Protecting client's financial interests

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8 July 2015

- You can download this discussion paper [#download] or read it below.
- The deadline for submissions to this discussion paper ended on 16 September 2015.
- The information that appears below is for reference purposes only.
- Analysis of responses to this discussion paper are in progress.

Part 1: Context

Purpose of this paper

1. We are continuing to review and reform our client financial protection arrangements. Our aim is to secure an appropriate balance between the overall level of financial protection and the cost and regulatory burden imposed on firms and individuals offering regulated legal services. If the cost of client protection arrangements prevent firms entering or remaining in the market then this could impact negatively on consumer choice, the diversity of the profession and access to justice.

2. This paper sets out and seeks views on a number of possible options for reforming our Professional Indemnity Insurance (PII) arrangements and for the Compensation Fund (CF). We hope this paper will facilitate a wide discussion about potential areas for further reform to achieve our aim. There may be options we have not identified and we would welcome views on this. It also explains where a proposed change to the PII arrangements might impact on the Compensation Fund so it is easier for respondents to consider the overall impact of the proposals.

3. Additionally and to inform more detailed proposals in particular changes to the SRA Minimum Terms and Conditions [https://upgrade.sra.org.uk/solicitors/handbook/introclipro/indemnityins/appendix-1/] (MTC) we are working with leading insurers providers in the solicitors PII market to undertake an up-to-date detailed analysis of claims data to capture information requested during an earlier consultation.

4. We will set out detailed proposals in a further consultation in early 2016. This means that the earliest any major changes can be implemented by is October 2016.

Background

5. In May 2014 we embarked on a major programme of regulatory reform with the aim of reducing regulatory burdens for law firms while maintaining important protections for consumers. We published a policy statement that set out our new approach, which is to:

    - remove unnecessary regulatory barriers and restrictions to enable increased competition, innovation and growth to serve the consumers of legal services better;
    - reduce unnecessary regulatory burdens and cost on regulated firms; and
    - ensure that regulation is properly targeted and proportionate for all solicitors and regulated businesses, particularly small businesses.

6. Our policy work on continuing to review client financial protection arrangements is an important part of achieving these aims. This paper focuses on the Compensation Fund and the PII arrangements. We will also be consulting later this year on a third aspect of our financial protection arrangements, the client account rules where we will set out our proposals to improve how we regulate the risks related to the holding of client money.

7. The options set out in this paper take place against a background of substantial costs to firms in acquiring PII (the premium for 2014-15 totalled around £250m) and a Compensation Fund that pays out on average in excess of £20 million per annum. These costs are not solely driven by incidents involving the mis-use of client money but they do play a very significant role.

8.

We are building on changes already made to client protection financial arrangements following on from our report commissioned in 2010 from Charles River Associates (CRA) [1 [#n1]]. The Assigned Risk Pool (ARP) which formed part of the insurance arrangements has been replaced by an extended policy period to be provided by a firm's existing insurers, and we have removed the requirement of a single renewal date. The reforms were introduced from October 2013 to sustain the viable longer-term operation of the market for the provision of PII whilst continuing to protect clients from sudden and disorderly closure. The different options for providing PII to solicitors are further explainer in paragraph 20.

The Assigned Risks Pool (ARP) - was an arrangement, underwritten by insurers that provided cover for a limited period to those firms that find it difficult to obtain cover from the commercial market.

Extended policy period - as a replacement for the ARP, from 1 October 2013 a firm's existing insurer is liable to continue to provide cover for the Extended Indemnity Period (30 days) and Cessation Period (60 days) if the firm does not renew its policy of qualifying insurance with them and does not obtain a policy of qualifying insurance with another participating insurer

Qualifying insurance – a professional indemnity insurance policy that meets the SRA's minimum terms and conditions.

9. •

In September 2014, following consultation [2 [#n2]], we made changes to the SRA Compensation Fund Rules 2011. We have changed the eligibility criteria to remove (subject to some limited exceptions) the right to claim on the fund by any sole traders, partnerships, body corporates, unincorporated associations or mutual associations with an annual turnover of more than £2 million. The Legal Services Board (LSB) approved changes to our regulatory arrangements and the criteria apply to all claims received from 1 April 2015.

10. •

We also issued a consultation on further changes to PII arrangements in May 2014 [3 [#n3]]. In that paper, we consulted on five proposals designed to ensure that regulation is proportionate and targeted. The aim was to assist small law firms in providing the appropriate level of protection to their clients whilst reducing unnecessary expense that drives up their costs and prices to consumers. There was a large response to this consultation with a variety of view expressed on the proposals. A key concern was that we were moving too quickly and that more information was needed to enable the impact of the proposals to be properly assessed. In addition, the relationship between the proposed changes to the PII arrangements and impact on Compensation Fund needed to be better understood.

11. •

In the light of the consultation responses, we deferred decisions on a number of proposals and sought LSB approval of two of the original five PII proposals. These were the introduction of a new Outcome in the SRA Code of Conduct 2011 to require firms to assess the appropriate level of PII cover and the reduction in the level of compulsory PII cover to £500,000. The LSB granted "part approval" by approving the introduction of the new Outcome on 1 April 2015 but not the reduction in the minimum level of compulsory PII cover. In reaching its decision, whilst the LSB accepted the need for a number of regulatory objectives to balanced in the overall design of the client protection regime, they felt that the proposals for PII arrangements could be better informed by analysis of the how the current insurance market was operating.

Ongoing review and reform of client protection regime

12. •

The review and reform of the client protection regime remains a live issue for us. There has been significant change in the legal services market since the CRA report - including the authorisation of Alternative Business Structures (ABSs) and the introduction of new rules relating to multi-disciplinary practices (MDPs). As we continue to review the arrangements we need to design them in a way that does not distort competition between different legal services providers or prevent entry and innovation in new business models and subject to appropriate consumer protections. For example, as firms begin to provide services across different professional disciplines we need arrangements that do not restrict their flexibility to have a single insurance policy covering all of their professional activities – rather than having to negotiate the gaps between different insurance policies each with slightly different minimum terms and conditions [4 [#n4]].

13. •

In order to start to build a stronger evidence base to support our proposals going forward we issued a "Call for evidence - client protection" [5 [#n5]] on 1 August 2014. We received only a limited response but a number of related issues were raised which are relevant to our ongoing review of financial protection arrangements. These are:

- whether there are alternatives to the need for SRA-authorised firms to hold client money;
- whether there should be a prohibition on SRA authorised-firms acting for lender and borrower;
- the impact of specific regulatory requirements on the supply and cost of insurance;
- the need for up to date analysis of claims trends and histories both arising from the Compensation Fund and PII claims to inform regulatory options for client protection going forward; and
- the importance of professional standards to support our aims for the regulation of client financial protection.

14. We are also working with leading insurance providers in the solicitors PII market to undertake an up-to-date detailed analysis of claims data. This is so that any further proposed changes to the arrangements are informed by detailed analysis of how the current arrangements are operating.

Regulatory approach

15. 15. In our May 2014 Policy Statement we stated that the purpose of our regulation is to:
    - protect consumers of legal services; and
    - support the operation of the rule of law and the proper administration of justice.

