

Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 to the Legal Services Act 2007, for the approval of changes to regulatory arrangements relating to the SRA's Compensation Fund and Professional Indemnity Insurance requirements

A. Summary

1. This application is made by the Solicitors Regulation Authority (SRA) to the Legal Services Board (LSB) for approval of changes to the SRA's regulatory arrangements, including new SRA Compensation Fund Rules (CFRs) and SRA Indemnity Insurance Rules (SIIRs). We are also seeking approval of:
 - glossary terms which are relevant to these rules
 - amendments to the SRA Code of Conduct for Solicitors, RELs and RFLs and the SRA Authorisation of Individuals Regulations.
2. The new rules implement decisions made on the SRA's Looking to the Future (LTTF) programme (which are reflected in the alterations to our regulatory arrangements that the LSB approved on 5 November 2018¹). These include changes to the ways that a solicitor may practise, for example, we will allow:
 - solicitors to provide unreserved legal services to the public from businesses that are not authorised by the SRA or not regulated by any other legal services regulator (non-LSA regulated business)
 - individual self-employed solicitors to provide reserved legal services to the public, subject to certain restrictions.

The new rules confirm the financial protections that are in place for consumers using a solicitor practising in different ways. They confirm which acts or omissions of a solicitor will give rise to a claim on the SRA Compensation Fund and that only businesses authorised by the SRA will need to have professional indemnity insurance (PII) in accordance with the minimum terms and conditions which we prescribe.

3. We have simplified the CFRs and SIIRs in line with our approach to drafting the new SRA Standards and Regulations. The simplification to the CFRs allows applicants and those advising them to better understand when a claim on the Compensation Fund will be considered. The SIIRs are designed to be more user friendly and accessible, so that the people and businesses we regulate understand them. We are making changes to the SRA Code of Conduct for Solicitors, RELs and RFLs and the SRA Authorisation of Individuals Regulations to clarify that PII must cover past as well as present practice. This is consistent with the PII requirements that will apply to SRA authorised firms.

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4. Draft versions of the rules were included in our consultation on reforms to our PII arrangements and how we operate the Compensation Fund². The drafts showed what our rules would look like if the reform proposals were implemented but also reflected changes made to implement LTTF decisions and to simplify the rules.
5. This application does not seek approval of rules that would implement wider reforms of our PII arrangements or how we operate the Compensation Fund as that programme of work is continuing separately.

B. Details of the SRA's current regulatory arrangements

6. Our financial protection arrangements aim to provide financial redress to consumers for loss caused by dishonesty, incompetence or unethical behaviour of a solicitor.

SRA Compensation Fund

7. The Compensation Fund provides a safety net for those affected by individuals or firms (in the CFRs these are defined as a “defaulting practitioner”) who have misappropriated, or failed to account for, money. The Compensation Fund is a discretionary fund of last resort and therefore, grants will not be made where the applicant is not eligible to make a claim or is otherwise indemnified against loss.
8. The Compensation Fund can also make grants in respect of the civil liability of a “defaulting practitioner” where they failed to take out a policy of qualifying insurance³. This does not extend to solicitors working in a non-commercial body as they are not required to make sure that the body has in place a policy of qualifying insurance.
9. Currently, the definition of “defaulting practitioner” is not limited to solicitors with a practising certificate working in an SRA authorised body and neither do the rules explicitly exclude the acts or defaults that arise from the activities of a non-LSA regulated business. Therefore, if a solicitor remained on the roll and worked in such a business as a non-practising solicitor, then under the current rules they will be a defaulting practitioner to which the rules apply, and a grant may be made in respect of their acts or defaults whether or not they are practising in breach of practising regulations. Clients of solicitors or Registered European lawyers (RELs) practising in non-commercial bodies also have access to the Compensation Fund.

