

To:	Board	
Date of Meeting:	26 November 2014	Item: Paper (14) 63

Title:	The Solicitors Regulation Authority application seeking approval of changes to its regulatory arrangements: SRA Amendments to Regulatory Arrangements (Miscellaneous No.1) Rules [2014] and SRA Indemnity Insurance Rules [2014].
Workstream(s):	Statutory Decisions
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Status:	Official

Summary:

On 15 July 2014 the Legal Services Board (**LSB**) received an application from the Solicitors Regulation Authority (**SRA**) for approval of changes to regulatory arrangements on professional indemnity insurance (**PII**) cover. The application set out two principal changes:

- the introduction of a new outcome in the SRA Code of Conduct 2011 for SRA regulated firms (including sole-practitioners and partnerships) to assess and purchase an appropriate level of PII cover;
- the reduction in the minimum amount of PII cover for SRA regulated firms (including sole-practitioners and partnerships) from £2 million (£3 million if a firm is incorporated) for any one claim to £500,000.¹

The principal changes were assessed against the criteria for refusal in paragraph 25, Part 3 of Schedule 4 to the Legal Services Act 2007 (**LSA 2007**). In making a decision the LSB may grant an application in whole or in part. To refuse an application, the LSB Board must be satisfied that the application meets one or more of the refusal criteria. The LSB's assessment against the refusal criteria concluded that:

- the proposal of a new outcome to the SRA's Code of Conduct did not satisfy any of the refusal criteria and the Executive recommends to the Board that this proposal should be granted.
- the change relating to the proposal to reduce the minimum level of PII cover from the current level of £2 million (£3 million for incorporated firms) to £500,000 satisfies any of the refusal criteria and the Executive recommends to the Board that this proposal should be refused.

In addition, the application contained further technical amendments relating to:

¹ Unless the claim relates to any insurance mediation activity in which case the limit relating to such activities is the amount required to comply with the requirements of the Insurance Mediation Directive applicable at outset, extension or renewal of the policy. This is currently € 1,120,200.

- the SRA’s Professional Indemnity Insurance Minimum Terms and Conditions of Cover to clarify when run-off cover comes into force;
- the introduction of an international trade sanctions exclusion;
- some of the definitions in the SRA Handbook Glossary.

The LSB’s assessment is that the further technical amendments do not satisfy any of the refusal criteria and the Executive recommends to the Board that the amendments should be granted.

The LSB’s scheme of delegations requires that the Board makes any decision to refuse (either in whole or part) an application made under Part 3 of Schedule 4 to the LSA 2007.

The Board is therefore asked to grant this application in part and to note the draft decision notice in **Annex A** (the draft decision notice will follow this paper, to be circulated to Board members before the meeting).

Recommendation(s):

The Board is invited:

- (1) to agree that the application is granted in part namely the proposal of a new outcome to the SRA’s Code of Conduct and further technical amendments to the SRA’s regulatory arrangements and to refuse the proposal to reduce the minimum level of PII cover from the current level of £2 million (£3 million for incorporated firms) to £500,000.
- (2) to note the draft decision notice set out in **Annex A** and to delegate the finalising of the wording of the decision notice to the Chairman and Chief Executive (the draft decision notice will follow this paper, to be circulated to Board members before the meeting).

Risks and mitigations

Financial: None

Legal: There is a risk that the SRA will seek to challenge the decision through a judicial review, however, after informal communication with the SRA we assess that this is a low risk. We have also received external legal advice that supports the LSB’s rationale for a decision to grant the application in part.

Reputational: The fact that the change introducing a new outcome has been granted without what is seen to be the “balancing” potential reduction in PII premium may be seen as an increase in regulation (see paragraphs 29 to 32 of this Board paper).