16. We believe that for regulated legal services there are particular types of client that require additional consumer financial protections above those required by the general law. Regulation directed at protecting more vulnerable consumers is consistent with the rationale we regulate the legal services market to secure the public interest.

17. Clients such a big corporations, do not face issues such as access to inferior information faced by other types of clients such as individuals and small businesses, so the justification for further regulatory protection is weak. Here, the market should function effectively to deliver efficient and high quality insurance products and services.

18. In determining the appropriate level of financial protection we must also balance the cost and market impacts of the regulatory requirements that we put in place. If indemnity and compensation arrangements are so onerous that firms cannot obtain or afford cover, then this could result in a reduction in the number of firms and therefore negatively on access to justice, diversity and competition. We remain concerned that the level of premiums for PII increases costs for firms in ways that make it more difficult to compete.

The overall model for the provision of PII

19. The CRA report considered three broad models: open market; Master Policy and industry self-insurance.

Open market – under this model each firm is obliged to purchase an insurance policy from a number of competing insurers.

Master Policy - means a single policy put in place to cover the entire profession with certificates of insurance being issued to individual firms. The policy would be underwritten by one or more insurance companies.

Self-insurance - under this model there is a single fund underwritten by the profession itself which meets all claims. This was the Solicitors Indemnity Fund model used in England and Wales until September 2000.

20. The report concluded that the best model for professional indemnity insurance is the open market. We agree and have seen no evidence to suggest that we need to re-visit this conclusion. Currently the Compensation Fund exists to provide a safety net for certain clients where the market fails. However, we do not think it is appropriate to consider a completely unregulated open market solution because the risks to consumers would be too high. By imposing requirements on the terms of solicitors' insurance arrangements we impact both on the range of products that can be offered by insurers and their price.

21. To secure the appropriate balance between the overall level of client protection and the cost and regulatory burden imposed on firms and individuals offering regulated legal services we think

there is merit in continuing to review the options for the MTC underpinning the current insurance arrangements.

MTC - means the minimum terms and conditions with which a policy of qualifying insurance is required by the SRA Indemnity Insurance Rules to comply, a copy of which is annexed as Appendix 1 to those Rules. They include a minimum amount of insurance cover per claim – currently £2m for partnerships and £3m for limited companies and LLPs.

Question 1:

Do you agree that the best model for professional indemnity insurance remains a regulated open market? What problems do you see with the way the market currently operates?

Question 2:

What are your overall views of the impact of the current financial protection regime in terms of the balance between the level of protection provided to consumers and the cost and regulatory burden on law firms?

Question 3:

What protections do you think are necessary for consumers? What are the potential consumer impacts from changing the current arrangements?

Relationship between PII and the Compensation Fund

22. In evaluating the impact of possible changes to the MTC we need to consider the impact on the Compensation Fund. If there is an impact on the Compensation Fund then we need to understand what this means for the overall level of consumer financial protection afforded and whether consumers are more cost-effectively protected by firms' insurance arrangements or through the Compensation Fund. We explain the purpose of the Compensation Fund and its costs and benefits in paragraphs 93 to 98.

23. 23. We do not want to make changes to the insurance arrangements where there is a risk that claims would be transferred to the Compensation Fund when insurers would have been better placed to bear the liability for these claims. This is consistent with the CRA report which suggests that because insurers, as part of the underwriting process, have an opportunity to assess misrepresentation and non-disclosure this will ultimately limit the number of claims that eventually arise. This is because, in some cases this process can lead insurers to decline cover where they are suspicious of misrepresentation. One possible outcome from this could be the exit of the firm from the market. In addition insurers can seek redress from a firm that misrepresents information and this provides an incentive for firms to provide accurate information [6 [#n6]].

24. Whilst the costs of dealing with a claim may be lower from the Compensation Fund as contributions do not attract insurance premium tax (IPT), brokers' fees and profit margins, it can only pay out after an event has occurred, it does not have the advantage of preventing claims arising in the first place.

25. PII covers firms in relation to claims for civil liability. Firms are obliged to provide cover up to the minimum amount required by the minimum terms and conditions (MTC). This is £2m for a partnership, £3m for a limited company or LLP. Firms can, but are not obliged to, buy top up cover for claims above this amount.

26. Firms can insure against fraud/dishonesty by their own partners/directors and staff – but that insurance can only cover those that were not involved in the fraud. A person cannot insure against their own dishonesty.

27. The Compensation Fund provides a safety net for those affected by authorised individuals or firms who have acted dishonestly or failed to account for client money in the course of practice. It does not protect individual practitioners – the starting point is always that the client has a claim on the firm/practising individual but the Compensation Fund can act to recover money on the client’s behalf and pays out when there is a default. It also make grants in respect of the civil liability of a defaulting practitioner, where the authorised individual/firm has failed to take out qualifying

insurance. But the Compensation Fund is not a top up scheme – provided the insurance taken out satisfies the provisions of the current MTC then the Fund does not compensate for uninsured losses for civil liability.

28. •

A hypothetical example could involve a partnership (A) that has taken out insurance that meets the MTC with the minimum £2m of cover, and a client (B) who has a £3m negligence claim for compensation. If A defaults, B would not be able to claim any of the £1m uninsured loss from the Compensation Fund since A would not have failed to have taken out qualifying insurance.

29. •

Businesses with a turn-over of more than £2m cannot claim on the Compensation Fund for any purposes.

30. •

This means that changes to the MTC do not always affect the Compensation Fund, although they might do so in certain circumstances. The charts included in Annex 1 are a visual summary of the relationship between consumer, firm, insurance policy and Compensation Fund. We also set out under each option for changes to PII arrangements our view on the impact on the existing Compensation Fund arrangements.

Part 2 Options for changes to PII arrangements

31. •

We refer at various points in this section to the PII arrangements of the Approved Regulators [7] [#n7] . A summary comparison of these is set out in Annex 2. This describes the overall model of provision, distinguishing for the open-market model between arrangements where insurers are required to agree to specific terms and conditions (open-market: participating / qualifying insurers) and where they do not (open-market).

Client coverage

32. •

Currently the MTC provide the same level of protection to all clients of a firm. This provides clients with a degree of certainty and consistency as to the minimum level of protection they have without the need to check. In their 2010 report CRA considered the scope of clients that should be protected and concluded that there was justification for intervention into the market on behalf of individual clients but not for corporations. Their arguments against applying the MTC to all clients were that:

- regulatory restrictions should be applied only where there is a market failure. While there is a concern about asymmetric information for individual clients, this does not appear to apply to the use of solicitors by corporations; and
- it may prevent innovation in insurance coverage for the corporate market or for sophisticated individual clients. Since all insurance contracts must have the MTC built into them this may prevent new types of coverage developing.

33. •

CRA recommended that the MTC require cover be in place for individual clients, but not for other clients, and that there was merit in having a common definition of eligible clients in the insurance arrangements as that used by the Legal Ombudsman. This would help consumers understand whether or not they are protected by the MTC.

34. •

In the May 2014 PII consultation, we proposed restricting compulsory cover under the MTC to individuals, small and medium sized micro-enterprises, trusts and charities in line with the CRA recommendation. The majority of respondents disagreed with the proposal. The main areas of concern were lack of clarity in the definition of eligible clients and the issue of timing of introduction of any changes, which was of particular concern to lenders. In our response we stated that we were going to return to the proposal as part of the wider review of the MTC.

