

APPLICATION MADE BY THE SOLICITORS REGULATION AUTHORITY BOARD TO THE LEGAL SERVICES BOARD UNDER PART 3 OF SCHEDULE 4 TO THE LEGAL SERVICES ACT FOR THE APPROVAL OF:

- **SCHEDULES 1 AND 2 OF THE QUALIFYING INSURER'S AGREEMENT 2012**
- **THE SRA INDEMNITY INSURANCE RULES 2012 (INCLUDING THE MINIMUM TERMS AND CONDITIONS OF COVER)**
- **THE SRA AMENDMENT TO REGULATORY ARRANGEMENTS (CLIENT PROTECTION) RULES 2012**
- **THE SRA INDEMNITY (ENACTMENT) RULES 2012 AND SRA INDEMNITY RULES 2012**

A PROPOSED ALTERATIONS

1. This application encompasses three distinct groups of amendments to the SRA's regulatory arrangements relating to client financial protection as follows:
 - (a) **SRA Financial Protection Review** - changes to the Qualifying Insurer's Agreement, the SRA Indemnity Insurance Rules (including the Minimum Terms and Conditions for compulsory professional indemnity insurance) and the SRA Compensation Fund Rules to implement the next stage of the SRA's Financial Protection Review. The principal changes are:
 - (A) the closing of the assigned risks pool (**ARP**) as a provider of policies of qualifying insurance from 30 September 2013 (with the exception of the continued provision of run-off cover incepted before that date);
 - (B) the introduction, from October 2012, of a requirement that all policies of qualifying insurance make provision for extension by 90 days at the end of the insurance period if the insured firm has not taken out a new policy of qualifying insurance;
 - (C) provisions for the funding of the ARP in 2012/13 to be provided by both the regulated community and the qualifying insurers; and
 - (D) provisions to remove the role of the ARP in 2012/13 for making payments in respect of uninsured firms and move this responsibility to the Compensation Fund.
 - (b) **Emergency Funding from the Compensation Fund** - changes to the SRA Compensation Fund Rules to ensure that the emergency funding decision-making structure is as robust as possible; and
 - (c) **Post six year run-off cover** - a change to the SRA Indemnity Rules to extend the end of the period of cover provided by the Solicitors

Indemnity Fund for post six year run-off claims from 30 September 2017 to 30 September 2020.

2. In addition there are changes to the SRA Indemnity Insurance Rules, the SRA Indemnity (Enactment) Rules, the SRA Indemnity Rules and the SRA Handbook Glossary (**the Glossary**) for the purposes of replacing the definitions within the rules with provisions applying the definitions contained in the Glossary.
3. All the changes will come into effect at the start of the next annual professional indemnity insurance period on 1 October 2012 (which will run until 30 September 2013).

B NATURE AND EFFECT OF THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

(1) PROFESSIONAL INDEMNITY INSURANCE ARRANGEMENTS

Qualifying Insurance

4. Principals in a firm carrying on private practice from offices in England and Wales are required to have compulsory professional indemnity insurance in compliance with the SRA Indemnity Insurance Rules (**SIIR**) and Minimum Terms and Conditions of cover (**MTC**). The SIIR apply to solicitors, registered European lawyers, registered foreign lawyers, and recognised bodies and their managers, but for ease, the term “solicitors” shall be used in this application. The main purpose of the insurance is to provide the public with a very good basic level of protection in the event that a firm is negligent or dishonest which results in a financial loss.
5. The breadth of cover, and the inability of Qualifying Insurers to avoid cover, is unparalleled in the commercial professional indemnity insurance market. This is because the cover was designed to replicate as closely as possible the cover provided under the previous compulsory professional indemnity arrangements (in place until 31 August 2000) based on a statutory fund called the Solicitors Indemnity Fund (**SIF**).

Claims Made Basis of Insurance

6. Professional indemnity policies are 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 may give rise to a claim are notified, rather than with the insurer that was on cover when the alleged negligent act took place. This is a very important distinction between professional indemnity insurance and many forms of insurance. So long as there was a single compulsory scheme with one insurer, as with SIF, this distinction was relatively unimportant. Under the current market based scheme it is crucial.

