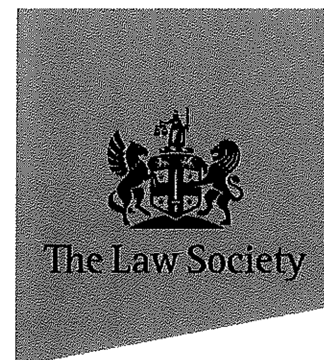

From the Chief Executive

Chris Kenny
Chief Executive
Legal Services Board
1 Kemble Street
London WC2B 4AN

3 July 2014

Dear Chris

SRA Board Decision (2nd July): to cut the minimum level of Professional Indemnity Insurance cover required from practitioners £500,000

I am writing to express the Law Society's concerns in light of the SRA Board's decision of 2 July 2014 to approve and recommend to the LSB a reduction in the minimum level of Professional Indemnity Insurance (PII) cover required from practitioners to £500,000 from this October.

As you will be aware, this was one of a number of proposals regarding PII contained in the consultations commenced in May this year. The Society is pleased that the SRA has decided to delay a decision on the other PII proposals and some other aspects of the May consultations in the light of the consultation responses received. However, we believe that this SRA's decision in relation to changes in the minimum or required PII was wrong and will have significant ramifications both for the public interest and the profession which have not been properly considered or debated.

I attach (for ease of reference) a copy of the Law Society's response to the SRA's proposals. You will be aware of our general concerns which have been echoed by many other voices. These include the bulk of those in the insurance industry, brokers, consumers and lenders. They are:

- This decision has been made without time for proper analysis of the risks posed: the consultation period was itself inadequate, lasting just 6 weeks, and the SRA did not have advanced discussions with all stakeholders, particularly from the insurance industry and broker community nor were there any impact assessments made. Not only that but in this curtailed period, there were of course not one but four complex and inter-linked consultations which had to be analysed and responded to.

- The level proposed is too low. No insurer that we have spoken to considers that it would be responsible to offer only £500,000 worth of cover. While it may well be that the bulk of claims fall below that amount, there remains the risk of higher claims. As an example, criminal and regulatory law are both cited as areas of low risk. However, cases can actually arise in both areas where a wrongly convicted professional person or, for example, an inappropriately struck-off senior doctor, might well find their losses significantly greater than that. The SRA has provided no adequate analysis of the impact on consumers or of the likely cases that would be affected if firms decided to adopt the proposed minimum Moreover, a solicitor cannot with any reasonable precision simply decide not to take on work that is risky

(given the obvious problems of accurately predicting the level of risk in new cases). Indeed, the claims made basis of this cover means that a firm has to consider the risk in respect of work done previously as well as the type of work to be done afresh in each indemnity year. Few firms will prudently be able to take advantage of the new minimum.

- The SRA has produced insufficient evidence to support its belief that premiums will fall by at least 5%; in fact, the opposite could be true as was the experience in Ireland. The Legal Services Consumer Panel also made this point in its 18th June response when it said: "The consultation documents contains insufficient evidence that reducing PII cover would lead to equivalent gains for consumers in terms of lower prices, greater choice, and wider access...We oppose the proposal to lower the level of compulsory cover to £500,000 for any one claim." Only one insurer (QBE) was quoted as suggesting that this might be the case and it needs to be borne in mind that that insurer suggested that, in fact, the minimum level might cover as little as 70% of claims. Insurers' books differ and it would be unwise to take the estimate of a single insurer as being conclusive.

- The minimum terms are a package which gives confidence to purchasers, particularly lenders, encouraging them to use a wide range of firms for their panels, thus enhancing access to advice and a competitive market. They also provide advantages for solicitors through an element of "bulk purchasing" which is likely to reduce costs. These minimum terms will be entirely inadequate for the conveyancing market and firms will need to obtain top-up cover. This top-up cover will not have the same level of protection as the minimum terms (aggregation clauses, provisions for non-disclosure etc will be different). This may not provide adequate protection for lenders and so obtaining insurance is likely to be significantly more difficult and expensive for small firms dealing with conveyancing, private client and PI work. Many may decide to leave the market, reducing access to advice and leaving their former clients much less well protected.

- The SRA has indicated that it will monitor the impact of changes. This will not avoid the risk of damage that cannot be undone both to clients who make claims in that year and the firms that may close.

- It does not appear that thought has been given to the consumers who find that insufficient cover is available to meet their claims. It is unclear whether the discretionary limit of the Compensation Fund will be lowered to the level of the Minimum Terms and Conditions or if any claims will be met by the whole profession via the Compensation Fund.

- Many smaller and medium sized firms will at short notice be presented with a radical new challenge – how to assess and value the risk in their book of completed client work and new work. The present level of cover has meant that this task has been largely unnecessary. It is unrealistic to expect that effected firms will be able to make a reliable assessment in the time available. There must be a risk that some firms will under-insure simply because they have not had the opportunity to make the assessment properly. We think it unlikely that a prudent broker will provide advice on what an appropriate amount would be other than as a specific paid for service requiring considerable work. Indeed it is unclear to us in the consultation proposals how the Board of the SRA has satisfied itself that its staff and/or processes have the expertise or processes to determine whether or not a firm has adequate cover. The SRA has not indicated how it will enforce the rule.

