Summary of Decision

The following table is a high level summary of the decision of the Legal Services Board. It is not a formal part of the decision notice.

Purpose of notice
To grant an application from the Solicitors Regulation Authority (SRA), approving alterations to its regulatory arrangements in respect of its professional indemnity insurance - switching regulators.
Alterations that are being approved by this decision
Removal of the six years of run-off cover required under the SRA's existing Indemnity Insurance Rules by introducing a new rule which states that run-off cover will not apply where the insured firm becomes regulated by another approved regulator that has signed a bilateral protocol with the SRA.

Decision notice

Issued by the Legal Services Board (LSB) under Part 3 of Schedule 4 to the Legal Services Act 2007 (the Act)

The Solicitors Regulation Authority (SRA) rule change application for approval of alterations to the regulatory arrangements relating to the SRA's professional indemnity insurance (PII) - switching regulators

The LSB has granted an application from the SRA for approval of alterations to its PII arrangements concerning SRA firms switching to other regulators.

The LSB is required by Part 3 of Schedule 4 to the Act to review and grant or refuse applications for approval by approved regulators who make alterations to their regulatory arrangements. The Law Society is an approved regulator and the SRA is the regulatory arm to which the Law Society has delegated its regulatory functions.

This decision notice sets out the decision taken, including a brief description of the changes. The notes at the end of the notice explain the statutory basis for the decision. The notice also sets out the chronology for the LSB's handling of this application.

Proposed changes

1. When a law firm ceases to operate, the SRA requires that the firm obtain run-off insurance cover to ensure that resources are in place to compensate consumers should they incur losses. The run-off cover accordingly replaces PII once the firm has ceased practice, which all practising solicitors must have in place.

2. Currently, when a SRA regulated firm moves to a different regulator, the switch is treated under the SRA's rules as a cessation of practice, so a requirement to obtain run-off cover is triggered (Rule 5.4 of the SRA's Indemnity Insurance Rules). The result is that firms that switch to another regulator can end up having dual cover (i.e. they must obtain run-off cover as required by the SRA, and additionally purchase PII as required by the firm's new approved regulator).

3. The change proposed by the SRA to its regulatory arrangements would remove the run-off cover requirement for firms that switch to another approved regulator. A new provision would be introduced into the SRA's Insurance Indemnity Rules (new Rule 5.8 in Annex 1) which states that Rule 5.4 will not apply where the insured firm becomes regulated by another approved regulator. Crucially, Rule 5.8 would only take effect where the new approved regulator has signed a bilateral protocol with the SRA, which requires regulators to share information so that the new approved regulator can assess the adequacy of the indemnity arrangements before accepting the firm into its regulation.

4. The overarching policy purpose of the change, according to the SRA, is to remove a potential barrier to firms switching regulators, since requiring a firm to have dual insurance represents a significant disincentive to the firm switching.

Issues raised in the assessment

5. The LSB generally welcomes any changes which remove barriers to firms wishing to switch regulators, provided that there are appropriate and proportionate safeguards for consumers who would no longer be protected by run-off cover, but who would instead be protected by the firm's new PII. The LSB notes the statement in the SRA's application, that if a firm switches regulators, a consumer may face the risk of a different level of protection to that they had when they originally chose the firm. We comment on this and other matters concerning the application below.

Application altered part way through LSB's assessment

6. The original application was submitted to the LSB on 14 July 2017 and included a draft protocol, which was a proposed multilateral agreement between the SRA and other approved regulators. While the proposed multilateral protocol itself was not considered to be a regulatory arrangement under section 21 of the Act, it nonetheless was positioned in the application as a significant mechanism to mitigate risk to consumers and was referred to in the proposed regulations. In its application the SRA said that the protocol would have confirmed that the responsibility of a firm's regulation and its PII arrangements would sit exclusively with the new approved regulator at the point of switching. The proposal was that the protocol would also sit under the existing overarching Framework Memorandum of Understanding between the approved regulators.

7. During the course of the LSB's consideration of the application, the SRA altered its approach to mitigating risks to consumers. It removed the proposed protocol and confirmed it would instead seek bilateral agreements with individual regulators. By removing the multilateral protocol mid-way through the LSB's assessment, and replacing it with an alternative mechanism, the LSB was required to consider the application on a new basis, and requested that the SRA provide additional information as to how the new bilateral approach would mitigate the risks the original proposed protocol was designed to address.

8. The LSB's consideration of an application is not a negotiation with an approved regulator, it is an assessment of finished proposals against the refusal criteria contained in paragraph 25(3) to Schedule 4 of the Act. We expect an application to be complete and, unless there are valid reasons, there should be no changes to critical elements part way through the LSB's assessment. We urge the SRA (indeed all regulators) to ensure that before submitting an application, all key elements, whether or not they are regulatory arrangements (and in particular mechanisms that are intended to mitigate risk to consumers), are settled.

SRA's proposals to mitigate risk to consumers

9. Having altered an aspect of the approach supporting the application after the SRA had submitted it, the LSB assessed the SRA's revised mechanism for addressing any risk to consumers from the proposals. The SRA acknowledged that its discussions with other regulators had highlighted that a single protocol covering all regulators was no longer feasible. This is because some regulators either do not regulate entities or do not envisage a law firm switching from another regulator to them because of their particular market position. This led the SRA to the view that it should conclude bilateral protocols with each regulator that wishes to operate this arrangement.

10. The SRA explained its position that the protocol, whether as a multilateral agreement between all regulators, or as a series of bilateral agreements between interested regulators, serves to mitigate any risk of consumer detriment that may arise from a firm being able to switch regulators without securing run-off cover.

11. The LSB notes that the SRA's application did not provide an assessment of the precise extent of any risk to consumers which the bilateral protocols are intended to address.