Minimum Terms and Conditions

7. The key terms of the MTC include:

- (a) Cover is for all civil liability arising from private legal practice, with only limited permitted exclusions;
- (b) The insured includes the firm (and any prior practice) together with any current or former principal and employee;
- (c) The definition of "firm" includes any "licensed body" in respect of its regulated activities;
- (d) Cover extends to the practice as a whole including any body corporate;
- (e) Cover extends to all activities permitted to a solicitor in England and Wales;
- (f) The minimum sum insured is £2 million any one claim for sole practitioners and partnerships and £3 million any one claim for limited companies and Limited Liability Partnerships (**LLPs**);
- (g) The minimum sum insured is exclusive of defence costs which are covered in addition without financial limit;
- (h) Qualifying Insurers are prohibited from avoiding or repudiating the insurance on any grounds whatsoever including non-disclosure, misrepresentation and failure to pay premium (although they may have rights of reimbursement against each insured);
- (i) The dishonesty exclusion only applies to the dishonest member(s) of the firm so that innocent partners are covered. If all the principals of the firm have been dishonest then the claim falls to be dealt with by the SRA's Compensation Fund;
- (j) If a firm ceases without successor practice then the policy is automatically extended by six years to provide run-off cover.

Run-off Cover

- 8. To ensure adequate public protection the scheme provides for automatic run-off cover for at least six years following the closure of a firm in the following ways:
 - (a) If a firm closed without successor practice on or before 31 August 2000 then the SIF continues to provide run-off cover in accordance with the arrangement then was in place until the Qualifying Insurance scheme came into place from 1 September 2000;
 - (b) If a firm closes without successor practice on or after 1 September 2000 then the Qualifying Insurer (or the ARP) on risk at the date of closure is required to provide cover for the balance of the indemnity year and for a further six years thereafter. At the end of the six years so called "post six year run-off cover" is provided by SIF currently until 30 September 2017;
 - (c) If a firm closes due to a succession by a successor practice then any future claims arising from the ceased firm will be covered by the Qualifying Insurer on risk for the successor practice at the date the claim is made.

Qualifying Insurers

- 9. Qualifying Insurance is available through Qualifying Insurers. Firms that cannot get cover on the commercial market can apply to be covered, for a limited period, through the ARP. All insurers authorised to conduct business in the UK can become a Qualifying Insurer provided they sign a Qualifying Insurer's Agreement (**QIA**) each year. The QIA 2012 is attached at **Annex 2**. (The SRA Indemnity Insurance Rules, MTC and ARP Policy are appended to

the QIA. The wording of the ARP Policy reflects the MTC). Under the QIA Qualifying Insurers have to agree to:

- issue policies that comply with the MTC;
 - participate in the ARP;
 - report suspected dishonesty to the SRA; and
 - arbitration arrangements for disputes between insurers.
10. There are currently 22 Qualifying Insurers. Individual Qualifying Insurers are under no obligation to offer terms to all firms. For example some insurers will offer terms to sole principals and small firms (up to three principals) while others will choose not to.

Assigned Risks Pool

11. The ARP was created as an integral part of the current arrangement to provide cover for a limited period to those firms that find it difficult to obtain cover from the commercial market. Without this, firms would be forced to close, perhaps as a result of short-term difficulties which had led to problems in obtaining insurance. However, it is essential that firms are covered by the ARP only for a limited period, because it is unacceptable for those who cannot obtain cover on the commercial market to be protected indefinitely.
12. The main features of the ARP include:
- High premiums, starting at 27.5% of the firm's gross fees plus a 20% default element for those who do not apply to the ARP or who do not apply within the prescribed time;
 - Firms in the ARP are subject to monitoring visits and can be required to implement special measures to reduce the risks of claims;
 - Time in the ARP is limited (currently up to 6 months);
 - Qualifying Insurers are required to participate in the ARP (by way of a "cash call") in proportion to their share of the market for compulsory insurance by reference to premium income. Each Qualifying Insurer bears its due proportion of the ARP losses;
 - If a firm practices without either a policy of Qualifying Insurance arranged in the market or an ARP policy then any claim that arises is dealt with under a separate Master Policy arrangement with the Qualifying Insurers similar to the ARP under which the SRA is the insured. This helps provide seamless protection for clients regardless of the failure of a firm to obtain cover.
13. The ARP is managed by a manager appointed by the SRA. The functions of the ARP Manager are currently carried out by Capita Commercial Insurance Services Ltd.

