



**Solicitors  
Regulation  
Authority**

# **Response document Removing barriers to switching regulators**

**Consultation on a proposal to amend our Professional Indemnity Insurance (PII) requirements to remove a significant barrier to firms who wish to leave SRA regulation to be regulated by another Approved Regulator**

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## Contents

Response document: Removing barriers to switching regulators .....	3
Introduction .....	3
Background .....	3
Our comments and next steps .....	4
Amending the MTCs .....	5
Maintaining ongoing consumer protection arrangements.....	5
Formal consultation responses .....	6
Responses to questions 1 and 2 .....	6
Responses to questions 3 and 4 .....	9
Further consultation with approved regulators .....	10
Preferred option.....	12
Establishing a switching protocol .....	13
Impact assessment .....	13
Mitigation.....	13
Annex A : SRA Indemnity Insurance Rules 2013 (Amendment) (No 2) Rules [2017].....	14

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# Response document: Removing barriers to switching regulators

## Introduction

1. The Legal Services Act 2007 (LSA) allows lawyers and firms to be authorised by any approved legal regulator, which then regulates the reserved legal activities the lawyer and/or firm carries out.
2. In April 2016, we consulted on a proposal to amend our professional indemnity insurance (PII) requirements. We proposed removing a significant barrier to firms who wished to leave our regulation and become regulated by another approved regulator. The proposal recognised that the Legal Services Board (LSB) has oversight of all approved regulators' PII arrangements.
3. This document summarises the responses to our proposals and the outcome of further work with the other approved regulators. This work explored three options for making sure appropriate consumer protection, including for historical work, would remain when a firm switches regulator.

## Background

4. If a firm we regulate switches to another approved legal services regulator, the minimum terms and conditions (MTCs) that underpin our insurance arrangements treat the firm as if it has ceased to practise. This leads to six years of run-off cover being automatically triggered. This happens even if the firm takes out a replacement PII policy for its future business that covers historical work, ie overlapping with the six year run-off period. This additional run-off premium, on its own, is typically around three times the annual premium, but will vary depending upon the facts of each case.
5. The obligation to make sure run-off cover is in place when a firm switches regulator is placed on the firm and the insurer through different mechanisms:
  - for the firm, it is through the SRA Indemnity Insurance Rules 2013 (the SIIR)
  - for the insurer, it is through the general framework we have put in place with insurers under the Participating Insurer's Agreement (PIA).

Under the PIA, all insurers must offer insurance that meets our MTCs, including the provision of six years run-off cover. We can remove the obligation on a firm to obtain run-off cover under our waiver policy where we are satisfied this is appropriate. However, this does not change the obligation on insurers under the PIA to provide run-off cover.

6. We therefore proposed changes to the PIA to allow a firm to switch to a new approved regulator without automatically triggering the run-off cover provisions.
7. Our consultation was, in part, triggered by:
  - a number of firms who wanted to change regulator asking us to reconsider our position
  - the Council of Licensed Conveyancers (CLC), to whom those firms wanted to switch.
8. While working to remove this barrier to a firm wishing to switch regulator, we are mindful of our statutory obligations, in particular to prevent conflicts across the requirements put in place by the approved regulators. This could be the case where obligations are duplicated by regulators. The LSA also permits an approved regulator to apply to the LSB if they think another regulator is not doing enough to prevent a regulatory conflict.

## Our comments and next steps

9. We were pleased to receive support for the proposal to remove the obligation for run-off cover when a firm switches from us to another approved regulator. We recognise that there are risks to consumer protection that arise from our proposals, and we have welcomed respondents' suggestions for addressing them.
10. Given the general concern around appropriate safeguards for consumers being in place, we had more detailed talks with the approved regulators on three options. These are explained in more detail at paragraphs 57 to 66. Specifically, we considered the issue of where the responsibility should lie for making sure that adequate indemnity insurance would be in place for future claims, including for the work carried out before a firm switches regulators.
11. We think the best approach is that the regulator to whom the firm is switching should solely be responsible for making sure adequate insurance is available to cover claims for financial loss, including from previous work. This is based on responses to the consultation and further discussions with the approved regulators. Depending on the facts of each case, there may be differences in the level and scope of insurance cover following the switch. When deciding whether or not to authorise the firm, it will be for the new regulator to take a view on whether appropriate insurance arrangements were in place. The former regulator would not need to make any checks on the level and/or scope of consumer protection going forward.
12. To help the new regulator make this assessment, both regulators, new and old, and the firm will need to share information during the switching process. A switching protocol would support this by clarifying responsibilities and the framework by which the regulators will share information.
13. We believe this approach meets the following regulatory objectives:

- Protecting and promoting the interests of consumers: it provides a clean break between regulators and clarity to consumers as to which regulator is responsible for consumer protection.
- Promoting competition in the provision of services: of the three options considered, it is the best for removing regulatory barriers to switching regulators, which should promote competition in the legal market.

It is also the one that best meets the obligation to take reasonable steps to avoid regulatory conflict with the arrangements of other approved regulators.

### Amending the MTCs

14. We originally proposed to implement waivers in our MTCs and to make an amendment to the PIA in order to remove the requirement for firms to have run-off cover when switching regulators.
15. However, we concluded that a better approach was to amend our MTCs, so that run-off cover was not automatically triggered when a firm switched to another approved regulator. This means that waivers are not needed for each request to switch. While waivers were appropriate in the event where we had responsibility for assessing the level and scope of future cover provided by the future regulator, this is no longer the case. We do not think we need to consult again as a result of changing the way we plan to implement the proposals. We have consulted on the principle, and the type of approach does not change the effect of the proposals.
16. The changes to the MTCs will come into force on 1 October 2017 or once the LSB approves them (whichever is earliest). Under this new rule, where a firm switches to an approved regulator which has signed a switching protocol on the agreed terms, cover will not be automatically triggered. We attach the proposed rule change at annex A.

### Maintaining ongoing consumer protection arrangements

17. In the consultation paper, we explained that once a firm switches regulator, it needs to comply with the regulatory arrangements of the new regulator. We identified the risk that the new regulator's arrangements might not cover all client matters concluded before the date the new regulator authorises the firm. For example:
  - insurance may be on a loss-occurring basis rather than claims made
  - the policy may only cover legal activity that is regulated by the new regulator
  - the new cover may allow a lower level of PII cover or a less advantageous set of MTCs.

18. While this does not alter the firm's liability in the event of a historical claim, it can lead to less consumer protection than was in place when the consumer instructed the firm to do the work.
19. To mitigate this risk, when a firm seeks to switch, we considered in the consultation paper whether we should make a case by case assessment of any new regulator's insurance arrangements. We would then waive the requirement for run-off cover only when the new regulator asked the firm to obtain insurance coverage comparable to our own MTCs.
20. We set out both conceptual and practical challenges with this approach and asked for views.
21. Conceptually, assessing the adequacy of other approved regulators' arrangements is not for us. This is the LSB's responsibility by statute and it will approve consumer protection arrangements in the context of its wider regulatory framework. Practically, once the firm has moved out of our regulation, its circumstances might change. This could impact on the conditions on which the waiver was granted. We would not – and should not – have control over the firm's continuing practice and ongoing insurance arrangements once it has moved into the jurisdiction of another regulator.

### Formal consultation responses

22. Generally, respondents were supportive of the aim to remove barriers to switching regulators. However, many were concerned that appropriate safeguards should be in place to make sure that consumers remained adequately protected. Respondents had differing views as to how this could be achieved.

### Responses to questions 1 and 2

**Question 1 – Do you agree that we should remove the obligation for run-off cover when a firm switches from the SRA to another approved regulator?**

**Question 2 – If you have answered yes to question 1, do you agree with our method for delivering this proposal?**

### Responses from other approved regulators

23. Overall, the approved regulators supported the proposal because it potentially prevents duplication of cover and therefore reduces regulatory burden. CILEx said it would need more detailed information before it could comment with any certainty and welcomed the opportunity to have further discussions.
24. The regulators had a range of views on how the proposal could be best implemented, to make sure adequate consumer protection was in place following the switch. The views, in part, were linked to the scope and coverage of their individual insurance requirements.

