased for new claims arising within existing practices to £2 million and £3 million for recognised bodies.

The Council of The Law Society determined that from 1 September 2007 the Fund would also provide cover for new claims and settle the associated liabilities arising from firms insured in the open market and which have ceased without successor from 1 September 2000 and where the requisite six-year run-off period provided by their last market insurer or the Assigned Risks Pool has elapsed. This cover was initially provided by way of a 10-year programme commencing on 1 September 2007 and ending on 30 September 2017, but was subsequently extended by an additional three years to 30 September 2020.

The purpose of the Fund is to:

- Manage the ongoing notified claims arising from the pre 1 September 2000 period (“historic claims”) and settle the associated liabilities arising. The number of notified cases has been decreasing as cases meet their statutory limitation periods and the number of claims outstanding has been decreasing as claims have been concluded.
- Manage new claims arising from 1 September 2000 against practices that had ceased without successor prior to 1 September 2000 and settle the associated liabilities arising (“historic claims”).
- Manage new claims and settle the associated liabilities arising from firms insured in the open market and which have ceased without successor from 1 September 2000 and where the requisite six-year run-off period provided by their last market insurer or the Assigned Risks Pool has elapsed (“post six-year run off claims”).

SOLICITORS INDEMNITY FUND

REPORT OF THE DIRECTORS OF THE ADMINISTERING COMPANY FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

PURPOSE AND PRINCIPAL ACTIVITIES OF THE FUND (continued)

- Manage the claim recoveries, and any interest due on those recoveries, that have materialised as a result of a previous claim settlement.

THE PROVISION OF CLAIMS AND ADMINISTRATION SERVICES

In 2010, the Company entered into an administrative services agreement with Vision Underwriting Limited for the provision of various administrative and claims handling services in respect of the run-off of the Fund for a period of ten years until 2020. The Company agreed to pay £4.7 million, payable on a reducing basis over ten years to reflect the anticipated decline in claims handling expected, to Vision Underwriting Limited for the provision of these services. During 2012, an escrow agreement was signed and an escrow account set up to hold the remaining outstanding fees under the agreement. As these fees are beneficially in the ownership of the Fund until formally due they will continue to be reflected within the Fund's financial statements until such time as they are paid. During 2014, the terms of the agreement were amended to reflect a change in counterparty from Vision Underwriting Limited to Liberty Mutual Insurance Europe Limited (the parent company of Vision Underwriting Limited).

The Board gave consideration to the appropriateness of the current arrangements for administrative and claims management and concluded it would be in the best interest of the Fund to take back ownership and control of the administration, claims handling and staff in order to begin to bring the activities of the Fund to a successful conclusion.

Consequently, on 29 March 2018, the Company terminated the administrative services agreement and escrow agreement with Liberty Mutual Insurance Europe Limited with effect from 31 December 2018. On 1 January 2019 two staff transferred to the Company under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). On the same date certain contracts and assets were also transferred to the Company. Liberty Mutual Insurance Europe Limited paid £0.2 million to the Company as a termination payment.

PRINCIPAL RISKS AND UNCERTAINTIES

The Fund's business carries significant uncertainties and the financial statements include significant judgements around claims costs and provisions, based on past historic experience and known circumstances. The principal risks from the Fund's indemnity operations arise from fluctuations in the timing, frequency and severity of claims compared to expectation and inadequate reserving.

In addition, the Fund is exposed to financial risks arising from the fluctuation in the returns of the investments it holds.

Risk management (considering indemnity risk, credit risk, market risk and liquidity risk) are discussed in Note 4 to the financial statements.

RESULTS FOR THE YEAR

The activities of the Fund gave rise to a deficit before tax of £0.5 million for the year (2017: deficit £1.9 million). The Fund benefitted from interest but due to large unrealised losses the investment portfolio generated a deficit of £0.1 million (2017: surplus £2.1 million); and incurred administrative expenses charge of £0.2 million (2017: £0.2 million). Collectively these account for £0.3 million of deficit (2017: surplus £1.9 million) with a deficit of £0.2 million (2017: deficit £3.8 million) arising from developments on the indemnity operations. The tax charge for the year was £nil (2017: credit £0.3 million), giving a net deficit after tax for the year of £0.5 million (2017: deficit £1.6 million).

The result of the operations will fluctuate as they are based on the development of claims and indemnity recoveries which may differ from expectation.

CLAIMS

As at 31 October 2018, there were 189 open cases (2017: 185) a net increase of 4 in the year. The increase in claims incurred net of insurance was £0.2 million (2017: £3.8 million), brought about by an decrease in net provision for claims of £0.2 million (2017: increase £0.6 million), whilst claims payments, net of indemnity claim recoveries, and including internal claims costs, during the year were a net cost of £0.4 million (2017: £0.1 million). No amounts were recognised as recoverable from insurers at year end (2017: £nil) whilst insurance recoveries in the year were nil (2017: £nil). In 2017 a one off payment of insurance premium of £3.1 million was made.