(2) SRA INDEMNITY (ENACTMENT) RULES AND SRA INDEMNITY RULES

Solicitors Indemnity Fund

14. The SRA Indemnity (Enactment) Rules to which are annexed the SRA Indemnity Rules (collectively called the **SIR**) provide for the establishment and maintenance of the Solicitors Indemnity Fund. SIF was the sole provider

of compulsory professional indemnity cover for solicitors in private practice in England and Wales up until 1 September 2000 when the current arrangements based on Qualifying Insurers was introduced.

15. SIF is now being run-off and the contributions that have been collected together with investment income are being used to fund the handling, defence and settlement of claims which fall to be dealt with by SIF. There are three main categories of claims being handled by SIF as follows:
 - **Pre 1 September 2000 claims:** SIF is handling claims made or intimated against practices before 1 September 2000 as well as claims arising from circumstances notified to SIF before that date.
 - **“Run-off” claims:** SIF provides cover in respect of claims first made on or after 1 September 2000 in respect of principals who had retired before 1 September 2000 without successor practice.
 - **“Post six year run-off” claims:** SIF provides post six year run-off cover as described in paragraph 9(b) currently until 30 September 2017.
16. The rules retain the power to collect contributions from the profession as and when required. SIF is currently carrying a surplus. The SIR set out a process for releasing surplus to the Law Society/SRA and prescribe how any surplus must be applied.
17. The Fund continues to be managed and administered by Solicitors Indemnity Fund Limited. The Board of Directors is currently appointed by the Board of the SRA.

(3) SRA COMPENSATION FUND RULES

Compensation Fund

18. The SRA maintains a Compensation Fund for the purposes of making grants to persons who have suffered loss by reason of the dishonesty of a solicitor and making grants to applicants who have suffered hardship as a consequence of a failure by a solicitor to account for money. Grants are made at the discretion of the SRA.
19. The SRA Compensation Fund Rules (**SCFR**) provide for the establishment of the Fund and sets out, inter alia, the collection of contributions, the scope of the Fund and the application process. Subject to the waiver provisions, the maximum grant is limited to £2m. The time limit for making applications is 12 months after discovery by the applicant but there is discretion to extend the time limit.
20. For many years, the Compensation Fund has where necessary made funds available to intervention agents to provide monies to enable clients, in the main, to complete conveyancing transactions which were imminent at the point of intervention. Agents are required strictly to verify the requirements for funds and that the criteria for a Compensation Fund grant have been fulfilled. The provision of "emergency funding" by the Compensation Fund in the course of interventions is a very successful process in terms of urgent public protection.

21. The Legal Services Act 2007 amended the Solicitors Act 1974 to provide, in effect, that the SRA could make rules relating to the Compensation Fund making “provision ... for the making of grants in respect of a compensation claim before it is finally determined”. The SCFR were amended to provide at Rule 3.5 that “A grant may, at the sole discretion of the SRA, be made as an interim measure.” However, the current process of making emergency funds available is not that an interim grant is made but rather that more general powers to use the Fund in the context of interventions are applicable, notably rule 2.12(d).

C. NATURE AND EFFECT OF AMENDMENTS TO THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

(1) SRA FINANCIAL PROTECTION REVIEW

22. A summary of the changes to the QIA, the SIIR and the MTC for 2012 as compared to the current 2011 versions is set out in **Annex 1**. A copy of the QIA 2012 is attached at **Annex 2** and a copy of the QIA 2012 showing all the changes as compared to the QIA 2011 is attached as **Annex 3**. Please note that some of the changes shown to the SIIR within **Annex 3** have previously been approved by the Legal Services Board as part of SRA Handbook changes since 1 October 2011. A copy of the SIIR 2012 is attached at **Annex 4** and a copy showing all the changes as compared to the current SIIR is attached at **Annex 5**. A copy of the SRA Amendment to Regulatory Arrangements (Client Protection) Rules 2012 is attached at **Annex 6** which sets out the amendments to the SCFR and the Glossary. Attached at **Annex 7** is a copy of the SRA Compensation Fund Rules 2011 marked up with the changes.
23. The key changes to the QIA are as follows:
- (a) the Master Policy for firms carrying on practice without Qualifying Insurance (Schedule 8 of the QIA 2011) has been deleted as cover for such firms will now be provided by the Compensation Fund;
 - (b) to enable the profession to contribute up to £30m to the ARP liabilities for the 2012/2013 indemnity period, all Qualifying Insurers will be required to participate in the ARP for that period by way of a Master Policy. The Qualifying Insurers will each be required to underwrite the Master Policy on the same proportionate basis on which they presently participate in the ARP. That basis, determined by reference to each Qualifying Insurer’s share of the solicitors’ professional indemnity insurance market, is (and will remain) as set out in Schedule 1 of the QIA. The Master Policy is included as Schedule 2 to the QIA. The ARP Policies will remain in substantially the same form. Each ARP Policy will be issued by the ARP manager to firms in the ARP as evidence of insurance under the Master Policy. The ARP Policy terms are included as Appendix 1 of Schedule 2 to the QIA;
 - (c) the SRA shall, on behalf of the Law Society, contribute to the ARP by way of making payment under the Master Policy (the ARP Master Policy Payment). The ARP Master Policy Payment will be made to meet the

