LEGAL RISK LLP
SOLICITORS

Consultations
Solicitors Regulation Authority

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Contact: Frank Maher
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Your Ref:
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Dear Sirs

Response to the SRA consultation on Protecting the users of legal services: balancing cost and access to legal services

Introduction

1. We have completed the online questionnaire. This letter supplements our response and addresses the generic issues relating to the proposals to reduce professional indemnity insurance (PII) cover and exclude claims by commercial clients from compulsory cover.

2. We set out our objections to the proposed changes because we do not believe that they are in the interests of the public or the profession.

3. We are an SRA-regulated law firm. Our clients are mainly law firms, insurers of law firms and some regulators in other jurisdictions; our law firm clients are drawn from the spectrum of legal practice including some of the world's largest firms, both in the UK and abroad, and some of the smallest.

4. We advise on professional regulation and professional indemnity law. We have extensive experience of advising on coverage issues and on claims which may be in excess of policy limits (commonly, but not always, through application of the aggregation clause), and where there may be disputes between primary and top up insurers.

5. We also have wide experience of defending several thousand claims under the Solicitors' Master Policy Scheme, Solicitors Indemnity Fund (SIF) and the open market. Two partners have combined experience of over 70 years.

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6. Any proposal to reduce the cost of insurance by reducing the amount or scope of cover must envisage that someone will lose out, be it claimants whose claims are unpaid, or solicitors or their staff against whom claimants enforce judgments. Those who lose out may be selected randomly: they may be banks, but, equally, they may be brain-damaged children or widows who have lost their homes.

7. The consultation therefore starts from the wrong end of the problem. If the cost of claims could be reduced, a reduction in insurance costs should follow. We make some suggestions at the end of this response.

8. The proposals in the consultation will be far more likely to have the opposite effect of what is intended: they will –

    (a) increase insurance costs,

    (b) impact the efficient settlement of claims, particularly by clients of small firms,

    (c) make it harder for people to retire from the profession,

    (d) reduce access to justice, and

    (e) impact ethnic minority firms.

9. We deal with each of these below.

10. We endorse the Law Society's response as a whole and their analysis of the SRA's claims data. We believe it is likely that the figures understate the true cost of claims significantly, because claims had not fully developed at the time the data was collected.

11. We also believe that the proposals may, if enacted, place the SRA/Law Society in breach of its regulatory obligations under section 28 of the Legal Services Act 2007. We also address this below.

12. It is critical to understand that professional indemnity insurance is not a consumer product which is simple to purchase. In particular, individual members of firms and employees, past and present, cannot in practice buy it for themselves. They may be personally liable to claimants, but cannot protect themselves.

13. It is also critical to understand the full effects of the insurance being written on a claims made basis. The consultation fails adequately to address this for reasons identified further below. (For a number of reasons, however, it is not realistic to consider any change from the claims made basis.)

14. By definition, many of the insurers whose figures were not included in the SRA claims data had left the market or become insolvent, in no small measure because of their adverse claims experience insuring solicitors – the very insurers which might be expected to have the largest claims. Those which became insolvent were Quinn (2,911 firms insured), Lemma (590), Balva (1500), ERIC (number unknown) and Enterprise (43), so the numbers are not insubstantial.

15. The SRA claims data largely predates the emergence of cyber claims and bank scams; according to the SRA's Risk Outlook 2017/18, by way of illustration (as there are no complete figures for losses), from the first quarter of 2016 to the end of the first quarter of 2017, solicitors reported over £12m of client money stolen by cyber criminals, though one may query whether this figure represents the full picture. We do not know what sums may have been lost by bank scams not involving a cyber element.

16. Even on the SRA's figures, which understate the claims, the conclusion that 98 per cent of claims would be covered by a £580,000 limit, does not provide a rational and proportionate basis for a reduction to a lower sum of £500,000 (albeit £1m for conveyancing), and does not address the fact that only 53 per cent by value would have been met. Nor is there any logic behind picking 98 per cent as the basis for any decision. Focusing on averages is in any event misleading: all types of claim listed in the SRA data have claims in excess of £1m.

17. Including only conveyancing in the proposed higher limit is illogical, when probate matters commonly involve estates which include property. Perceptions of wealth will vary widely depending on one's viewpoint, but an estate which exceeds £500,000 does not in itself reflect high net worth given the value of property, even 'starter homes', particularly in London and the South East.

18. The definition of conveyancing needs further consideration. Would it include a claim arising from a related SDLT avoidance scheme, for example?