SOLICITORS INDEMNITY FUND

REPORT OF THE DIRECTORS OF THE ADMINISTERING COMPANY FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

CLAIMS (continued)

Provision has been made within claims incurred but not reported (“IBNR”) for the total estimated future liabilities arising from the post six-year run off claims. This is estimated using external actuarial advice, based on all available information at that time including historic trends and recent development and amounts to £4.0 million (2017: £5.5million). Further information is provided in Note 12.

INSURANCE PROGRAMME

During 2017 the Company entered into an Insurance Programme (IP) with a leading insurer to insure the Fund’s claim liabilities for post six-year run off claims (with the exception of one claim). The Fund’s ultimate claim liabilities on the post six-year run off book of business in excess of £8.4 million and up to a maximum of £20 million are covered by the IP with effect from 1 November 2016. A one off premium of £3.1 million was paid for this cover in 2017. Paid and estimated liabilities to 31 October 2018 (and at 31 October 2017) from claims falling under this cover have not reached the excess point and, therefore, there is no recoverable amount included within the Insurers’ Share of Claims Provision for this cover.

INVESTMENTS

The Fund’s investment strategy is to hold a varied and diversified portfolio to maximise returns whilst minimizing risk to capital. The Fund holds a managed fixed income portfolio consisting of investment grade credit, high yield bonds and other securities. The Fund also holds a managed index portfolio, which has a wider range of asset class and securities within it including equities. This provides the Fund with a constant income from investment. There remains volatility in the underlying value of the funds within the portfolio, which is accounted for as either an unrecognised loss or gain in the Statement of Comprehensive Income. Further details are provided in Note 9.

INTEREST ON INDEMNITY CLAIM RECOVERIES

The Fund is entitled to interest on certain indemnity claim recoveries. Where the legal right to interest exists, the interest can be accurately calculated and there is a reasonable expectation of recovery, the interest receivable has been recognised within these financial statements as a receivable item within Debtors. Further details are provided in Note 10.

OPERATING EXPENDITURE

The charges incurred by the Fund during the year for the provision of administrative and claims handling services by Liberty Mutual Insurance Europe Limited were £0.03 million (2017: £0.1 million). Other operating expenses incurred during the year were £0.24 million (2017: £0.2 million), giving total gross operating expenses incurred of £0.3 million (2017: £0.3 million).

INDEPENDENT AUDITORS

BDO LLP have expressed their willingness to continue in office, and this has been confirmed by the Directors.

THE LAW SOCIETY

The financial statements of the Fund are consolidated with the financial statements of The Law Society as at 31 October 2018 based on an assessment by The Law Society that the Fund should be a consolidated part of The Law Society’s Group due to the control of the Fund and its entitlement to surplus accumulated reserves. Copies of The Law Society financial statements can be obtained from The Law Society, Law Society Hall, 113 Chancery Lane, London, WC2A 1PL.

STATEMENT OF RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The Directors are responsible, on behalf of the Fund, for preparing the financial statements for the Fund for each financial year. The Directors are responsible for preparing the financial statements in accordance with United Kingdom Accounting Standards, comprising FRS 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland” and the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Fund and of the deficit for the Fund that year.

SOLICITORS INDEMNITY FUND

REPORT OF THE DIRECTORS OF THE ADMINISTERING COMPANY FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

STATEMENT OF RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS (continued)

In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable United Kingdom accounting standards, comprising FRS 102, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Fund will continue in business.

The Directors are also responsible for keeping adequate accounting records that disclose with reasonable accuracy at any time, the financial transactions and the assets and liabilities of the Fund. They are further responsible for safeguarding the assets of the Fund and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

STATEMENT OF DISCLOSURE OF INFORMATION TO AUDITORS

In the case of each director in office at the date the Directors' report is approved, the following applies:

- so far as the Directors are aware, there is no relevant audit information of which the Fund's auditors are unaware; and
- the Directors have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Fund's auditors are aware of that information.

Approved on behalf of Solicitors Indemnity Fund Limited

J. T. Young



Chairman

26 February 2019

SOLICITORS INDEMNITY FUND

INDEPENDENT AUDITORS REPORT TO THE DIRECTORS OF SOLICITORS INDEMNITY FUND LIMITED (AS ADMINISTRATOR OF SOLICITORS INDEMNITY FUND)

OPINION

We have audited the non-statutory financial statements (“the financial statements”) of Solicitors Indemnity Fund (“the Fund”) for the year ended 31 October 2018 which comprise the Statement of Comprehensive Income, the Balance Sheet, Statement of Changes in Equity and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the Fund’s affairs as at 31 October 2018 and of its deficit for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice.