aggregate liabilities of the ARP for the indemnity period commencing on 1 October 2012 (the ARP Liability), on the following basis:

- (A) £10 million to be applied as required to meet the first £10 million of the ARP Liability; and
- (B) £10 million to be applied if and to the extent that the ARP Liability exceeds £20 million; and
- (C) £10 million to be applied if and to the extent that the ARP Liability exceeds £40 million.

The ARP Master Policy Payment is inclusive of all taxes and levies. It is expected that the payment will be subject to, and is therefore inclusive of, Insurance Premium Tax (IPT). The terms governing the Profession's Contribution are set out in paragraphs 1.2 - 1.4 of Schedule 1 to the QIA.

To help assess the impact of these changes the SRA engaged Marsh to carry out modelling of the ARP for 2012/13. The ARP was modelled using two dynamics: market appetite and economic environment. The modelling provide comfort to the SRA as to the likely ultimate outcome of the ARP for 2012/13 and in respect of the cash flow requirements in the first 12 months;

- (d) Qualifying Insurers will be required to disclose their credit rating (or lack thereof) to the SRA and to any firm to which they provide a quotation; and
- (e) to reflect the adoption of Glossary definitions in the SIIR, a new Schedule 8 has been added to the QIA which contains relevant extracts from the Glossary as used in the SIIR and MTC.

24. The key changes to the SIIR and MTC are as follows:

- (a) commencing 1 October 2013, a firm's last insurer of record under the QIA 2012 will be liable for cover for an Extended Indemnity Period and Cessation Period if the firm does not renew its policy of qualifying insurance with its existing qualifying insurer and does not obtain a policy of qualifying insurance with another qualifying insurer. Amendments are made to implement the change as follows:
 - (A) SRA Indemnity Insurance Rules 2012: Rule 4.2, commentary following Rule 4.4 and Rule 5.3; and
 - (B) Minimum Terms and Conditions (MTC): clauses 5.1 to 5.5 and clause 7.2;
- (b) the introduction of a requirement on firms that have not obtained a policy of qualifying insurance at the expiration of the Cessation Period to cease practise and to notify the SRA;
- (c) no firm will eligible to remain in the ARP beyond 30 September 2013 and any certificate issued to a firm in the ARP will ceases to have effect from that date;

- (d) the addition of a new power to collect contribution from firms for the purpose of allowing the SRA to raise and apply the profession's contribution in any manner necessary (i.e., by way of levy or otherwise); and
 - (e) the removal of Appendix 4 (Definitions) to the SIIR to be replaced by the application of the SRA Handbook Glossary.
25. The key changes to the SCFR are as follows:
- (a) to provide cover for claims made against uninsured firms that would previously have been covered by the Assigned Risks Pool (ARP) under the arrangements for "non-applied firms". New rules have been inserted at rules 3.2, 5, 8.2 and 13.3 and amendments have been made to existing rules see rules 3.1 and 3.4. The cover has been redrafted since the consultation to more closely reflect the scope of cover that is currently provided through the ARP arrangements whilst still retaining the discretionary nature of the Compensation Fund;
 - (b) The modelling carried out by Marsh (see paragraph 23(c)) included claims against "non-applied firms" which for the 2012/13 indemnity period will be covered by the Compensation Fund.

26. The key changes to the Glossary are as follows:

- (a) the insertion of the new definitions of "cessation period", "existing instructions" and "extended indemnity period"; and
- (b) a number of minor corrections and updates to existing definitions have been made as set out in **Annex 6**.