Resource: None

Consultation	Yes	No	Who / why?
Board Members:	√		Ed Nally and Marina Gibbs have provided input as the application has progressed.
Consumer Panel:		√	While not formally invited to comment, the Consumer Panel did submit a letter to the LSB on the application.
Others:	The LSB does not conduct a public consultation process on any rules change application it receives. However, when we published the SRA's application, a number of individuals and organisations submitted correspondence stating their opposition to one of the principal changes set out in the application. The LSB invited the SRA to respond to those submissions and in the interests of transparency, all submissions and the SRA response were published on the LSB website and will be available at the Board meeting. We have also sought external legal advice (see paragraph 22 to 24 of this Board paper and Annex B) on our proposed decision and the draft decision notice.		

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
Annex A	Section 22 – this is the draft version of the document. The final version is intended for future publication which may include some minor changes depending on the outcome from the Board meeting.	N/A
23 and Annex B	Section 42 – this is confidential legal advice received from external counsel obtained by the LSB to help the Board make its decision.	N/A

LEGAL SERVICES BOARD

To:	Board	
Date of Meeting:	26 November 2014	Item: Paper (14) 63

Solicitors Regulation Authority's (SRA) application seeking approval to changes to regulatory arrangements: SRA Amendments to Regulatory Arrangements (Miscellaneous No.1) Rules [2014] and SRA Indemnity Insurance Rules [2014]

Background / context

1. The SRA has embarked on a programme of regulatory reform. On 7 May 2014 it published a consultation paper which contained the following proposals:
 - to reduce the compulsory level of cover to £500,000 for any one claim for all firms, with no distinction between different types of firm;
 - to introduce a cap on insurers' ultimate exposure through a new aggregation limit;
 - to limit the range of clients covered by compulsory PII to individuals, small and medium enterprises (businesses with turnover not exceeding £2 million), charities with income of less than £2 million and trustees of a trust with a net asset value of less than £2 million;
 - to reduce the period for which run-off is to be maintained from six years to three years;
 - to introduce an additional outcome to the Code of Conduct; "You assess and purchase the level of cover that is appropriate to your current and past practice, taking into account potential levels of claim by your clients and others and any alternative arrangements you or the client may make".
2. The consultation period lasted for six weeks and 142 responses were submitted.
3. There were mixed views on the proposals from some respondents. A common theme of the responses was the lack of impact assessment evidence to support some of the detailed proposals; the apparent haste at which the consultation was being completed; and the planned implementation plan which would bring in the changes by 1 October 2014 in time for the annual compulsory professional indemnity insurance period which runs from 1 October to 30 September each year.
4. In response to the comments made on the two proposals set out in the SRA's application, the SRA restated its concern about the impact of the level of insurance premiums, particularly for small firms, and its view that this is a high cost of regulation that could be restricting access for clients. In response to one

of the common themes from the responses – that the proposal would not reduce premiums – the SRA also noted that it had received advice that the reduction of the minimum limit per claim could reduce premiums by 5% to 15%.

5. The SRA concluded in its consultation response document that it was right to proceed with the proposals to reduce the PII cover to £500,000 and introduce a new outcome in the SRA Code of Conduct for SRA regulated firms to assess and purchase an appropriate level of PII cover.
6. In relation to the other proposals in the consultation paper, while confident that there were merits in those proposals (and noting that there was some support) the SRA took the decision not to introduce them in October 2014. This would give time to gather additional data and give further consideration to the impacts; allow the proposals to be considered alongside other potential changes to the minimum terms and conditions of PII cover put forward in the responses; and to combine further changes to the minimum terms and conditions of PII cover with a wider review of the SRA's Compensation Fund arrangements.
7. On 1 August 2014 the SRA launched a call for evidence² to inform its work to improve the way that client protection is delivered through the Compensation Fund and PII arrangements. The deadline for response was 30 September 2014 and the SRA is yet to publish its findings.