BASIS OF OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor’s responsibilities for the audit of the financial statements section of our report. We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC’s Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

CONCLUSIONS RELATING TO GOING CONCERN

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors of Solicitors Indemnity Fund Limited (“the Company”) use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors of the Company have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Fund’s ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

OTHER INFORMATION

The Directors of the Company are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

SOLICITORS INDEMNITY FUND

INDEPENDENT AUDITORS REPORT TO THE DIRECTORS OF SOLICITORS INDEMNITY FUND LIMITED (AS ADMINISTRATOR OF SOLICITORS INDEMNITY FUND) (continued)

RESPONSIBILITIES OF DIRECTORS

As explained more fully in the Statement of responsibilities in respect of the financial statements, the Directors of the Company are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors of the Company determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors of the Company are responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors of the Company either intend to liquidate the Fund or to cease operations, or have no realistic alternative but to do so.

AUDITORS RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

This report, including the opinion, has been prepared solely for the purpose set out in the Engagement Letter dated 25 September 2018 and we will not be liable for any losses arising from any other use of our report. This report should not be reproduced or referred to in any other document or made available to any third party without our prior written consent, unless the exceptions noted in the Terms of Business apply and we shall not be liable for any losses arising from any third party using or relying upon our report.

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the Financial Reporting Council's website at:

<https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditors report.



BDO LLP
London, UK
26 February 2019

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

SOLICITORS INDEMNITY FUND

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 OCTOBER 2018

	Note	31 October 2018 £000	31 October 2017 £000
Claims costs (net of indemnity recoveries)	5	(436)	(121)
Insurance recoveries		-	-
Net claims costs		(436)	(121)
Decrease/(increase) in gross provision for claims	12	277	(283)
Decrease in expected indemnity claim recoveries	10	(54)	(315)
Decrease/(increase) in net provision for claims		223	(598)
Insurance premium		-	(3,136)
Increase in claims incurred net of insurance		(213)	(3,855)
Realised (losses)/gains on investments	6	(67)	347
Unrealised (losses)/gains on investments		(397)	1,315
Interest from investments and indemnity claim recoveries	7	329	490
Investment expenses		(8)	(14)
Total interest and investment movements		(143)	2,138
Administrative expenses charge	5	(184)	(211)
Contributions receivable		1	7
Deficit before taxation	5	(539)	(1,921)
Taxation (charge)/credit	8	(7)	349
Deficit for the year		(546)	(1,572)
Other comprehensive income:			
Other comprehensive income		-	-
Other comprehensive income for the year, gross of tax		-	-
Total comprehensive expense for the year		(546)	(1,572)

All activities of the Fund relate to continuing operations.

The notes on pages 11 to 22 form part of these financial statements.

SOLICITORS INDEMNITY FUND

BALANCE SHEET AS AT 31 OCTOBER 2018

		31 October 2018	31 October 2017
	Note	£000	£000
Current assets:			
Financial assets at fair value through profit or loss			
Investments	9	30,537	31,248
Financial assets that are debt instruments measured at amortised cost			
Debtors	10	1,799	1,812
Cash held in Escrow		-	55
Cash and Bank		322	389
Total current assets		32,658	33,504
Current liabilities:			
Financial liabilities measured at amortised cost			
Creditors	11	(127)	(150)
Net current assets / Total assets less current liabilities		32,531	33,354
Liabilities due in more than one year:			
Provisions	12	(10,511)	(10,788)
Total liabilities due in more than one year		(10,511)	(10,788)
Total Liabilities		(10,638)	(10,938)
Net Assets		22,020	22,566
Retained Surplus		22,020	22,566

Approved on behalf of Solicitors Indemnity Fund



J. T. Young
Chairman

26 February 2019

On behalf of Solicitors Indemnity Fund Limited, in its capacity as administrator of the Fund.

The notes on pages 11 to 22 form part of these financial statements.

SOLICITORS INDEMNITY FUND**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 OCTOBER 2018**

	Retained surplus	Total
	£000	£000
Balance as at 1 November 2016	24,138	24,138
Deficit for the year	(1,572)	(1,572)
Other comprehensive income for the year:		
Other comprehensive income	-	-
Total comprehensive income for the year	-	-
Distributions to The Law Society	-	-
Total transactions with owners, recognised directly in equity	-	-
Balance as at 31 October 2017	22,566	22,566
Deficit for the year	(546)	(546)
Other comprehensive income for the year:		
Other comprehensive income	-	-
Total comprehensive expense for the year	-	-
Distributions to The Law Society	-	-
Total transactions with owners, recognised directly in equity	-	-
Balance as at 31 October 2018	22,020	22,020

The notes on pages 11 to 22 form part of these financial statements.

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018

1. GENERAL INFORMATION

The Solicitors Indemnity Fund is a statutory fund established within the United Kingdom in 1987 governed by the Solicitors' Indemnity Rules 1987 as amended from time to time as outlined in the Report of the Directors. The principal office where the Solicitors Indemnity Fund is administered is 10 Lower Thames Street, London, EC3R 6AF, United Kingdom.

2. STATEMENT OF COMPLIANCE

The individual financial statements of Solicitors Indemnity Fund have been prepared in compliance with United Kingdom Accounting Standards, comprising Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 102").