(2) EMERGENCY FUNDING FROM THE COMPENSATION FUND

27. An amendment has been made to rule 14.2 (previously rule 13.2). The effect of the change is that the provision of emergency funds will be by way of an interim grant rather than general use of the Fund under Rule 2.12(d) and a new rule 14.3 has been inserted.
28. Since emergency funds are needed with great urgency it is necessary to make a further amendment to abrogate the need for advance notice to the intervened solicitor. The existing exception to the requirement to give notice has been extended but the effect is to be mitigated by the introduction of a requirement to provide retrospective notice with a discretion given to the SRA to waive its rights of recovery against the defaulting practitioner. The change can be seen in Rule 14.3 in **Annex 7**.

(3) POST SIX YEAR RUN-OFF COVER

29. The proposed three year extension of the post six year cover provided by the SIF requires one minor amendment to a date in Rule 8.5(a) of the SIR. In that rule "30 September 2017" is to be replaced by "30 September 2020".

30. The definitions contained in the SIR have been removed to be replaced by the application of the SRA Handbook Glossary.
31. A copy of the SIR 2012 is attached at **Annex 8** and a copy showing all the changes as compared to the current SIR is attached at **Annex 9**.

D. RATIONALE FOR THE CHANGES TO THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

(1) SRA FINANCIAL PROTECTION REVIEW

32. The rationale for the changes arising from the review of financial protection arrangements are set out in the April 2011 [SRA financial protection policy statement](#) issued in April 2011 which is attached as **Annex 10**. The policy agreed by the SRA board followed the [independent review of client financial protection](#) undertaken for the SRA by Charles River Associates (CRA) in 2010 and the extensive consultation undertaken by the SRA on its own client financial protection reform proposals published in December 2010. The transition plan annexed to the policy statement summarises the three year programme of change.
33. The changes set out in the attached documents are necessary to deliver on the changes required for the 2012/13 indemnity period and to prepare for the replacement of the ARP by the 90 day extended policy period applicable to those policies of qualifying insurance which will come to an end on or after 30 September 2013.

(2) EMERGENCY FUNDING FROM THE COMPENSATION FUND

34. The rationale for the proposed change to the SCFR is that the provision of emergency funds should be by way of interim grant rather than general use of the Fund under Rule 2.12(d) since they are akin to grants (e.g. they are payable to members of the public to compensate them for their loss) and should be subject to the same controls so far as is consistent with their emergency nature. The change will ensure that the process is carried out with minimal legal risk.
35. There is no change to the policy of making funds available on an emergency basis.

(3) POST SIX YEAR RUN-OFF COVER

36. The Financial Protection Committee has reviewed the policy relating to post six year run-off cover and has concluded that, from the SRA's perspective as a regulator, the primary purpose of post six year run-off cover is to protect consumers of legal services.
37. The point has now been reached where if a firm closes now without successor neither it or its clients will not have the benefit of any post six year run-off cover unless action is taken to extend the cover beyond the current cut off date.

38. The initial estimates of costs of a short extension of the period of post six year run-off cover provided by SIF beyond 30 September 2017 indicate that they could comfortably be met out of the Fund without the need to collect additional contributions. The availability of SIF surplus (which must be applied for an indemnity purpose if a reasonably practicable one is available) is a compelling reason for extending the current arrangement rather than replacing with a new one, at least for the time being.
39. As part of the discussions with the Legal Services Board concerning the sunset clause in the section 69 order relating to the Compensation Fund the we have committed to undertake a fundamental review of our "compensation arrangements". This will follow on from the similar review of our "indemnification arrangements" carried out in 2010/11. The realistic timeframe for the review is three years with a view to implementing changes in late 2014.
40. To maintain client financial protection it is important to ensure that our "compensation arrangements " dovetail with our "indemnification arrangements". As an interim measure it is proposed to extend the post six year run-off cover provided by SIF by three years to 30 September 2020 and to review these arrangements again once the outcome of the review of the compensation arrangements is known.

E. STATEMENT IN RESPECT OF THE REGULATORY OBJECTIVES

Protecting and promoting the public interest

41. The changes proposed as part of the review of client financial protection are intended to maintain a high degree of financial protection which is in the interest of all stakeholders but particularly the consumers of legal services, for whom the security afforded by the arrangement is of a very high order. The phasing out of the ARP will help create more stable and sustainable conditions in the professional indemnity market for solicitors to the benefit of consumers of legal services.
42. The change related to emergency funding by the Compensation Fund in the course of interventions will put a very successful process in terms of urgent public protection on a clearer and firmer footing within the SCFR.
43. The three year extension of the period of post six year run-off cover provided by SIF will provide additional public protection.