Professional indemnity insurance

10. Our PII arrangements offer substantial consumer protection. The SRA Indemnity Insurance Rules 2013 (SIIRs 2013) set out insurance requirements that apply to individuals and firms that we regulate which are carrying on private practice. The rules require all SRA authorised firms carrying on a practice during any indemnity period to take out and maintain qualifying insurance. The rules also include:
 - the minimum terms and conditions (MTCs) on which PII cover must be sought for it be classed as a policy of qualifying insurance
 - special provisions which apply when one or more of the principals in an SRA authorised firm are RELs. These provisions allow RELs to rely on

² <http://www.sra.org.uk/sra/consultations/access-legal-services.page>

³ means a policy that provides professional indemnity insurance cover in accordance with the minimum terms and conditions (MTCs) but only to the extent required by the MTCs.

indemnity insurance which complies with their home professional rules provided that the cover is equivalent in its conditions and extent to that which would be provided under the MTCs.

11. Firms have a continuing obligation to make sure that they always have in place PII which satisfies the MTCs for qualifying insurance.
12. Firms are required to take out and maintain PII of at least £2 million for any one claim. Depending on the type of client and the matter on which advice is sought, we expect those we regulate to carry out an assessment and to consider whether the minimum level is sufficient.
13. Outcome 7.13 of the SRA Code of Conduct 2011 reinforces the requirement for firms to assess and purchase the level of PII cover that is appropriate for their current and past practice, considering potential levels of claim by their clients and others and any alternative arrangements the firm or their clients may make.
14. The effect of the current rules means that they also apply to sole practitioners and partnerships that are not authorised by any approved regulator, but which are only capable of being authorised by the SRA. Such practices fall within the definition of a “firm” exclusively for the purposes of the SIIRs 2013. This means that these unauthorised practices must take out qualifying insurance, and if they do not, then any PII claim arising against the practice could fall on the Compensation Fund.
15. Solicitors that work in non-commercial bodies are required to make sure that the body has in place insurance which is reasonably equivalent to the indemnity cover required under our current rules.

C. Nature and effect of the proposed alterations to the SRA’s regulatory arrangements

SRA Compensation Fund (Annex 1)

16. In our earlier application to the LSB seeking approval of changes to the SRA's regulatory arrangements relating to our Looking to the Future proposals, we confirmed that clients of:
 - solicitors who work in businesses that we do not regulate will not be able to make a claim on the Compensation Fund
 - individual self-employed solicitors and RELs will have access to the Compensation Fund⁴
17. To make it clear when there will be access to the Compensation Fund, we have changed the term *defaulting practitioner* to only include:
 - solicitors, RELs, registered foreign lawyers (RFLs), recognised bodies and licensed bodies (or their employees or managers) working in or as an SRA-authorized firm
 - solicitors or RELs practising in a non-commercial body

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https://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/2018/SRA_application_to_LSB_Aug18.pdf (see paragraphs 153 and 201)

- solicitors and RELs practising on their own who are self-employed and practise in their own name and are engaged directly by their clients.

18. Under the new SRA Standards and Regulations, solicitors practising as freelancers can carry on reserved legal activities, subject to certain restrictions. Freelancers may also carry on non-reserved legal activities without any restriction. We do not think that it would be realistic for a client to be able to identify across the solicitor's client base, whether any work done involved reserved legal activities or whether they were complying with the restrictions for example, not to hold any client money, in order to determine whether a claim could be made. The simplest and most practicable arrangement is therefore for the client to be able to make a claim on the Compensation Fund provided that at the time of the act or omission the freelancer:

- was self-employed and practising in their own name, and not through a trading name or service company
- did not employ anyone in connection with the services they provided
- was engaged directly by their clients with their fees payable directly to them.

19. This means that when a solicitor is practising as a freelancer, a claim can be made on the Compensation Fund if our assessment confirms that the loss of money has arisen because of:

- the solicitor's dishonesty, or
- a failure to account for only that money which the solicitor is permitted to receive and hold (i.e. money held for fees and unpaid disbursements when carrying on reserved legal activities).

