

**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:**

- **CLAUSES 2.10, 6.2 AND 6.11 OF THE QUALIFYING INSURER'S AGREEMENT 2010**
- **THE SOLICITORS' INDEMNITY INSURANCE RULES 2010**
- **THE MINIMUM TERMS AND CONDITIONS OF COVER**
- **THE ASSIGNED RISKS POOL POLICY**

**A PROPOSED ALTERATION**

1. Professional indemnity insurance for firms in private practice in England and Wales has been compulsory since 1976. Its primary purpose is to provide financial protection to clients in circumstances where they have suffered a loss due to the acts or omissions of their solicitors. The annual Solicitors' Indemnity Insurance Rules (the Rules) set out the requirements of the SRA's compulsory professional indemnity insurance arrangement. The insurance must comply with the Minimum Terms and Conditions of cover (MTC) which set out the scope of cover and which are appended to the Rules. The arrangement is known as "Qualifying Insurance".
2. The proposed alteration is to introduce the Solicitors' Indemnity Insurance Rules 2010 (the new Rules) in time for the start of the next annual professional indemnity insurance period on 1 October 2010 (which will run until 30 September 2011). The 2010 rules are based on the Solicitors' Indemnity Insurance Rules 2009 with a number of amendments.
3. The purpose of the new Rules and MTC is to enable the SRA to:
  - maintain the arrangements for compulsory professional indemnity insurance;
  - maintain broad coverage for the protection of consumers and the profession;
  - allow the profession access to a competitive, commercial professional indemnity insurance market.
4. The Rules and MTC are amended each year to come into effect at the start of the indemnity period on 1 October. The amendments this year include general updates and revisions relating to the normal annual date changes. Other more significant changes relate to policy developments that have occurred through this current indemnity period, and that have been influenced by factors such as the putting into administration under Irish insurance law of one of the Qualifying Insurers (Quinn Insurance Limited), the deteriorating position of the Assigned Risks Pool (ARP) which is integral to the current

arrangement, and the increasing pressure from Qualifying Insurers for significant amendments to the MTC.

5. The changes to the new Rules are made under section 37 of the Solicitors Act 1974 and were made by the SRA Board on 4 May and 18 June 2010 for implementation by 1 October 2010. This date is crucial as the annual indemnity period currently begins each year on this single date and Qualifying Insurers must be allowed sufficient time to make any necessary changes to their policy wording before the start of the renewal process. Qualifying Insurers usually start to send out proposal forms in July.
6. A range of degrees of consultation with stakeholders has taken place this year. Some changes have been the subject of very full and lengthy public consultation and full Equality Impact Assessments. In respect of other changes there was limited consultation coupled with initial impact assessments.
7. The new Rules and MTC are attached as **Annex 1 (pages 18 to 41 and pages 42 to 63)** respectively) to this application in amendment mode for ease of comparison with the current Rules.

## **B NATURE AND EFFECT OF THE PROFESSIONAL INDEMNITY INSURANCE ARRANGEMENT**

### **Qualifying Insurance**

8. Principals in private practice as a firm carrying on private practice from offices in England and Wales are required to have compulsory professional indemnity insurance in compliance with the Rules and MTC. (The Rules 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 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.
9. 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**

10. 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**

11. The key terms of the MTC include:
- Cover is for all civil liability arising from private legal practice, with only limited permitted exclusions;
  - The insured includes the firm (and any prior practice) together with any current or former principal and employee;
  - Cover extends to the practice as a whole including any body corporate;
  - Cover extends to all activities permitted to a solicitor in England and Wales;
  - 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);
  - The minimum sum insured is exclusive of defence costs which are covered in addition without financial limit;
  - 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);
  - 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;
  - If a firm ceases without successor practice then the policy is automatically extended by 6 years to provide run-off cover.

## **Run-off Cover**

12. To ensure adequate public protection the scheme provides for automatic run-off cover for at least 6 years following the closure of a firm in the following ways:
- 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;
  - 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 6 years thereafter;
  - 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.

