



Legal Services Board – Decision Notice issued under Part 3 of Schedule 4 to the Legal Services Act 2007

Solicitors Regulation Authority (SRA) application for approval of alterations to the regulatory arrangements relating to client financial protection

The Legal Services Board (LSB) has approved alterations to the following SRA regulatory arrangements (see **ANNEX** for links to the full documents):

- Schedules 1 and 2 of the Qualifying Insurer’s Agreement 2012
- The SRA Indemnity Insurance Rules 2012 (including the Minimum Terms of Conditions of cover)
- The SRA Amendment to Regulatory Arrangements (Client Protection) Rules 2012 including:
 - SRA Handbook Glossary 2012
 - SRA Compensation Fund Rules 2011
- The SRA Indemnity (Enactment) Rules 2012 and SRA Indemnity Rules 2012

This decision notice sets out the basis for the LSB’s approval and the decision taken, including a brief description of the changes.

Introduction

1. The LSB is required by Part 3 of Schedule 4 of the Legal Services Act 2007 (the Act) to review and grant or refuse applications by approved regulators to make alterations to their regulatory arrangements. SRA is an approved regulator.
2. Paragraph 25 of Schedule 4 to the Act explains that the LSB may only refuse an application setting out a proposed change to the regulatory arrangements if it is satisfied that by granting the application one or more of the criteria specified in sub paragraph 25(3) (and listed in the footnote below¹) will be met. Most notably, the LSB’s granting of the application to alter the regulatory arrangements must not be prejudicial to the regulatory objectives overall. Accordingly, if the LSB is not satisfied that one or more of the criteria for refusal are met, then it must approve the application in whole, or at least the parts of it that can be approved when only part of the application meets the criteria.

¹ The Board may refuse the application only if it is satisfied that—(a) granting the application would be prejudicial to the regulatory objectives, (b) granting the application would be contrary to any provision made by or by virtue of the Act or any other enactment or would result in any of the designation requirements ceasing to be satisfied in relation to the approved regulator, (c) granting the application would be contrary to the public interest, (d) the alteration would enable the approved regulator to authorise persons to carry on activities which are reserved legal activities in relation to which it is not a relevant approved regulator, (e) the alteration would enable the approved regulator to license persons under Part 5 to carry on activities which are reserved legal activities in relation to which it is not a licensing authority, or (f) the alteration has been or is likely to be made otherwise than in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration.

3. As provided for by paragraphs 20(1) and 23(3) of Schedule 4 to the Act, the LSB has made rules² about how the application to alter the regulatory arrangements must be made including the contents of that application. The rules highlight the applicant's obligations under section 28 of the Act to have regard to the Better Regulation Principles. The rules also require that the applicant provides information about the nature and effect of each proposed change and of appropriate consultation undertaken. Sub paragraph 25(3)(f) of Schedule 4 to the Act requires that each proposed alteration has been made or is likely to be made in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration. This therefore includes the LSB's rules.
4. The chronology for the LSB's handling of this application can be found towards the end of this decision notice.

Background

5. On 13 April 2011, the SRA's Board approved their financial protection policy statement which sets out the SRA's policy for client financial protection for the period to 2014. The statement includes the specific changes that will be made to professional indemnity insurance requirements for the 2011 indemnity year and changes to the requirements for the 2012/13 and 2013/14 indemnity years which were to be subject to further discussion and consultation. The policy also includes changes to be considered to the SRA's Compensation Fund arrangements and work to be undertaken by the SRA in other areas of responsibility which bear directly on the arrangements for client financial protection.
6. The changes proposed in the SRA's application to the LSB to make alterations to the regulatory arrangements relating to client financial protection, are the second stage of implementation of that policy.
7. A draft order made under section 69 of the Act (the "Section 69 Order") to modify the SRA Compensation Fund has been published on the LSB website for a public consultation, in accordance with section 70 of the Act. The consultation will run from 14 June 2012 and close 18 July 2012. The effect of the Section 69 Order will ensure that there continue to be adequate compensation arrangements for SRA regulated ABS firms after 31 December 2012. The Section 69 Order consultation notes that the SRA is undertaking a comprehensive review of the compensation fund, the review will take place over the next two years and the outcome may lead to various changes.
8. The LSB supports the comprehensive review of the existing regulatory arrangements and will continue to engage with the SRA as the review progresses.
9. The SRA's application to the LSB for the approval of alterations to the regulatory arrangements relating to client financial protection encompasses four distinct groups

² Rules for Rule Change Applications – Version 2 (November 2010)

of amendments. These amendments are explained in further detail in the '**Decision**' section directly below.