- The haste also accentuates uncertainty, the last thing the PII market needs following the experience of last year's renewal round. The Society and the industry advises solicitors to prepare for the PII round at the earliest stage, to gather evidence and support for their proposals around May so that they can find the best deals and present the most accurate case. The current consultation has caused uncertainty throughout the PII supply chain and the threat of another late market resulting in higher premiums for many firms. No adequate reason has been given for the urgency of this work.

- There has been no proper impact assessment. We have invited the SRA to publish the details of its impact assessment(s). We note that the figures on which the proposals were based are many years old. For a change of this magnitude, we would have expected the SRA to look in detail at:

  - The likely effect on premiums;
  - The most recent figures for claims;
  - The availability and the likely terms for cover above the minimum;
  - The effect on the behaviour of lenders and, particularly, on the availability of solicitors to undertake conveyancing work and the effect on their charges;
  - The effect on smaller firms and, particularly, the diversity of the profession.

None of the papers that we have seen achieve this and we question whether the SRA has complied with the Regulatory Objectives in proposing these changes in such a small space of time when there is no evidence as to the urgency.

The PII issues raised by the SRA are important and merit proper discussion. However, the Society is deeply troubled by the inadequate consultation which has stymied evidence-based decision-making. There was no objective need for the haste. Both consumers and firms are owed a better basis for change than mere hope that it will somehow make things better.

In conclusion, given the relevant timescales and the profound implications of the proposition I wanted to share at the earliest stage our concerns, to alert you to the fact that the Society will formally urge the LSB not to approve this proposed change.

Indeed, it not presently clear to us, given the points above that the LSB would be in a position to approve the rule change. It may well be you and your Board may consider it more appropriate to propose instead that they defer this proposal to enable further analysis and discussion in the same way that they rightly have done in relation to the other proposed reforms in this area.

Whilst the President would welcome the opportunity to discuss this directly with you or your Chair if that would be helpful, it would I think be also useful if you and your relevant colleagues were to meet with our Regulatory Affairs Board and we would be happy to facilitate an early meeting of that Board.

I look forward to hearing from you.

Yours sincerely

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Chief Executive

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Response to the SRA Consultation on proportionate regulation

Changes to Minimum Compulsory Professional Indemnity Cover

18 June 2014

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Summary

1. This is the Law Society's response to the Solicitors Regulatory Authority (SRA) consultation on proposed changes to the Minimum Terms and Conditions (MTCs) for solicitors' Professional Indemnity Insurance (PII). The Law Society is strongly opposed to the proposals in principle. We also consider that the proposed rushed timetable to implement will lead to unacceptable chaos in the market and significant damage to consumer protection which it will not be possible to repair. However, we should make clear that delaying implementation will not be sufficient to address these concerns. The proposals need to be reconsidered from scratch, supported by proper evidence.

2. The Law Society readily accepts that there are elements of the PII regime that would benefit from reform. However, the proposals in the SRA's consultation paper seen rushed and risk creating considerable consumer detriment and additional cost for an unspecified, unquantifiable benefit that might arise from an aspiration for greater competition and reduced costs for firms.

3. We can appreciate that there may be some aspects of the proposals in this consultation paper (and indeed in the three other consultation papers) that may present themselves as being superficially attractive to some members of the profession. In a very few cases, some of the proposals may indeed produce a modest benefit for a very few in the profession. We consider, however, that it is incumbent to consider the effect of all of the proposals in this and the three other consultations from the point of view of their impact on the whole of the profession and their clients.

4. The current client financial protection arrangements provide unrivalled protection for the consumer. It is unheard of for individuals to be left destitute or without some level of redress if a solicitor is negligent or dishonest. The effect of these proposals is that those days will go and that:

    - Some consumers will be left facing hardship as a result of the actions of a solicitors regulated by the SRA;
    - The negative impact on the reputation and strength of the legal profession and on the credibility of the SRA may be out of all proportion to the actual number of people finding themselves in this position.

5. The SRA has not provided sufficient justification for reducing the protections in this way. The SRA suggests that there will be benefits from reducing the costs of insurance which may lead to greater competition and so to greater access to justice. What is disappointing is that there is no analysis or evidence to show that:

    - Premiums will, in fact, be reduced;
    - The firms benefitting from premium reductions are actually likely to provide greater access to justice as a result;
    - Firms in other areas will not be adversely affected with significant increases in premiums, more risk-averse reaction from lenders;

- In fact, there is a risk that a decline in access to justice might result as firms leave markets which as a result are perceived to be risky.

6. The Law Society considers that there is limited scope for premium reductions because:

   - The market currently prices-in risk to the existing premiums and firms with low exposure to risk already pay low premiums;
   - Claims are dealt with on a 'claims made' basis which means that the insurer is liable for all claims arising in that year, irrespective of when the action giving rise to the claim took place – insurers are assessing a firm's history, not simply the current work;
   - Firms tend to offer a mix of services, some of which carry greater risk than others.

7. The proposals instead are likely to lead to:

   - Increased premiums;
   - Reductions in the number of firms undertaking work;
   - Disadvantages to BAME practitioners who are strongly represented in the risky areas;
   - Consumers left unprotected and with a loss.