## **Successor Practice**

13. When setting up the Qualifying Insurance scheme in 2000 one of the principal differences between the cover afforded by SIF and the commercial market was in respect of run-off cover. Under SIF run-off cover was provided at no additional charge to a ceased practice - the cost of such cover was met by the ongoing profession. Under the Qualifying Insurance arrangement each firm

has a contract of insurance with a Qualifying Insurer. Since the identity of that Qualifying Insurer may change from year to year, any claim must be attributed to the relevant policy and settled under the terms of that policy, irrespective of when the negligent act or omission occurred. The Qualifying Insurance scheme is structured such that, where there is a merger or acquisition resulting in a succession by another firm, then run-off cover will not be triggered. Rather, cover for the prior practice is provided through the Qualifying Insurance effected by the successor practice, so the responsibility for providing cover would, generally, rest with the practice that had acquired the benefit of the ceased practice. From 1 October 2010 firms that are ceasing due to a succession will be able to elect before cessation to be insured under run-off cover rather than under the successor practice's policy of Qualifying Insurance.<sup>1</sup>

### Qualifying Insurers

14. 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 is attached at **Annex 2**. (The 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;
  - Agree to arbitration arrangements for disputes between insurers.
15. There are currently 27 Qualifying Insurers. The number and identity of insurers fluctuates each year to some degree but the main insurers (in terms of premium written) have remained constant. 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

16. 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.
17. 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;

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<sup>1</sup> See paragraph 34

- 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;
  - 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 will be dealt with under a separate 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.
18. 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 and include the following:
- To process applications to enter the ARP from firms and to issue ARP policies;
  - To administer renewals and cancellations of ARP policies;
  - To determine premiums payable by each ARP firm in accordance with the Rules;
  - To calculate and adjust each Qualifying Insurer’s initial participation, percentage participation and percentage liability;
  - To receive notice of claims and to negotiate, settle and pay claims on behalf of all Qualifying Insurers participating in the ARP;
  - To provide data to the SRA relating to ARP policies and ARP firms in default covered by the ARP.
19. There are some difficulties surrounding the ARP. Primarily these are the increasing numbers of firms in the ARP and the cost. In 2008/09, 98.5% of firms were able to secure Qualifying Insurance in the market with 1.5% covered through the ARP. However, the small percentage of firms in the ARP cost a huge amount of money and the position is worsening. In 2007/08 there were 28 firms in the ARP which rose to 169 in 2008/09. In the current 2009/10 indemnity period there are 259 firms. There is a concern that the ARP entitles high-risk firms to continue in practice when it would be better that they were closed.
20. The SRA recognises that the ARP is putting a very good scheme under stress and has taken some urgent steps to alleviate the pressure.<sup>2</sup>

### **Committees**

21. The SRA’s Financial Protection Committee (FPC) deals with policy issues, and advises the Board, on all matters relating to compulsory professional indemnity insurance, including the Rules, MTC and QIA. The Qualifying Insurers and SRA exchange views and discuss indemnity insurance issues through the forum of the Indemnity Liaison Committee (ILC) made up from representatives of the Qualifying Insurers, the ARP Manager and the FPC.

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<sup>2</sup> See **section D**

The ILC considers proposed amendments to the indemnity insurance arrangements, including proposed variations to the Rules, the MTC and the QIA.

### **The Current Professional Indemnity Insurance Market**

22. The compulsory professional indemnity insurance arrangements have provided individual firms with a choice of Qualifying Insurers whilst maintaining a high level of public protection. The key objective is to maintain the balance between protecting the public and ensuring a competitive and sustainable compulsory indemnity insurance market. For the early years of the Qualifying Insurance arrangement this was achieved with some success. However that balance has been increasingly hard to maintain in recent years. Pressure for change has been building and it is clear that the current arrangements are not sustainable.
23. Qualifying Insurers are increasingly concerned about, and hostile to, the increasing cost of the ARP that they have to bear under the terms of the QIA and the lack of control they have in relation to that ARP exposure. The huge disparity between ARP premiums and claims is unsustainable. Loss ratios (that is the ratio of value of claims incurred to the value of premium income received) for the last nine years is currently running at close to 600% necessitating regular and very substantial cash calls on the Qualifying Insurers.
24. Market premiums are rising after a long period in which competition and a favourable economic climate have tended to keep premiums in check. This has led to a concern among small practices that they might find themselves facing unaffordable premiums.
25. There are concerns amongst some firms that Qualifying Insurers appear to be discriminating against BME solicitors.
26. The 2009/10 renewal on 1 October 2009 was very difficult. The 2010/11 renewal on 1 October 2010 is likely to be more so, given the likelihood that the 2,912 firms currently insured with Quinn (mainly one to three partner firms) will be seeking insurance from a different Qualifying Insurer. Whilst there is obviously a significant degree of uncertainty about what will happen at the 2010/11 renewal, it is anticipated that there will be pricing and significant affordability issues and a limited choice of Qualifying Insurer for the small end of the market (one to three partner firms) with the real risk that some firms may fare badly in the process.

