SRA BOARD
22 June 2020

CLASSIFICATION – PUBLIC

Solicitors Regulation Authority

This paper will be published

Professional Indemnity Insurance – post six-year run-off cover

Purpose

1 To ask the Board to consider the options for responding to the Law Society's recent request to extend the post six years run-off cover provided by the Solicitors Indemnity Fund (SIF) for a further three years beyond September 2020.

Recommendation

2 The Board is asked to:

a) consider whether to change our regulatory rules to extend the Solicitors Indemnity Fund scheme and, if so, over what period.

If you have any questions about this paper please contact: Chris Handford – chris.handford@sra.org.uk

Equality, Diversity and Inclusion considerations

Consideration	Paragraph nos
The Law Society noted in its PII survey for 2017/18 that smaller firms are more likely to close without a successor practice and so enter run-off. We know that Black, Asian and Minority Ethnic (BAME) solicitors are disproportionately represented in the group of sole practitioners/small firms. So any extension to post six-year run-off cover provided by SIF, or alternative arrangement to meet claims falling outside of the six year period, could have particular benefits to BAME solicitors and the communities they have provided services to, in the event of a claim.	Paragraph 48
The cost of any extension or alternative arrangement will be at a cost to the profession and ultimately consumers from every community.	Paragraph 45
The cost of PII is a significant overhead for small firms which have a higher representation of BAME solicitors and partners, so any increase in costs will disproportionately impact on this group.	Paragraph 48

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Professional Indemnity Insurance – post six-year run-off cover

Background

3 At its 11 May 2020 meeting, the Board was asked to consider a request by the Law Society to extend by three years the cover that the Solicitors Indemnity Fund (SIF) currently provides to firms in respect of claims made more than six years after they close. The Society argued that this extension was both appropriate and necessary in view of the current extraordinary circumstances created by Covid-19.

4 The Law Society introduced this "post six year run off cover" provision in 2004, to be funded through residual funds that SIF had built. This additional cover was time limited, applying to claims notified before 30 September 2017.

5 In 2012 the SRA Board agreed a three-year extension to this end date and the SRA Indemnity Rules 2012 provide that this cover applies to claims notified to SIF before 30 September 2020.

6 In March 2016, the SRA Board decided not to agree to a new request made by the Law Society to again extend the post six-year run off cover provided by SIF for a further three years.

7 The main reasons for the Board's 2016 decision were that:

a. an extension did not align with the SRA's policy position that the appropriate level of mandatory run off cover should be six years

b. there was uncertainty at that time about whether there would be sufficient surplus in the SIF to finance an extension.

8 The 2016 Board paper queried whether an extension would be proportionate on a calculation of running costs versus the number of consumer compensation claims paid. This is still a key consideration and the actuarial advice the Board asked SIF to commission will be important in determining both affordability and proportionality.

9 The Board minutes from the 2016 meeting reflect a recognition that any limits on the scope of post six-year run-off cover would mean that some claims might not be covered. It was always assumed that some firms would be able to attain replacement post six-year run-off cover, while others would not, and that this would be a matter for the market to price on the basis of the usual cost-risk ratios insurers follow.

10 In reaching its decision the Board made a distinction between consumer protection and the so called "sleep easy" factor for retired solicitors, the former being a regulatory issue for the SRA and the latter being the domain of the Society as professional body.

11 Before responding to the Society's latest extension request, the Board asked the Solicitors Indemnity Fund Limited (SIFL) to commission some actuarial analysis of:

- the potential exposure to the SIF arising from post six year run off claims for a one, two and three-year period from 30 September 2020
- whether or not Covid-19 and the subsequent economic fall-out would likely impact on claims and liabilities.

12 The Board also asked that the Executive do further work to better understand both how Covid-19 is impacting on the PII market as it relates to present obligations on firms generally, as well as in relation to run-off cover.

13 This further work, summarised below, is to inform the Board's decision about whether or not the environment has changed significantly in a way that alters its 2016 decision. And, if so, what the options open to it are.

Key points

14 The professional indemnity insurance market has hardened and contracted significantly since the Board made its decision in 2016, particularly so in the last 18 months. Covid-19 is currently having a further negative impact on the insurance market generally, the full of extent of which is not yet known.

15 Insurers and brokers have reported reduced capacity and lower risk appetites, often due to new prudence rules set by their own regulatory bodies, the Prudential Regulatory Authority and the Financial Conduct Authority. This is impacting on the cost and availability of PII for many law firms generally. The priority for insurers is maintaining their existing clients and portfolios. Many are reluctant to develop new and untested products or take on additional uncertain risk.

16 This changing market and the added pressures, including uncertainty created by Covid-19, has effectively stalled activity in the insurance market in developing post six-year run-off cover products.

17 It is too early, however, to estimate what impact Covid-19 might have on the types of post six-year run off claims that might come through or on the ability of solicitors / former partners within firms to cover civil liabilities themselves in the absence of insurance.