8. The analysis underpinning the SRA's anticipated outcome of increased consumer welfare benefit is at best superficial, lacking in supporting evidence and is not thought through. There has been no consultation of key stakeholders to test out the proposed changes, no impact assessment nor equality and diversity impact assessment. The anticipated outcome is ideological and aspirational and the actual outcome potentially damaging for all those it is intended to benefit. It also appears to ignore significant parts of the 2010 Charles River Associates report for the SRA,[1] ('the CRA report').

9. The existing level of protection took considerable negotiation and time to develop. Once dismantled, it is unlikely to be possible to reinstate it. It is deeply disturbing that the SRA should think that it is right to create significant risk for consumers based on a six week consultation period and without the time either for the industry or firms to adequately adjust to the new regime. No thought has been given to how clients are to be educated on how they are expected to handle the greater risks of their exposure to lesser client financial protections. This outcome will be contrary to the regulatory objective of increasing public understanding of the citizen's rights and duties. It seems highly unlikely that the outcomes will fit with the regulatory objectives of the Legal Services Act of protecting and promoting the public interest and the interests of consumers, of improving access to justice and of promoting and maintaining adherence to the professional principles. They are also likely to shake confidence in the regulator and in the profession.

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[1] CRA Report: Review of SRA client financial protection arrangements, Report prepared for the Solicitors Regulatory Authority, September 2010 http://www.sra.org.uk/documents/SRA/cra-report-on-sra-financial-protection-arrangements.pdf

Introduction

10. The SRA's proposals are to:

    - Reduce mandatory cover to £500,000;
    - Introduce a cap for insurers in any one year by an aggregate limit on claims (amount to be determined through the consultation);
    - Limit compulsory cover for claims requirements to individuals, small enterprises, charities and trusts but exclude large clients, in particular lenders and the financial institutions.
    - Reduce the run-off cover from six years to three;
    - Introduce a new regulatory requirement that each firm assess the level of PII cover that is appropriate for its work;
    - Announce changes for early August for implementation on 1 October 2014.

11. In effect, the proposals lower the current caps on mandatory cover and widen the number of firms which will need to assume responsibility for ensuring that they have appropriate and sufficient additional tailored cover than at present. Most firms will no longer be able to rely on a homogenous PII product. Those that currently purchase an excess layer in addition to the compulsory PII will need to reassess what new additional cover they will require. Firms will also face the additional regulatory burden and expense of self-assessment with the threat of sanctions if they fail to get the level of client financial protections appropriate for them.

12. The MTCs were established in 2000 when the profession went to the open market. They largely replicated the extent of all-embracing PII cover that was available under the Solicitors Indemnity Fund (SIF). In broad terms, the cover indemnifies solicitors against civil liability incurred in private practice. The benefits of the MTCs were clarity and certainty. The cover does not differentiate between client or work types. It is designed to avoid coverage disputes.

13. The current upper limit of compulsory cover when it was set for most firms at £2 million was an approximation of the value of a serious personal injury claim and/or an upper-end residential property. This clarity and certainty meant that anyone dealing with a solicitor could trust them and be assured that if anything went wrong they would receive fair treatment and settlement. The limit was tested by the CRA report's analysis and not found wanting.

14. The proposals appear to be based on the following assumptions:

    - Reducing the minimum terms will mean lower premium costs producing benefits to be passed on to consumers;
    - Firms will be able to make an adequate assessment of their exposure in time for October 2014;
    - Consumers will understand the implications of a firms' insurance limits;
    - The insurance market and firms can adjust to this in the time available.

15. These assumptions are flawed for the following reasons:

- Premiums paid by individual firms are not set simplistically on the basis of the £2 million minimum cover (£3 million for incorporated firms) but vary according to a number of factors, such as the type of legal work undertaken, risks factors, firm's turnover, number of partners, gross fee income etc.[2] Firms undertaking lower risk areas of work - crime, legally-aided work and employment law for example, do not pay as high a premium as those where the work is higher risk, such as property work. Underwriters will write that risk appropriately and proportionately, on the basis of the claims statistics and claims exposure.
- Since very few firms - even small firms - limit their business to single-issue legal services, the current all embracing arrangements permit firms carrying out low-risk work to undertake occasionally other work and still be insured. Hence, a firm which carries out low risk work and which occasionally might carry out conveyancing or probate work would be covered. The fact that most firms carry a basket of risks is in itself good risk management.
- The market operates on a 'claims made' basis. In other words, the insurer insuring a firm in 2014 will cover all claims, known and unknown, arising for that firm in 2014 irrespective of when the negligence took place. This means that firms cannot adjust their practices in the short term to change the level of risk. Indeed consumers and businesses who instructed firms on the basis of the cover available in 2012 may well, as a consequence of the proposed changes, find the cover available as of 1 October 2014 is inadequate to meet their needs.
- Consumers and firms will not be in a position to judge whether a firm's insurance is adequate because they cannot assess the risk of claims from previous years and how this will affect the cap or how a firm's insurance cover may change in future years.
- The Law Society's conversations with insurers and brokers revealed that a substantial education and support programme will be required so that firms will be aware and appreciate the onus to be placed on them when purchasing PII and the personal exposure that will be increased for many practitioners as a result of the proposed changes. Firms are likely to incur additional costs in obtaining advice for the purposes of the new compliance requirement. Small firms, sole practitioners and firms that are not part of a LLP model will be particularly affected as they could be personally liable for mistakes.