35. •

Our position remains that more sophisticated clients, such as large corporations many of whom have substantial in-house legal resources, should be able to assure themselves as to the adequacy of insurance arrangements relating to legal services and therefore do not require the protection of the MTC. Limiting the compulsory cover provides potential for more flexibility and a lower cost of insurance, especially for firms providing services only to this group of clients. There is of course nothing to prevent any lawyer or firm to purchase the level and extent of cover that they consider is right for them and their clients.

36. •

Since the consultation was issued last year, similar eligibility criteria (see paragraph 10) have been introduced into the Compensation Fund rules with effect from 1 April 2015. There is now a pronounced mismatch between the client coverage of the Compensation Fund and the MTC. We believe it would be consistent if the client coverage of the MTC was more closely aligned to the Compensation Fund. We accept that we need to address the issue of the clarity of the definitions and the timing of the introduction of any change.

37. •

The Building Society's Association and the Council of Mortgage Lenders were amongst those that opposed the changes. They argued that lenders would require coverage in any event and that that some of them would not have the resources to check that firms have appropriate coverage. They said that the changes proposed could result in a reduction on panel numbers, more separate representation, and a shift towards lenders using Licensed Conveyancers.

38. •

The Code of Conduct requires all firms to obtain appropriate insurance. We welcome further evidence and views on the possible impacts on the conveyancing market of the removal of compulsory requirements for more sophisticated clients including large corporations.

39. •

We would also welcome respondents' views on the extent to which the issues raised by those that oppose the change could be dealt with by, for example:

- More lead-in time for those solicitors on panels to confirm their insurance position;
- Requirements for better information about cover to be provided to clients;

40. •

There would be no impact on the Compensation Fund as we would tie in any definition of clients that are not covered by the MTC with that of the clients excluded from compensation.

Question 4:

Do you have views on the impact of removing compulsory requirements for insurance for more sophisticated clients in particular on the conveyancing market?

Question 5:

Do you have any further evidence or issues that we should consider in relation to client coverage for the MTC?

Aggregation limit

An aggregation limit is a contractual term contained in some insurance policies to limit the total amount that the insurer will pay in relation to claims made in the policy period. Often the limit is referred to as an annual aggregate limit, which is just the total amount an insurer will pay in a single year.

41. •

In the 7 May 2014 consultation paper we proposed the introduction of a cap on insurers' ultimate exposure through an aggregation limit. Such a cap would remove insurers' unlimited sideways exposure and could be a driver for lowering the cost of insurance.

42. •

A major concern raised about imposing a limit was that it could increase uncertainty for consumers that their claims would be met by the firm's insurer and have arbitrary impacts. For example, under the current arrangements, a corporate client may have their claim met in full, but a valid claim by a vulnerable member of the public may not be paid because the aggregate limit under the firm's policy had been reached. It would also be very difficult to explain the position to consumers in advance.

43. •

Our initial view is that these seem valid concerns even where we changed the eligibility criteria. Nevertheless we are seeking any additional evidence and views about the impact of imposing an aggregation limit and whether any negative consequential impact on consumers could be mitigated.

44. •

There would be no impact on the Compensation Fund if this measure were introduced. The Compensation Fund may make grants in respect of claims against uninsured firms but not in respect of claims not met by a firm's policy of qualifying insurance due to the operation of an aggregation clause.

Question 6:

What are the issues that we should consider in relation to the imposition of an aggregate limit? Are there particular types of client more likely to be affected by such a limit?

Reduction of the minimum compulsory cover

45. The LSB rejected our proposal to reduce the compulsory cover to £500,000 on any one claim. Whilst the LSB accept that there are a number of regulatory objectives to balance, our proposals need to be better informed by analysis of how the current insurance market is operating. We are working with insurers to obtain the data to enable us to do this. The LSB also acknowledge that there might be other options to provide more effective assurance as to the adequacy of insurance cover than a blunt instrument of setting a minimum level.

46. Now we have the new outcome in the Code of Conduct requiring firms to assess and purchase an appropriate level of PII cover, one option might be to have no minimum limit. This would maximise the opportunities for firms to negotiate limits most appropriate to their business activities with the associated reductions in cost benefiting consumers.

47. We received clear advice from some insurers during the consultation in 2014 that the reduction of the minimum limit would reduce insurance premiums. This was confirmed by our professional advisers. There was some evidence of lower prices being offered during the period before LSB issued its warning notice in relation to its partial refusal of the rule change [8] [#n8].

48. We have requested from insurance companies to improve our evidence base to inform further proposals on minimum compulsory cover early next year.

49. We believe that any such change would be best combined with requirements to make information available to consumers so prospective clients could make informed choices. The issue is discussed further below.

50. There would be no impact on the Compensation Fund if changes were made to the minimum cover limit. The Compensation Fund may make grants in respect of claims against uninsured firms but not in respect of claims not met by a firm's policy of qualifying insurance due to the operation of an indemnity limit.

Question 7:

Do you have any further comments or evidence on the issue of minimum cover?

Run-off cover

Run-off cover is insurance against claims made after a firm has stopped trading.

51. Professional indemnity policies are generally written on a "claims made" basis rather than a "losses occurring" basis. This means that responsibility for paying a claim lies with the insurer at the time the claim arises, or circumstances which might give rise to a claim are notified, rather than with the insurer that was on cover when the alleged negligent act took place. It might be sometime after a service has been delivered that a claim arises and therefore it is important that insurance is in place for a period after a firm has closed.

52. Under the current compulsory PII arrangements, if a firm ceases due to a succession by another firm, then future claims made against the ceased firm fall within the cover of the successor practice's qualifying insurance. In the event that a firm ceases without a successor practice, then the participating insurer at the date of cessation is required to provide six-year run-off cover. Most

insurers have a charging clause in their policy which typically is set at around three times the annual premium as a one-off payment for the six years of run-off cover.

53. •

Under the current arrangements, cover beyond the end of the six years is provided by the Solicitors Indemnity Fund (SIF). This is provided by SIF from available surplus under the provisions set out in the SRA Indemnity Rules with a current end date for this arrangement of 30 September 2020. We are considering whether the end date should be further extended by one or two more years, subject to the necessary surplus being available within SIF.

54. •

There are challenges in obtaining run off cover from the market. Our research suggests it is generally only provided as part of a single compulsory schemes for lawyers e.g. in Northern Ireland, Scotland, Paris and in some Australian states. Run off cover was a problem in the Republic of Ireland leading to it being added to their ARP to become the Special Purposes Fund which provides run-off cover funded by the insurers in the same way as the ARP. Other regulators recognise the lack of availability of run-off cover and require their regulated entities to make reasonable endeavours to obtain it.

55. •

In our May 2014 consultation, we proposed reducing the period of run-off cover under the MTC to three years. The proposal prompted a great deal of debate and we decided that there was merit in undertaking further research and discussion before making any final detailed proposals. To achieve a reduction in premiums, it would be necessary to reduce the period of run off cover such that it excluded enough claims to make difference to premiums. This in turn would leave some consumers unprotected. The options here, will be informed by the analysis of the up to date claims data that we have requested from insurers.