19. The proposals fail to consider the substantial sums which even small firms may hold in client account.

20. The £2m turnover limit for commercial claimants is also irrational. It is proposed that the provision be applied when the claim is made, which means that advice to a client may appear to be subject to the MTC at the time it is provided, but not when the claim is made. A firm may act for a property company which buys a plot of land. While it awaits development, the company may be below the £2m turnover threshold; a claim made in that year would be covered (subject to the firm having bought conveyancing cover). A few years later, the company builds three houses on the plot and sells them on the same day for £700,000 each. A claim in that year would not be covered. If the three sales were split, with

two on the date of the accounting year end and one a day later, then claims would be covered.

21. The proposals create an irrational array of limits of cover –

    (a) Nil – for clients with turnover in excess of £2m at the time of the claim;

    (b) Nil – where run-off cover has been capped and has reached the cap;

    (c) £500,000 – standard cover;

    (d) £1m – conveyancing;

    (e) €1,250,000/aggregate €1,850,000 under the Insurance Distribution Directive.

22. In particular, capping run-off cover with an aggregate limit will create a race to judgment in which some contestants will not even know that the race has started.

23. When the limit was last increased, The Law Society's Gazette of 27 January 2005 reported that "…The index contains elements which are not relevant to claims against solicitors and omits relevant elements, such as the value of property and the level of personal injury claims. Property values generally have more than doubled since 1989 and, ignoring the impact of structured settlements, maximum personal injury awards now exceed £3 million." That applies with even more force given the passage of a further 13 years.

24. Comparisons with other legal sector regulators' arrangements do not greatly inform the debate. The claims experience of the bar, for example, is significantly different from that of solicitors. A more realistic understanding of the impact of the proposed changes might be gained from brokers' experience of the IFA market for PII, where claims have been rife, restrictive provisions in policies common, and cover difficult to obtain; we leave it for brokers to comment further on that.

Increase in insurance costs

25. The proposals include a requirement, as at present, to 'take out and maintain professional indemnity insurance that provides adequate and appropriate cover in respect of current or past practice…' It should be borne in mind that assessment of what is appropriate is an art, not a science.

26. Even on the basis of the SRA's own data, which we believe understates the true cost of claims, most firms will have to buy more cover, albeit this may be on terms less beneficial than the Minimum Terms and Conditions (MTC). Minimum premiums mean that any saving from the reduction in MTC cover will probably be outweighed by additional premiums to

cover the difference between the proposed £500,000/£1m (conveyancing) and the current £3/2m limits. This is particularly so in the case of small firms.

27. The proposals are predicated on the untested assumption that the requisite top up insurance will be available. That may be the case for larger firms, but the market is contracting, with two insurers having exited the market for the first layer over the present compulsory limit of £3/2m, and it would be dangerous to assume without enquiry that those who remain would be willing to provide cover at a lower attachment point of £500,000 or even £1m because this would be a working layer of cover.

28. The obligation to obtain additional cover will be unenforceable against firms which have closed. As the aggregate run-off is exhausted, it may not be practicable to obtain further cover. The firm may be an unattractive proposition for cover, and funds to pay premiums may not be available in any event.

29. The SRA has advised in its consultation paper on the Insurance Distribution Directive that firms doing conveyancing, probate or personal injury will generally require cover of €1,250,000 with an aggregate of €1,850,000. The number of firms which might conceivably benefit from a reduction is therefore already reducing.

30. For many firms, including our own, the compulsory cover under the proposals would apply to very few clients, as most are commercial clients with turnover in excess of £2m. The impact would therefore be significant.

31. Even if there were savings in overall premiums of the scale asserted in the consultation paper, which is contrary to the evidence submitted in responses by experienced insurance brokers, these could only be minimal as a proportion of a firm's overall overheads. Frims are facing increases in other overheads such as the effect of the minimum wage increases and business rates. Many firms are facing significant challenges in maintaining fee income in areas such as personal injury and crime. It is therefore highly improbable that firms would reduce their charges to clients in the way the SRA contemplates.

32. The only firms with any prospect of saving on insurance are those doing solely immigration or crime and with no exposure from prior work in other areas (directly or as successor practice to a firm which has done other work areas). The issues which the SRA seeks to address are already addressed by insurers' pricing models which take account of work type.

Impact on the efficient settlement of claims, particularly by clients of small firms

33. In common with other solicitors who advise on professional indemnity claims, we are seeing more cases of insurers taking points on aggregation, under which multiple claims may be subject to one policy limit. This will increase if the policy limit is reduced, because in some

cases the application of the provision may make little difference to insurers if the total of multiple claims falls within the current primary cover of £3/2m.

34. At present, where there is a dispute between insurers of different policy years as to which is liable to indemnify, each insurer is contractually bound by clause 12 of the Participating Insurer's Agreement so one or other must 'conduct any claim, advance any defence costs and. If appropriate, compromise and pay any such claim' and seek reimbursement later.