16. The current minimum cover cap continues to provide assurance and certainty for most firms and for consumers. By proposing to move to a lower mandatory' model for the minimum compulsory cover cap, the aggregation cap and the reduction of run-off cover to three years as a starting point for risk-based differential regulation, the SRA proposals threaten to disrupt that consumer assurance and to introduce a serious element of uncertainty and risk for the more vulnerable end-consumer for whom the redress process may be lengthy, costly and not guaranteed.

[2] Section 6 of IFF Research Professional Indemnity Insurance Research 2013-14 Prepared for the Law Society, February 2014.

17. What is not explicit in the consultation document is that insureds will have to purchase a package of differentiated top-up insurance products outside the current MTC PII package tailored to their business model. The anecdotal evidence the Law Society has gained, through informal discussions with the insurance industry, is that the cost of the additional insurance products, assuming these are created, will inevitably be greater than the current cost of inclusion in the current homogenous MTC package.

18. The additional burden of providing assessments to the SRA of compliance will also result in additional costs for firms which are likely to offset any initial savings in premiums.

19. A new worry for firms will be the resulting increased risk of coverage disputes and potential gaps in cover. Additional cover purchased above the MTCs is governed by the usual laws of insurance as set out in the Marine Insurance Act 1906 and will not be subject to the mandatory client protections of the MTCs. There will be scope - and in a hard market, an incentive - for insurers to write in small print conditions and exclusions in order to reduce premiums.

Question 1: Do you agree with reducing the compulsory cover to £500,000?

20. No. The Law Society believes that any changes to the MTCs need to be considered in the context of the existing package of client financial protections holistically. It is not appropriate to make individual significant changes which may have distorting and potentially detrimental effects on consumer protection and on the legal services market without a full analysis. The proposal to reduce level of compulsory cover is a case in point and the Law Society disagrees with this proposal.

21. The 2010 CRA report, which seems to be the only documentary evidence the SRA relies upon for its proposals, noted that 23 per cent of claims were of more than £1m in value. The data used in that report was for claims incurred in 2005/2006 - 2007/2008 – six to nine years ago. Since that time, there has been enormous inflation in claims related to damages for personal injury (because of the availability of all sorts of new therapies and computer and mechanically aided care and treatments). The CRA found that it can it take several years for a claim to emerge and that while claims are still outstanding, there is absolutely no certainty as to amount that will actually be paid. Limiting the mandatory cap to £500,000 for any one claim also fails to take into account house price inflation in many parts of the country - which is relevant to conveyancing and probate work. Nor is there any regard in setting this limit to the time lag curve between house price inflation and property-related claims emerging. There is likely to be an increase in 'recession-related claims' also coming through, about which no assessment of risk/likelihood has apparently been made either.

22. The £500,000 cap is likely to result in unfortunate unintended consequences for consumers:

    - Reduced choice of legal service provider - they may no longer be able to go to the firm of their choice for all or certain of their demand

for legal services if that firm refuses the work because it has insufficient cover;
- Exposure to risk if a firm has underestimated the amount of cover needed; or
- Higher costs arising out off top-up insurance that the firm undertaking conveyancing or other work has had to purchase, costs which will be passed on to the consumer.

23. The lack of foresight of these unintended consumer consequences is all the more astounding given the consultation paper's statement '*...it is common to offer less protection for corporate clients who have the resources and capabilities to assess quality and are often repeat purchasers of services who can make their own insurance arrangements. In contrast, individual consumers will usually require greater protection*'.

24. The SRA consultation paper does not recognise that firms are also consumers - in this instance, of PII. The proposal risks resulting in firms having to pay more for their PII cover than at present. If the level of cover taken out is too low, firms might find that their defence costs might not be met in full as a result.

25. Firms requiring additional cover will either have to negotiate their own policies or take advantage, possibly, of such block policies as the market can arrange. These are unlikely to be readily achievable in the time available for the October start. Moreover, the advantages in terms of costs of premiums that bulk policies can provide are likely to be lost, with higher costs ultimately passed on to the consumer.

26. Preliminary discussions the Law Society had with the Council of Mortgage Lenders (CML) and the Building Societies Association (BSA) indicated that lenders are generally opposed to these reforms and, if they were implemented, are likely to lead to lenders taking a more risk-adverse approach with respect to panel management. This could result in smaller and more highly managed panels and a move towards using licensed conveyancers instead of solicitors. It could also lead to reduced choice for consumers.

27. The CML has said that[3]:

“...there are a raft of potential unintended consequences such as:

- Lenders moving to very small panels whose PII cover suits the lenders’ needs (assuming the lenders will want to see their panel firms hold comparable cover to existing MTC, which is what we expect)

- This may mean sole practitioners and small firms won’t be able to act for lenders

- More separate representation as a result

[3] The Law Society Gazette, 5 June 2014.

- Potentially a shift towards more lenders using Licensed Conveyancers in light of their master policy cover

"*Additionally we do not believe there is evidence to sustain the SRA's views that premium levels will reduce as a result of the changes. The minimums they propose for individual claim limits and for run-off, we suspect will not impact significantly on the premium levels. We understand that it was not the insurance market driving this consultation.*"

28. The threat of lender reaction to the proposal is not a hollow one. The HSBC's short-lived introduction in 2012 of a restriction that homebuyers could only instruct one of a panel of just 43 of Countrywide's panel firms resulted in consumers who still retained their own conveyancer reporting transaction delays and increased costs. The situation was reversed after the Law Society intervened and reached an agreement with the HSBC to amend its conveyancing approach to enable all solicitors accredited with the Law Society's Conveyancing Quality Scheme (CQS) to act for the HSBC as well as its mortgage customers, expanding the number of firms carrying out the work to more than 1,400. The proposal threatens to result in restricting that number severely across all lender consumer services.

