

Thematic review of restrictions on choice of insurer: analysis of the current arrangements

July 2016

Summary

Professional indemnity insurance (**PII**) is important. It protects consumers' and practitioners' interests and builds public confidence in buying legal services.

Previous LSB research highlighted concerns about PII, which is an important but costly aspect of doing business for regulated legal practitioners.¹

Regulatory restrictions on the supply of PII are likely to have implications for practitioners, consumers and approved regulators (**ARs**). We have looked at one aspect of this: the restrictions imposed by ARs on legal services practitioners' choice of PII provider.

We have reviewed the different approaches used by ARs and the rationales put forward in favour of them. We have taken a first principles approach and examined the question of choice of insurer against the regulatory objectives² and better regulation principles³ – the duties of ARs under the Legal Services Act 2007 (**the Act**).

Our policy and legal analysis has been complemented by independent economic advice from the Regulatory Policy Institute (**RPI**)⁴. Our review has produced a list of questions that we suggest ARs should answer to ensure they have identified the best regulatory response for their respective regulated communities.

Our findings are summarised below.

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

² Set out in section 1(1) of the Act – (a) protecting and promoting the public interest; (b) supporting the constitutional principle of the rule of law; (c) improving access to justice; (d) protecting and promoting the interests of consumers; (e) promoting competition in the provision of services within subsection (2); (f) encouraging an independent, strong, diverse and effective legal profession; (g) increasing public understanding of the citizen's legal rights and duties; (h) promoting and maintaining adherence to the professional principles.

³ The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, along with any other principle appearing to represent the best regulatory practice.

⁴http://www.legalservicesboard.org.uk/news_publications/LSB_News/PDF/2016/20160715_RPI_Advice_To_LSB_On_PII.PDF

1. About the review and PII

- We were interested in understanding if setting limits on choice of PII insurer is necessary. If so, what is the least burdensome approach?
- PII is costly. It has been found to affect decisions about entry to the legal services market, mobility and innovation within it, and exit from the market.⁵
- We looked at this issue because it spans the market for regulated legal services and is not specific to one AR. It is important that these market-wide perspectives are not overlooked.
- ARs are best placed to assess relevant information and determine their regulatory arrangements. We are not looking to specify the ‘right’ answer for each AR.

2. What we found

- Historically there have been restraints on the choice of PII provider for legal services providers. The general direction of travel has been towards fewer and fewer regulatory limits on who can provide insurance to legal services practitioners, i.e. towards competition in who can supply PII.
- However, today there is no common approach across all ARs, with many ARs allowing open market provision, through to the mutual fund approach for the Bar. A range of views also exists on the merits of different models for supplying PII.
- The broad categories of model are:
 - **Open market:** Those seeking PII are able to select their own provider, although this may be subject to limitations set by the relevant AR, e.g. insurers having to sign up to specified minimum terms and conditions (with a view to consumer protection) or having a suitable credit rating. For example, insurers must sign the Solicitors Regulation Authority’s Participating Insurer’s Agreement under which they agree to offer policies that meet set minimum terms and conditions.
 - **Master policy:** Collective purchasing of PII to deliver a policy that covers each member of a group, for example with a body (such as an AR) arranging the policy and then determining how its total cost is apportioned between those insured. For example, until 2011 the Council for Licensed Conveyancers required practitioners to use a master policy scheme and the Law Society of Scotland still requires practitioners to use one.
 - **Mutual fund:** A profession becomes its own insurer, paying premiums into a common fund to cover claims. Members effectively own the

⁵ <https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf> and <https://research.legalservicesboard.org.uk/wp-content/media/RPI-Final-Report-for-LSB-and-TLS-15-December-2013.pdf>

insurance company (with barristers and the Bar Mutual Indemnity Fund an example) and the majority of practitioners, if not all, seek cover from the fund.

