

To:	Legal Services Board	
Date of Meeting:	26 May 2016	Item: Paper (16) 36

Title:	Thematic review of restrictions on choice of insurer	
Workstream(s):	Breaking down regulatory barriers to competition, innovation and growth	
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Status:	Official	

Summary:

This paper gives an overview of the scope and findings of the thematic review of choice of insurer, a strand of the LSB's 2015-16 business plan. **Annex A** contains our analysis to date. Our assessment of current regulatory arrangements will be published in quarter 1 of 2016.

Professional indemnity insurance (**PII**) plays an important role in the provision of legal services. Regulatory requirements seek to protect individual consumers against mistakes by regulated persons and promote confidence among the general public to engage in the sector. Research across different professional groups indicates concerns around the cost of PII and that it acts as a barrier to market entry, exit, mobility and to innovation. Changes made by some ARs to permit wider choice of insurer have reported cost savings for practitioners.

The review did not analyse the costs of PII but instead took a high-level look at the issue of choice of insurer. This is only one aspect of a complex subject and it is important that ARs understand and monitor this issue. The review did not focus on any particular set of regulatory arrangements and did not seek to set out the 'right' answer. It recognised that depending upon the circumstances there could be advantages and disadvantages to different approaches to delivering PII. The analysis has identified points that ARs should give thought to in the light of changes in the legal sector, including their duties in relation to them by the regulatory objectives and best regulatory practice.

Our views are consistent with the independent advice we commissioned from the Regulatory Policy Institute (**RPI**). This advice and our assessment of the ARs' arrangements will be published. RPI's advice offers information and assistance to ARs, including in the form of questions and data to make decision about any restrictions they may wish to impose.

In releasing the assessment the LSB will not be formally exercising its powers under the Legal Services Act 2007 (**the Act**). We will be giving a clear signal on our views and encouraging ARs to adopt the conclusions. Publication will bring this strand of work to a close, but we will give consideration to returning to this issue in the future; potential options for follow-up work are outlined under next steps.

Recommendation(s):

The Board is asked to note the findings of our thematic review of regulatory restrictions on choice of insurer at **Annex A**, which is intended to be published as an assessment of current arrangements in quarter 1.

Risks and mitigations	
Financial:	N/A
Legal:	[REDACTED]
Reputational:	[REDACTED]
Resource:	N/A

Consultation	Yes	No	Who / why?
Board Members:	X		As the nominated Board representative for this project, Marina Gibbs has been involved at scheduled intervals during its delivery.
Consumer Panel:		X	
Others:			[REDACTED]

Freedom of Information Act 2000 (FoI)		
Para ref	FoI exemption and summary	Expires
Risks and mitigations: Legal	Section 42: information subject to legal professional privilege	N/A

Risks and mitigations: Reputational	Section 36(2)(b)(ii): information likely to inhibit the exchange of views for the purposes of deliberation	N/A
Others row; Para 6, last sentence; Para 19, last sentence	Section 41: information provided in confidence	
Annex A	Section 22 – the analysis of current regulatory arrangements is intended for publication in June 2016	N/A

LEGAL SERVICES BOARD

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Thematic review of restrictions of choice of insurer

Recommendations

1. The Board is asked to note the findings of our thematic review of regulatory restrictions on choice of insurer at **Annex A**, which is intended to be published as an assessment of current arrangements in quarter 1.

Background

2. The decision last year to initiate a thematic review reflects the importance of professional indemnity insurance (**PII**) in the provision of legal services. Securing some level of PII is generally appreciated as being in the interests of practitioners, given that its function is to cover claims associated with work-related mistakes. This is reflected in research that indicates many practitioners would look to put it in place regardless of any requirement to do so.¹ However, it also has a wider benefit to the legal profession in protecting its reputation as a whole. As these incentives may not be sufficient to deliver the regulatory objectives, approved regulators (**ARs**) have intervened with regulatory arrangements in order to avoid harm to individual consumers and to maintain public confidence in the sector.
3. Research has identified concerns among legal services providers about PII. It represents a continuing significant operating cost, plus acts as a barrier to entry, exit and mobility.² Additionally, PII requirements for barristers have been reported as impeding service development and innovation.³ Among other things, this can have implications for access to justice.
4. Since PII is likely to raise issues that span ARs it is appropriate for the LSB to exercise its oversight role in relation to this topic. While we aim to inform thinking, ARs are best positioned to access and analyse relevant information with a view to determining their respective regulatory requirements.
5. The issue of choice of insurer was highlighted during the latter stages of a 2014 application by the Bar Standards Board (**BSB**) to change its regulatory arrangements to enable it to authorise lawyer owned entities.⁴ The BSB sought to extend its existing requirement on self-employed barristers – to secure their primary layer of PII from the Bar Mutual Indemnity Fund (**BMIF**) – to single-