29. In addition to the threat of loss of work from lenders, the current business model of many small firms will be under threat of further loss of work from charities and trusts, which might go to larger firms for the reassurance that size will be an assumption of sufficiency of cover. Work requiring undertakings to be given by small firms during the course of commercial transactions will be under similar threat since larger firms will not wish to risk the smaller firm lacking sufficient PII cover. This additional erosion of the work available to smaller firms will contribute adversely to the viability of their business model and of their presence on the high street. It is important to remember that a significant number of firms in this category are owned by or employers of BAME solicitors and this risks also the diversity of the profession.

30. A further unfortunate consequence could be that of a further 'Balva' scenario in which an unrated insurer with an unsustainable business model will see a ready profitable entry opportunity and sell minimum compulsory PII cover at a lower premium – at an unsustainably low premium. The consumer detriment from past insurer failure in the PII market is all too recent and familiar. The risks here need to be addressed rather than heightened.

31. In conclusion, the SRA has provided no proper evidence to justify the proposed reduction of the limit of cover to £500,000 nor any research or consultation data to suggest that it will result in a lowering of premiums. It seems far more likely that premiums will rise. Indeed, the consultation paper is silent on the CRA's finding that the experience of the Irish Law Society when implementing similar changes resulted in premiums almost doubling.[4]

[4] CRA report, page 167.

Those cost increases will inevitably be passed on to consumers who will also be subjected to increased risk.

Question 2: Do you agree with introducing a cap on insurers' liability?

32. The cap on limiting insurer exposure is intended to result in cost savings (presumably for insurers) from which the consumer will benefit. The absence of an identified appropriate monetary cap level in the SRA's consultation paper, coupled with the clear lack of understanding of the 'claims made' basis of PII, is deeply troubling, coming from an organisation which is championing the protection of consumers. This proposal too has overlooked the fact that in a 'claims made' insurance system, firms will, in practice, need to ensure that they are covered for all claims arising from previous years.

33. In our view, the following problems will arise:

    - Firms, in practice, are unlikely to be in a position to be certain about a 'safe' level of insurance, given the 'claims-made basis of the system;
    - Amounts above the cap will be the responsibility of the firm and, if the principals are not able to satisfy those, it may, under some employment contracts, be possible to sue employees and former employees. This will lead to consequences which will be unfair on the individuals in that such employees could not have forseen the risk or protected themselves against such a risk. Potentially, this could impact on their employability in subsequent firms and have the power to destabilise their current firm;
    - Consumers will be unable to judge whether a firm's insurance is sufficient because they will have no picture of the firm's overall work and, in any case, the crucial time for the cover will be some years in the future;
    - If the insurance will not cover the case, the consumer will have to go against the practitioner or other partners personally, which is unlikely to be in their interests;
    - While this may cap an insurer's exposure, it is not clear how often this will make a difference in practice or whether that difference can be passed on in lower premiums;
    - Astute consumers will take their future business to a larger firm where there might be more confidence of sufficiency of cover and, indeed, greater level of protection, hence removing work from smaller high street firms, reducing access to justice and adversely affecting BAME solicitors.

34. It is not clear why this change is or will be in anyone's interest but insurers', or how it will assist client protection. The result seems likely that there will be no protection against, or compensation available, for instances of some of the most notorious and high-value serial claims (particularly those based around fraud).

Question 3: Do you think any such cap should be £1,500,000, £5,000,000 or another figure?

35. It is not a question of where should the minimum compulsory cover for any one and aggregate claims be set. This proposal is fundamentally flawed and should be dropped since it places both consumers and firms in an intolerable level of risk. Consumers cannot be expected to ask whether each and every claim will be included and should not bear the risk that they might not if they emerge as a claim in the future because the SRA got the level of aggregation cap wrong. The 'any one claim' wording should remain.

Question 4: Do you agree that the introduction of a cap should be balanced by reducing the opportunity for claims to be added together to treat them as 'one claim'?

36. As will be clear from the responses above, we believe that the disadvantages of a cap will not be balanced by any advantages arising from a reduction of the opportunity to argue that claims should be aggregated.

Question 5: Do you agree with limiting the compulsory cover requirements to individuals, small enterprises, charities and trusts?

37. The proposal that compulsory cover should be available only in respect of claims from individuals, small enterprises, charities and trusts and exclude large clients, in particular lenders and the financial institutions, is linked to the proposal in the separate consultation paper on restricting eligibility to claim from the Compensation Fund. It will give rise to the supply and consumer concerns discussed in preceding paragraphs in relation to conveyancing work and lender institutions.

38. The proposal is also fraught with difficulty since it is linked to the 'claims made' problem. The consumer risks already identified might be further exacerbated by the expectation that that a firm will be able to assess, when carrying out a client's business, whether the client's turnover is going to be less than £2 million at some unstated relevant given time.