### **C. NATURE AND EFFECT OF THE SOLICITORS' INDEMNITY INSURANCE RULES 2010**

27. The proposed changes to the new Rules, particularly in respect of the ARP, have enabled the SRA to hold steady the Qualifying Insurance arrangement for the next indemnity period (the 2010/11 period) in order to maintaining client financial protection whilst keeping a competitive market for solicitors' compulsory professional indemnity insurance.

28. Qualifying Insurers have an increasing antagonism towards the breadth of cover under the MTC and further significant change to the MTC is likely to be required in the future. The Qualifying Insurers have generally welcomed the e SRA Board's decision to undertake a complete review of client financial protection. Although the current arrangements for professional indemnity insurance have, until recently, worked well in terms of the level and scope of consumer protection, and the profession's ability to obtain cover at an advantageous price, it has been accepted that there are some intrinsic problems with the current system which require fundamental review.

#### **D. RATIONALE FOR THE CHANGES TO THE SOLICITORS' INDEMNITY INSURANCE RULES 2010**

##### **General Changes**

29. There are general revisions as usual this year relating to the normal annual date changes, and to make reference to the Legal Ombudsman set up by the Office for Legal Complaints. The Legal Ombudsman will begin to resolve legal complaints on 6 October 2010.

##### **Policy Changes**

##### **Eligibility to the ARP (rule 3.1, rule 10.2)**

30. Against the background summarised under paragraphs 22 to 26 some changes have had to be made to the ARP this year. Two consultations on the review of the ARP<sup>3</sup> and the successor practice definition<sup>4</sup> took place earlier this year and as a result of the feedback<sup>5</sup> received and equality impact assessment<sup>6</sup> undertaken, the SRA Board has decided to retain the ARP but with some key changes from 1 October 2010. Closing the ARP from October 2010 was not viable because almost every group consulted (including the profession and the Qualifying Insurers) opposed that proposal, and analysis showed the very detrimental consequence of adopting that option (including the real possibility of Qualifying Insurers at the smaller end of the market leaving the market rather than bear the brunt of the new system). Widespread closure of small firms would raise issues of access to justice and would be detrimental to the public interest.
31. New firms will not be eligible to be issued with an ARP policy. All the larger stakeholders consulted seemed to support this change. In addition the maximum period a firm can be covered by the ARP is reduced from 24

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<sup>3</sup> The ARP review consultation paper can be found at <http://www.sra.org.uk/sra/consultations/assigned-risks-pool-arp-review-november-2009.page?ref=search>

<sup>4</sup> The successor practice consultation paper can be found at <http://www.sra.org.uk/sra/consultations/successor-practice-definition.page>

<sup>5</sup> The full feedback report and analysis on both consultations can be found at <http://www.sra.org.uk/sra/equality-diversity/impact-assessments/assigned-risks-pool-review-and-successor-practice-definition.page>

<sup>6</sup> The full equality and impact assessment on those consultations can be found at <http://www.sra.org.uk/sra/equality-diversity/impact-assessments/full-impact-assessments/review-assigned-risks-pool-april-2010.page>

months to 12 months. There was widespread support for this. Consequently, the definition of “Eligible Firm” at **rule 3.1** (definitions) (**Annex 1, pages 21 to 22**) has been amended so that eligibility for the ARP is confined to firms who have obtained Qualifying Insurance outside the ARP in the past. In other words, new firms are not eligible for the ARP from the commencement of the 2010/11 indemnity period unless they have first obtained Qualifying Insurance in the open market.