¹http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2015/LSB_Cost_of_Regulation_Survey_Report.pdf

² <https://research.legalservicesboard.org.uk/wp-content/media/RPI-Final-Report-for-LSB-and-TLS-15-December-2013.pdf>

³ <https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf>

⁴ Section 21 of the Legal Services Act 2007 provides that an approved regulator's regulatory arrangements includes indemnification arrangements, which are *arrangements for the purposes of ensuring the indemnification of those who are or were regulated persons against losses arising from claims in relation to any description of civil liability incurred by them, or by employees or former employees of theirs, in connection with their activities as such regulated persons*

person (but not multiple-person) entities.⁵ This appeared, at least in part, to be driven by concerns raised by BMIF about its viability in the absence of regulatory compulsion. Following discussion with us the BSB decided to address PII requirements for these entities separately.

6. The BSB consulted on insurance requirements for single person entities in June 2015⁶ and recommended to its Board in July 2015 that a rule change application be made to require them to obtain their primary layer of PII from BMIF.⁷ We have not yet received an application, although we have been clear on points that we would expect an application to address. In the meantime, there have been lower numbers of entities than were forecast. [REDACTED]
7. This review, though, is not specifically focussed on the BSB's arrangements and is fully distinct from any rule change application that it may bring forward.
8. The general direction of travel among ARs on this issue has been toward competition, i.e. broader choice of PII provider. Although this has not been without some debate, changes to permit choice of insurer have been reported as bringing about continuing benefits in terms of cost savings.^{8,9} For example, the SRA (which has experience of most insurance models), CILEx Regulation (in relation to entities) and CLC have allowed choice (with the CLC now consulting on withdrawing its master policy PII arrangement that entities can currently opt out of).¹⁰ In contrast the BSB is an outlier in applying restrictions on the majority of those it regulates.
9. While at present conditions for securing PII in these 'open' markets are described as good for most practitioners, this has followed a period of reported 'turmoil' for solicitors and varied factors mean that these conditions are not assured going forward.
10. In focussing on the basis for intervention around choice of insurer, the review represents a starting point in considering this important and complex subject.

Purpose of this paper

11. This paper explains the thematic review's objectives and scope, as agreed by the Senior Leadership Team. It then delivers on commitments in the project initiation document to:
 - a. deliver a report to the Board on the review's findings
 - b. deliver a draft publication (at **Annex A**) setting out our findings in more detail.

⁵ Which we understand the BSB may take to mean one authorised (but not necessarily barrister) owner, but potentially with other authorised person employees.

⁶https://www.barstandardsboard.org.uk/media/1662760/consultation_paper_on_insurance_requirements_for_single_person_entities_-_pdf_-_final.pdf

⁷ https://www.barstandardsboard.org.uk/media/1681399/bsb_part_1_agenda_150723.pdf

⁸ <http://www.sra.org.uk/sra/how-we-work/reports/cra-financial-protection-arrangements.page>

⁹ <http://www.lawsociety.org.uk/news/press-releases/law-society-annual-professional-indemnity-insurance-survey-confirms-favourable-market-for-firms/>

¹⁰ <http://www.conveyancer.org.uk/Latest-news/2016/May/Consultation-on-new-arrangements-for-Professional.aspx>

The review's objectives and scope

Objectives

12. The business plan said that the review would:¹¹

- analyse regulatory requirements that restrict individual and entity choice of insurer
- aim to identify the potential positive or negative costs of such restrictions and the impact of removing them
- consider whether the restrictions identified are consistent with general competition law, the regulatory objectives and better regulation principles.
- In terms of approach this involved understanding the rationales for different approaches taken to choice of PII providers by legal sector regulators over time, including taking into account market changes and the experiences of relevant stakeholders. We have also secured advice on economic and regulatory principles relevant to this work and how these might be applied, as independent context for our work.