39. Clearly there is scope for debate about the extent to which large financial institutions should be covered. However, it is naïve to assume that such bodies will not require firms to hold such cover. Indeed, this is crucial to ensuring a wide choice of solicitors and diverse range of suppliers. The insurance market has shown itself able to manage the risks of these under the present arrangements and to adapt the premiums of those who do not work for such bodies accordingly. It is hard to see how any savings will arise from these proposals.

Question 6: Do you agree with reducing the run-off cover to 3 years?

40. The assumptions underpinning this proposal are flawed and if it is implemented, a large number of consumers' claims will not be met. The consultation paper does not address how consumer losses will subsequently be redressed.

41. This proposal is based on the assumption that 60 per cent of claims are made within the first three years after a firm's closure. This is a misreading of the CRA report's analysis on run-off cover. As we note above, the CRA found that it can it take several years for a claim to emerge and that while claims are still outstanding, there is absolutely no certainty as to the value of those claims that will actually be paid. It also found that insurers typically take between one to three years to deal with claims. The consultation paper has not taken account of the CRA conclusion that :

> '...*we consider it appropriate to use a period of time that is greater than 3 years and have chosen a period of 6 years*'.[5]

42. The development curve of conveyancing experience and time lag for claims up to last year can be demonstrated by the SIF. For firms dealing with negligence claims, generally the time limit runs from the date of knowledge, or in respect of someone who does not have capacity to conduct their own affairs, from when they have such capacity, for some individuals, time never runs against them. Therefore, although such claims may be relatively rare, there is potentially no limit to when such claims may emerge, but in cases of this type claims could be made well beyond the three or even six year limit.

43. The proposal, if implemented, will be a nightmare for consumers who find themselves without protection. There have been suggestions that the Compensation Fund will pick up claims arising from this (and it would be wrong for it do so). Consumers will, therefore, be left with no recourse but to take action against individuals, including former partners and, possibly, employees of the firm (see our points in respect of the cap at para 32 above). It is by no means certain that consumers will actually be able to seek redress in this way, particularly if the practitioner has retired abroad or has inadequate assets to meet the claim. This will erode the existing confidence that consumers have in a profession that up to now has been able to ensure no clients suffer loss.

44. The option for purchasing extended run-off cover, assuming the market is prepared to offer such a product to practitioners whose past history - and hence their risk profile - might not be known, will not result in lower costs and the higher costs will be passed on to consumers. The Law Society accepts that there are problems with the present arrangements but it is not acceptable to put this level of risk on consumers who may be significantly out of pocket with no chance of redress.

Question 7: Do you agree with the proposed changes to Code of Conduct Outcome?

45. While it is obviously right that practitioners should be aware of the limits of their cover and assess their exposure, this proposal will place another additional layer of burdensome regulation on small firms - one which does not exist under the current MTCs. While self-assessment is the norm for larger

[5] CRA report prepared for the Solicitors Regulation Authority, Review of SRA client financial protection arrangements, page 84 and 85.

firms, it will be smaller firms that will feel this burden the most, including those carrying out conveyancing work. Additionally, our comments above on the 'claims made' nature of PII work and on aggregation apply. If the firm gets the assessment wrong, it will be subject to sanctions - assuming that the SRA has the expertise and resources to assess annually the 11,000 PII policies. Those firms which innocently fail will be punished while those determined to circumvent requirement will no doubt do so.

Question 8: Do you have any views about our assessment of the impact of these changes?

Timing

46. The SRA consultation paper is explicit that no impact assessment or equality and diversity assessment has been carried out.

47. The proposed timing is too tight. The six week consultation period does not give adequate time to address the likely unforeseen consequences of these changes. Industry stakeholders, moreover are clearly indicating that there is insufficient time for them too to react to the changes should the proposals be implemented. Given the likely impact of these changes, we urge that these proposals should not be introduced and that there should be proper time taken to consider the impacts and alternatives.

Proposals are inconsistent with standards for consultation

48. The Law Society does not agree with the SRA that this consultation is consistent with good practice on consultation.[6] The short deadline for responses, failure to update old data and statistics and to consult stakeholders, the lack of supporting evidence for the theory of consumer welfare benefit that is expected to flow from the proposed changes and most worryingly, the re-stated intention to go ahead with implementation in October which will not allow time for the market to adjust and to educate and produce guidance for firms, seem totally at odds with the Regulators' Code.

49. The SRA is trying to act like an economic regulator by introducing measures to re-engineer the market for legal services in order to increase consumer access but without the rigours applied to consultation for making such changes - see for example the Competition and Markets Authority (CMA) guidance Rules of Procedure for Merger, Markets and Special Reference Groups.[7] These principles are not there to delay but to ensure that proper consideration is given to policies which are likely to have a significant impact on consumers and providers.

Question 9: Are there any impacts, available data or evidence that we should consider in finalising our impact assessment?

50. See above. In particular, there needs to be an answer to the questions:

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[6] Department for Business Innovation & Skills Better Regulation Delivery Office Regulators Code. April 2014.
[7] CRA report prepared for the Solicitors Regulation Authority, Review of SRA client financial protection arrangements, page 84 and 85.

- Will these proposals in fact have any effect on premiums?
- What are likely to be the impacts on consumers?
- What are likely to be the impacts for the profession through the Compensation Fund?
- What will be the impacts on BAME firms and their clients?
- What are likely to be the effects of lenders and other bodies relying on the profession?