What is the claims profile for post six-years run off claims?

18 We are awaiting the actuarial analysis of the likely profile of post-six years claims that might be made between September 2020 and 2023. This information will be available before the Board meeting on 22 June.

19 The SIF information previously provided to the Board suggests that the numbers of post-six years run off claims have historically been low and restricted to certain categories of claim.

20 The primary limitation period for negligence claims is six years. However, limitation periods may extend beyond six years in some circumstances. This may be because, for example, the negligence comes to light at a later date. And limitation periods can be postponed in light of “fraud, concealment or mistake”.

21 We do not yet know what impact Covid-19 and the connected economic downturn might have. The historical pattern is of professional liability claims increasing after every economic downturn. However, we do not have data about whether this applies to historical work done by firms that have been closed for at least six years.

What additional cover would the Law Society’s requested extension achieve?

22 When a legal firm closes without a successor practice, its former clients and partners are protected for compensation claims relating to work done by the firm when it was open by its PII run-off cover. Where there is a successor firm, the successor firm will normally assume liability for these claims.

23 The SRA’s rules mandate that a firm closing without a successor practice purchases six-years run off cover. This will cover claims made within six years of the firm closing which relate to work that the firm did when it was open.

24 Our agreement with insurers requires that the last insurer at the time the firm closes provides six-years run off cover. This is irrespective of the firm’s risk profile and irrespective of whether the firm actually pays the insurer the required premium for that cover. This means that all firms closing without a successor practice are guaranteed to have cover for compensation claims made against it within the first six years after it closes.

25 Since 2007, SIF has provided additional cover for former clients and solicitors of firms who have closed without a successor practice for claims made against that firms more than six years after the firm has closed. So, this provides cover beyond the period of run-off cover that we mandate.

26 When SIF closes, solicitors and firms will only be covered for claims made more than six years after their firm closed without a successor practice if they purchase additional cover from an insurer on the open market. The Law Society has asked that we extend the SIF cover by three years meaning that any closed firms who are beyond their mandated six-year run-off cover would remain covered for claims made before September 2023. At this point the position set out in the paragraph above would apply.

Why hasn't the market developed a product as expected?

27 In 2016, the insurance market was considered soft, meaning that it was well capitalised and competitive. Many insurers were actively looking for new opportunities to expand their offering and attract new clients. Therefore, at the time that the Board decided not to extend SIF's post six year run off cover, it was considered likely that a range of products would be available to provide cover when SIF closed. Although, as highlighted earlier in this paper, we did not expect that all applicants would be successful in securing this cover.

28 Further discussions with brokers and insurers, have confirmed that this is no longer the case. Instead our discussions indicate that, as we approach the September 2020 deadline for the end of SIF's post six-year run off cover, there are very limited, if any, options for purchasing alternative cover. This may mean that a larger proportion of firms are unable to get cover than the Board assumed in 2016.

29 As highlighted in the 11 May 2020 Board paper, some insurers have indicated that they would consider providing cover beyond the mandatory six-year run-off period. This however may only be for firms that are already on their PII book (existing business), on a periodic, and case by case basis. This would likely exclude those firms that they consider high risk or who have not paid the premium due for the mandatory six-year period. Since that meeting, we have also heard from brokers that insurers will be increasingly concerned about the ability to pay any excess as well as the premium.

30 However, we have not been able to ascertain that any of the insurers have put in place such policies. We have been told that developing new products is not a priority for many insurers and brokers as they grapple with the day to day impact of the Covid-19 pandemic. Insurers and Brokers are facing the same challenges as many across the wider economy in adapting to a new way of working during the lockdown. This has also contributed to a focus on existing or "core" business for some.

31 It has also been suggested that, given the above, momentum from insurers and brokers that may have been considering, or were willing to consider, developing post- six year run-off cover has been lost in the face of the current Covid-19 disruption. One reason for this is that given the immediate challenges being faced, planning for developments in September is not considered a priority. This is especially the case given that there is still uncertainty about whether SIF cover will end at that point and whether new products are definitely needed.

What options are open to former clients in the absence of insurance cover?

32 In the absence of insurance cover, former clients may still take legal action to seek redress from individual solicitors and partners from the closed firm, who may be found to be personally liable. The evolving economic situation may impact on income and the value of assets, meaning that these individuals are

less able to meet those liabilities. We cannot yet know how significant this change might be.

Is there a case for a long-term regulatory response?

33 The Board confirmed its view that the existing requirement for six years run off cover is appropriate as part of the fundamental review of our PII arrangements that concluded in December 2019.

34 The Board decided that this provides a proportionate balance of guaranteed consumer protection and cost, accepting that this does not offer 100% protection. The Board considered a range of run-off claims data at that time which showed that ninety per cent of all claims relating to work done by closed firms were made within the first six years.