- We found that arguments are made in favour of each model, but there is not always evidence available to support those views.
- Impacts associated with different models for supply of PII:
 - **Costs for practitioners:** The way that PII is supplied can have a direct effect (e.g. on premium cost) and an indirect effect (e.g. time involved in putting cover in place) on costs. If there is a restriction on choice of PII provider, practitioners will be unable to shop around for cheaper cover and will be unable to pass any savings on to consumers.
 - **Consumer choice:** It has been argued that different models of PII provision can influence the number of different practitioners in a market that consumers can choose between.
 - **Client protection:** a guarantee of PII cover, particularly where there is cross-subsidisation from low risk to high risk practitioners, may keep practitioners in the market who otherwise would have to improve their risk management – in other words, they would otherwise have to provide a better service to consumers. On the other hand, it has been argued that mutual schemes may be more likely to meet claims as this is in the interests of the mutually insured profession as a whole.
 - **Regulation:** with a limited or single supplier of PII cover, it may be easier for ARs to confirm that practitioners are insured. A limited number of PII suppliers may also make it more straightforward for ARs to access and analyse summary data on the nature and scale of claims.
- There is a need for more evidence to support some of the claims that are made, as ARs have obligations under the Act that include having regard to best regulatory practice, e.g. transparency in consulting on relevant evidence and proportionality in a decision on the need for intervention being based on assessment of that evidence and what represents the least burdensome response.
- Commercial insurance providers appear to view their target market as legal services generally, rather than separate markets for individual professional groups (e.g. one for barristers, one for conveyancers and one for solicitors etc.).
- We can expect AR requirements to be reviewed from time to time, because of changes in the provision of legal services and in how PII markets function (which can have an impact on the provision of legal services).
- If ARs consider changing arrangements, there are risks during the transition from one set of arrangements to another of which they should be mindful.

3. What are ARs' statutory duties?

- An AR's decision on any restrictions on choice of PII provider should be guided by the Act's legislative framework and other applicable legislation.
- Different models for PII provision will have varying impacts on **the regulatory objectives** set out in the Act. A thorough analysis of evidence and data will help ARs consider these impacts fully and guide their decisions on which model to adopt. We consider the following objectives will be particularly relevant to an AR's decision:
 - **Protecting and promoting the public interest:** the Act requires regulatory arrangements to be delivered independently of representative interests, whereas choosing a model of PII provision for the benefit of practitioners (which is what a representative body would do) does not give adequate consideration to consumer and wider public interests (which is what an AR needs to do)
 - **Improving access to justice:** a restriction on choice may have the effect of preserving numbers of legal services providers in the market
 - **Protecting and promoting the interests of consumers:** the basis of PII provision can have implications for numbers of providers, service quality and cost of services
 - **Promoting competition in the provision of legal services:** restrictions on choice may have an adverse effect on competition between providers through 'related markets' effects
 - **Encouraging an independent, strong, diverse and effective profession:** restrictions may have the effect of promoting diversity, but they may also restrict innovation or quality of service, for example among providers who may otherwise have to improve their performance or exit the market if there was no guarantee of – or cross subsidy available for - PII cover.
- **Better regulation principles:**
 - **Transparency:** using effective consultation to drive decisions on the model of PII provision
 - **Accountability:** coherently explaining the rationale for these decisions
 - **Proportionality:** any restriction is based on an assessment of the relevant evidence, including risks
 - **Consistency:** in the absence of evidence in favour of a variation in approach, adopt a consistent approach
 - **Targeted:** only intervening specifically to restrict choice where there is evidence that intervention is necessary.

- **Competition law** – competition authorities have taken an interest in restrictions of this nature in other markets. An AR will want to consider the compatibility of any regulatory restrictions on choice of PII provider with competition law.

4. What can ARs do?

- Ongoing developments and changes in the legal services and PII markets all point to ARs needing to regularly review any restrictions they impose on choice of PII provider to stay assured that those restrictions remain fit for purpose. This is both in terms of the market and in terms of the legislative obligations that each AR must meet. This review suggests some tools that ARs can use to understand what options are available regarding choice of PII provider.
- The RPI's advice on this subject sets out key questions and identifies data that ARs can gather to answer them. These focus on the PII market (since what happens here can have implications for the legal sector) and the entire legal services market, rather than just those legal providers overseen by a single AR.
- Areas for review and assessment include:
 - Identifying different options regarding choice of PII provider.
 - Understanding the impact of different options on the market for PII, for legal services broadly and a regulated community specifically.
 - The effectiveness of competition in the PII market, risks of exit of PII providers, unwillingness to cover risks, effectiveness of cover for different practitioners.
 - The benefits and costs of different options for practitioners, consumers and competition.
- Data to inform assessments include size of market, level of claims, claims ratios, number of PII suppliers, entry and exit rates, cost of cover, transactional costs, use of top-up cover and extent of shopping around for cover.