Question 10: Are there any other aspects of the minimum terms and conditions for PII that you think we should review?

51. The SRA has relied on some, but not all of the recommendations and principles in the CRA report. As already stated, the Law Society believes that any review of the PII market and rules needs to be carried out holistically. It is not appropriate to make individual significant changes which may have significantly detrimental effects to consumer and the legal services market without a full analysis.

52. The Law Society's PII Committee informed the SRA earlier this year of a number of work areas concerned with the MTCs and their effectiveness which we believe should be examined. These include:

    - A proper formal analysis of why there has been instability in the solicitors' PII market so that changes, based on evidence rather than anecdote, can be considered.

    - How to overcome problems with data matching and data compilation. This would help in spotting trends in claims and concentrate resources on the main areas (either by work or firm type) where these are occurring. It will assist the SRA's regulatory objectives and make things easier if things go wrong, for example, by knowing immediately which firms insure with, say, Balva and who relies on Balva for run off. It will provide open, objective and transparent data to insurers and brokers and that would encourage wider participation in the market. It will enable firms to understand the costs of their insurance.

    - Work to examine how to reduce the barriers and costs of retirement (run-off cover).

    - The lessons learned from Balva and from last year's Extended Indemnity Period.

53. The Law Society remains open to discuss these issues further with the SRA.

THE LAW SOCIETY'S COMMENTS TO THE LSB ON THE SRA'S ASSESSMENT OF ANTICIPATED IMPACTS

1. The Law Society requests the LSB to consider the additional observations made after full consideration of the SRA's assessments of impacts made in the SRA Board Paper of 2 July and in the SRA's 15 July application, 'Changes to the Participating Insurer's Agreement and Regulatory Arrangements' application to the SRA.

   Timing

2. The application recognises, at paragraphs 73-75, that already, the timetable for the market's preparations for the 1 October renewal has slipped considerably. We do not share the SRA's belief that a decision by the LSB at the end of August, on such a controversial change is still feasible because:

   a. Firms will not necessarily have the time to consider their full insurance needs properly;
   b. The insurance market is unlikely to have the flexibility to develop new products.

3. The rush may well lead to firms buying inappropriate policies and to ill-thought through behaviours by lenders (see below). Anecdotal information suggests that the uncertainty pending the LSB's decision is creating confusion in the market and will add to the bottle-neck of policies to be renewed on 1 October. This does not help any of the players. Moreover, there is no "burning platform" to suggest that the decision with the potential impacts that we discuss below needs to be taken so swiftly.

   Body of concern about negative impacts and lack of supporting evidence

4. The number of respondents opposed to the proposal is striking. According to the SRA, of the 142 respondents, 92 were against the £500,000 proposal; 34 supported it, and 16 were 'unsure'. There is not a full analysis of the responses, but it is implicit that only one insurer supported the proposals, while every other industry body, other than the Law Centres Federation, appears to have opposed them. While consultations are not referendums, the fact that so many are against the proposal ought, of itself, to require considerable thought and analysis. It is notable that the Association of British Insurers (ABI), in commenting on the 4 July on the SRA Board's decision, issued a statement criticising the decision:

   'Reducing the minimum level of PII cover for solicitors does not change the risk profile of the firm and only increases the risks to consumers if things go wrong. Consumers will end up paying the price because the SRA thinks solicitors should save money rather than protect consumers. The SRA is misguided in thinking that lowering the limit will lead to a meaningful reduction in premiums for small firms.

   'The SRA has not made a final decision on whether consumers who are failed by a lower PII limit will be able to make a claim from the compensation fund. If they can, this will result in an increased levy on those firms who make prudent and sensible arrangements for their own PII cover.

   'The Legal Services Board needs to ask itself whether the SRA's proposals are a good outcome either for the legal profession or, more importantly, the profession's customers'.

5. We also question whether the SRA had sufficient time to do a full and objective analysis of the responses. As an example, it is disturbing that the SRA, correctly, refers to QBE as

giving some support to the proposals and as suggesting that there may be a decrease in premiums (the only insurer to do so). However, the QBE response is significantly more nuanced than this would suggest and indicates that it would not itself offer cover of less than £1m. Since QBE is the only insurer that the SRA can find to support the proposals, it is concerning that the full flavour of the response appears not to have been put to the SRA Board. Many of the responses are not available to the public and we consider that it might be appropriate for there to be a fuller analysis of exactly what was said.

Impact on premiums

6. It would be surprising if there were no reduction in premium for those firms that decide that they need only the minimum cover. However, the SRA makes no assessment at all of the additional costs of top-up cover for firms. It also indicates that insurers are likely to offer cover on the same terms as at present for a similar price.

7. It is quite clear from the evidence given by insurers and from common prudence that the overwhelming majority of firms will need substantially more cover than £500,000. Firms will therefore need to purchase top-up cover. Top up cover is a separate policy and includes all the usual costs of underwriting and assessment. Essentially, the SRA will be removing the economies of scale that exist out of quoting for a single bulk policy and replacing it with two policies, the terms second of which may vary widely within the market. It seems likely that the costs of two policies to take cover up to £2m may well exceed the current cost of the single policy. Indeed, we are aware of one insurer that, if these are approved, plans to offer a policy replicating the existing cover but at nearly double the current premium, thus contradicting the advice that the SRA has received.