32. There are transitional provisions to cater for firms that are already in the ARP at 1 October 2010 and who have the legitimate expectation of cover by the ARP for two years. There is a consequential amendment at **rule 10.2** (applying to the ARP) (**Annex 1, pages 30 to 31**). Consequential amendments have been made to the commentary (guidance notes) in the new Rules. If a firm fails to get insurance after that 12 months it will have to close. The SRA retains the power (rule 19 – waiver powers) to allow a firm to remain in the ARP beyond the maximum period.
33. As at 1 July there were 259 firms in the ARP of which 18 were new firms that have set up during the current 2009/10 indemnity period. There is a significant risk that this number will increase in the 2010/11 period as Qualifying Insurers become more selective. The decision that new start-up firms will not be eligible to go into the ARP will help to some extent. Also the reduction of the maximum period in the ARP does not apply to firms already on their first year in 2009/10 so up to 196 firms may be eligible to remain in the ARP for 2010/11.

#### **Successor Practice (MTC – Clause 5.3)**

34. Clause 5.3 of the MTC has been amended to allow a firm that is to cease by way of a succession (with a successor practice) to elect before its cessation to trigger its own run-off cover (**clause 5.3(a) – Annex 1, page 48**). This election is subject to the obligation to report the succession cover election to the SRA within 7 days and of payment of the premium. If the firm fails to make an election or to pay any premium due before its cessation then the position will revert to that of a successor practice under (**clause 5.3(b)**). The vast majority of respondents to the consultation were in favour of this change.

#### **Defence Costs (MTC – Clause 1.2(c))**

35. At present the MTC provides cover for defence costs in respect of claims and in relation to disciplinary proceedings arising from any claim. Under the new Rules and MTC cover will not be provided for defence costs in relation to any disciplinary proceedings brought by the SRA (**clause 1.2(c) – Annex 1, page 42**).
36. Cover in respect of disciplinary proceedings was not provided under the previous SIF arrangement. When drawing up the current arrangements in 1999/2000 the opportunity was taken to add it in as a “nice to have” type provision. However it does nothing to protect consumers of legal services and it is difficult to justify as part of a compulsory professional indemnity scheme. It can result in a situation where there may be appropriate grounds for declining cover for a particular claim (e.g. the dishonesty of a sole practitioner) but there exists an obligation to defend the insured against the very allegations the Qualifying Insurer will be relying on to decline cover.

These defence costs in relation to disciplinary proceedings can be substantial and Qualifying Insurers look to recover these costs from the profession by way of increasing premiums. Removing this cover from the MTC removes this pressure on premiums.

37. The impact on the profession is less clear. Solicitors who are faced with a claim and associated disciplinary proceedings will not have the benefit of automatic cover under the MTC. For the profession as a whole the change is likely to reduce to some extent the pressure on premium and may increase the availability of cover for some practices if Qualifying Insurers no longer have to underwrite this risk. From an initial consideration of the equality impact of this proposal, there is a potential adverse impact for BME solicitors because, for reasons as yet unknown, this group is disproportionately represented in the SRA's regulatory outcomes. Some of the figures for 2008 are shown below for various areas of the SRA's activity.

SRA 2008 summary by ethnicity	Solicitor Population	New Conduct Investigations	Accounts Inspections	Interventions	Referrals to the SDT	Late Accountant's Reports
BME total	10.1%	15.8%	22.2%	25.8%	22.8%	16.9%
White / European	89.9%	84.2%	77.8%	74.2%	77.2%	83.1%
Ethnicity known	86.9%	85.1%	85.1%	70.2%	79.0%	98.7%
Ethnicity not known	13.1%	14.9%	14.9%	29.8%	21.0%	1.3%
<b>TOTAL INDIVIDUALS</b>	<b>109,952</b>	<b>3,507</b>	<b>228</b>	<b>88</b>	<b>461</b>	<b>306</b>

There has not been the opportunity to conduct a full equality impact assessment of this proposal or consult with the profession.