56. •

Reducing the period of run-off cover would not impact the Compensation Fund. The Compensation Fund may make grants in respect of claims against uninsured firms but only where the firm should have had, but did not have, in place a policy of qualifying insurance against which a claim could be made in respect of such civil liability.

Question 8:

What further issues should we consider in relation to run off cover?

Question 9:

Do you have any views on whether the post six-year run-off cover provided by SIF should be extended beyond 30 September 2020, and if so, whether the extension should be for one or two years?

Defence costs

Defence costs are the legal costs of defending the claim.

57. •

Currently, the MTC provide that defence costs are covered with no monetary limit (clause 2.2, MTC) and that no excess applies to defence costs (clause 3.3, MTC). These provisions are in addition to the cost of awards and do not directly protects consumers as defence costs cannot be deducted from the award. We understand that some firms have separate arrangements with their insurers under which the firms handle their own claims and meet their own defence costs. Removing these provisions relating to defence costs would give firms and their insurers flexibility to arrange policies that best meet the needs of the firms without impacting on the protection afforded to consumers as the prohibition on deducting these costs from awards would be maintained.

58. •

There would be no impact on the Compensation Fund as defence costs are not covered by the Compensation Fund.

Question 10:

What further issues and evidence should we consider in relation to the payment of defence costs?

Funding of the excess

The excess is the minimum amount the firm has to pay of any claim before the insurance policy will cover the rest.

59. •

Clause 3.4 of the MTC provides that if an insured firm fails to pay a claimant any amount which is within the excess within 30 days of it becoming due for payment, the claimant may give notice of the insured's default to the insurer, whereupon the insurer is liable to remedy the default on the insured's behalf. In normal liability policies, an insurer would settle a claim net of any excess, and the claimant would then have to seek the balance of the settlement from the insured firm. If the insured either refused or was unable to pay this balance then the claimant would be left to pursue the insured through debt recovery procedures or else would not receive the full agreed settlement.

60. •

The effect of this term is that the credit risk of a firm defaulting on payment of its excess falls on the insurer. This means that it is not necessary to mandate a maximum excess as insurers set the excess based on an assessment of the firm's ability to meet it. If the provision was removed then instead we would need to set maximum excess levels to avoid firms arranging cover with too high an excess in exchange for a reduced premium leaving consumers exposed to risk of significantly reduced settlements.

61. •

We believe this clause continues to be targeted protection for consumers in circumstances where a firm is at risk of being unable to meet its financial responsibilities in the event of a qualifying insurance claim.

62. •

There would be no impact on the Fund if changes were made in this area. The Compensation Fund may make grants in respect of claims against uninsured firms but not in respect of claims not met by a firm's policy of qualifying insurance due to the operation of an excess clause.

Question 11:

What further issues and evidence should we consider in relation to funding of the excess?

Unpaid premium

63. •

63. One of the special features of the MTC is that they do not permit an insurer to cancel a policy of qualifying insurance on the ground of non-payment of premium [9 [#n9]]. The reason for this is to ensure that consumer protection is maintained even if a firm is in breach of the terms of its insurance policy. The insurer may have rights of reimbursement against a firm to the extent that it suffers prejudice as a result of the non-payment of premium. Usually insurers require receipt of premium before commencing a policy and this mitigates the risk of non payment and therefore cost impact on annual premiums.

64. •

64. In respect of the premium for run-off cover, the insurer is obliged to provide six years run-off cover even if it is unable to collect any premium that may be due. The default rate on run-off premium may be around 50% [10 [#n10]], and therefore the cost of providing run-off cover will be factored into general insurance rates, particularly for smaller firms that are more likely to close without a successor practice and so trigger run-off cover.

65. •

In the 2010 report, CRA set out the arguments in favour and against the requirement that insurers cover solicitors who do not pay their premium [11 [#n11]]. CRA recommended a change to the MTC such that insurers would not need to continue providing cover in the absence of payment. This would apply for both particular indemnity years and for run-off. CRA suggested that insurers would no longer need to be on risk once they had reported failure to pay premiums to the SRA and that there would not need to be notice from insurers to firms of failure to pay before insurers came off risk for the firm. The CRA recommendation was also made at a time when the ARP was still in existence.

66. •

Allowing policies to be cancelled for non-payment of premium would impact on the Compensation Fund and the overall level of consumer protection. Claims for uninsured firms may be covered by the Compensation Fund under Rule 5 of the SRA Compensation Fund Rules. There are differences in coverage between the two schemes with claims against the Compensation Fund subject to a shorter time limit of 12 months from discovery and a £2m limit per claim. As with all claims on the Compensation Fund the process also involves application of discretion.

67. •

We are aware that the need to pay for run off cover can be a significant issue for sole practitioners who cannot find a successor for their practice. Anecdotally, we have been told of cases where sole practitioners (who are, for example, unwell and in order to avoid financial failure) have been forced to keep their businesses going because they cannot afford the run off premium.

68. •

One option to mitigate these impacts could be to use a centralised fund such as the SIF that firms could apply to on hardship grounds for payment of all or part of the run-off cover premium. The costs of this would be need to borne by the regulated community as a whole.

69. •

Our current arrangements are targeted in that only the firms that trigger run-off cover pay for that cover, although as noted above there might be high default rates. Changing this may not be consistent with encouraging risk management. Nevertheless, there might be circumstances which were genuinely unforeseeable and which a hardship test could take into account.

70. •

Our initial view is that there is not currently sufficient evidence that the impact on the costs of insurance from removing this requirement would outweigh the potential impact on the reduction of the level of consumer protection and on the Compensation Fund.

Question 12:

What further issues and evidence should we consider in relation to the provision which prevents policies being repudiated for non-payment?

Question 13:

Do you have any evidence on the option of a hardship fund for run off cover premiums?

Avoidance, repudiation, adjustment and denial

These are terms for provisions in the insurance contract or in the general law that allow insurers to refuse to pay (in whole or in part) because of a breach of the agreement by the insured, This would include any failure by the insured to disclose relevant facts or any misrepresentation in relation to those facts.

71. •

Under the current MTC, insurers are not entitled to avoid or repudiate the insurance on any grounds whatsoever (clause 4.1, MTC) except to the extent that one of the permitted exclusions applies (clause 4.2, MTC). This is to ensure that clients remain protected. The insurer may have rights of reimbursement against the firm to the extent that the insurer has suffered prejudice as a result of non-disclosure, misrepresentation or breach of any term or condition.

72. •

Some insurers have stated that they want these restrictions removed and that removal might mean fewer claims are met and premiums may reduce. Removal might incentivise better risk management, but the effect would be that clients with valid claims could be delayed receiving, or even denied, a remedy.

73. •

Where the contract of insurance is allowed to be cancelled or deemed void then the claim would fall to be covered by the Compensation Fund under Rule 5 of the SRA Compensation Fund Rules. However, in other cases, vulnerable clients in particular might not receive appropriate compensation.