25. In its formal response, the ICAEW considered that it would not be appropriate for us to look for equivalent PII requirements in the other regulator when considering requests for a waiver. The ICAEW thought it was the LSB's role to assess the appropriateness of each body's regulatory arrangements.
26. The CLC supported the use of waivers as an interim measure to remove the barrier to switching, but thought that a waiver should only be granted if we were confident that consumer protections would be equivalent under the new regulator's arrangements. As a result of further discussion, the CLC said they understood the reasoning for the option we are taking forward - that the new regulator is responsible for making sure indemnity insurance is appropriate when a firm is asking to switch to them.
27. The Bar Standards Board (BSB) thought the onus should be on both regulators to be satisfied that appropriate arrangements were in place. In support of this, it said that its arrangements had been approved by the LSB for firms providing a specific set of legal services. They would not be suitable for historic work that might have been provided by a firm previously authorised by us. It emphasised the need for the alignment of switching arrangements and cooperation between regulators during the switching process.

#### Responses from groups representing lawyers

28. The Law Society and the Junior Lawyers Division (JLD) believed that there should not be any reduction in current consumer protections. Both thought that because the level and extent of mandatory cover varies between approved regulators, firms should only be allowed to switch without triggering run-off cover where the new approved regulator's PII cover provided equivalent protection for solicitors' firms clients.
29. The Law Society did not agree that granting a waiver would be the best implementation method. Instead, it suggested that there should be set rules for when a firm can switch regulator without triggering run-off cover. This might be in a similar vein to the current successor practice rules, which do not trigger a disposing firm's run-off cover where the insurer of the acquiring firm must cover claims made against the prior practice. The Law Society also said that clients of firms we regulate should be informed when a firm switched regulator.
30. The Liverpool Law Society (LLS), while not opposed to changes that would achieve the regulatory objective of promoting competition, did not think that the proposal would best achieve that objective. The LLS also identified a potential impact (increased financial exposure) on outgoing and former partners of the entity as well as consumers, if the level of cover was reduced as a result of a firm switching to another regulator.

#### Responses from law firms

31. The six law firms who responded mostly agreed to the proposals to remove the run-off requirement. They thought the current cost of run-off could act as a

barrier to switching regulators and served limited public interest benefit, whereas the LSB has ensured that other approved regulators have appropriate alternative arrangement in place. However, Khiara Law felt that the waiver route for any outgoing firm continuing to be regulated was unnecessarily complex, beyond our regulatory reach and contrary to our obligations under the Legal Services Act. The firm believed that we should not be required to monitor firms we no longer regulate where they were covered by another regulator's regime.

32. Other groups of respondents had different views on implementation. A number of firms thought the waiver approach for the firm as set out in the consultation paper was unduly complex. They said it was for the LSB, not us, to make sure there was consistency between the insurance requirements of different approved regulators. They felt we should be relieved of any obligation to police firms once they had switched to another regulator. That the firm complied with the rules of the new regulator was their only requirement.

#### **Responses from groups representing consumers of legal services**

33. The Legal Services Consumer Panel (LSCP) supported the proposal. It commented that the current requirement was unduly restrictive and costly for those who wished to switch from our regulation to another approved regulator. The LSCP considered that the automatic trigger of six years run-off cover – even if the firm took out replacement PII for its future business – was an unjustifiable cost passed onto consumers.
34. The LSCP referred to its 2013 report, which identified gaps and inconsistencies in financial arrangements across the regulatory landscape. This led to a recommendation which asked the LSB and others to work towards centralised protection arrangements for all regulated legal advice providers. The LSCP raised a concern that the proposals could exacerbate the situation.

#### **Responses from insurance market**

35. An insurance provider supported the proposal, on the basis that the new approved regulator asked the firm to have retroactive cover equivalent to the relevant provisions of the SRA's Indemnity Insurance Rules 2013.
36. The International Underwriters Association (IUA) agreed that we should remove the obligation for run-off cover when a firm switched from us to another approved regulator. They suggested that the most effective way to make changes to the PIA would be through the use of slip endorsements. The Royal Institute of Chartered Surveyors and the ICAEW's brokers have used this method to make quick changes to the agreement.