Supporting the constitutional principle of the rule of law

44. The SRA considers that the changes to the QIA and the various rules will be neutral towards this objective.

Improving access to justice

45. The Qualifying Insurance market for one to three partner firms is limited. The key risks of not making the proposed changes to the QIA and the SIIR now are increases in premium rates and a lack of capacity particularly for small

firms. This is a segment of the market that a number of Qualifying Insurers have exited in recent years. Two and three partner firms are considered to be the most difficult to underwrite, particularly in relation to cover for fraud and dishonesty. Following the announcement of the proposed changes in the April 2011 policy statement, particularly the closing of the ARP in 2013, the market for solicitors professional indemnity insurance has eased with evidenced by a dramatic fall in the number of firms in the ARP this year.

46. It is therefore reasonable to assume that taking no action would potentially have a disproportionate impact on BME and small firms. These firms often provide a very specialised and localised service sometimes within a particular community with a higher population of people from BME communities. Reducing the impact of renewal upon BME and small firms, and seeking to ensure that a competitive professional indemnity insurance market remains in place for this sector of the profession in particular safeguards the public's access to such firms. The new QIA and SIIR will maintain access to justice.
47. The changes relating to emergency funding and post six year run-off cover will have a neutral effect on this objective.

Protecting and promoting the interests of consumers

48. Consumers of legal services are entitled to expect a good quality service from their solicitor, and they should be able to have confidence that if something does go wrong resulting in a financial loss to them that there is in place a source of financial redress. The Rules and the changes proposed this year are aimed at providing those consumers with continued assurance and confidence that comprehensive financial protection arrangements remain in place whilst the ARP is phased out. The sharing of the liabilities of the ARP between the profession and the Qualifying Insurers should help mitigate against a difficult renewal on 1 October 2012. Even if the 2012/13 renewal proves very difficult for some firms, with some not able to get cover in the market or not able to afford the premium due, the level of client financial protection will be maintained save only that claims against uninsured firms will be subject to a limit of £2m under the Compensation Fund whereas under the MTC the limit is £3m in respect of any firms that is an LLPs or limited company. The current arrangements are under strain and the public interest will not be served by a collapse of the current arrangements. This was one of the drivers for our root and branch review of our financial protection arrangements.
49. The various client protection rules and the MTC clearly do protect and promote the interests of consumers and the wider public interest, the amendments are being made to ensure that the arrangements are sustainable.
50. The change related to emergency funding by the Compensation Fund in the course of interventions will put a very successful process in terms of urgent public protection on a clearer and firmer footing within the SCFR and in so doing will help protect the interests of the consumers of legal services.
51. The three year extension of the period of post six year run-off cover provided by SIF will extend the period in which the interests of consumers are protected.

Promoting competition in the provision of services

52. The SIIR will promote competition in the provision of services within the context of the Qualifying Insurance arrangement and the changes will have a positive impact. At present there are 22 Qualifying Insurers. We anticipate that, as in previous years, there will be some insurers that will stop writing new business and there will be new entrants. The changes, particularly the phasing out of the ARP, seek to strike the balance between providing excellent protection for consumers of legal services and fostering a competitive market for solicitors. The changes proposed aim to strike the right balance and to create conditions so that those firms most vulnerable at renewal (such as small firms) will still have a market, rather than having to resort to the ARP (in 2012/13) or in some cases having to close due to the lack of available insurance.
53. The pending closure of the ARP in 2013 and the transfer of cover for claims against uninsured firms from the ARP to the Compensation Fund will remove a barrier to new insurers entering the market for solicitors professional indemnity insurance which will promote competition.
54. The changes relating to emergency funding and post six year run-off cover will have a neutral effect on this objective.

Encouraging an independent, strong, diverse and effective legal profession

55. The phasing out of the ARP in particular will help create the conditions for a more competitive market for solicitors professional indemnity insurance which will particularly benefit small firms, a sector in which BME firms are over represented. The changes to the QIA and SIIR will thereby help to encourage a diverse and independent legal profession.
56. The changes relating to emergency funding and post six year run-off cover will have a neutral effect on this objective.

