CHAIRMAN'S INTERIM REPORT
JANUARY 2020

Bar Mutual's Financial Position

I am pleased to report that Bar Mutual continues to be in very sound financial health.

Although a modest operating loss of £0.7m is currently forecast for the year to 31 March 2020, this is part of a strategy agreed by the Board to reduce Bar Mutual's capital to a level in line with its risk appetite. Thus, for the 2019 renewal, the premium deferral was maintained at a relatively high level (20%), which of course reduced the amount of premium Bar Mutual received from its Members.

Despite the forecast operating loss for the period to the end of the current financial year, Bar Mutual will still be well capitalised, with the excess regulatory capital over its regulatory capital requirement expected to be about the same as for last year (£21.5m compared to £22.8m).

Rates for the 2020 Renewal

As a mutual insurer, Bar Mutual's policy is to underwrite at cost, that is to say, barring a need to build capital for solvency purposes, the premium charged to Members is calculated to produce enough income to meet its costs and not to generate a surplus.

At its meeting in November 2019, the relevant sub-committee of the Board performed the annual task of considering, for each practice area, the projected costs of that area for the coming year (the largest element of which is the total gross claims incurred) and each area's projected fee income at renewal on current rates. This produces the "notional rating' for each area of practice, i.e. the rate to be applied to the projected fee income that would cover the projected costs.

The Board accepted the sub-committee's recommendation that the notional rates justified a reduction in the rates charged at the last renewal for three areas of practice and an increase for two. The rates for all other areas of practice will remain the same as they were for the 2019 renewal.

The rate for Commercial and Financial Services will reduce from 0.7% to 0.6%; and the rates for Personal Injury and Planning will both fall from 1.2% to 1.0%.

The rate for Chancery: Non Contentious will increase from 1.2% to 1.5% and the rate for Revenue: Non-Crown: Non-Contentious will increase from 6.5% to 7.25%.

As regards the premium deferral for the 2020 renewal, given that the strategy of maintaining a high deferral in order to eliminate, at a prudent speed, the surplus capital built up in recent years has been effective, the Board agreed with the sub-committee's recommendation that whilst it should continue with this strategy, it was appropriate to reduce the premium deferral by a modest amount. Accordingly, the premium deferral applied to Members' premiums for the 2020 renewal will be 15%, down from the 20% applied for the 2019 renewal.

Bar Mutual's Rules

Should Bar Mutual wish to call for additional capital from its Members to increase its financial resources in order to meet its liabilities, amongst the options available under its Rules is to call for payment of some or all of the deferred premium from the open policy years on which Bar Mutual has yet to waive its right to do so. It can also call for Supplementary Contributions to be paid.

Premium Deferral

In my Chairman's Report last year I commented that the Board had decided to provide more information to Members in respect of their individual contingent liabilities for deferred premium. Members were therefore provided with (i) a breakdown of their premium deferral for the 2019/20 renewal and (ii) an annual statement setting out their contingent liabilities for the deferred premium on all policy years on which the right to demand payment had not yet been waived. A similar statement was sent to all Members who were ceasing practice as a self-employed barrister.

I write again on the premium deferral as, from correspondence received by our Managers from some Members since the two documents referred to above were sent, the existence of the premium deferral and Bar Mutual's power to call for its payment may not be as well appreciated as it should. Although the premium deferral has been mentioned in nearly all my previous reports, a difficulty may be that, as the annual renewal of Members' insurance in some chambers is dealt with centrally, Members may not have seen past Chairman's Reports; and indeed some Members may not have received copies of the breakdown of their annual premium sent last year or the statements showing past premium deferrals. The notes accompanying the renewal documents this year will therefore urge chambers to ensure that all barristers see their premium deferral statements.

That the operation of the premium deferral is fully understood is especially important now that Bar Mutual's insurance regulator, the Prudential Regulation Authority, has accepted that a proportion of the deferred premium available to be called by Bar Mutual can be recognised as part of Bar Mutual's regulatory capital for the purposes of meeting its regulatory capital requirement. The ability to do this reduces the risk of having to call for payment of the deferred premium in the event of a substantial decline in Bar Mutual's capital position.

I noted in my January 2019 Interim Report that, since 1999, Bar Mutual has collected less than 100% of the Basic Premium ("the premium") charged to its Members on policy years and deferred collection of the balance of the premium. The amount deferred is conveniently referred to as the premium deferral. The level of the premium deferral is determined by Bar Mutual's Board in advance of the renewal for each year, and is driven primarily by Bar Mutual's risk appetite statement, a policy guiding the preferred level of capital Bar Mutual should hold in order to ensure that it can continue to meet its regulatory capital requirement and so continue insuring its Members in the longer term. The rate of the premium deferral has been as low as 5% and as high as 27.5%. In recent years the premium deferral has been unusually high as, over a period, surplus funds were generated by strong investment income on Bar Mutual's investments, a better than expected claims outcome and favourable reinsurance arrangements.