Due to the nature of the Fund it is not required to comply with the Companies Act 2006 and as such these are non-statutory financial statements. However, the Fund has complied with those elements of the Companies Act relevant to the financial statements that the Directors believe are necessary to enable the financial statements to give a true and fair view.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The most significant accounting policies adopted by the Fund are described below and these have been applied consistently to all the years presented, unless otherwise stated. The Fund continues to prepare its financial statements in accordance UK Accounting Standards.

Whilst not required to comply with Financial Reporting Standard 103 "Insurance Contracts" where relevant the principles the standard have been used in determining the accounting policies.

Following the decision of the Council of The Law Society in June 1999 to move to market insurance, the Fund went into run-off on 1 September 2000.

The Company which administers the Fund, holds title to all of the legal assets which are beneficially held for the Fund. In accordance with the initial set up guidelines for the Fund, all of the assets and liabilities are recorded in these financial statements as if they belong to the Fund, and are not recognised in the financial statements of the Company.

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3 (p).

(b) Going Concern

Having assessed the principal risks, the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

(c) Exemption for qualifying entities under FRS 102

FRS 102 allows a qualifying entity certain disclosure exemptions, subject to certain conditions, which have been complied with, including notification of and no objection to, the use of exemptions by the Fund's shareholders.

The Fund has taken advantage of the following exemptions:

- i) from the requirement to prepare a statement of cash flows as required by paragraph 3.17(d) of FRS 102;
- ii) from the requirement to present a reconciliation of the number of shares outstanding at the beginning and end of the period as required by paragraph 4.12(a)(iv) of FRS 102;
- iii) from the requirement to disclose the key management personnel compensation in total as required by paragraph 33.7 of FRS 102.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) **Basis of accounting**

The financial statements are prepared under the historical cost convention with the exception of the valuation of investments. See Note (e).

(e) **Valuation of investments**

Investments, comprising listed securities are valued at their mid-market value at the Balance Sheet date on a portfolio basis. Realised gains or losses represent the difference between net sale proceeds and purchase price. Investments are measured at fair value. Changes in fair value are recognised in the Statement of Comprehensive Income. The fair value of investments are obtained at the balance sheet date based on net asset value readily available from an exchange, investment manager or pricing service.

(f) **Interest from investments and interest from indemnity claim recoveries**

Income from the various investment portfolios is remitted throughout the year but is accounted for on an accruals basis. Interest from indemnity claim recoveries are recognised when they are able to be reliably measured and there is a reasonable expectation of recovery.

(g) **Contributions**

Contributions are accounted for on the accruals basis.

(h) **Insurance recoveries**

Insurance recoveries are accounted for as and when payment becomes due based on the liability being incurred.

(i) **Claims costs**

Claims costs recognised each year comprise claims handling costs including the costs of panel solicitors, damages paid out, and other costs net of indemnity recoveries. Claims costs are accounted for when incurred and indemnity recoveries are recognised at the point they can be reliably measured and there is a reasonable expectation of recovery.

(j) **Claims provisions**

Estimation techniques are used to determine the Gross Claims Provision which represents the estimated outstanding liabilities relating to all indemnity years.

Ultimate claim settlements are estimated by the use of statistical projections of historical data, together with case by case reviews of notified losses, and are based on information available at the time the estimates are made. There is uncertainty as to the quantum of the ultimate settlement of the liabilities which is inherent in the process of estimating such that, in the normal course of events, unforeseen or unexpected future developments could cause the ultimate cost of settling the outstanding liabilities to differ from that currently estimated. Any differences between provisions and subsequent settlements are dealt with in later accounting periods as actual costs and non-insurance recoveries are known. Claims provisions include the estimated future costs of panel solicitors and claims handling costs, including a proportion of overheads. Claims provisions are not discounted.

(k) **Insurance provisions**

Insurance policies are held to provide cover for the risk associated with uncertainties of certain claims settlements and costs. Claims are made against policies to the extent that criteria have been met. Amounts are recognised to the extent that the Directors believe they are recoverable with provision made for any doubtful debts.

(l) **Indemnity recoveries provisions**

Indemnity recoveries are recognised at the point at which they can be measured and there is a reasonable expectation of recovery, practically when the Fund is notified of entitlement to amounts. Assessment is made of the likelihood of recovery and subsequent provision made if required.

The Fund does not make provision for other potential future indemnity recoveries due to the uncertainty of whether any amounts can be recovered.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Taxation

Taxation expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the Statement of Comprehensive Income, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case tax is also recognised in other comprehensive income or directly in equity respectively.

Current or deferred taxation assets and liabilities are not discounted.

Current tax

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end.

Deferred tax

Deferred tax arises from timing differences that are differences between taxable profits and total comprehensive income as stated in the financial statements. These timing differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the financial statements.

Deferred tax is recognised on all timing differences at the reporting date. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted by the period end and that are expected to apply to the reversal of the timing difference.