38. Qualifying Insurers have indicated that they would be prepared to provide an endorsement to write this cover back into the policy but on a firm by firm basis. The cost (if any) and availability of this extension would depend on the Qualifying Insurers' risk assessment of the firm.
39. The Law Society does not support the proposal as it would be unfortunate for solicitors facing very burdensome regulation to have no defence scheme. Their full comments were set out in the supplementary paper considered by the SRA Board<sup>7</sup>.
40. In agreeing the proposed change the SRA Board took account of the possible impact on the profession, the comments of the Law Society and also of the need to relieve some of the pressure that has built up in the market. The SRA Board were satisfied that the change strikes the right balance between scope of cover, public protection and the need for a viable market for solicitors' compulsory professional indemnity insurance.

#### **Award by Regulatory Authority (MTC - Clause 1.8)**

41. At present clause 1.8 provides the following:

<sup>7</sup> The supplementary paper can be viewed as item 5 (PII –Supplementary Paper) at <http://www.lawsociety.org.uk/aboutlawsociety/how/committees/view=viewmeeting.law?MEETID=3386&COMMITTEEID=10754>

*The insurance must indemnify each Insured against any amount paid or payable in accordance with the recommendation of the Legal Services Ombudsman, the Legal Complaints Service, the Office for Legal Complaints or any other regulatory authority to the same extent as it indemnifies the Insured against civil liability.*

42. There is a lack of clarity in this wording that has led to some uncertainty as to how this provision applies to Inadequate Professional Service awards made by the Legal Complaints Service (LCS). The LCS reports that the approach of insurers has been mixed. Approximately one third pay the full awards and two thirds dispute that return of fees is covered under the MTC and have settled IPS claims less the return of fees. This is a product of the lack of clarity of the current wording.
43. The introduction of the Office for Legal Complaints and its Legal Ombudsman service has provided the opportunity to clarify the position going forward. In summary, under section 137(2) a determination of the Legal Ombudsman from 6 October 2010 may be a direction as follows:
- (a) *that the solicitor or firm apologise to the complainant;*
  - (b) *that*
    - (i) *the fees for the work undertaken be limited to a specified amount specified, and*
    - (ii) *under one or more of the directed “permitted requirements”, all or some of those fees be refunded or waived;*
  - (c) *that the solicitor or firm pays compensation to the complainant as directed for any resultant loss, inconvenience or distress suffered by the complainant;*
  - (d) *that the solicitor or firm rectifies at their own expense the error, omission or other deficiency arising in connection with the matter;*
  - (e) *that the solicitor or firm take at their own expense any other action in the interests of the complainant as directed.*
44. **Clause 1.8 (Annex 1 page 44)** has been amended to reflect the compensatory awards the Legal Ombudsman will be able make under section 137(2)(c) and the payment of interest on such awards under section 137(4). The amendment makes it clear that certain awards of the Legal Ombudsman relating to compensation to a complainant for their loss, inconvenience and distress and interest thereon are within the scope of cover for civil liabilities save in respect of an award to refund any fees paid to the insured.
45. The SRA had the benefit of comments from the Legal Ombudsman on the proposed drafting. As follows:
- “Having looked at the current proposals, I see that it is intended to cover awards made under s137(2)(c) & s137(4)(b), compensation and interest; but there will be no cover for any awards made under s137(2)(b)- (fees received or reduced). So, no recompense for any reduction in fees whether the client has paid them or not. In principle this looks to be a fair resolution of the problem as it would seem to be wrong that a legal practitioner could have recourse to insurance and receive a benefit for poor service and essentially have an opportunity to recover any loss from the insurer. However my interest here is to try and protect the consumer who has a benefit of a decision that*

*contains an element of return or reduction of fee, in particular where fee's have been paid 'up front'. In the normal course of events there should be no problem as if the legal practitioner/firm is still in business, the complainant will have the ability to recover the monies directly from the practitioner/firm and if there is any problem the award can be enforced through the courts. The case however may be dramatically different if the practitioner or firm has ceased to trade or has gone out of business. In such circumstances the consumer may be left without any effective remedy. In my view this would be a very regrettable position and would not be meeting the spirit of the changes envisaged by the Legal Services Act 2007.*