20. As mentioned in paragraph 6, there is access to the Compensation Fund for civil liability losses where the defaulting practitioner was required to have in place PII cover but did not. The new rules carry this position over but only for SRA authorised firms – given that freelancers, and solicitors in a non-commercial body, will not be subject to mandatory PII requirements which require them to obtain cover which meets our MTCs. We will, however, keep this issue under close review under the new arrangements.

Professional Indemnity Insurance (Annex 2)

21. Through the LTTF programme and the alterations to the regulatory arrangements which the LSB has approved, we have confirmed:

- for solicitors working as freelancers, in order to be entitled to carry on reserved legal activities, they must take out and maintain indemnity insurance that provides adequate and appropriate cover in respect of the (reserved and non-reserved) services that they provide. This requirement is set out in the SRA Authorisation of Individuals Regulations.
- for solicitors or RELs carrying on reserved legal activities in a non-commercial body, they must make sure that the body takes out and maintains indemnity insurance that provides adequate and appropriate cover in respect of the (reserved and non-reserved) services that the individual provides. This requirement is included in the SRA Code of Conduct for Solicitors, RELs and RFLs.

- For solicitors providing non-reserved legal services in a non-LSA regulated firm there is no mandatory PII requirement.
22. The new SIIRs confirm that the obligation to have in place and maintain a policy of qualifying insurance which meets our MTCs will only apply to SRA authorised firms and their principals.
 23. SRA authorised firms will continue to be required to make sure that they assess and purchase the level of PII cover that is appropriate for their current and past practice. This should take account of the potential levels of claims by their clients and others and any alternative arrangements the firm or their clients may make. This replicates the requirements that currently sit in Outcome 7.13 of the SRA Code of Conduct 2011 and now appear in rule 3.1 of the SIIRs.
 24. The SIIRs also confirm that clients of an SRA authorised firm should have the benefit of indemnity insurance and the SRA authorised firm must not exclude or attempt to exclude liability below the minimum level of cover required under these rules. This replicates the requirement that currently sits in Outcome 1.8 of the SRA Code of Conduct 2011 and now appears in rule 3.2 of the SIIRs. This specific requirement relating to exclusion of liability does not apply to solicitors working in non-commercial bodies or freelancers, as insurance requirements which apply to them are not comparable to those which apply to SRA authorised firms and do not specify a minimum level of cover.
 25. We have also simplified and updated the MTCs to reflect wording used in our new Standards and Regulations. A key change to the MTCs is that we have amended the definition of “private legal practice” to confirm that the PII cover will apply only to the practice of an SRA authorised firm.
 26. We have also simplified the special provisions which apply to RELs. The provisions now provide an easier navigation route to confirm which MTCs are varied when the firm is given a partial exemption from the need to have qualifying insurance.
 27. SRA authorised firms will also need to make sure that they give information about who they are insured with in the event of a claim. We have taken the opportunity to remind firms to comply with any obligations imposed on them by the Provision of Services Regulations 2009 (rather than replicate the legislation in the new rules).

Rule amendments for insurance requirements on solicitors working in non-commercial bodies or practising on their own (Annex 3)

28. As mentioned above, the current requirement in the SRA Code of Conduct 2011 includes the concept of considering both current and past practice when deciding what is “appropriate” in terms of the coverage of a PII policy. PII in the legal services market generally operates on a “claims made” basis. Therefore, anyone maintaining “adequate and appropriate” insurance will need to make sure that it will meet the claims that they could receive in that period, which will include claims arising from past practice.
29. For consistency and to make sure that the requirements are easy to understand, we think that it would be sensible for our requirements for solicitors working in

non-commercial bodies and those practising as freelancers that are carrying on reserved legal activities to follow the wording in rule 3.1 of the new SIIRs.