(n) Financial instruments

The Directors have chosen to adopt the Sections 11 and 12 of FRS 102 in respect of the financial instruments.

Financial assets

Basic financial assets, including trade and other debtors and cash and bank balances are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Such assets are subsequently carried at amortised cost using the effective interest method.

At the end of each reporting period financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognised in the Statement of Comprehensive Income.

Other financial assets, including investments in equity instruments which are not subsidiaries, associates or joint ventures, are initially measured at fair value, which is the normal transaction price.

Such assets are subsequently carried at fair value and the changes in fair value are recognised in profit or loss, except that investments in equity instruments that are not publically traded and whose fair values cannot be measured reliably are measured at cost less impairment.

If there is decrease in the impairment loss arising from an event occurring after the impairment was recognised the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognised. The impairment reversal is recognised in the Statement of Comprehensive Income.

Financial assets are derecognised when (a) the contractual rights to the cash flows from the asset expire or are settled, or (b) substantially all the risks and rewards of the ownership of the asset are transferred to another party or (c) control of the asset has been transferred to another party who has the practical ability to unilaterally sell the asset to an unrelated third party without imposing additional restrictions.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) Financial instruments (continued)

Financial liabilities

Basic financial liabilities, including trade and other creditors are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the debt instrument is measured at the present value of the future receipts discounted at a market rate of interest.

Debt instruments are subsequently carried at amortised cost, using the effective interest rate method.

Trade creditors are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognised initially at transaction price and subsequently measured at amortised cost using the effective interest method.

Financial liabilities are derecognised when the liability is extinguished, that is when the contractual obligation is discharged, cancelled or expires.

The Fund does not hold or issue derivatives financial instruments.

Offsetting

Financial assets and liabilities are offset and the net amounts presented in the financial statements when there is an enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle to liability simultaneously.

Fair value estimation

Financial instruments carried at fair value can be categorised by the following valuation methods:

Level 1	Quoted prices in an active market
Level 2	Recent transactions in an identical asset if there is an unavailability of quoted prices
Level 3	Use of a valuation technique if there is no active market or other transactions which are a good estimate of fair value.

The Fund's investments of £30.5 million (2017 £31.2 million) comprise of equities, investment grade credit, high yield bonds and other securities. They are all categorised as level 1.

(o) Related party transactions

The Fund discloses transactions with related parties which are not wholly owned with the same group. It does not disclose transactions with members of the same group that are wholly owned.

(p) Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Note 12 provides a breakdown of the provisions.

Sources of estimation uncertainty

The Fund makes estimates and assumptions concerning the future. The resulting accounting estimates may differ to actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are addressed below.

The ultimate liability arising from claims

The estimation of the ultimate liability arising from claims under indemnity contracts is the Fund's most critical accounting estimate. The Fund's Provisions at year-end total £10.5 million (2017: £10.8 million) and consist of three components: case reserves, claims incurred but not reported ("IBNR") and a claims handling costs provision. Case reserves are estimated on a case by case basis by claims handlers and, where deemed necessary and appropriate, further opinions are sought from third party solicitors.

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Critical accounting judgements and estimation uncertainty (continued)

The ultimate liability arising from claims (continued)

External actuaries estimate IBNR using standard actuarial claims projection techniques on a triennial basis or when deemed appropriate. Such methods extrapolate the development of paid and incurred claims, indemnity recoveries from third parties, average cost per claim and expected loss ratios. The main assumption underlying these techniques is that past claims development experience is used to project ultimate claims costs. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged through the Statement of Comprehensive Income in future years.

Direct claims handling costs are recognised to the extent they can be separately identified as specifically relating to claims handling expected to be incurred due to known claims and IBNR cases.

4. RISK MANAGEMENT

The process of governance and risk management is addressed through a framework of policies and procedures as documented within the Administering Company's Corporate Risk Register. Risk management policies are developed by the Directors and executives taking into account the size and nature of the organisation. The Directors are responsible for satisfying themselves that a proper internal control framework exists within the Fund to manage financial risks and that adequate controls are in place and operate effectively.

a) Indemnity Risk

The principal risks from the Fund's indemnity operations arise from fluctuations in the timing, frequency and severity of claims compared to expectation for known claims (claims reserves and expected indemnity claim recoveries) and future claims (IBNR). These reserve risks are considered in turn.

i) Claims Reserves

These provisions are for all known cases and are notified on a "claims made" basis and fall within an indemnity year. Reserve estimates are made by specialist claims experts and panel solicitors of the likely damages and potential costs involved in settling the claim, as well as any expected indemnity recoveries to be made. These reserves are revised on a regular basis based on updated information as the claims progress. These provisions are sensitive to changes in the complexity of the case and the potential outcome and therefore cost of damages changing. Therefore there is a risk that known claims may have been inadequately provided for or there may be a deterioration in the claim leading to adverse development.