LSB's handling of the application

8. On 15 July 2014 the LSB received from the SRA the application seeking approval for the introduction of a new outcome and the reduction in the minimum level of PII cover. The application also sought approval for further technical amendments to the SRA's regulatory arrangements.
9. The initial decision period of 28 days³ was extended on 6 August 2014 taking the decision period to Friday 10 October 2014.⁴
10. The initial list of issues was sent to the SRA on 30 July 2014 and a response was received from the SRA on 6 August 2014. Further information was sought from the SRA on our initial list of issues on 13 August 2014. We received a response on 18 August 2014.
11. Having considered the responses to the issues, we concluded that we may need to refuse part of the application. In accordance with the requirements of the LSA 2007⁵ a warning notice was issued to The Law Society (as the approved regulator) on 18 August 2014 informing it that we were considering refusing part of the application. In a separate letter to the SRA of the same date, we set out further details of the concerns and invited the SRA to submit (by 5 September

² SRA website: <http://www.sra.org.uk/sra/consultations/client-protection-call-evidence.page>

³ Paragraph 21 (4), part 3 to Schedule 4 to the LSA 2007.

⁴ Paragraph 21 (5) (7), part 3 to Schedule 4 to the LSA 2007.

⁵ Paragraph 21 (1) (2), part 3 to Schedule 4 to the LSA 2007.

2014) any further information that it had to address these concerns. The SRA provided a response to the issues set out in the warning notice on 5 September 2014.

12. On 12 September 2014 the LSB sought clarification and additional information from the SRA in relation to its 5 September 2014 letter; the SRA's response was received on 22 September 2014.
13. We asked for clarification on one further point relating to the SRA Compensation Fund on 1 October 2014 and we received a response from the SRA on 10 October 2014.
14. The LSB completed its assessment of the application and the additional information sought from the SRA and as part of the rules change process closed the issues set out in the issues log that were satisfactorily answered by the SRA.

Other correspondence on the application

15. Following the submission and publication of the application, the LSB received a number of submissions from organisations and individuals of which the majority urged the LSB to refuse the proposal to reduce the minimum level of PII cover to £500,000.
16. As mentioned, the rules change process does not normally involve "consultation" by the LSB; however, in the interests of fairness and transparency, and with the agreement of the correspondents, the letters were sent to the SRA who was invited to comment on the issues raised. All of the letters received and the SRA response were published on the LSB website.⁶ Copies will be available at the Board meeting.

Powers of the LSB in relation to changes to regulatory arrangements

17. Part 3 of Schedule 4 to the LSA 2007 sets out the LSB's powers when considering applications for alterations to regulatory arrangements. Paragraph 25(3) states "the Board may refuse an application only if it is satisfied that..." and there then follows a list of matters (which we refer to as the "refusal criteria") which could lead the Board to decide not to grant an application.
18. The Board can make a decision to grant the application (in whole or part) or refuse the application. A decision to refuse an application is one of the matters reserved to the Board.

⁶ LSB website: http://lsbtest/Projects/statutory_decision_making/current_applications.htm

Assessment of the SRA proposals against the refusal criteria

19. The LSB in making its decision is required by the LSA 2007 to consider the application and accompanying material and the other information provided by the SRA throughout the LSB's assessment. The LSB may also consider other information which we think is relevant to the application.
20. The LSB in its assessment considered whether there was reason to refuse the application which required a review of the refusal criteria against each of the principal proposals set out in the application.
21. We have determined that in relation to the proposals set out in the application that:
 - the new outcome and the technical amendments do not satisfy any of the criteria on which we can refuse an application; the Executive therefore recommends to the Board that this part of the application should be granted.
 - the reduction in the minimum level of PII cover, satisfies the refusal criteria in particular, paragraph 25 (3)(a) *'granting the application would be prejudicial to the regulatory objectives' (protecting and promoting the interests of consumers)* and paragraph 25(3)(c) *'granting the application would be contrary to the public interest'*; the Executive therefore recommends to the Board that this part of the application should be refused.
22. We have sought external legal advice on the LSB's assessment of the application including a legal test; the issue of whether approval in part is open to legal challenge (as the SRA have implied that the proposals set out in the application are a single package of measures) and the draft decision notice.
23. Counsel's full advice has been included at **Annex B** to this paper. A summary of that advice is included below:
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]

24. The LSB has considered the advice from external counsel and determined that it has sufficient reason to recommend to the Board that the application is approved in part.
25. In making our recommendation to the Board, it is clear that the SRA has not presented enough information to support the proposal to decrease the minimum level of PII cover to £500,000 (this is explained further in the decision notice at **Annex A**, the draft decision notice will follow this paper to be circulated to Board members before the meeting). However, this does not mean that the LSB supports the current level of £2 million (or £3 million if incorporated) or that we disagree with the SRA's assumption that this is an arbitrary figure.