74. •

Under the Law Society of Ireland's minimum terms and conditions, the insurance may exclude liability of the insurer to indemnify in respect of any claim by a financial institution in certain circumstances. These are where the insurer can demonstrate that any insured was guilty of any material misrepresentation or material non-disclosure in placing the insurance, save that liability shall not be excluded on the grounds of innocent misrepresentation or innocent non-disclosure on the part of the insured. Removing sophisticated clients from the protection of the MTC - as discussed in the client coverage section of this paper- would provide the potential for flexibility and for these types of exclusions to be agreed bi-laterally between and insurers.

75. •

We would be interested in any evidence concerning the impacts of introducing wording similar to that used by the Law Society of Ireland in its minimum terms and conditions.

Question 14:

What further issues or evidence should we take into account when considering the current provisions in MTC 4.1 and 4.2 restricting repudiation, avoidance, denial or reduction of liability?

Cover for partner fraud

76. •

One of the permitted exclusions in the MTC relates to fraud or dishonesty. The MTC allow insurers to exclude liability to indemnify a particular person to the extent that any liability arises from their own fraud or dishonesty. However the insurance must nonetheless cover that person liabilities arising from the fraud of others. (clause 6.8, MTC).

77. •

The effect of this provision is that, as long as there is at least one principal who was not involved in the fraud or dishonesty, then any related claim will be dealt with under the firm's policy of qualifying insurance. If all the principals are caught by the exclusion then any related claim will fall to the Compensation Fund.

78. •

The removal of the element of compulsory cover for partner fraud might provide better incentives for principals to undertake risk management in respect of fellow principals. Additionally, insuring against fraud within the business is common market practice in other fields. If such insurance were excluded from the MTC firms could continue to purchase this cover in any event outside of the MTC.

Excluding all fraud by principals from the MTC is likely to have an adverse impact on the Compensation Fund as claims that previously would have been dealt with under PII will fall on the Compensation Fund. In the past, the Compensation Fund has been able to recover significant sums from insurers under this clause. There is also likely to be a degree of consumer detriment as the situations in which the Compensation Fund makes grants are more restricted than under PII.

Question 15:

What other factors should we take into account in considering the issue of cover for partner fraud?

Awards by the Legal Ombudsman

79. •

The MTC provides cover for a direction by the Legal Ombudsman that a solicitor or firm pays compensation to the complainant as for any resultant loss, inconvenience or distress suffered by the complainant. Cover is also provided for interest on such awards. However, the insurer has no liability in respect of any determination by the Legal Ombudsman for the refund of any fees paid to the solicitor or firm.

80. •

It could be argued that there is no clear reason why firms should be required to insure against a finding against them by the Ombudsman – they might choose to do so but that should be a matter for them.

81. •

One justification for retention of such a condition is to protect consumers where the firm itself is not able to meet an award – i.e. it is insolvent and/or no longer in existence.

82. •

There would be no impact on the Compensation Fund if changes were introduced in this area. The Compensation Fund may make grants in respect of claims against uninsured firms but not in respect of claims not met by a firm's policy of qualifying insurance due to the claim falling outside the scope of the MTC.

Question 16:

Are there any other arguments for or against the retention of cover for Ombudsman awards in the MTC?

Removal of the extended policy period

83. From September 2000 (when the current market based PII scheme was introduced) until 30 September 2013, firms that were unable to obtain a policy of qualifying insurance in the market were able to apply for an ARP policy. From 1 October 2013, the protection afforded by the ARP was replaced by an extension of the cover provided by the existing insurer on cover for the firm for up to 90 days. The first 30 days are called the "extended indemnity period" (EIP) in which a firm can carry on practice while it seeks replacement insurance. If a firm has not obtained replacement cover by the end of the 30 days it enters a 60 day "cessation period" (CP) in which the firm cannot take on any new work and should simultaneously prepare for an orderly closure.

84. The provision of the extended policy period provides a short safety net period for firms and permits an orderly closure of uninsurable firms, thus minimising the adverse effect on the firm's clients.

85. The alternative would be to remove the obligation on insurers to provide cover in the EIP and CP. A likely consequence of this is that, faced with no safety net, firms would start looking for PII cover well in advance of the policy renewal date and those that cannot obtain PII will close on or before the renewal date. There is a risk that some firms will leave it too late or an event happens in the run up to the renewal date that makes the firm uninsurable. In these circumstances there is a real risk that the firm either carries on practicing without insurance which would impact the Compensation Fund or it may necessitate an intervention.

Question 17:

Do you have any further evidence or comments in relation to the continuation of the extended policy period in particular its impact on the cost of insurance and of removing it from the MTC?

Consumer information

86. At present, there is no specific requirement in the Code of Conduct to inform clients of the level of insurance cover that the firm has in place. Although the Handbook suggests that a firm/individual that is likely to be meeting the requirements under the Code would make it clear to clients where they have limited liability to a level above the MTC requirements [12] [#n12].

87. The provision of high quality services in particular increasing transparency and consumer information, is an integral purpose of Directive 2006/123 on services in the Internal Market [13] [#n13]. The Provision of Services Regulations 2009 [14] [#n14] that implemented this Directive and state that where the provider is required to hold PII the information must include the contact details of the insurer and the territorial coverage [15] [#n15].

88. If changes are made to minimum levels of insurance or to the types of consumer that are covered by the MTC, this increases the need for clients to be clearly informed of the protections that are in place. Alongside considering changes to the MTC, we are therefore looking at what additional information on insurance cover should be provided to better inform consumers so that they are empowered to drive better market outcomes.

89. Issues include:

    - Whether this will be a general duty or limited to particular circumstances?
    - Whether the requirement would be to confirm the specific amount of cover, or that cover exceeded a certain minimum amount?
    - Whether any other details (such as relevant exclusions) should be provided?

90. We also think there might be merits in consumers being able to access information from firms about the scope of claims that can be made against the Compensation Fund and how they may be different in scope and value to those that can be claimed against firms' PII insurers. This is so that the boundaries and limits of client protection arrangements are better understood.

Question 18:

Is there a case for a requirement to provide better information to clients about insurance cover and CF arrangements?

Question 19:

Do you have any evidence or examples from other professions or jurisdictions where providing this information is a requirement?

Question 20:

Are there any other changes to the insurance arrangements that we should consider for consultation?

Part 3: Options for changes to the Compensation Fund arrangements

The purpose of the Compensation Fund

91. The SRA is required to have in place compensation arrangements and the Solicitors Act 1974 sets out that practitioners can be required to fund compensation arrangements.

92. The Compensation Fund is a statutory purpose trust and provides a safety net for those affected by authorised individuals or firms who have misappropriated or failed to account for money in the course of practice. Most payments are necessary as a result of intervention by the SRA on the grounds of suspected dishonesty, breach of accounts or other rules or in the event of financial difficulty. The Fund also has the discretion to make grants in respect of the civil liability of the defaulting practitioner, where the authorised individual or firm has failed to take out qualifying insurance. In line with its purpose it is not intended that grants are made where the applicant is otherwise indemnified against loss.

93. In addition the Fund can be used for the following purposes [16] [#n16]:

    - payment of premiums to insure the Fund;
    - repayment of money borrowed for the purposes of the Fund and payment of interest on any money so borrowed;
    - payment of any other costs, charges or expenses incurred in establishing, maintaining, protecting, administering or applying the Fund;
    - payment of any costs, charges or expenses incurred by the SRA in exercising its intervention powers;
    - payment of any costs or damages incurred by the Law Society, the SRA, their employees or agents as a result of proceedings against any or either of them for any act or omission in good faith, and in the exercise or purported exercise of their intervention powers.