Increasing public understanding of the citizen's legal rights and duties

57. The SRA considers that the changes will be neutral towards this objective.

Promoting and maintaining adherence to the professional principles

58. The SRA considers that the changes will be neutral towards this objective.

E. STATEMENT IN RESPECT OF THE BETTER REGULATION PRINCIPLES

Proportionality

59. The SRA has to balance the demands of the Qualifying Insurers who underwrite the compulsory professional indemnity scheme with the differing needs of the profession and consumer protection. The SRA has responded in a proportionate way to these conflicting requirements and to developments imposed by the state of the market, including the growing concerns of the Qualifying Insurers in order to preserve for the immediate future the SRA's compulsory professional indemnity insurance arrangement.

60. The three year extension of the period of post six year run-off cover provided by SIF is a proportionate response to the fact that the existing arrangements will end on 30 September 2017 and will provide an interim solution pending the outcome of our review of our compensation arrangements.

Accountability

61. The SRA is accountable to all its stakeholders in relation to client financial protection matters: consumers; the profession; the Qualifying Insurers; BME groups. The SRA has to provide arrangements that are effective but sustainable. Ineffective client financial protection arrangements will impact on all these stakeholders, and the larger public interest.
62. The justification for the changes arising from the review of client financial protection arrangements is set out in the [SRA financial protection policy statement](#) issued in April 2011.

Consistency

63. The new QIA and rules are consistent with previous rules but are in the process of evolving in accordance with the [SRA financial protection policy statement](#) in order to meet changing needs and market conditions. They have adapted, and will have to do so again in the future, to the introduction of firm based regulation, outcome focused regulation and licensed bodies.

Transparency

64. The changes to the SIIR, SIR, SCFR and the Glossary will be published on the SRA website as part of changes to the SRA Handbook to be introduced on 1 October 2012. The QIA 2012 will also be published on the website. Comparison software on the website will enable all the changes to be identified by means of comparisons with existing documents.
65. Two of the amendments will impact transparency for stakeholders. The phasing out of the ARP will significantly reduce (if not remove altogether) the need for insurers to factor into their premiums a loading to cover their exposure to ARP liabilities. This will mean that premiums payable by firms should more accurately reflect the risk posed by those firms. The requirement for Qualifying Insurer's to disclose their credit ratings (or the lack thereof) will enable firms to make more informed decisions when arranging qualifying insurance.

Targeted

66. The changes arising from the client financial protection review are targeted at addressing the primary risk to the stability of the SRA's client financial protection arrangements which is the ARP and the replacement of the protection provided by the ARP with alternative arrangements involving extended policy periods. To bring about this change smoothly amendments are being made to the structure and funding of the ARP in its final year.

F. STATEMENT IN RELATION TO DESIRED OUTCOMES

67. The changes with respect to the client protection review are being made in accordance with the programme of reform set out in the [SRA financial protection policy statement](#) issued in April 2011. The changes are a necessary step in the process of change to give effect to the outcomes set out in the policy statement.
68. The change related to emergency funding by the Compensation Fund in the course of interventions is to ensure that the very valuable process of public protection is placed on the soundest legal footing.
69. The three year extension of the period of post six year run-off cover provided by SIF will help deliver on the SRA's policy of maintaining the protection afforded to clients regardless of when a valid claim is made.

G. STATEMENT IN RELATION TO IMPACT ON OTHER APPROVED REGULATORS

70. The QIA and rules are aimed at solicitors, registered European lawyers, registered foreign lawyers, recognised bodies, licensed bodies and their managers. We have not identified any adverse impact on people regulated by other approved regulators.

H. IMPLEMENTATION TIMETABLE

71. The annual compulsory professional indemnity insurance period runs from 1 October to 30 September each year, with the new rules coming into force on 1 October 2012.
72. As well as publicising the new rules on our website the Qualifying Insurers have to be informed in advance, usually in June, to enable them to adapt the wording of their policies which have to meet the requirements of the MTC. Qualifying Insurers start to send out proposal forms in July and the profession start to return these completed in August. The single deadline for renewal of 1 October 2012 means that huge numbers of proposal applications have to be completed and processed by Qualifying Insurers or their brokers in a very short time. Hence the need for the renewal process to start during July. There is an urgent need for the approval process to be completed as quickly as possible to enable insurers to have certainty as the terms of the QIA and the MTC in particular.
73. All the changes to the QIA, the SIIR, the SIR, the SCFR and the Glossary set out in the annexes to this application will come into force on 1 October 2012.