Scope

13. The scope of this work was focused on providing a high-level assessment and conclusions on the specific issue of regulatory restrictions on choice of insurer. This approach took account of available resources and risks associated with the potential to go beyond the LSB's expertise and remit, particularly with respect to competition law.

14. As such, the review was not intended to set down the 'right' answer for any AR, and determine what particular regulatory arrangements should look like. To be clear, although discussion with the BSB prompted us to look at this subject, this work is not about that regulator specifically. Equally, while a LSB publication might seek to assist an AR's thinking, and may inform any further work we do on this subject (discussed below under next steps), our findings will not fetter LSB's decision making on any rule change application.

15. While undoubtedly of relevance to the discussion at paragraph 3, other aspects of PII such as minimum terms and conditions on which it must be supplied were beyond the scope of this review.

Overview of the review's findings

16. The effects of PII on consumers and legal services providers underlines the need for ARs to understand the PII market, not just in terms of the options for provision, and to monitor the appropriateness of their regulatory requirements.¹² While ARs may not have duties or powers in relation to the PII market, how that market functions can have a significant impact on provision of legal services.

17. ARs have used a range of approaches over time, with each presenting different advantages and disadvantages. The point, though, is that regulatory requirements must be considered from first principles. We are interested in, whether setting limits on choice is warranted and, if so, what is the least burdensome

¹¹ *Breaking down regulatory barriers – reviewing and removing regulatory obligations*

¹² This may include taking account of the decisions of other ARs and insurers. For example, the size of the total PII premium associated with solicitors in England and Wales means that the ability of other practitioners to secure insurance could conceivably be affected by decisions made by the SRA.

regulatory response. Advantages and disadvantages may inform the assessment of options if a response is needed.

18. Our findings are supported by the independent advice we obtained from the Regulatory Policy Institute (**RPI**). A copy of that advice is available at the Board meeting or on request. It offers a valuable and accessible resource that we could expect ARs to use. It identifies questions that an AR should ask itself about its regulatory requirements when considering restrictions on choice and data that should be sought to inform its consideration. The ease with which this can be done is likely to vary, but data and support are available, as are good examples of ARs taking steps to overcome data deficiencies.
19. ARs also need to be mindful of competition law in their work. For example, the Office of Fair Trading investigated the Law Society of Scotland's PII arrangements between 2003 and 2005. The Competition and Market Authority's (**CMA**) current investigation of the energy market highlights the potential for regulatory action to be found to have an adverse effect on competition. [REDACTED]
[REDACTED]
[REDACTED]

Publishing the findings

20. Subject to finalising drafting, including in the light of the Board's comments, publication is planned at the end of June 2016. It is suggested that the findings are presented as an assessment of current arrangements. This approach was taken, for example, with the 2014 review of regulatory sanctions and appeals processes.
21. A risk, though, is that ARs may not take account of our conclusions, which will not be binding (this is the case for all thematic reviews). This is highlighted in the draft report in relation to the LSB's position on the meaning of the regulatory objectives. Where appropriate we will seek to address this at the Chairman's quarterly meetings with ARs, through providing a clear signal on the LSB's views and encouraging the ARs to have regard to them. We could, however, choose to revisit this subject at a future date. Possible options for further work at that point are outlined below under next steps.

Next steps

22. We do not at this stage have plans to engage with individual ARs, beyond highlighting key points from our work through the LSB's programme of meetings and in relation to relevant rule change applications. To be clear, however, decision making on these applications will not be able to have regard to the views we have set out in our review because it is not binding or indeed formal guidance.
23. With regard to the point above at paragraph 21, depending on actions taken by ARs and other evidence that may subsequently emerge, it is possible we may decide to revisit this subject in the future. At this point, options for further work that we may consider as part of future business planning currently include:
 - guidance under section 162 of the Legal Services Act 2007 (**the Act**). Key points from the LSB publication could be issued as guidance. The Act then allows us to have regard to the extent to which an AR has complied with this when exercising its functions. While the Act does not require it, best practice is for the LSB to consult before issuing guidance

- a policy statement under section 49 of the Act. This would provide a set of principles against which requests to approve or alter regulatory arrangements can be considered. Actions would therefore be as incumbent on the LSB as they would be for ARs
- a more detailed analysis of any concerns we have about particular regulatory requirements and associated options available to the LSB, appreciating that this paper and the assessment at **Annex A** are not directly concerned any individual AR.

26.05.2016