12. Against that background, the LSB considered the following factors in mitigation of any risk of consumer detriment:

    - Firstly, firms would be switching from one of the Act's approved regulators to another, so their consumers would continue to benefit from all of the consumer protection arrangements mandated within the Act. While this does not expressly address any differences in PII minimum wording between the approved regulators, the regulatory environments in which firms are expected to work require the utmost integrity among its authorised individuals and this mitigates the risk of a PII claim arising in the first place.
    - Secondly, the LSB has been assured by the SRA that, by using bilateral protocols, steps are contemplated by the SRA to specifically target and mitigate the potential consumer harm that has been identified.

13. Having taken the above into consideration, the LSB made a carefully balanced judgement against the refusal criteria in paragraph 25(3) to Schedule 4 of the Act and concluded that there is insufficient reason to refuse the application solely on the basis of potential harm to consumers, when there is no evidence that the change would lead to significant consumer risk.

Impact on SRA's Compensation Fund

14. In its assessment, the LSB asked the SRA if it had considered any impact on its Compensation Fund. For example, whether there might be a gap in PII consumer protection when a firm switches, and whether a client would be able to turn to the receiving or leaving regulator's Compensation Fund. The SRA confirmed that it had considered the impact on the Compensation Fund. It clarified that the rule change is

not intended to change compensation fund arrangements. It further confirmed that the Fund would consider an eligible claim if the event that gave rise to the loss occurred when the firm was still regulated by the SRA. The new regulator would need to consider eligibility under its own compensation fund rules if it happened after the providing firm had switched.

LSB's oversight role

15. The SRA said it recognises there is a theoretical possibility for claims on the Compensation Fund to be made for matters that would otherwise have been covered by run-off cover. The SRA's assessment is that it seems likely that there will only be fairly limited circumstances where this might happen because of the LSB oversight in relation to the appropriateness of regulatory arrangements in respect of insurance and the commitment of the regulators to work together to implement an effective switching process.

16. The application further mentioned in the context of its statement in relation to impact on other regulators, that the LSB has a responsibility for oversight and approval of all of the approved regulators' indemnity arrangements. This could be implied that the LSB has a greater role in oversight on this matter than is the case. For the avoidance of doubt, the LSB does not have oversight responsibility for a receiving regulator's decision when it takes on an individual firm from another approved regulator.

Decision

17. The LSB has considered the SRA's application against the criteria in paragraph 25(3) of Schedule 4 to the Legal Services Act 2007 (the Act) and has decided to grant the application.

18. The Annex to this decision notice contains the regulations approved by the LSB.

Chronology

- The LSB confirmed receipt of an application from the SRA on 14 July 2017
- The LSB issued an extension notice on 8 August, which extended the LSB's period for considering the application to 11 October 2017.
- Submission of additional material by SRA on 15 September 2017
- This decision notice is effective from 28 September 2017
- The decision notice will be published on our website on 28 September 2017

Neil Buckley, LSB Chief Executive
Acting under delegated authority granted by the Board of the Legal Services Board

*Notes***:**

1. The LSB is required by Part 3 of Schedule 4 to the Act to review and grant or refuse applications by approved regulators to make alterations to their regulatory arrangements.

2. Paragraph 25(3) of Schedule 4 to the Act explains that the LSB may refuse an application setting out a proposed change to the regulatory arrangements 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 this 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 [of the Act] 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. The designation requirements referred to in paragraph 2(b) above are set out in paragraph 25(4) of Schedule 4 to the Act and are:
    (a) a requirement that the approved regulator has appropriate internal governance arrangements in place
    (b) a requirement that the applicant is competent, and has sufficient resources to perform the role of approved regulator in relation to the reserved legal activities in respect of which it is designated, and
    (c) the requirements set out in paragraphs 13(2)(c) to (e) of Schedule 4, namely that the regulatory arrangements are appropriate, comply with the requirements in respect of resolution of regulatory conflict (imposed by sections 52 and 54 of the Act) and comply with the requirements in relation to the handling of complaints (imposed by sections 112 and 145 of the Act).

4. In accordance with paragraphs 20(1) and 23(3) of Schedule 4 to the Act, the LSB has made rules[1] about the manner and form in which applications to alter regulatory arrangements must be made. Amongst other things, the rules highlight the applicant's obligations under section 28 of the Act to have regard to the Better Regulation Principles. They also require applicants to provide information about each proposed change and details of the consultation undertaken.

5. 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 the parts of it that can be approved.

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

Annex A
SRA Indemnity Insurance Rules 2013 (Amendment) (No 2) Rules [2017]

Rules made by the Solicitors Regulation Authority Board on [date made by Board] under sections 31, 37, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, and section 83 of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007.

Approved by the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007 on [date of approval by LSB].

Rule 1

Amend the SRA Minimum Terms and Conditions of Professional Indemnity Insurance in Appendix 1 to the SRA Indemnity Insurance Rules 2013 as follows:

(a) at the beginning of clause 5.4, insert “Subject to clause 5.8,” and replace “The” with “the”;

(b) in the final paragraph of clause 5.4, after “clause 5.4” insert “and clause 5.8”;

(c) after clause 5.7 insert:

“5.8 Transfer to another approved regulator

Clause 5.4 above does not apply where the *insured firm* becomes an *authorised non-SRA firm* provided that the *approved regulator*, with which the *authorised non-SRA firm* is authorised, is a signatory to a protocol on terms agreed by the *SRA* which relates to switching between *approved regulators*.”

Rule 2

These rules come into force on 1 October 2017 or on the seventh day following approval by the Legal Services Board, whichever is the later and replace the SRA Indemnity Insurance Rules 2013 (Amendment) Rules 2017 which never came into force.