*Therefore, in the circumstances I wonder whether it might be possible to amend the proposals to provide cover for the small number of cases where the practitioner/firm has gone out of business to provide the requisite cover in the professional indemnity policies that will apply to our awards where there is an element of a requirement to return already paid fees."*

46. The suggested amendment was considered by the SRA's Financial Protection Committee but was not accepted as the proposed change would put clients with such an award in a better position than those with a judgement.
47. The position of the Qualifying Insurers is that clause 1.8 should be removed from the MTC, but if it has to remain then return of fees should not be covered as this is not a loss to the firm and has no place in a policy of indemnity insurance. Return of fees was not covered under SIF. No adverse equality and diversity impact has been identified following an initial review of this provision. The Law Society made no comment on this proposal in the limited time available to them.
48. In making this change the SRA takes the view that the proposed coverage for awards by the Legal Ombudsman is both reasonable and proportionate.

#### **Debts and Trading Liabilities (MTC - clause 6.6(b))**

49. Clause 6 of the MTC sets out the exclusions from cover. The change to **clause 6.6(b) (Annex 1, page 49)** was prompted by the introduction of the Land Registry Network Access Agreement earlier this year. Solicitors are required to sign the agreement to access the Land Registry's online services. The change makes it clear that if a firm enters such a contract for the supply of goods or services to the practice the exclusion will not apply to any legal liability arising in the course of the firm's practice if such legal liability would have attached in the absence of the contract. In other words the entering into a contract will not take away cover that the firm had before entering the contract.
50. This change is being made in response to an external development and takes account of a drafting point raised by the Law Society. It preserves client financial protection and the protection of firms. No adverse Equality and Diversity impact has been identified following an initial review of this provision.

## Qualifying Insurer's Agreement 2010

51. Qualifying Insurers will be invited to enter into a fresh QIA for the 2010/11 indemnity period which will append the ARP policy, the new Rules and the MTC. This reflects the changes set out above as well as the usual date and consequential changes. The QIA is attached at **Annex 2**. Although the QIA is the contract between Qualifying Insurers and the SRA that binds the Insurers into the Rules, the MTC and the ARP Policy, clauses 2.10, 6.2 and 6.11 of the QIA have an effect upon solicitors as insureds.
52. Clause 2.9 of the QIA (scope) provides that in the event of any inconsistency between the MTC and the terms of any individual policy of Qualifying Insurance, the MTC shall take precedence. Clause 2.10 provides that clause 2.9 shall be directly enforceable against an Insurer by an insured. Clause 2.9 and 2.10 are at **Annex 2, pages 4 and 5**. Rule 5 of the Rules (**Annex 1, page 29**) (Responsibility) imposes a responsibility upon a solicitor who is a principal in a firm that requires professional indemnity insurance to ensure that Qualifying Insurance (and so the MTC) is in place.
53. Clause 6.2 of the QIA (reporting) also impacts upon solicitors in that if any failure to pay a sum due to a Qualifying Insurer under a policy is believed to have been wilfully refused, the insurer may notify the SRA of that refusal. Clause 6.2 is at **Annex 2, page 7**. Rule 17 of the Rules (**Annex 1, pages 38 and 39**) (Use of Information) permits a Qualifying Insurer to bring to the SRA's attention pay failure to pay sums due.
54. Clause 6.11 of the QIA (successor practice election) (**Annex 2 page 8**) is new to reflect the changes to allow the successor practice election. This corresponds to new clause 5.3 of the MTC (**Annex 1, page 48**).<sup>8</sup>
55. One important change is to clause 4.4 to reflect the SRA's decision to amend the backdating provision to 30 days throughout the indemnity period from 1 October 2010. Currently in October and November of the indemnity period Qualifying Insurers have had a discretion to backdate their cover for 60 days to start on 1 October, in which case a firm that is in the ARP can leave the ARP (subject to some conditions). During the rest of the year cover can only be backdated by 30 days. This has meant that the SRA's monitoring visits of ARP firms are not carried out in the first two months of an indemnity period as, until 1 December, it is not certain that any particular firm will have been in the ARP. The intervening Christmas period means that visits do not start until January. The backdating provision will be changed from 1 October 2010 to a period of 30 days at any time of the year, so speeding up the start of the visits to ARP firms.
56. **The ARP Policy (QIA - Schedule 2) (Annex 1, pages 1 to 17)** has been amended in line with the recommended changes to the MTC.