30. We have therefore amended paragraph 5.6 of the SRA Code of Conduct for Solicitors, RELs and RFLs and regulation 10.2(b)(vi) in the SRA Authorisation of Individuals Regulations.

New glossary terms (Annex 4)

31. The new CFRs and SIIRs bring with them new defined terms and other defined terms that need to be updated to reflect our new regulatory arrangements. These new terms are set out at Annex 4 to this application. Once approved, we will incorporate the updated and new defined terms into the SRA Glossary.

D. Rationale for amendment

32. Our objective is to make sure that our regulatory requirements are proportionate, providing solicitors and firms with the flexibility to innovate and better meet the needs of members of the public and businesses, while maintaining appropriate levels of public protection.
33. We therefore continue to review and modernise our regulatory requirements, removing unnecessary restrictions and requirements that burden firms with unnecessary costs and prevent solicitors and firms from meeting the needs of the public and businesses. At the same time, we want to make sure that protections for people that need them are set and maintained at appropriate levels.

SRA Compensation Fund

34. Section 36 (2) of the Solicitors Act 1974 makes provision for rules to be made which set out the circumstances in which grants may and may not be made from the Compensation Fund. The Compensation Fund operates as a fund of last resort which is financed by the profession.
35. Our view is that the CFRs best achieve our objectives by:
 - providing protection to consumers that is proportionate to the specific risks of clients suffering a loss of money when engaging with a solicitor practising as a freelancer
 - making sure that consumers are not confused about the protections that apply, or disadvantaged when using an individual self-employed solicitor either for a reserved or non-reserved legal activity
 - addressing points raised by consumer organisations in response to our LTTF consultations, and
 - limiting the operational impacts of assessing the eligibility of a claim from a client of a solicitor practising as a freelancer.

Professional indemnity insurance

36. The SIIRs deliver the policy position that was set out in our response to the LTTF consultation⁵ which is to maintain appropriate consumer protection while providing flexibility.

⁵ <https://www.sra.org.uk/documents/SRA/consultations/lttf-position-paper.pdf>

37. Only SRA authorised firms will be required to have insurance that meets our MTCs. The SIIRs confirm this obligation but also make sure that all other insurance requirements which apply to SRA authorised firms are set out in one place. This helps make sure that our requirements are easily understood.

E. Statement in respect of the regulatory objectives

38. The SRA must, so far as is reasonably practicable, act in a way that is compatible with the regulatory objectives set out in the Legal Services Act 2007 (LSA), and in a way that it considers to be most appropriate for the purpose of meeting those objectives.

Protecting and promoting the public interest

39. Confidence in the legal system supports the delivery of this objective. Consumer confidence in the legal services market is underpinned by an expectation that consumers will be protected if something goes wrong. This protection is delivered through the requirement on firms we regulate to have PII and access for consumers to the Compensation Fund.

Protecting and promoting the interests of consumers

40. The changes made to the rules are proportionate and continue to protect the interests of those consumers who need support through our regulatory arrangements. Consumers of legal services are entitled to expect a good quality service from the firms and individuals that we regulate, and they should be able to have confidence that if something goes wrong, there is in place a source of financial redress. The rules continue to provide the public and others with the assurance and confidence that client financial protection arrangements remain in place.
41. Firms we authorise and solicitors practising as freelancers that are engaged to provide legal services will be under an obligation to provide information to their clients about the protections that are available to them. Rule 4.3 of the SRA Transparency Rules for example, will require freelancers to let their clients know before engagement that they are not subject to the requirement to purchase qualifying insurance on the SRA's MTCs. They will also need to specify that alternative insurance arrangements are in place and if requested by the client, provide information about the cover provided.
42. Allowing access to the Compensation Fund where any solicitor practising as a freelancer has caused a loss of money because of their dishonesty promotes the regulatory objective to protect and promote the interests of consumers. When a client engages with this type of solicitor there will be less confusion about the protections that apply should a client lose their money.