Having calculated the premium but deferred collection of a proportion of it, the Members' contractual obligation to pay the balance of the premium remains unless Bar Mutual decides, pursuant to its Rules, to waive its entitlement to receive the balance of the premium for any one year. The rationale for retaining the right to collect the balance of the premium is to ensure that Bar Mutual has access to additional capital in the event that its capital position deteriorates significantly. Bar Mutual's practice to date has been to forego its entitlement to the deferred premium on a policy year five years after the end of that policy year.

A natural question that arises is whether circumstances currently exist that would require Bar Mutual to request payment of the deferred premium. Members should be aware that, since the premium deferral was first applied, Bar Mutual has never had occasion to consider calling for payment of any deferred premium in respect of any policy year. Nor is there any reason to assume that this state of affairs will change in the future.

One of the reasons that calling for payment of any deferred premium is unlikely is Bar Mutual's business model. The premium set for individual areas of practice at each renewal is based on the areas' claims experience, and so the premium charged by Bar Mutual is intended to collect sufficient premium to pay what is forecast will be incurred in claims payments. Second, to the extent that adverse movements in the claims could erode Bar Mutual's financial strength, it transfers a substantial amount of its claims exposure on high value claims to reinsurers. And to reduce the risk of loss on the reinsurance contracts, any concentration risk is addressed by capping at 25% the placement with any one reinsurer; and the risk of insolvency is dealt with by requiring a minimum credit rating of A (on the Standard & Poor's rating scale) on Bar Mutual's reinsurers. Third, Bar Mutual has deliberately formulated a low risk investment policy intended to preserve its capital in real terms (using the CPI rate of inflation) over the medium term (3 to 5 years). This reduces the risk of Bar Mutual's capital being drained by substantial losses on its investment holdings. And finally, Bar Mutual's agreed risk appetite statement for capital requires it to maintain a healthy buffer between its regulatory capital requirement and its total regulatory capital actually held. This is to ensure that, should there be any unexpected adverse experience in the normal course of its operations (whether from the claims arising, investment performance or any other source or risk), Bar Mutual would still comfortably meet its regulatory capital requirement.

Supplementary Contributions

Bar Mutual's Rules also permit it to call for Supplementary Contributions to be paid by its Members, which is a request for payment of additional premium over and above that originally calculated as the premium due for a policy year. This is a typical arrangement common across 'mutual' insurance companies.

A request to pay Supplementary Contributions will therefore result in a Member's total premium for the policy year in which the Supplementary Contribution applies exceeding 100% of the original premium.

As with the premium deferral, Bar Mutual has never in its history had cause to consider requesting a Supplementary Contribution and, as explained above, its operating model has been conceived so as to minimise the risk of this occurring. In addition, as with calling for payment of the premium deferral, Bar Mutual's practise is to close policy years after five years thereby foregoing the right to make a Supplementary Call on that year.

Nevertheless, in the interest of transparency, and given the importance of Members appreciating precisely how additional capital could be requested from them, I am specifically bringing this to Members' attention.

Foreign Practice

Bar Mutual currently provides cover for Members in respect of foreign practice if it is incidental to their practice as a barrister in England and Wales or otherwise if Bar Mutual specifically agrees to provide such cover. However, it will always be the responsibility of each Member engaged in foreign practice to ensure that professional indemnity insurance cover is in place which satisfies any requirements of the particular jurisdiction in which the Member engages in practice. I mention this not just in the context of Brexit, but also because it has come to Bar Mutual's attention that the Irish authorities have recently introduced a requirement that Irish barristers be insured under a "qualifying insurance policy", and cover with Bar Mutual would not satisfy that requirement as it is not authorised or licensed to transact business in the Republic of Ireland.

Adequacy of Cover

I make no apology for raising this issue, as I do every year. In my time as Chairman of the Board I have become aware of occasions when, unfortunately, Members have not obtained or maintained a limit of cover (either with Bar Mutual or by purchasing top-up cover) that is commensurate to the claims exposure arising from their practices.

Our Managers are in the process of sending out the renewal papers for the 2020 policy year renewal. When they are received I urge all Members to give careful consideration to rC76 of the BSB Handbook. This requires Members to ensure, in light of the claims risk arising from both their current and historical practice as self-employed barristers, that they purchase an adequate limit of cover (whether within Bar Mutual's primary £2.5m limit of cover plus defence costs or a higher limit with the assistance of brokers who offer to arrange top-up insurance).

As a Board we have been informed of several instances where the sums claimed against a Member well exceeds the Member's limit of cover, and although in most instances, where there was a settlement, it was possible to resolve the claim within the Member's limit of cover, this is not always the outcome and Members have in the past had to contribute to a claim payment from their personal assets.

Board of Directors

In my July 2019 Report I thanked Alexandra Healy QC for her substantial contribution to Board and Committee meetings of Bar Mutual. Although Alexandra did not serve on the Board as a representative of the Criminal Bar, one of her roles was to bring the perspective of the Criminal Bar to the deliberations and decisions of the Board. I am therefore very pleased to report that Nathaniel Rudolf, also a member of the Criminal Bar, was appointed to the Board at the Annual General Meeting on 23 October 2019. I and my fellow directors welcome Nathaniel's presence on the Board as I am sure it will strengthen the quality of our deliberations and decision making. I therefore thank him for his willingness to serve as a Director.

Colin Edelman QC
Chairman
January 2020