94. In 2014, 1,699 claims were made to the Fund for a total value of £56.73m. The majority of claims related to firms' failure to account, to pay conveyancing costs (in particular failure to pay Stamp Duty and Land Tax) and claims relating to probate matters. The average claim amount for quarter one of 2014 was £38,824 decreasing to £25,329 in Quarter 4. The largest claim was for £5.1m, however under the current arrangements a grant from the Compensation Fund cannot exceed £2m. As at December 2014 there were 580 applications under consideration and the pending value of open claims was £17m.

95. Under the current arrangements the burden of proof is on the applicant to establish they have a legitimate claim and in administering the Fund there is discretion in the classes of claim and level of grants made i.e. whether to make a payment in individual cases.

96. Currently there is an annual flat-rate fee contribution to the Fund of £32 on all practising certificates and of £548 on all entities that hold client money. This means the costs of the Fund including individual cases of dishonesty are funded from the whole profession. Although the Fund has the option of seeking recovery from the defaulting practitioners, such action is often impractical due to the costs of legal action and the chances of success.

Review of Compensation Fund

97. We want to make sure that solicitors compensation arrangements are effective and appropriate and stand the test of time. This includes the impact of the introduction of alternative business structures which provide legal services but which are not necessarily owned or managed by solicitors and changes to the separate business rule removing the existing prohibitions in Chapter 12 of the SRA Code of Conduct 2011 on regulated individuals and firms having links with separate businesses that carry on non-reserved legal activities.

98. We have been reviewing the effectiveness and efficiency of arrangements in order to consider whether:

    - compensation is an essential part of the overall client financial protection regime;
    - entitlement to claim compensation should be limited in any way;
    - different arrangements are needed for different types of legal services providers;
    - the basis of calculation of contributions to the current Compensation Fund remains appropriate;
    - there are any gaps in client protection.

99. As part of this review we have been gathering evidence including about compensation schemes in other jurisdictions and we have produced a comparison report [17] [#n17]. We believe there remains a strong case for the safety net provided by the current arrangements. It might be more comprehensive and therefore expensive than other models. It is also used for purposes other than compensation and we need to evaluate the ongoing appropriateness of how it is paid for.

100. So we believe it is right to review the arrangements. There might be reforms we can make to the existing model or there might be other models that better achieve our overall regulatory objectives to secure the appropriate balance between the cost of the Compensation fund and effective client protection.

Limiting payments out of the Fund

101. The Fund may provide grants of up to £2 million. This is a higher maximum payment than observed in compensation schemes operated in other jurisdictions, even though the schemes might cover similar losses to those covered by the SRA's Compensation Fund [18] [#n18].

102. We are continuing to analyse the number and nature of claims made including modelling to assess the impact on the level of claims of the recent changes in eligibility rules outlined above.

103. We currently have power to pay claimants costs as well as reimburse for losses, our analysis will include these payments. We would welcome views as to appropriateness of fund covering these costs.

Question 21:

Do you think there is evidence to support the introduction of a lower limit for the maximum award made from the Fund or to limit the types of payment made out of the Fund?

Calculation of contributions to the Fund

104. There could be fairer approaches for how contributions to the Compensation Fund are calculated.

105. A rationale for the current approach whereby all firms/individuals contribute equally to the Fund is the benefit drawn across the whole profession because there is a Compensation Fund in place. In considering alternative approaches we will analyse the impact on the distribution of contributions and any equality, diversity impacts and on small firms. Reducing the proportion paid by large firms may have equality and diversity considerations and could lead those who benefit most financially from the regulatory brand contributing the least.

106. •

Any change in the calculation of contributions would need to take into account the other uses for the Compensation Fund and set out in paragraph 95.

107. •

A robust approach to calculating risk-based contributions may lead to firms improving their systems and controls for the management of the risks relating to the holding of client money. We would need a valid methodology for predicting between low and high risk firms and also to be effective to establish a clear link between the level of contribution paid and the effort firms are willing to make to manage and reduce risk.

108. •

Economic Insights undertook analysis [https://upgrade.sra.org.uk/globalassets/documents/sra/compensation-fund-review.pdf] , that suggests pricing on a risk basis presents challenges due to:

- the highly unusual or extreme nature of the claims. Many amount to the deliberate or inadvertent use of the funds in client accounts as a consequence of the firm (or individual in the firm) getting into financial difficulty. This behaviour is likely to be linked to the circumstances and attitudes of individuals, which is inherently hard to observe measure and so predict.
- the claims are (as a consequence of the above) infrequent. Therefore, there is not a large 'history' of claims that can be learnt from and from which to form predictions.
- the need to develop a measure/proxy measure of the effort 19 [#n19] firms make to manage and reduce risk such as the adequacy of internal financial controls or through some form of self-assessments by firms and the burden that that might impose on firms.

The holding of client money

109. •

Nevertheless, it might be possible that alternative ways of calculating contributions can be designed in a way that reduces the value of claims on the Compensation Fund whilst maintaining appropriate protections for consumers.

110. •

While individual and firm contributions to the fund are not significant, they are necessary to recover costs for claims in excess annually on average of £20 million, costs that ultimately fall on consumers. A simple way to reduce claims arising from the risks associated with holding client money would be to prevent solicitors from doing so. This would be in line with barristers. This does not seem to be a proportionate or targeted intervention. There are benefits to consumers that arise from solicitors' roles in handling client money. For example the conveyancing system is largely built around this. We also recognise the benefits that accrue to solicitors and firms from their ability to hold client money, such as interest payment benefits and links to lower borrowing costs. While we cannot therefore see a strong case for banning solicitors from holding client money it may be possible to better align the costs associated with risks of misuse of that facility with contributions to the Compensation Fund.

111. •

This might be best achieved by basing contributions on average client balances, excluding money held on behalf of clients not eligible to make a claim. We already hold information on client balances but this does not currently distinguish between client balances according to the new eligibility criteria to claim on the fund introduced recently. We would need to therefore consider the burden on firms from separating these balances and the impact on contributions across different firms.

112. •

Before making any firm proposals here, we will continue to consider how we might ensure that the funding of the Compensation Fund is consistent with the better regulation principles.

Question 22:

Do you think there are fairer ways of calculation for firms and individuals contributions to the CF and what do you think are the pros and cons of the alternatives we have set out?

Other models

113. •

We welcome views on whether there are alternative models for solicitors compensation arrangements that are more effective than the current arrangements.

114. •

An issue with the current model is that in some cases, the Compensation Fund is relied on for grants where there is a case that insurers should have borne the cost of the claim but have refused to indemnify or make payments. There can be significant costs incurred to challenge these declinations and/or to recover the costs from solicitors or insurers directly after the event in order to protect clients.

115. •

We have in the past explored with insurers the viability of insuring some of the risks covered by Compensation Fund, for example stop loss cover designed to deal with catastrophic and unexpected events but at that time the prospect of a viable scheme seemed poor. The insurance market may have evolved since then.