I. STAKEHOLDER ENGAGEMENT

74. The SRA carried out a full public consultation between 25 October 2011 and 17 January 2012 regarding the changes relating to the client financial protection review. The consultation was published on our website in the usual way. A total of 38 responses were received from a range of

stakeholders including a very detailed response from the Law Society. A copy of the [report on consultation responses and SRA conclusions](#) is attached as **Annex 11**.

75. We held meetings with the Chief Executive of the Law Society and other Law Society staff on 16 December 2011 and 19 March 2012 to talk through the proposals and the issues raised by the Law Society. A further meeting with the Law Society was held on 23 March 2012 to go through detailed points. In addition to our regular Liaison Committee meetings with qualifying insurers and the Association of British Insurers (ABI) attended by representatives of the Law Society, on 23 March 2012 we held a meeting with the ABI and qualifying insurers to discuss the proposed changes including the changes to the structure of the ARP.
76. Copies of the executive summary of the Marsh modelling report have been provided to qualifying insurers and the Law Society on a confidential basis.
77. We have listened to stakeholders and where we felt that valid points had been raised which merited amendment of our proposals we have made amendments, for example:
 - (a) there will be no carve-out of cover for liabilities incurred in respect of "new instructions" during the Cessation Period as previously contemplated. The relevant Qualifying Insurer will be required to provide cover for such liabilities although the reimbursement provisions will be amended to allow the Qualifying Insurer to seek reimbursement of any amounts paid to meet such liabilities from the firm and its Principals;
 - (b) the cover to be provided by the Compensation Fund for "non-applied firms" has been brought more into line with the scope of the MTC;
 - (c) the proposal to require insurers to provide notice of an intention not to renew cover has been dropped.
78. Regarding the change relating to emergency funding, we have taken the view that there is no change to the policy of providing emergency funding to ensure that clients of intervened firms are not prejudiced and therefore there is no need for consultation. The change is simply to ensure that the decision-making structure is as robust as possible.
79. We have taken the view that it is not necessary to formally consult on the date change in the SIR related to the extension of post six year run-off cover proposal for the following reasons:
 - the extension of the period of cover provided by SIF for post six year run-off cover does not amount to a change of policy;
 - using the surplus within SIF means there is no additional cost impact for the profession or consumers of legal services;
 - the Law Society supports an extension of the existing arrangements for a further three years and has issued a [post 6 year run-off cover press release](#) to that effect.;
 - the change proposed is "de minimis".

80. The Law Society has recently proposed that the three year extension of cover for post six year run-off claims should be subject to an aggregate cap of £10m. This proposal has been considered but is not being taken forward for the following reasons:
- We take the view that seeking to introduce a cap could adversely affect public protection and therefore we would need to consult before any such change could be introduced.
 - SIF has given an initial, albeit provisional, estimate of the likely additional cost provision that would have to be made within the SIF accounts if it is decided to extend post six year run-off cover by three years to 30 September 2020. The estimate is less than a quarter of the proposed cap and, accepting that further analysis may be needed, the figure is comfortably within the funds currently available as surplus within SIF.
 - From the SRA's perspective the primary purpose of the cover is to maintain client financial protection. Introducing a cap, even a high cap, runs the risk that valid claims will not be met or will not be met in full.

J. FURTHER EXPLANATORY INFORMATION

81. There is no further explanatory material that the SRA wishes to submit.

ANNEXES

- Annex 1:** Note summarising changes to the Qualifying Insurer's Agreement and the SRA Indemnity Insurance Rules
- Annex 2:** Qualifying Insurer's Agreement 2012
- Annex 3:** Qualifying Insurer's Agreement 2012 showing all changes since the QIA 2011
- Annex 4:** SRA Indemnity Insurance Rules 2012
- Annex 5:** SRA Indemnity Insurance Rules 2012 showing all changes as compared to the SRA Indemnity Insurance Rules 2011
- Annex 6:** SRA Amendment to Regulatory Arrangements (Client Protection) Rules 2012
- Annex 7:** SRA Compensation Fund Rules 2011 showing the changes
- Annex 8:** SRA Indemnity Rules 2012
- Annex 9:** SRA Indemnity Rules 2012 showing all changes as compared to the SRA Indemnity Rules 2011
- Annex 10:** SRA financial protection policy statement - April 2011
- Annex 11:** Report on consultation responses and SRA conclusions

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