LSB decision notice – publication of restricted information

26. The Board should note that the draft decision notice refers to information to be treated as 'restricted' within the meaning of section 167 of the LSA 2007, as it has been obtained by the Board in the exercise of its functions which refers to independent advice received by the SRA from Marsh Insurers which contains commercially sensitive information.
27. Generally, restricted information should not be published, but there are exceptions to this rule and disclosure is not prohibited where the LSB relies on any power to publish information under the LSA 2007. In this case, paragraph 25(7) of Schedule 4 requires us to give reasons for any refusal in part. In addition, we have a general power to disclose restricted information to enable us to exercise our functions (in section 168(2) LSA 2007). We therefore have a discretion as to how to act in this matter and should consider weighing up the publication of this information against the public interest in acting in an open way, as well as our obligation to have regard to the principle of transparency. If we decide against publication, the decision notice should then make it clear that we have had regard to the information supplied to us, without going on to quote from that information.
28. We believe it is appropriate to provide the SRA with a confidential version including specific reference to the Marsh Insurers information and publish a redacted version on the LSB's website.

Reputational risk to LSB

29. The consequence of the LSB's decision for the SRA will be the approval of the introduction of the new outcome to the SRA Code of Conduct and may be seen as introducing new regulation. The SRA has argued that the new outcome should only be introduced if the "balancing" provision of reduced minimum cover is also introduced. We are not convinced of this argument as the market for top-up cover is available already and any additional costs would be marginal. In so far as the costs will fall to firms who are failing to cover their risks without telling

consumers that they are doing so, the introduction of a new outcome to assess appropriate levels of cover is expected to assist the market in working more effectively.

30. In making the recommendations set out in this paper, the Executive has considered whether the two principal proposals set out in the application are intrinsically linked and should be considered in its decision as a package rather than as separate proposals, meaning both parts must therefore be either both granted or both refused. We are of the view that the SRA consultation indicates clearly that the issues were linked only by virtue of being part of a more comprehensive package of proposals. In so far as the SRA has subsequently sought to establish a link, its argument that the potential adverse impact on consumers of the reduction in the minimum level of cover (if firms under-insure) is mitigated by the existence of an obligation to ensure appropriate cover, is a fair one. However, we do not agree with the SRA's assertion that the existence of an appropriate cover outcome necessarily involves a reduction in the current minimum level.
31. The provisions in the LSA 2007 relating to the decisions under Schedule 4 presume that an application will be approved. Since we have concluded that there are no grounds for refusing the new outcome, we recommend the application be granted in part.
32. The SRA may have the option not to implement the new outcome and so avoid the additional regulatory burden but this will leave uncompleted regulatory arrangements in the SRA Code of Conduct which would not be ideal.

Conclusion and recommendations

33. Having completed the assessment of the application, we recommend that the part of the application relating to the new outcome and further technical amendments be approved and, that the part of the application relating to the reduction in the minimum level of PII cover be refused.
34. The Board is invited:
 - 1) to agree that the application is granted in part namely the proposal of a new outcome to the SRA's Code of Conduct and further technical amendments to the SRA's regulatory arrangements and to refuse the proposal to reduce the minimum level of PII cover from the current level of £2 million (£3 million for incorporated firms) to £500,000.
 - 2) to note the draft decision notice set out in **Annex A** and to delegate the finalising of the wording of the decision notice to the Chairman and Chief Executive (the draft decision notice will follow this paper, to be circulated to Board members before the meeting).

19 November 2014