8. In looking at the impact, we would have expected that the SRA would have looked at the number of firms likely to need top up cover, together with the additional cost of that cover and consider the extent to which this might add or reduce the cost of insurance overall. Inevitably, this would be speculative but the absence of this research and or evidence of this sort of discussion with insurers is concerning. Insurers are unlikely to want to reduce the amount that they take from the market and this proposal provides an opportunity to increase it.

Impact on cases covered

9. The MTCs incorporate a number of protections which are unusual in commercial policies. For example, there is very limited ability to cap liability or to avoid the contract for non-disclosure. Run-off cover will be provided even if it is not paid for. These provide important protections for the public. They were part of the protections insisted upon by the then Master of the Rolls when he agreed to the profession moving from the Solicitors Indemnity Fund to the open market in 2000. These requirements will not apply to top-up cover and there is already evidence of insurers reducing their exposure by taking away elements of the MTCs from top-up arrangements. Individual firms are unlikely to have any power to change that. In our view, the SRA should have sought to assess (a) the impact of this and (b) how it would affect price. It seems quite possible that, as a whole, the profession and its consumers may end up paying more for reduced overall protection.

Impact on the Compensation Fund

10. The SRA paper, while stating that the Compensation Fund is not intended to become a top-up fund, recognises that there is some scope for applications to the fund by consumers who are without redress as a result of these changes. This is unacceptably vague. It is essential for the SRA to be clear about what will and will not be covered by the Compensation Fund and the likely impact. It seems very likely that there will be additional claims coming to the Compensation Fund as a result of this and, therefore, an increased burden. If, in fact, this outweighs any savings from reduced insurance premiums, the exercise will be nugatory.

Impact on Lenders' behaviour

11. The application briefly discusses the implications of the proposal for firms carrying out mortgage conveyancing work and refers to the response to the consultation of the Council of Mortgage Lenders. We believe that those concerns need to be taken very seriously indeed, partly because of what they say but also because of the likely behaviour of lenders. The SRA may or may not be correct that the proposed cover will be sufficient for the bulk of conveyancing transactions, but recent experience has not always shown that lenders act in a proportionate way to perceived problems. Lenders have considerable power to choose firms which are on their panels and so act for both themselves and the borrower. Short of clear breaches of competition law there is no mechanism to require them to ensure that they maintain panels of a particular size and coverage. The Society has worked closely with lenders to try to restore confidence in conveyancing practitioners and to ensure that there remains a strong supply of solicitors for consumers to choose from.

12. It is disturbing that the SRA has not held more discussions with lenders to establish an idea of the sort of level of cover that lenders would expect from firms undertaking conveyancing work and what, for them, are key features of the MTCs to ensure that lenders have confidence in the system. Without this, it is likely that lenders will insist upon their own requirements which may or may not be practical for firms to achieve: it may be that additional cover will be out of the reach of smaller firms or be practically unobtainable for them on the market. This would not be inconsistent with the approach of lenders in recent years and would mean that competent firms of solicitors would leave the market, reducing client choice. If this were to happen in the course of a policy year (as the Yorkshire Building Society did when it required firms to have cover with a rated insurer) then that might cause significant disruption in the market. The SRA has no levers to prevent this.

Impact on cost of regulation

13. The proposals provide two new requirements for firms: to assess their likely insurance requirements and, if they exceed the minimum, to do the extra work necessary to source the additional cover on the market. While both are obvious things that a prudent firm should do, they still represent new burdens which were unnecessary for most small firms because the cover was, broadly, sufficient to cover the overwhelming bulk of claims they were likely to face. Assessing cover needed is more complex than simply the value of a transaction. Two of the most basic cases on solicitors' PII relate to a straightforward lease where the solicitors got the drafting of leases disastrously wrong so that significant claims for lost profits arose. It is not unusual for an apparently low-value personal injury case to turn into something more serious later. Firms will need (a) time to assess the level of insurance that they need, (b) education on how to do so and (c) guidance from the SRA on what a reasonable approach would look like. There is not the time to do this now.

Impact on access to justice

14. It is trite economics to suggest that a lowering of the costs of business is likely to encourage more entrants. However, the effect of these proposals may be to reduce costs for one part of the profession but increase them for another, probably greater, part. The SRA makes no attempt to show how far even a 15% reduction in premiums is likely to make all the difference to firms who might enter the market and how far this may be outweighed by an increase in costs elsewhere. For example, the reduction may well assist firms dealing with housing and benefits cases, but those advising SMEs are likely to need significantly greater cover than the minimum.

15. The Board paper concludes that the implementation of this proposal will be positive. Rather than consult on the impacts, it has chosen instead to monitor the change - at the Board meeting, it stated that it would monitor developments through the Law Society Annual PII survey. By then it will be too late to reverse any damage which might emerge. This is not acknowledged. At the end of paragraph 26 of the impact statement, it states that:

    '*this will be the first time that insurers will be able to compete on coverage terms given the new limit, and we will need to monitor the market and ensure the next stage of reforms takes into account any developments*'.

16. Implementing this change without a proper analysis of impact in advance, on the basis that its effect can be monitored, introduces an unacceptable new risk to firms and to consumers.