116. •

We have considered the option of replacing the Compensation Fund arrangements with with an insurance policy in the name of the SRA to meet the claims of clients who have suffered loss as a result of an firm's dishonesty or failure to account. This might offer benefits from a better alignment between the two schemes. A market solution across the two schemes could also facilitate risk-based pricing.

117. •

When considering the case for other models the features of the current model are important:

- the impact on the current flexibility allowing us to exercise discretion to make awards to consumers very quickly in circumstances where delays in receiving payment might exacerbate the losses resulting from the original misuse/misappropriation. For example, a solicitor acting for the seller in a conveyancing transaction fails to redeem the seller's mortgage and misappropriates the money held for this purpose. The purchaser of the property faces repossession proceedings by the lender. In these circumstances, the Fund has previously made awards to the purchaser to mitigate that loss and halt the repossession proceedings, and then claimed the relevant sum from the firm’s professional indemnity insurance where appropriate.
- the impact the other uses to which the Compensation Fund is currently put including the arrangements currently in place to make funds available during an intervention to manage the adverse impact on clients and expedite the distribution of client money held on the Statutory Trust Account.
- The current 'backstop' role of the Fund of protection for claims that ought to have been covered by a firm’s professional indemnity insurance, for example, in circumstances where a firm did not have the necessary insurance policy in place.

Question 23:

Do you think there are areas where the Compensation Fund arrangements should be reformed in order to provide a better balance between the overall level of client financial protection for regulated legal services and the costs on firms and individuals?

Assessing impact

118. •

The options set out above will impact differently on individual solicitors, firms and consumers. We will undertake a full regulatory/equality impact assessment in developing the detailed proposals for consultation later this year.

Next steps

119. •

This consultation is open for ten weeks . We have previously consulted on some of the options set out in this paper. Informed by responses to this paper and further analysis of insurance and Compensation Fund claims data, we will be undertaking a further 12 week consultation on detailed proposals early in 2016.

Consultation questions

Question 1:

Do you agree that the best model for professional indemnity insurance remains a regulated open market? What problems do you see with the way the market currently operates?

Question 2:

What are your overall views of the impact of the current financial protection regime in terms of the balance between the level of protection provided to consumers and the cost and regulatory burden on law firms?

Question 3:

What protections do you think are necessary for consumers? What are the potential consumer impacts from changing the current arrangements?

Question 4:

Do you have views on the impact of removing compulsory requirements for insurance for more sophisticated clients in particular on the conveyancing market?

Question 5:

Do you have any further evidence or issues that we should consider in relation to client coverage for the MTC?

Question 6:

What are the issues that we should consider in relation to the imposition of an aggregate limit? Are there particular types of client more likely to be affected by such a limit?

Question 7:

Do you have any further comments or evidence on the issue of minimum cover?

Question 8:

What further issues should we consider in relation to run off cover?

Question 9:

Do you have any views on whether the post six-year run-off cover provided by SIF should be extended beyond 30 September 2020, and if so, whether the extension should be for one or two years?

Question 10:

What further issues and evidence should we consider in relation to the payment of defence costs?

Question 11:

What further issues and evidence should we consider in relation to funding of the excess?

Question 12:

What further issues and evidence should we consider in relation to the provision which prevents policies being repudiated for non-payment?

Question 13:

Do you have any evidence on the option of a hardship fund for run off cover premiums?

Question 14:

What further issues or evidence should we take into account when considering the current provisions in MTC 4.1 and 4.2 restricting repudiation, avoidance, denial or reduction of liability?

Question 15:

What other factors should we take into account in considering the issue of cover for partner fraud?

Question 16:

Are there any other arguments for or against the retention of cover for Ombudsman awards in the MTC?

Question 17:

Do you have any further evidence or comments in relation to the continuation of the extended policy period in particular its impact on the cost of insurance and of removing it from the MTC?

Question 18:

Is there a case for a requirement to provide better information to clients about insurance cover and CF arrangements?

Question 19:

Do you have any evidence or examples from other professions or jurisdictions where providing this information is a requirement?

Question 20:

Are there any other changes to the insurance arrangements that we should consider for consultation?

Question 21:

Do you think there is evidence to support the introduction of a lower limit for the maximum award made from the Fund or to limit the types of payment made out of the Fund?

Question 22:

Do you think there are fairer ways of calculation for firms and individuals contributions to the CF and what do you think are the pros and cons of the alternatives we have set out?

Question 23:

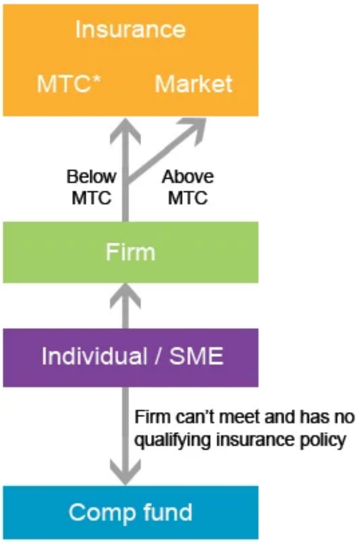
Do you think there are areas where the Compensation Fund arrangements should be reformed in order to provide a better balance between the overall level of client financial protection for regulated legal services and the costs on firms and individuals?
Notes

1. Charles River Associates, September 2010, 'Review of SRA client financial protection arrangements' - /sra/how-we-work/reports/cra-financial-protection-arrangements [https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/cra-financial-protection-arrangements/]
2. http://www.sra.org.uk/sra/consultations/consultation-listing/introduction-eligibility-criteria/ [https://upgrade.sra.org.uk/sra/consultations/consultation-listing/introduction-eligibility-criteria/]
3. http://www.sra.org.uk/sra/consultations/consultation-listing/professional-indemnity-insurance [https://upgrade.sra.org.uk/sra/consultations/consultation-listing/professional-indemnity-insurance/]
4. See http://www.sra.org.uk/sra/policy/policies/multi-disciplinary-practices-sept-2014 [https://upgrade.sra.org.uk/sra/policy/policies/multi-disciplinary-practices-sept-2014/]
5. http://www.sra.org.uk/sra/consultations/client-protection-call-evidence [https://upgrade.sra.org.uk/sra/consultations/consultation-listing/client-protection-call-evidence/]
6. Section 6.7 of the CRA report
7. https://www.legalservicesboard.org.uk/about-us/approved-regulators/ [https://www.legalservicesboard.org.uk/about-us/approved-regulators/]
8. http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/20140905_SRA_Response_To_WN.pdf [http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/20140905_SRA_Response_To_WN.pdf]
9. See MTC 4.1, 4.2, 4.3
10. Section 6.5.3 of the report by Charles River Associates, September 2010 - http://www.sra.org.uk/sra/how-we-work/reports/cra-financial-protection-arrangements [https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/cra-financial-protection-arrangements/]
11. Section 6.5 Ibid
12. Indicative behaviour 1.8 in SRA Handbook: if you seek to limit your liability to your client to a level above the minimum required by the SRA Indemnity Insurance Rules, ensuring that this limitation is in writing and is brought to the client's attention
13. Directive 2006/123/EC on services in the internal market - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:376:0036:0068:EN:PDF
14. The Provision of Services Regulations 2009 - http://www.legislation.gov.uk/ukdsi/2009/9780111486276/contents [http://www.legislation.gov.uk/ukdsi/2009/9780111486276/contents]
15. Regulation 8(1)(n) of The Provision of Services Regulations 2009
16. Section 36A of the Solicitors Act 1974 and the Compensation Fund Rules 2011, Part 2.
17. http://www.sra.org.uk/documents/SRA/comparative-study.pdf [https://upgrade.sra.org.uk/globalassets/documents/sra/comparative-study.pdf]
18. http://www.sra.org.uk/documents/SRA/comparative-study.pdf [https://upgrade.sra.org.uk/globalassets/documents/sra/comparative-study.pdf]
19. Other insurance products have premiums set on the basis of (i) observable characteristics (and (ii) historic behaviour (e.g. the number of speeding endorsements). Because of the link with historic behaviour, prices