35 The Board also acknowledged that the cost of run-off cover is significant and has been reported to be a barrier to closing for some firms. Law Society survey data shows that the average premium for six years run-off cover varies between two and a half and three times the closing firm's last year annual premium. The latest available survey data from 2018 indicates that the average annual premium for a sole practice was £8,655, rising to £148,988 for a 11 to 25 partner firm.

36 In this context, we considered reducing the mandatory run-off cover to less than six-years as part of the recent PII review but concluded "our data analysis shows that significant proportions of run-off claims continue to arise until the sixth year and therefore we do not support reducing the length of cover".

37 We have not seen any evidence to suggest that it would now be proportionate to extend the level of mandatory run off cover, with its associated costs, on consumer protection grounds in the longer term.

Is extending SIF affordable?

38 The analysis of affordability is not available at the time of writing this paper. We will update the Board at the meeting with the details of the SIF actuarial analysis of the affordability of extending post six years run-off cover by 1, 2 and 3 years. The actuarial analysis will also help provide an updated picture of the likely claims versus administration costs calculation for any extension. Further evaluation of the proportionality of different consumer protection options related to post-six years run-off claims could be undertaken if the Board decided to temporarily extend the post-six years SIF cover.

What are the possible options for responding to the Law Society's request?

39 We have identified three options for the Board to consider. Each has pros and cons.

40 The First Option is for the Board to refuse the extension request put forward by the Law Society as it considers six-years run-off cover is sufficient on consumer protection grounds. While it would benefit some consumers if more firms were able to secure post six-year run-off cover, this detriment is, arguably, not so great as to require regulatory intervention. The SIF surplus would then return to the Law Society to use for the benefit of the profession.

41 The Second Option is to agree to the three years extension requested. This would be on the grounds that although we do not consider that it is proportionate to mandate six-years of run off cover when a firm closes, it is still an appropriate use of existing SIF surplus to provide this additional level of consumer protection. This would give maximum certainty to both former clients and solicitors to protect against any currently unknown impacts of Covid-19 on post six-year compensation claims and the ability of consumers to pursue individual solicitors on a personal liability basis, and of those solicitors to meet that liability. The Board will however wish to consider the proportionality of this option, including around the running costs of SIF versus the number of compensation claims it is likely to be able to afford to meet.

42 The Third Option is to extend by a shorter time, for one or two years. This would allow the Executive time to gather data and consult the insurers directly on the potential impacts of Covid-19 and any related potential unforeseen impacts on consumers in relation to post six-years run-off claims. Suggested work might include a joint SRA and Law Society working group to engage with the insurance market to drive momentum for developing a more generally accessible post six-years run off product. Also to consider any other potential options for using the SIF surplus to provide consumer protection in relation to these claims at a proportionate cost. This would also provide stability and security for consumers and retired solicitors while the longer- term position following the Covid-19 pandemic becomes clearer. On the downside, the same questions around proportionality highlighted in Option Two do however remain. And there is a risk that the additional work does not deliver new insights or developments in the insurance market.

Recommendation: the Board is asked to consider whether to change our regulatory rules to extend the Solicitors Indemnity Fund scheme and, if so, over what period.

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Supporting information

Links to the Corporate Strategy and/or Business Plan

43 This work aligns with two of the five strategic aims/objectives outlined in the SRA Corporate Strategy 2017 to 2020:

- We will make sure our regulatory requirements are proportionate, providing solicitors and firms the flexibility to innovate and better meet the needs of members of the public and businesses, while maintaining appropriate levels of public protection.

How the issues support the regulatory objectives and best regulatory practice

44 The issue is around establishing the right level of post six-years run off cover to balance appropriate consumer protection with the cost and burdens of regulatory requirements that are ultimately borne by consumers. These considerations are core to following best regulatory practice and balancing regulatory objectives such as improving access to justice and protecting and promoting the interests of consumers.

Public/Consumer impact

45 If the Board does not extend SIF cover, consumers will have as a minimum the same six year run off cover as is available on the open market. They may also have recourse to legal action to secure redress from the individual solicitors and partners from the closed firm, in the same way as they currently do.

What engagement approach has been used to inform the work and what further communication and engagement is needed

46 We have engaged extensively the Law Society, SIFL, insurers and brokers.

What equality and diversity considerations relate to this issue

47 The Law Society noted in its PII survey for 2017/18 noted that smaller firms are more likely to close without a successor practice and so enter run-off. We know that BAME solicitors are disproportionately represented in the group of sole practitioners/small firms. So any extension to post six-year run-off cover provided by SIF, or alternative arrangement to meet claims falling outside of the six year period, could have particular benefits to BAME solicitors and the communities they have provided services to in the event of a claim. Any additional costs for the profession may also impact disproportionately on this group.

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Annexes:	
Annex 1	**A brief summary of the changing PII market**