Supporting the constitutional principle of the rule of law

43. The proposals will have a neutral impact on the constitutional principle of the rule of law.

Promoting competition in the provision of services

44. The changes to introduce new ways in which solicitors can work will promote competition in the provision of services. The PII and Compensation Fund

arrangements will make sure this is underpinned by a proportionate client protection regime.

Improving access to justice

45. The changes will have a neutral impact on access to justice.

Encouraging an independent, strong, diverse and effective legal profession

46. We have already carried out an assessment of any equality impacts relating to LTTF policy decisions as part of the wider programme of work. We have not identified any equality impacts in making rules which implement those LTTF policy decisions or in simplifying the CFRs or SIIRs.

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

47. The changes will have a neutral effect on this regulatory objective.

Promoting and maintaining adherence to the professional principles

48. The changes will have a neutral effect on this regulatory objective.

F. Statement in respect of the better regulation principles

49. The SRA considers that the proposed alterations fulfil our obligation under section 28 of the LSA to have regard to the better regulation principles. This work revolves around policy decisions made on the LTTF programme and the simplification of our rules is in line with our objective to maintain appropriate protections. This aligns with the better regulation principles of transparency, proportionality and targeting, and best regulatory practice. The simplification of these rules also makes them consistent with the style of rules already approved by the LSB.

G. Statement in relation to desired outcomes

50. The SRA continues to ensure that it has in place a regulatory framework which is proportionate and targeted and contains only those regulations and processes that benefit the public interest.

51. Access to PII and the Compensation Fund will play a key role in maintaining public confidence in using SRA regulated law firms or solicitors practising as freelancers. The LTTF reforms allow consumers to have greater choice in who provides them with legal services and these arrangements will make sure that consumers remain appropriately protected in the event of a claim for civil liability losses or a loss of money.

H. Stakeholder engagement

52. As part of our LTTF programme, we have outlined our strategy to help people understand the changes we proposed. This includes helping members of the public and supporting them as any changes are implemented. We are continuing with this work. Any areas where it becomes apparent that extra support or guidance is needed will be addressed as part of our overall support package.

53. LTTF has been supported by a wide-ranging campaign of engagement with all our major stakeholders. This campaign will be continued to support implementation of the new Standards and Regulations.
54. As part of our response to LTTF, we confirmed that we are developing our consumer information strategy⁶. This work is being developed and is linked to our work on price transparency and our digital badge. Our information strategy will set out how we will make sure that good quality and authoritative information is made available and accessible at the points at which consumers need it. This includes making sure consumers have information about the financial protections attached to the services provided by, for example, regulated law firms and solicitors practising as freelancers. The objective of this is to allow consumers to make choices quickly and easily, while being able to choose the "best" option for them.
55. Draft rules which implemented LTTF decisions and had been simplified, but also dealt with the proposed wider reforms, were included in our consultation published in March 2018 on changes to our financial protection arrangements. Respondents that commented on the draft rules focused mainly on the rule changes relating to the proposed wider reforms to our PII and Compensation Fund arrangements.

I. Statement in relation to impact on other approved regulators

56. We do not believe our proposals give rise to any conflict between any of the approved regulators.

J. Implementation timetable

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February 2019	Publication of our new Standards and Regulations
March 2019	Application to the LSB for approval of regulatory arrangements relating to the SRA's Compensation Fund and Professional Indemnity Insurance requirements
2019	Proposed implementation of the new Standards and Regulations

K. SRA contact for matters relating to this application

40. If the LSB has any queries in relation to this application please contact:

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⁶ <http://www.sra.org.uk/documents/SRA/consultations/lttf-our-response.pdf>

Annexes (attached separately)

- Annex 1: SRA Compensation Fund Rules**
- Annex 2: SRA Indemnity Insurance Rules with their annexes**
- Annex 3: SRA Regulatory Arrangements (Indemnity Insurance) (Amendment) Rules 2018**
- Annex 4: SRA Glossary terms**