35. The impact of multiple different limits of indemnity will make it hard to determine in some cases what the applicable limit is, and whether cover is compulsory or not.

36. Where claims payments (including claimants' costs) exceed the limit of indemnity, defence costs cover is reduced pro rata, leaving the insured to bear their share. This can create funding difficulties.

37. Excesses on defence costs make claims handling by insurers' panel firms more complicated in practice, and may cause practical difficulty where an insured refuses or is unable to pay. The proposal will not make any useful overall saving because firms will have to hold reserves for defence costs; unless the insured is a limited company, reserves will be taxed as income.

38. We have experience of defending claims which exceed the limit of indemnity. Some do so by millions of pounds, through aggregation or otherwise, but problems are not confined to the larger claims: in the writer's experience any claim over the policy limit causes potential conflicts of interest which may be significant, may delay settlement of claims, and prejudice claimants.

39. There will therefore be far more claims where, to the detriment of both claimants and insureds, their resolution is impeded by one or more of the following –

    (a) A dispute between primary and excess layer insurers; or

    (b) Insufficient cover, placing not only a firm but its members and potentially staff, who could be sued individually, at risk of insolvency; or

    (c) A dispute between insurers, but uncertainty as to whether they are bound to handle the claim or not; or

    (d) Practical difficulty in dealing promptly with the handling of a claim because of difficulties in obtaining payment of the defence costs excess or pro rata contribution to defence costs.

40. These issues will arise in cases which are straightforward on liability and causation, and the damage to the public perception of the profession when law firms appear outwardly to be dragging their feet over settlement may be significant. It is a recipe for chaos.

Making it harder for people to retire from the profession

41. The SRA is concerned about the cost of run-off cover, yet the proposals will increase the cost of run-off cover for many, particularly those in smaller firms.

42. The risk is that when an individual leaves a firm or retires, or when a firm closes, there will be insufficient cover in future years. This is a product in part of cover being on a claims made basis.

43. Because of the proposed reductions in cover, even where there is a successor practice, those retiring would have to pay for some form of run-off cover.

44. If the proposals take effect, solicitors and their staff will face a very real threat of spending a large proportion of their pension and savings on premiums for run-off cover – typically for two years at a time – or on claims, if they are unable to obtain cover. An adverse claims experience during run-off may preclude obtaining renewals of cover.

45. This in turn may have the opposite effect of what is intended, forcing people to carry on working in the profession. As the population ages, this may increase risk with people practising when they may be impaired by age-related conditions. It may also have the indirect effect of discouraging social mobility and a new generation of solicitors coming into the profession.

Reducing access to justice

46. Many small firms, including a high proportion ethnic minority practices, have a high degree of dependence on conveyancing practice.

47. When the SRA last proposed changes to PII, the Council of Mortgage Lenders (now part of UK Finance) indicated that members may not retain firms on their panels if cover were reduced.

48. The new proposals would exclude all commercial lenders from MTC cover.

49. It appears inevitable therefore that small firms would be excluded from panels, restricting consumer choice and potentially putting small firms out of business at the same time.

50. The proposed reduction in cover would also mean that many firms would be likely to refuse to rely on undertakings provided by small firms. These are an essential part of legal practice, particularly in conveyancing. Requiring firms to disclose their level of cover does not address the issue, because cover is on a claims made basis, so may be reduced by the time of any claim, and because top up cover would not afford the recipient of the undertaking sufficient protection, as cover may be declined by insurers for reasons which may even be wholly unconnected with the matter in question.

Impact on ethnic minority firms

51. These firms are often small. For the reasons explained above, the proposals have a disproportionate impact on small firms, through the cost of top up in a market where availability is declining, increased run-off costs, and the likely removal of many from conveyancing panels.

Regulatory objectives

52. Firms are prevented by O(1.8) from limiting liability below the current minimum cover. This gives rise to a legitimate expectation on the part of clients, solicitors and their staff that claims up to that limit will be protected by insurance. Because of the claims made basis of insurance, a lower limit applying in future could mean both clients and law firms are caught out and find that the available cover is less than the limit they had agreed through no fault of their own (because they may have no control over the applicable limit and breadth of cover).

53. This may put the SRA (or, more accurately, the Law Society) in breach of the right to property under Article 1 of the First Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms as scheduled to the Human Rights Act 1998: in *Wilson v First County Trust Ltd (No 2)*[1], Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Hobhouse of Woodborough and Lord Scott of Foscote held that "possessions" within the meaning of article 1 of the First Protocol included contractual rights.