Claims reserves are made up of all outstanding claims relating to the pre 1 September 2000 operational period and include claims made against practices that had ceased without successor since 1 September 2000 but only in respect of those firms that had ceased prior on or before 31 August 2000. The claims reserves also include for all the claims arising from the post six-year run off protection provided by the Fund. This protection relates to claims made against firms that had ceased without successor on or after 1 September 2000 and after a lapse of the six-year run off cover provided by the prior market participating insurer. The development of the historic claims are almost complete and there remain only a few cases left to resolve. The majority of claims reserves in value and volume relate to the post six-year run off protection provided.

The table below sets out the split of claims reserves by historic claims and post six-year run off claims:

	31 October 2018	31 October 2017
	£000	£000
Historic claims	1,182	1,342
Post six-year run off claims	3,830	2,714
	<u>5,012</u>	<u>4,056</u>

The movement of claims reserves are a Key Performance Indicator and are reviewed by the Directors periodically. Furthermore, the Directors are provided with significantly more information relating to large and sensitive claims being any claim with a reserve in excess of £20,000.

4. RISK MANAGEMENT (continued)**a) Indemnity Risk (continued)****ii) IBNR**

This provision relates to claims incurred but not reported (IBNR). These claims arise where the event that triggers a claim has already happened i.e. an act of negligence has occurred at some time in the past but is presently unknown to the Fund because it has not been reported. When disclosed to the Fund it would still be subject to any statutory limitation provisions applying. An actuarial projection is made of this provision. The principal assumptions underlying the actuarially calculated liability estimates is that the future claims development will follow a similar pattern to past claims development experience. Additional qualitative judgements are used to assess the extent to which past trends may not apply in the future, for example, one-off occurrence, changes in market factors such as public attitude to claiming, recession, cessation of firms and other market conditions. Judgement is further used to assess the extent to which external factors such as judicial decision and government legislation affects the estimates. Conveyancing claims make up the majority of claims by value and volume within the IBNR provision and are the single largest risk type by category.

Actuarial reviews are carried out on a triennial basis or when deemed necessary. The latest actuarial review was undertaken during 2016. The Directors review the development of claims against the expected actuarial projection and where necessary adjust the provision accordingly. Directors assess movements to determine an appropriate reserve in the intervening periods. The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Fund, where more information about the claim event is generally available.

iii) Claims Handling Costs

Provision is made for all future costs that will be incurred in the direct management and administration of claims. There are a number of steps that need to be followed before settlement of any claim. Claims made are assessed for their validity, negotiated and then settled. These procedures carry administrative and operational costs for the Fund and, bearing in mind the sole activity of the Fund is to manage all claims made prior to 30 September 2020, is a key element in the claims management development process. Estimates are made of all future costs of the Fund and an analysis is carried out to assess the extent to which these costs are directly attributable to claims handling.

iv) Expected Indemnity Claim Recoveries

Indemnity recoveries are only recognised once there is a reasonable expectation of the recovery being received and this is reserved at the net anticipated recovery value. Indemnity claim recoveries relate almost entirely to historic claims and generally relate to assignments and charges obtained against third party assets as a consequence of an underlying claim settlement. The recovery reserves are subject to periodic review for changes in circumstances, such as changes to underlying asset values and adjustments are made if required.

The Directors review and monitor the progress of indemnity claims recoveries periodically. Detailed commentary on the recovery as well as updates are provided for all recoveries. The Director actively seek to crystallise any potential future recovery at the earliest time whilst being mindful of the sensitivities that surround any given claim.

v) Sensitivity analysis

There is a wide range of possible outcomes in assessing claim provisions due to the uncertainty associated in estimating ultimate claims liabilities.

For known claim reserves and indemnity recoveries estimates, a range of outcomes are identified and a best estimate of the claims settlement or recovery value is used to raise a claim reserve or expected claim recovery.

For all actuarial projections, the final outcome will depend on the actual development of claims which in turn relies on the appropriateness of the historical data to predict the likely development of claims by type. Unforeseen changes may affect the suitability of that data and would be expected to have an impact on the accuracy of the results and increased uncertainty in the projections. Such changes could include unexpected claims inflation, shocks to the global economy, deep recession or a house market crash, changes in legislation or the emergence of new types of claim.

An estimate is made of future claims handling costs for both type of reserves. Estimates are made annually of all future costs of the Fund and an annual analysis is carried out to assess the extent to which these costs are directly attributable to claims handling and the proportion relevant to known claims and IBNR.

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

4. RISK MANAGEMENT (continued)

v) Sensitivity analysis (continued)

Sensitivity analysis is provided by the actuarial forecasts, whereby the 50th percentile and 99.5th percentile forecast provides differing outcomes of the IBNR provision for post six year run off claims. The Directors have adopted the mean (50th percentile) value for these financial statements. The Directors consider the 99.5th percentile to be the level to which the Fund should be protected against any adverse development.

