

Protecting the users of legal services: balancing cost and access to legal services

Post consultation position: Professional Indemnity Insurance arrangements

December 2019

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Background

- 1 Appropriate Professional Indemnity Insurance (PII) is an essential component of consumer protection. The principle that clients of law firms will be protected by a minimum mandatory level of insurance has served the sector well. However, it is important that arrangements are subject to periodic review to ensure that they are meeting the needs of the legal market. We highlighted in our consultation some potential issues with the current arrangements.
- 2 Our insurance requirements are among the most comprehensive of any profession in any jurisdiction¹. For example, they largely place the same requirements on firms irrespective of the risk in the type of the work that they do, which may mean that some firms have more insurance than they need to safely protect most consumers.
- 3 We put forward the view that the cost of insurance may be a barrier to entry to some, which may reduce the availability of legal services. We also suggested that the cost of run-off cover can be prohibitive, risking disorderly closure of firms and detriment to their clients.
- 4 Therefore, in our consultation we set out proposals with the aim of:
 - allowing firms more flexibility to buy the most appropriate insurance given the risk profile of the legal services they provide
 - providing the opportunity for lower insurance premiums, resulting in savings for some existing firms, particularly small firms, and encouraging new firms to enter the market
 - if the market is competitive, therefore reducing costs for consumers, helping people to access legal services
 - making run off-cover more affordable so that it would be easier for firms to close, rather than close in a disorderly way, and with more firms meeting their obligation to pay run-off premiums.
- 5 While seeking to achieve the appropriate balance between our regulatory objectives to achieve consumer protection, and to promote competition and to improve access to justice, we acknowledged that the consultation was dealing with 'complex areas with no easy answers' and that arriving at the right level of protection would be 'a fine balance'.

¹ See Annex 1 to the consultation – PII comparison by professional group:
<https://www.sra.org.uk/sra/consultations/access-legal-services.page>

What we consulted on

Changes to the MTCs

- 6 The scope and level of the mandatory insurance we require regulated firms to have in place are in our Minimum Terms and Conditions (MTCs). We set out proposals to:
- reduce the minimum level of cover required for a single claim from £2m for most firms (£3m for incorporated firms) to £500,000, apart from claims for conveyancing services
 - introduce a separate requirement that those carrying out conveyancing services would have to include cover for this work, with a minimum limit of £1 million for a single claim. Cover relating to any conveyancing work may be declined if the firm did not buy this cover
 - exclude cover for financial institutions and large businesses from our minimum requirements. Firms would still need to buy adequate and appropriate cover for these clients, but this could be on different terms
 - allow firms and insurers more flexibility in their arrangements for defence costs (to maintain consumer protection, defence costs would continue to be excluded from the calculation to establish when an indemnity limit has been reached)
 - introduce a total cap for the level of cover over the six-year run-off period of £3m for firms that need cover for conveyancing services and a cap of £1.5m for other firms.
- 7 We also said that all firms, as is the case now, would remain under an obligation to buy adequate and appropriate insurance to cover the risk profile of the legal services being provided to their clients. This would mean some firms would need to buy cover above our minimum requirements.

Definition of a successor practice

- 8 We asked an open question about whether our successor practice requirements could be improved. Our current rules require the successor practice to cover claims for past work, rather than the closing firm having to obtain run off cover. This is designed to provide a clear position for firms and for clients who may seek to bring a claim. However, we understand that there are issues with this in practice. For example, we have been told that some firms

structure themselves in a way to avoid meeting our definition of successor practice, so they also avoid insurance liability. We have also been told that multiple firms may meet the definition of successor practice, resulting in confusion as to where the liability lies. We were concerned that some of the complexities of the requirements may put off successor practices, making it harder for firms to close.

Cybercrime

- 9 We asked for suggestions on approaches or strategies that we might adopt to protect firms from being victims of cybercrime attacks. This was in the context of the risk of cyber-attacks resulting in large losses from firms' client accounts. In most cases, these losses will be covered by the MTCs and we had been told by insurers that this is putting upward pressure on premiums.