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<sup>8</sup> Paragraph 34 above

## **E. STATEMENT IN RESPECT OF THE REGULATORY OBJECTIVES**

### **Protecting and promoting the public interest**

57. The preservation of a continuing professional indemnity scheme offering a high degree of financial protection is in the interest of all stakeholders but particularly the consumers of legal services, for whom the security afforded by the arrangement is a very high order. The costs of providing this protection are high and fall on the insurers, the profession and ultimately consumers of legal services. Whilst the changes to the new Rules and MTC do not go as far as the Qualifying Insurers have demanded, the changes for 2010/11 (together with the SRA's undertaking to conduct a root and branch review of the SRA's financial protection arrangements in time for renewal on 1 October 2011) we believe will be sufficient to enable the current arrangements to continue for the next indemnity period.

### **Supporting the constitutional principle of the rule of law**

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

### **Improving access to justice**

59. As explained at paragraph 26, the Qualifying Insurance market for one to three partner firms is limited. The key risks of not making the proposed changes to the new Rules now (and of not making future significant changes to the MTC) 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 over the course of the last couple of years. Two and three partner firms are considered to be the most difficult to underwrite, particularly in relation to cover for fraud and dishonesty.
60. 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 Rules will maintain access to justice.

### **Protecting and promoting the interests of consumers**

61. 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 until at least 30 September 2011. Even if the 2010/11 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 not be affected and will continue to be that provided by the Rules and the MTC. The current arrangements are under strain and the public interest will

not be served by a collapse of the current arrangements. This is one of the drivers for our root and branch review of our financial protection arrangements.

62. The Rules and the MTC clearly do protect and promote the interests of consumers and the wider public interest, the issue is the sustainability of the current arrangements.

### **Promoting competition in the provision of services**

63. The Rules 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 27 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 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 or in some cases having to close due to the lack of available insurance.

### **Encouraging an independent, strong, diverse and effective legal profession**

64. The Equality Impact Assessment following the ARP review and successor practice consultations shows that BME firms in particular will benefit from the retention of the ARP (with a few modifications) as compared to closure of the ARP. Complete closure of the ARP would have had a disproportionate effect on such firms and potentially adverse impacts for race and age equality as most ARP firms are small with 41% having a BME majority make-up. The new Rules will encourage the continuation of a diverse and independent legal profession. The changes to the ARP eligibility provisions especially will help to encourage a strong and effective legal profession by ensuring that any new firm that sets up cannot start its life as an uninsurable firm.

### **Increasing Public understanding of the citizen's legal rights and duties**

65. The SRA considers that the Rules will be neutral towards this objective.

### **Promoting and maintaining adherence to the professional principles**

66. The profession's reputation for high-quality and conscientious service is built on the foundation of the professional rules and principles of conduct established by the SRA. The compulsory professional indemnity insurance arrangement underpins this. The changes to the Rules will promote and maintain this objective.

## **E. STATEMENT IN RESPECT OF THE BETTER REGULATION PRINCIPLES**

### **Proportionality**

67. 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.

### **Accountability**

68. The SRA is accountable to all its stakeholders in relation to professional indemnity insurance matters: consumers; the profession; the Qualifying Insurers; BME groups. The SRA has to provide an insurance scheme that is effective but sustainable. An ineffective professional indemnity insurance arrangement will impact on all these stakeholders, and the larger public interest.
69. The Rules and other information are published on the website. and attract a great deal of interest and scrutiny in the current conditions.

### **Consistency**

70. The new Rules are consistent with previous Rules but have evolved 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 and outcome focused regulation.