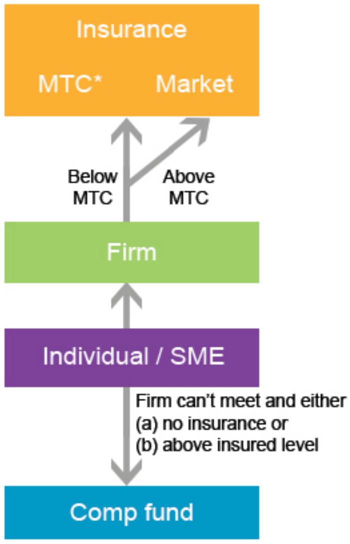
adjust to reflect efforts to reduce risk. It is difficult to set contributions to the Fund on the basis of "historic behaviour" since, in most cases, a claim on the Fund will follow the closure of the firm involved

Annex 1: Links between PII and Compensation Fund

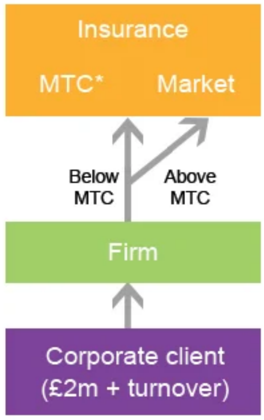
Civil liability



Dishonesty / failure to account



Civil liability & dishonesty / failure to account



*MTC = Minimum Terms and Conditions

Annex 2: Comparison of Approved Regulators schemes of 2015

	Solicitors	Barristers	Legal Executives	Chartered Accountants	Licensed Conveyancers	Patent / Trade Mark Attorneys	Costs Lawye
Regulatory Body	SRA	Bar Council	CILEx Regulation	ICAEW	Council for Licensed Conveyancers	Chartered institute of Patent Attorneys / Intellectual Board	Costs Law Standards Board
Type of PI cover	Open market / participating insurers	Mutual Insurance Company	Open market / Qualifying Insurers	Open market / Participating Insurers	Master policy or approved insurer	Approved insurers	Open marl
Size of profession (individuals)	167,000	13,000	20,000	18,000	1,200	5,000	562
Value of premiums	£246,637,000	£14,742,000	TBD	£30,000,000	£25,000,000	£3,000,000	£250,000
Premium basis	Insurer determined	Fixed rating schedule set by Mutual	Insurer determined	Insurer determined	Insurer determined	N/A	Insurer Determine (the major the profes insure witl industry m PAMIA)
Renewal	No Fixed Date	1 April	No Fixed Date	No Fixed Date	1 July	No Fixed Date	No Fixed D
Level of cover	£2,000,000 / £3,000,000 each claim	£500,000 to £2,500,000 each claim dependent on the area of practice and revenues	£2,000,000 any one claim	£100,000 to £1,500,000 in the aggregate dependant on firm size but GBP equivalent of	£2,000,000 per claim	Minimum of £250,000 in the aggregate	£100,000 claim

				EUR 1.12m per claim EUR 1.68m in the aggregate for mortgage mediation activity and £500,000 per claim if an accredited probate firm.			
Excess	None specified	£350 for professional misconduct or wasted cost applications	£3,000 per partner with a 15 partner cap (i.e. £45,000)	Not more than £30,000 x the number of principals but no restriction for firms with more than 50 principals	Residential conveyancing must be no more than £3,500 or the sum of: 5% fees for fees of £0-£0.2m: 3% fees for fees of £0.2m-£0.5m: and 2% fees on fees between £0.5m and £1m. Firms with fees over £1m can apply to increase the excess	£500-£7,500 per claim. Exceptions apply.	None spec
Significant Exclusions	Partnership disputes, employment breaches, Directors' and Officers' liability	Employment breaches, Intra-chambers administrative disputes	No funding by insurers of retention, provision of services from an office outside of England & Wales.	Proceedings brought or professional business undertaken from an office in USA/Canada, liability assumed by the Insured under any express warranty or guarantee unless attaching in the absence of such warranty/ guarantee	Insurers can avoid for non-disclosure or mis-representation unless free of fraudulent intent (insured to prove) and for false or fraudulent claims	Liability in respect of award requiring repayment, reduction or waiver of any fees. Disciplinary proceedings arising out of any complaint by one insured against another insured. Disciplinary proceedings arising out of any dishonest, fraudulent, criminal or malicious act or omission of the Insured.	No minimu terms in fc
Fraud	No cover for person committing or condoning dishonesty or fraudulent act or omission	No cover for fraudulent or malicious act or omission on the part of the insured but cover for acts of servant or agent for which they are liable so long as no awareness or	Fraud and dishonesty covered for Insureds not committing or condoning the dishonest act	No cover for dishonest or fraudulent acts or omissions committed by any person after discovery or reasonable cause for suspicion of fraud or dishonesty on	Fraud is not covered	No cover for liability arising from a dishonest or fraudulent act or omission committed or condoned by the Insured	No minimu terms in fc

		involvement in the act		the part of that person.			
Run-Off	Six years	£500,000 automatically with option to increase limit for up to 6 years to level of cover previously held if higher.	6 years conditional o payment of premium.	2 years although guidance recommends 6 years and firms must make “best endeavours" to secure cover	6 years	No guidance.	6 years (recomme
Assigned Risks Pool	Closed October 2013	N/A	None	ARP in place. Insurers required to subscribe to it.	N/A	N/A	N/A
ARP Access	N/A	N/A	N/A	Firm must demonstrate actual or constructive declinature from commercial market. Cover for up to two years.	N/A	N/A	N/A
ARP Shortfall funding	N/A	N/A	N/A	Insurers may be signed up to original written lines.	N/A	N/A	N/A
Client Fund	Insurance / compensation fund	Prohibition on handling client funds	Insurance / compensation fund	Insurance / compensation fund	Insurance / compensation fund	Insurance	Prohibitior holding cli funds but disbursem and paym fees

Downloadable document(s)

- [Protecting client's financial interests discussion paper (PDF 29 pages, 384KB)](https://upgrade.sra.org.uk/globalassets/documents/sra/consultations/protecting-clients-financial-interests-discussion-paper.pdf) [https://upgrade.sra.org.uk/globalassets/documents/sra/consultations/protecting-clients-financial-interests-discussion-paper.pdf]