Participating Insurers Agreement

- 10 We proposed to review the Participating Insurers Agreement (PIA). This was with a view to removing unnecessary overlap and duplication with the MTCs, with the PIA focusing on:
 - our relationship with insurers - the information we share and how we work together
 - how disputes involving more than one insurer should be resolved.

Potential impacts of our proposals

- 11 Prior to the consultation we published our PII market trends and claims analysis². This drew on 10 years of claims data from insurers actively operating in the legal market. It provided evidence on the type and level of claims covered by firms' PII policies for the period 2004 to 2014. This analysis, along with the external economic review³ that we published alongside the consultation, and the information we obtained from our engagement with stakeholders, informed our assessment of the impacts of the proposals.

² <https://www.sra.org.uk/sra/news/press/pii-trends-published.page>

³ <https://www.sra.org.uk/sra/consultations/access-legal-services.page#download>

12 Our view was that:

- the proposals could reduce the cost of meeting our minimum insurance requirements – our MTCs - for all firms by a range of nine to seventeen percent⁴
- small firms⁵ could particularly benefit because relative to income they pay proportionately more (almost double) for their insurance
- firms specialising in lower risk work and not doing conveyancing could achieve reductions in premiums towards the top end of the range we set out
- there would be potentially larger reductions in the cost of run-off cover because of the proposed cap to the level of cover provided.

13 Our analysis of historical claims data also informed our assessment of the impact of our proposals on consumers. We said that a small number of people with particularly high value claims could lose out if firms did not buy top-up cover and lacked internal resources to pay these claims.

Responses to consultation

14 We received 160 responses to the consultation. A list of respondents and summary of their responses is provided in our detailed summary and analysis of responses published alongside this post consultation position document.

15 We also carried out targeted engagement to discuss the proposals and to understand better what the impact on certain groups might be. We spoke at events, held roundtable meetings with key stakeholders and met with specialists. We hosted consumer focus groups seeking to find out what the public understood how they are protected when they go to a solicitor and what they thought about the proposals.

⁴ This range was calculated as the combination of impact of the lower single claims limit (five to ten percent) and the flexibility introduced permitting different defence costs arrangements (four to seven percent)

⁵ A small firm is defined by the SRA as a sole practitioner or a firm with no more than four partners, members or directors, which has an annual turnover of no more than £400,000.

- 16 The Law Society (TLS), the Legal Services Consumer Panel (LSCP) and others suggested that the dataset being relied on to demonstrate the impact on firms and consumers was not reliable. The main reason given was that the data excludes some insurers that had exited the market, including insolvent insurers. Respondents suggested that this meant we had underestimated the consumer protection impacts because these insurers were more likely to have dealt with high value claims than the insurers who remained in the market.
- 17 Many respondents disagreed with our analysis that the proposals would reduce premiums, or if they did, they thought this benefit would not outweigh the impact of a reduction in consumer protection. In addition to this, they thought the proposals would actually increase insurance costs overall. Respondents highlighted that the proposals would make the arrangements more complex and firms would need to buy multiple policies to remain adequately insured. Many highlighted that less uniform minimum requirements would result in higher search costs for firms buying insurance and for purchasers of legal services to understand what insurance firms have in place.
- 18 Insurers argued that most firms would need to buy top-up cover and said that this would be expensive. They thought this would exceed any reduction in the cost of the MTCs cover increasing insurance costs overall. And they said there would be no guarantee that a firm could get top-up insurance because the market was hardening and contracting. They provided some evidence of price increases in these top-up layers of insurance.
- 19 Some small firms, for whom a lower level of cover might be appropriate, thought they would continue to buy the level of cover set out in the current MTCs. This could be because for example: they are risk adverse, they are committed to maintaining current limits for past clients or retired partners or because potential clients such as lenders require this.
- 20 Some respondents, including TLS and the LSCP, also questioned whether, if there were savings, they would be passed on to consumers.
- 21 We had feedback that the proposals could lead to other issues that should be considered alongside any benefits of the changes. For example:
- more claims against brokers for poor advice
 - an increase in coverage disputes and possible uninsured losses
 - insurance business models (co-insurance⁶) ceasing to be commercially viable for the reduced level of cover being bought resulting in fewer insurers offering cover and at higher prices.