### **Transparency**

71. The changes to the new Rules in relation to eligibility to the ARP and the successor practice election have been developed through a full public consultation and engagement with stakeholder groups. The consultation on the review of the ARP has made more transparent the costs and difficulties associated with the ARP. The principle of transparency requires those that have to pay for the costs of the ARP (the Qualifying Insurers and the profession) to understand the complexities and intricacies that underpin the professional indemnity insurance arrangement of which the ARP remains an integral part. Full liaison has taken place with the Qualifying Insurers through the forum of the Indemnity Liaison Committee.
72. There were some inadequacies in the rule making process this year in relation to some of the changes that were proposed in respect of the lack of time and information provided to stakeholders. Whilst the changes to the new Rules this year in relation to the ARP and the rules relating to successor practice were the subject of full consultation and a full Equality Impact Assessment, this was not the case with a small number of other changes. The preparation of the SRA Board papers was delayed whilst an assessment was made of the need to make additional radical changes to the MTC in order to get through the 2010/11 renewal. In the event, these radical changes have not been progressed this year.

### **Targeted**

73. The new Rules are targeted at complying with the requirements of the relevant provisions of the Solicitors Act and Legal Services Act. Responses to the ARP review consultation clearly showed concern about ineffective monitoring and lack of regulatory response to certain firms. The SRA is undertaking further work to identify those firms at risk either through not

paying premiums to their Qualifying Insurers or to the ARP. Dedicated resources will be available to manage this risk at the earliest opportunity by way of targeted visits to those firms concerned. The SRA is proposing to put in place an initiative to manage down the risk of unstable firms.

#### **F. STATEMENT IN RELATION TO DESIRED OUTCOMES**

74. The SRA seeks to amend the Rules that support the professional indemnity insurance arrangement which:
- Complies with sections 31, 37, 79 and 80 of the Solicitors Act 1974 and section 9 of the Administration of Justice Act 1985;
  - Ensures that an effective scheme of compulsory insurance is in place that continues to provide the best possible consumer protection;
  - Is efficient and fair, clear and transparent.
75. The SRA has made a commitment to review financial protection. The review will scrutinise the effect of current and alternative arrangements on the ability of the SRA to regulate effectively, and will consider the scope of protection offered to consumers (including sophisticated consumers such as financial institutions) of legal services, the means by which that protection is delivered, and the impact of those arrangements on consumers, individual firms, the legal services sector as a whole, and the SRA itself. Given the changes to the legal services sector, the review will also consider alternative business structures as part of the population of firms for any proposed financial protection arrangements. It is planned to consult on the findings of the review (which is to be conducted by an external consultant and will engage the main stakeholders throughout) by early 2011 with a view to introducing changes flowing from the outcome of the review on 1 October 2011.

#### **G. STATEMENT IN RELATION TO IMPACT ON OTHER APPROVED REGULATORS**

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

#### **H. IMPLEMENTATION TIMETABLE**

77. 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 2010. Normally the new Rules are ready for approval in early June but there has been a delay this year due to market developments.
76. As well as publicising the new Rules to the profession 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 2010 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.

## **I. STAKEHOLDER ENGAGEMENT**

78. The SRA carried out a full public consultation between 19 November 2009 and 12 February 2010. The consultations were published on our website. They were drawn to the attention of firms in the ARP and representatives of the Qualifying Insurers through the Indemnity Liaison Committee. The SRA held meetings with representatives of BME groups and other representatives.
79. The Law Society was fully involved in this consultation which helped in communicating the changes to the ARP to the profession.
79. There were a number of other changes where consultation was limited namely:
- Defence Costs (MTC – Clause 1.2(c)) see paragraphs 35 to 40;
  - Award by Regulatory Authority (MTC - Clause 1.8) see paragraphs 41 to 48; and
  - Debts and Trading Liabilities (MTC - clause 6.6(b)) see paragraphs 49 and 50.

## **J. FURTHER EXPLANATORY INFORMATION**

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

**Annex 1:** The ARP policy 2010, the Solicitors' Indemnity Insurance Rules 2010 and the Minimum Terms and Conditions

**Annex 2:** 2010 Qualifying Insurer's Agreement

## **SRA CONTACT FOR MATTERS RELATING TO THIS APPLICATION**

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