The securing of the IP as reported in the Report of the Directors on Page 4 limits the Fund's exposure to IBNR risk on the post six year run off book of business in as much as any deterioration in that book of business above what is estimated and provided for is covered by the IP up to an additional £11.6 million. So the IP covers the Fund beyond the 99.5th percentile. The Fund is exposed to any further deterioration above £20 million which is considered remote.

b) Credit, Market and Liquidity Risk

Credit risk is the risk an obligor or counterparty will be unable to pay amounts in full when due. Market risk is the risk of fluctuations to the net asset value of investments due to the volatility or level of financial variables impacting the value of the Fund's investment portfolio. Liquidity risk is the risk that cash may not be available to pay obligations when due.

The Fund's primary financial risk, and exposure to the above risks, is that proceeds from financial assets are not sufficient to meet its claims settlement obligations due under the run-off its indemnity business. As the Fund has no premium income, the underlying security of the investment portfolio is paramount to ensure that the income generated is available to contribute towards payment of claims and operating expenses.

The Directors have set an investment strategy, within its risk appetite as identified by the Corporate Risk Register, and has retained the services of an independent investment manager under specific mandates to administer the Fund's investments.

At present, the Fund has invested in two diversified, and appropriately liquid, investment portfolios that are fully managed by its investment managers. These are held either independently via a custodian or through unitised shares. One is a managed fixed income portfolio, which consists of investment grade credit, high yield bonds and other securities. The Fund also holds a managed index portfolio, which includes equities, government bonds, investment grade credit and other securities within it.

The investment manager produces periodic investment reports to explain movements in the investment mix, performance against benchmark indices and any changes in investment strategy. These reports are considered periodically and contact is maintained throughout the year with the investment manager and meetings take place at least once a year to discuss the performance and appropriateness of the investment portfolios given the Directors risk appetite.

5. DEFICIT BEFORE TAXATION

Deficit before taxation is stated after charging the following amounts:

	31 October 2018	31 October 2017
Expenditure in the year:	£000	£000
Administration service charges costs paid to Liberty Mutual Insurance Europe Limited	35	100
Staff costs	6	-
Insurance and other operating costs	22	15
Legal and professional	161	197
Audit	47	50
Net operating expenditure in the year	271	362

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

5. DEFICIT BEFORE TAXATION (continued)

	31 October 2018	31 October 2017
	£000	£000
Included within the Statement of Comprehensive Income as follows:		
Cost of claims handling, including claims related share of overheads included within 'claims costs'	87	151
Non claims related costs included within 'administrative expenses charge'	184	211
	<u>271</u>	<u>362</u>

Administrative costs

The administration service charges costs of £35k (2017: £100k) relate to payments by the Fund to Liberty Mutual Insurance Europe Limited under the administrative agreement disclosed in further detail within the Report of the Directors.

Other

Audit expenditure of £47k (2017: £50k) is in respect of the audit of the financial statements. Non-audit services paid to the auditors was nil (2017: £nil).

Directors' emolument costs of £63k (2017: £80k) are charged directly to the Fund and are included above within legal and professional costs.

Analysis of claims costs within the Statement of Comprehensive Income is as follows:

	31 October 2018	31 October 2017
	£000	£000
Amounts paid	(428)	(365)
Indemnity recoveries received	79	395
Claims handling costs	(87)	(151)
Claims costs (net of indemnity recoveries)	<u>(436)</u>	<u>(121)</u>

6. GAINS AND LOSSES ON INVESTMENTS

	31 October 2018	31 October 2017
	£000	£000
Net realised (losses)/gains	(67)	347
Net unrealised (losses)/gains	(397)	1,315
	<u>(464)</u>	<u>1,662</u>

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

7. INTEREST FROM INVESTMENTS AND INDEMNITY CLAIM RECOVERIES

	31 October 2018	31 October 2017
	£000	£000
Interest from investments	282	352
Interest on indemnity claim recoveries	47	138
	329	490

8. TAXATION CHARGE/(CREDIT)

	31 October 2018	31 October 2017
	£000	£000
(a) Analysis of total tax (credit)/charge in the year		
Current Tax		
Current Tax - Income tax credit on deficit for the year	-	(348)
Adjustment in respect of prior years	-	(1)
Current tax credit	-	(349)
Deferred Tax		
Deferred tax charge	7	-
Write-down of deferred tax asset	-	-
Total deferred tax charge	7	-
Total tax charge/(credit) on deficit for the year	7	(349)
b) Factors affecting tax charge for the year		
Deficit before taxation	(539)	(1,921)
Tax credit at 20% (2017: 20%)	(108)	(384)
Capital allowances in excess of depreciation	-	(3)
Accrued income taxable when received	-	(3)
Expenses not allowable for tax purposes	1	-
Adjustment in respect of prior years	-	(1)
Movement in previously unrecognised deferred tax asset	114	42
Total tax charge/(credit)	7	(349)

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

9. INVESTMENTS

	31 October 2018	31 October 2017
	£000	£000
Managed index portfolio	23,251	23,483
Managed fixed income portfolio	7,286	7,765
	30,537	31,248

The historic cost of investments amounts to £27.9 million (2017: £28.1 million).