⁶ An insurance policy that is underwritten jointly with another insurer or others and each will apportion between them any loss covered by the policy according to a fixed percentage of the value for which the firm is insured.

- a reduction in the number of firms sitting on lender panels because lenders would look to minimise the search costs of checking whether firms had adequate cover.
- 22 A number of respondents, including the Sole Practitioners Group, agreed that it is currently difficult for some solicitors to close their practice and that run-off cover was one of the barriers to this. However, most respondents did not think that our proposal to introduce a cap on run-off cover would solve the problem and argued that it could result in some negative consequences for the profession for example, individuals becoming personally liable for claims once the cap had been reached, as well as reducing consumer protection.
- 23 The LSCP, while supporting in principle that it was right for us to review the appropriate balance between consumer protection and its impact on the cost of legal services, did not support the package we proposed.
- 24 An important consideration for them was consumers' lack of expertise and experience in dealing with legal matters. The LSCP thought these changes would make it harder for consumers to navigate the protections they have when using an authorised firm.
- 25 There was some limited in principle support for the proposals, with a small number of firms saying the proposed cover would be appropriate for their risk profile. However, several of these respondents went on to question whether the potential benefits we set out would materialise in practice.

Post consultation position

- 26 We have explored concerns about the dataset and carried out further analysis based on the data that we hold on the size of firms and the risk in the work they undertake. Our view is that the data is robust and supports the proposal that a significant number of firms could potentially reduce their cover and be adequately insured.
- 27 However, having reviewed the consultation responses, it seems unlikely that firms or insurers would respond to our proposals in a way that would lead to the intended benefits materialising. These views were largely consistent across all groups of respondents. In particular, we were told:
- most firms, even those that could benefit from lower limits, would respond by buying additional layers of insurance to maintain their current level of insurance, increasing the potential cost and complexity for both firms and consumers

- consistent with evidence about the way the market has responded in the past to changes in the level of cover, insurers would not necessarily lower premiums. And if they did, they would not be significant enough to lower prices for consumers (if any savings were passed on)
 - the proposals would not reduce the pressures on insurers in a hardening market that has seen insurers increasing premiums, declining to cover 'riskier' firms and some exiting the market. And the changes may make the situation worse by reducing the sustainability of some current insurance models.
- 28 Having taken these points into account, we are not proceeding with the changes we consulted on either as a package or with any individual proposal.
- 29 We are reluctant to risk disruption to a hardening and contracting insurance market when we cannot be confident that the intended benefits of change to be realised. However, we will continue to work to understand the challenges for firms and the drivers for the hardening market and will keep the efficacy and impacts of our insurance arrangements under review in this context.
- 30 In the meantime, we will draw on the helpful suggestions, views and information provided by consultation respondents to continue our work in three discrete areas:
- Firm closures – we will take forward a project to examine how we can make it easier for firms to close in an orderly way. We will consider ways to help firms manage the cost of run-off cover. We will review our successor practice rules. We will also consider wider support that we can give to firms wishing to close, to potential purchasers and to affected clients.
 - Cybercrime – we will work with insurers to support the development of insurance products and help define what should be in the scope of cybercrime cover. We will also consider the helpful suggestions made by respondents about how we can help firms protect themselves against cybercrime as part of our on-going work in this area⁷.
 - Participators Insurers Agreement – insurers agreed that the PIA should be reviewed. We will work with insurers with a view to introducing an improved agreement for the 2020/21 indemnity year.

⁷ SRA Risk Outlook 2019/20: <https://www.sra.org.uk/risk/outlook/risk-outlook-2019-2020/>