Decision

Schedules 1 and 2 of the Qualifying Insurer's Agreement 2012

10. Qualifying Insurance is available through Qualifying Insurers. All insurers authorised to conduct business in the UK can become a Qualifying Insurer provided they sign a Qualifying Insurer's Agreement (**QIA**) each year.
11. Under the current regime, firms that cannot get cover on the commercial market can apply to be covered, for a limited period, through the assigned risks pool (**ARP**). However, as part of the proposed amendments, the ARP as a provider of policies of qualifying insurance will close from 30 September 2013, with the exception of the continued provision of run-off cover incepted before that date.
12. The SRA proposed changes to Schedules 1 and 2 of the QIA 2012. The key changes to the QIA are as follows:
 - the Master Policy for firms carrying on practice without Qualifying Insurance has been deleted as cover for such firms will now be provided by the Compensation Fund (see paragraphs 30 to 32 of this Decision Notice);
 - Qualifying Insurers will be required to participate in the ARP by way of a Master Policy. This will require the profession to contribute up to £30m to the ARP liabilities for the 2012/2013 indemnity period. The SRA, on behalf of the Law Society, will contribute to the ARP by way of making payment under the Master Policy (the ARP Master Policy Payment);
 - Qualifying Insurers will be required to disclose their credit rating (or lack thereof) to the SRA and to any firm to which they provide a quotation;
 - to reflect the adoption of the SRA Handbook Glossary (the Glossary) definitions in the SRA Indemnity Insurance Rules 2012 (**SIIR**), a new Schedule 8 has been added to the QIA which contains relevant extracts from the Glossary as used in the SIIR and Minimum Terms and Conditions of cover (**MTC**).
13. The LSB considers these changes are reasonable and are in line with the intentions set out in the SRA's client financial protection policy statement (approved by the SRA Board on 13 April 2011).

*The SRA Indemnity Insurance Rules 2012 (**SIIR**) (including the Minimum Terms and Conditions of cover (**MTC**))*

14. Principals in a firm carrying on private practice from offices in England and Wales are required to have compulsory professional indemnity insurance in compliance with the

SIIR and **MTC**. The SIIR apply to solicitors, registered European lawyers, registered foreign lawyers, and recognised bodies and their managers. The main purpose of the insurance is to provide the public with a very good basic level of protection in the event that a firm is negligent or dishonest which results in a financial loss.

15. The SRA proposed changes to the SIIR (including the MTC). The key changes are as follows:

- commencing 1 October 2013, a firm's last insurer of record under the QIA 2012 will be liable for cover for an Extended Indemnity Period and Cessation Period (together providing cover for 90 days) if the firm does not renew its policy of Qualifying Insurance with its existing Qualifying Insurer and does not obtain a policy of Qualifying Insurance with another Qualifying Insurer;
- the introduction of a requirement on firms that have not obtained a policy of Qualifying Insurance at the expiration of the Cessation Period to cease to practise and to notify the SRA;
- no firm will be eligible to remain in the ARP beyond 30 September 2013 and any certificate issued to a firm in the ARP will cease to have effect from that date;
- a rule in the SIIR 2012 has been drafted to allow the Law Society to collect a contribution from firms and apply it as it considers appropriate to fund the ARP. The requirement for firms to pay a contribution towards meeting the liabilities of the ARP is very much akin to the requirement to pay premium under a Master Policy, and is in fact this is in line the manner in which it is proposed the ARP will be funded under the Master Policy.
- the removal of Appendix 4 (Definitions) to the SIIR to be replaced by the application of the Glossary.

16. The LSB considers that these changes are reasonable and are in line with the intentions set out in the SRA's client financial protection policy statement.

The SRA Amendment to Regulatory Arrangements (Client Protection) Rules 2012 including the SRA Handbook Glossary 2012 and the SRA Compensation Fund Rules 2011

17. The SRA Compensation Fund Rules 2011 (**SCFR**) provide for the establishment of the Fund and sets out, inter alia, the collection of contributions, the scope of the Fund and the application process. Grants from the Fund are made at the discretion of the SRA.

18. The SRA proposed amendments to the SCFR and the SRA Handbook Glossary 2012 (the Glossary).

19. The key changes to the SCFR are as follows:

- to provide cover for claims made against uninsured firms that would previously have been covered by the ARP under the arrangements for "non-applied firms" (un-insured firms);
 - an amendment has been made to rule 14.2 (previously rule 13.2), the effect being that the provision of emergency funds will be by way of an interim grant rather than general use of the Fund under Rule 2.12(d) and a new rule 14.3 has been inserted.
20. The key changes to the Glossary are as follows:
- the insertion of the new definitions of "cessation period", "existing instructions" and "extended indemnity period";
 - a number of minor corrections and updates to existing definitions.
21. The SRA has provided assurance that it has in place a robust decision-making structure in terms of a grant for emergency funding from the Compensation Fund. The SRA has in place guidelines as to what classifies as an emergency claim and work is currently being undertaken on the procedures to ensure that emergency payments can be made and to satisfy the criteria for a grant. This will be completed by October 2012.
22. In terms of one of the changes to provide cover for claims made against non-applied firms that would have been previously covered by the ARP, the LSB notes that the scope of cover has been redrafted since the consultation to more closely reflect the scope of cover that is currently provided through the ARP arrangements whilst still retaining the discretionary nature of the Compensation Fund. The Law Society raised with the LSB issues relating to the process that had been followed for the changes of non-applied firms in the Compensation Fund. These are covered in more detail in paragraphs 29 to 31 below.