54. In *AIG v Woodman*,[2] the recent case in the Supreme Court on the interpretation of the aggregation clause in the MTC, in which the SRA intervened, leading counsel for the SRA, Mr David Edwards QC, submitted as follows –

> 'The basis for the SRA's intervention has been twofold. First of all the SRA has been the statutory trustee of the Compensation Fund and as you will know my Lords, the Fund does not generally respond to claims for which insurance is available…
>
> 'But my Lords, secondly, and more importantly, the SRA intervenes as the body responsible for regulating the solicitors' profession and as the body responsible for setting the Minimum Terms and Conditions. So far as that is concerned, my lords, as regulator the SRA is obliged by s.1 of the Legal Services Act 2007 to act compatibly with certain regulatory objectives which include protecting and promoting the public interest, protecting and promoting the interests of consumers, and encouraging an independent, strong, diverse and effective legal profession. *In*

[1] [2003] UKHL 40
[2] [2017] UKSC 18

short, my Lords, the SRA has to have regard to the interests of solicitors, consumers and indeed the broader public interest.' [Our emphasis.]

55. This reflects the decision of the House of Lords in *Swain v The Law Society*[3] in relation to section 37 of the Solicitors Act 1974: the compulsory insurance arrangements are for the benefit of solicitors and, importantly, their staff, as well as consumers. As appears from the SRA's submission to the Supreme Court in *AIG v Woodman*, this is unaffected by the subsequent enactment of the Legal Services Act 2007.

56. The point is significant, because many people who may be subject to personal liability have no say whatsoever in the level and scope of insurance purchased by a firm. These may include staff, former partners and even current partners – and of course clients. They also have no means of ensuring that a firm complies with the terms of any policy – a point of critical importance in relation to –

    (a) Any claims within primary cover which are excluded from MTC protection by the reforms, such as claims by commercial clients with turnover in excess of £2m; and

    (b) Top up insurance, which may not afford the protections of MTC cover, giving rise to a declinature where, for example, an employee has concealed a matter which should have been disclosed on a proposal form, or where there are onerous notification provisions, such as those seen in IFAs' policies, for example, covering only 'claims made and notified' during the policy year, to give but one example.

57. By section 28 (2) of the Legal Services Act 2007 (the Act) the SRA is required to promote the regulatory objectives in section 1 (1) of the Act. These include –

    (b) supporting the constitutional principle of the rule of law; and
    (f) encouraging an independent, strong, diverse and effective legal profession;

    The proposals may put the SRA and the Law Society in breach of these requirements as explained above for two reasons.

58. First, they fail to protect the right to property of clients, solicitors and their staff, by virtue of the legitimate expectation created by the prohibition on limiting liability below the current £3/2m limits of indemnity and by failing adequately to protect claimants and current and former members of firms, particularly those who may have no say in the insurance arrangements by reducing MTC cover to nil (in the case of commercial clients) or limits which are below those considered appropriate in 2005.

[3] [1983] 1 A.C. 598

59. Secondly, the impact on small firms – increasing their insurance costs, excluding them from acting for lenders and making it harder to retire from practice - has consequences on diversity as explained earlier.

60. By section 28 (3) of the Act, the SRA must have regard to 'the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed'.

61. The proposals would place the SRA and the Law Society in breach of these requirements because –

    (a) Reliance on claims data which is incomplete and almost certainly under-reports claims is not transparent, accountable or proportionate;

    (b) The array of different limits of indemnity (see paragraph 21) is irrational and therefore not proportionate;

    (c) Increasing the cost of insurance in return for less cover is not proportionate;

    (d) Risking the exclusion of small firms from lender panels and reducing consumer choice (or forcing consumers to pay for two sets of advice) is not proportionate.

62. Further, on 14 June 2018 the SRA confirmed its intention to allow freelance solicitors to practise with insurance which does not meet the MTC. The impact of this, and the SRA's further proposal to allow employed solicitors to offer services to the public more widely than at present, should be assessed before proceeding with the current proposals on PII.

Steps which could be taken to reduce claims

63. The SRA could target conveyancing work which is the cause of approximately half the claims according to the SRA's claims data.

64. The causes of conveyancing claims are largely unchanged since the 1990s, when they reached epidemic proportions with significant impact on SIF and it would not be particularly difficult to carry out a review.

65. One option would be to carry out thematic reviews along the lines of the money laundering reviews.

66. A further option for consideration would be a procedure along the lines of the skilled person reports adopted by the Financial Conduct Authority. While that operates under a statutory framework in section 166 of the Financial Services and Markets Act 2000, it might be possible to implement something similar as a term of a regulatory settlement agreement.

67. The SRA could engage a commercial provider to send test phishing emails. If a member of a firm opened one of these, they would be directed to an online training course. The SRA could also be notified, which would assist it in identifying firms with vulnerabilities.

Yours faithfully

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