10. DEBTORS

	31 October 2018	31 October 2017
	£000	£000
VAT recoverable	6	7
Expected indemnity claim recoveries	879	933
Interest on indemnity claim recoveries receivable	905	871
Other debtors	9	1
	1,799	1,812

Interest on indemnity claim recoveries receivable includes £0.5 million (2017: £0.7 million) falling due after more than year. All other amounts are considered due within one year except for the expected indemnity claim recoveries, of which £0.6 million (2017: 0.7 million) is falling due after more than one year.

Recoveries are only recognised when management and external advisors believe there is a reasonable expectation of recovery.

As explained in Note 13 there are some additional assets over which the Fund has some title or claim, which may lead to potential future recovery. However, there is such uncertainty over the timing and amount of any recovery that no estimate can be made of the value of the asset.

11. CREDITORS

	31 October 2018	31 October 2017
	£000	£000
Accruals and deferred income	48	71
Claims payable	68	70
Deferred tax liability	7	-
Tax and social security payable	4	9
	127	150

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

12. PROVISIONS

The claims provisions are made in accordance with the accounting policies and as explained in the Report of the Directors, they carry a significant level of judgement and rely on estimation techniques based on experience and available information.

There are three main aspects to the provisions as follows:

	31 October 2018	31 October 2017	Movement
	£000	£000	£000
Gross claims reserves	5,012	4,056	956
IBNR	4,006	5,464	(1,458)
Claims handling costs	1,493	1,268	225
	<u>10,511</u>	<u>10,788</u>	<u>(277)</u>

- a) Gross claims reserves – Provision is made for known cases. Estimates are made by specialist claims experts and panel solicitors of the likely damages and potential costs involved in settling the claim, as well as any expected indemnity recoveries to be made. These estimates are revised on a regular basis based on updated information as the claims progress. These provisions are sensitive to changes in the complexity of the case and the potential outcome and therefore cost of damages changing.
- b) Incurred but not reported (IBNR) – An estimate is made of those cases where the event that triggers a claim has already happened i.e. an act of negligence has occurred at some time in the past but is presently unknown to the Fund because it has not been reported. When disclosed to the Fund it would still be subject to any statutory limitation provisions applying. An actuarial projection is made of this provision periodically. The risk exposure of all IBNR claims reduces over time as cases reach their primary or statutory limitation period. There remains significant risk in the post six-year run off provision as this is a developing area of business that took effect from 1 September 2007 when the Fund began providing cover for certain post six-year run off claims. The Directors believe while there is a risk that there maybe some additional historic claims they are so uncertain that they cannot be quantified and so no IBNR provision is made for these potential claims.
- c) Claims handling costs - These costs are recognised to the extent they can be separately identified as specifically relating to claims handling expected to be incurred due to known claims and IBNR cases. The provision for direct claims handling costs relating to gross claims reserves are £747k (2017: £242k) and IBNR of £747k (2017: 1,026k). There are additional costs which will be incurred in the administration and management of the Fund. However in accordance with UK Accounting Standards these have not been provided for. These are and will continue to be very real and significant costs the Fund will need to bear. As provision cannot be made for these in these financial statements, they will be set aside from within the surplus and ring-fenced.

13. CONTINGENT GAINS AND LOSSES

There are a some assets over which the Fund has some title / claim which may lead to potential future recoveries. These potential assets are not recognised as part of the provisions for indemnity recoveries as, in the opinion of the Directors, they are so uncertain that they cannot be practically measured and hence no estimate is included here.

14. RELATED PARTY TRANSACTIONS

The Fund is exempt from disclosing other related party transactions as they are with other companies that are wholly owned within The Law Society Group.

SOLICITORS INDEMNITY FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 OCTOBER 2018 (continued)

15. ULTIMATE CONTROLLING PARTY

In the opinion of the Directors the ultimate controlling party is the Council of The Law Society by virtue of it being the controlling party of the Fund due to The Law Society's entitlement to surpluses of the Fund. Copies of The Law Society's financial statements can be obtained from The Law Society, Law Society Hall, 113 Chancery Lane, London, WC2A 1PL. Consolidated financial statements including the Fund are prepared by The Law Society, which is the parent undertaking of the largest and smallest group of undertakings to consolidate these financial statements at 31 October 2018.

16. EVENTS AFTER THE BALANCE SHEET DATE

As explained in the Report of the Directors on page 3, the Company terminated the administrative services agreement with Liberty Mutual Insurance Europe Limited for the provision of various administrative and claims handling services in respect of the run-off of the Fund with effect from 31 December 2018. On 1 January 2019 two staff transferred to the Company under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). Certain contracts and assets were also transferred to the Company. Liberty Mutual Insurance Europe Limited paid £0.2 million to the Company as a termination payment.