The SRA Indemnity (Enactment) Rules 2012 and SRA Indemnity Rules 2012

23. The SRA Indemnity (Enactment) Rules, to which are annexed the SRA Indemnity Rules (collectively called the **SIR**), provide for the establishment and maintenance of the Solicitors Indemnity Fund (**SIF**). SIF was the sole provider of compulsory professional indemnity cover for solicitors in private practice in England and Wales up until 1 September 2000 when the current arrangements based on Qualifying Insurers was introduced. The rules retain the power to collect contributions from the profession as and when required. SIF is currently carrying a surplus. The SIR set out a process for releasing surplus to the Law Society/SRA and prescribes how any surplus must be applied.
24. SIF is now being run-off and the contributions that have been collected together with investment income are being used to fund the handling, defence and settlement of claims which fall to be dealt with by SIF.

25. The SRA proposed changes to the SIR. The key changes are as follows:

- The proposed three year extension of the post six year run-off cover provided by SIF requires one minor amendment to a date in Rule 8.5(a) of the SIR. In that rule "30 September 2017" is to be replaced by "30 September 2020";
- The definitions contained in the SIR have been removed to be replaced by the application of the Glossary.

26. The SRA has determined that the primary purpose of post six year run-off cover is to protect consumers of legal services. It considers that this protection should be available equally to all consumers. However, because of the mismatch between the current 30 September 2017 deadline and the probable date of completion and the completion of the overall compensation review in 2014, there is a risk that neither firms nor clients will be able to benefit from run-off cover in respect of relevant claims. The limited extension of the deadline to 30 September 2020 therefore ensures consistency of treatment until broader issues are resolved pending the outcome of the wider review of the client financial protection arrangements.

27. The LSB considered that the extension of the post six year run-off cover to 30 September 2020 is appropriate, pending the outcome of the wider review of the client financial protection arrangements.

28. We note that the SRA does not anticipate the need to call on further contributions from the profession to provide for these changes. We note from the application that extension of the period of cover was supported by the Law Society.

Concerns raised by The Law Society on the proposed changes to the Compensation Fund

29. On 23 April 2012, Des Hudson, Chief Executive of The Law Society wrote to the LSB regarding the SRA proposed rule changes to the Compensation Fund. Among his concerns, he highlighted that the transfer of cover of non-applied firms from the ARP to the Compensation Fund was inadequately consulted on. As a consequence of this letter, there was an exchange of correspondence between the SRA and the LSB.

30. The LSB has taken a view in light of the issues raised by The Law Society and has concluded that although the SRA did not cover the full implications and impacts of the transfer of cover of non-applied firms from the ARP to the Compensation Fund in its October 2011 consultation, its consultation paper did in fact enable the issue to be further explored. This is evidenced by The Law Society responding to the issue, in detail, in its consultation response. Although The Law Society's points were not discussed in detail in the SRA's consultation response document, the LSB accepts the assurance provided by the SRA that The Law Society's concerns were properly considered and reflected in the final decision, notably in the detailed rule redrafting and the two stage process for assessing claims.

31. We also note that the SRA has taken into consideration the detailed modelling analysis of the ARP conducted by Marsh LLP. The LSB has been assured that the Marsh LLP analysis has been shared with The Law Society and Qualifying Insurers, neither of whom has challenged its fundamental conclusions. In light of this information the LSB is satisfied that the SRA have completed an adequate process in terms of both expert input and proper transparency and concludes that the transfer of cover issue has been properly considered by the SRA.

Chronology

- The LSB confirmed receipt of an application from the SRA on 29 May 2012. Further information was received on 15 June 2012.
- The 28 day initial decision period for considering the application ends on 24 June 2012.
- This Decision Notice is being published on our website on 25 June 2012.

Chris Kenny, Chief Executive

Acting under delegated authority granted by the Board of the Legal Services Board

Link to the LSB website with the documents containing the rule changes

[Schedules 1 and 2 of the Qualifying Insurer's Agreement 2012](#)

[The SRA Indemnity Insurance Rules 2012 \(including the Minimum Terms of Conditions of cover\).](#)

[The SRA Amendment to Regulatory Arrangements \(Client Protection\) Rules 2012 including the SRA Handbook Glossary 2012 and the SRA Compensation Fund Rules 2011.](#)

[The SRA Indemnity \(Enactment\) Rules 2012 and SRA Indemnity Rules 2012](#)