### Responses from other stakeholders

37. The Council of Mortgage Lenders (CML) was broadly supportive of the proposed change. However, the CML also acknowledged that there were potential risks to consumers around reduced protections. It thought there should be no 'gap' in consumer protection in the event a firm did change regulator. It also thought there was a potential for firms to move regulators to avoid meeting higher standards. The CML suggested that the approved regulators should work closely with the LSB to guard against these risks to consumers, so that firms can more easily switch regulators.

### Responses to questions 3 and 4

**Question 3 – Do you have any further comment on our proposal or on the changes to the PIA or terms of the core waiver proposed?**

**Question 4 – Do you have any views about our assessment of the impact of these changes and, are there any impacts, available data or evidence that we should consider in developing our impact assessment?**

### Responses from other approved regulators

38. The CLC reiterated its view that, prior to any change, the approved regulators and the LSB should agree that there would not be any regulatory gaps that could lead to an inappropriate reduction in consumer protection as a result of switching regulators.
39. CILEx and the BSB both said further discussion was needed to align processes and to make sure appropriate consumer protection for historic work was in place.

### Responses from groups representing lawyers

40. The Law Society suggested that the template wording provided for the waiver needed amendment. It said it did not take into consideration that a firm switching regulator may not do so under the same trading entity.
41. The JLD suggested that, to safeguard consumers, making any waiver should be conditional upon comparable cover being continued. It suggested amendments to the wording of the PIA and proposed waiver were needed to achieve this.
42. The LLS's position was that, as an approved regulator, we should strike the right balance between removing a barrier to competition and potentially creating a consumer detriment in some cases. It was keen to know more about what criteria would be applied when granting a waiver.

### Responses from law firms

43. Firms reiterated their view that the current arrangements were unnecessarily stringent, and that changes should be implemented as soon as possible to remove a real barrier to changing regulators. One firm added that where firms were switching to our regulation from another approved regulator, it would be for us to make provisions for assuming run-off liabilities in our insurance arrangements. Where the outgoing regulator's PII requirements were lower than our MTCs, then it should be for us to decide whether it was necessary for these to be required.

### Responses from groups representing consumers of legal services

44. The LSCP believed it was beyond our remit to assess the PII arrangements of another approved regulator. It said it was the responsibility of all approved regulators to make sure that consumer protection did not fall between the gaps of regulatory boundaries. The risk of financial loss to consumers was simply too high not to safeguard against it collectively. If this risk materialised, the LSCP also felt there was a risk to the entire profession, because it would likely weaken consumer trust and have harmful impacts on the legal profession's credibility as a whole. The LSCP believed the lead should come from the LSB as the oversight regulator, with full support from all approved regulators. It thought the LSB should respond to market developments by understanding the drivers for switching and mitigate against any risk that was likely to happen, including the risk of further fragmentation.

### Responses from other stakeholders

45. An insurance provider noted our view that the proposal was a "workable temporary solution to the problem" and should not be delayed pending wider planned consultation concerning PII reforms. In terms of an impact assessment, it said that without first knowing more about the outcome of that wider consultation, it could not assess the full impact of these proposals. It did not see any urgency to press ahead with the proposals at present.

### Further consultation with approved regulators

46. Given the general concern around appropriate safeguards being put in place, we undertook further consultation with the approved regulators on three options for making sure appropriate consumer protection was in place after the switch. These considered where the responsibility should lie for future insurance claims arising from prior work carried out before a firm switches regulators. We wrote to all approved regulators to seek their views on these options.

### **Option one: Former regulator has responsibility for consumer protection**

47. We would waive the current requirement, using the mechanism set out in the consultation paper, to allow alternative consumer protection arrangements to be put into place. Under our present arrangements, if a firm wishes to leave our regulation, clients are protected by means of the automatic triggering of six years run-off cover. However, once the firm has switched regulators, we, as the former regulator, might wish to set conditions on a waiver but have no power over the firm to make sure such terms were met.
48. We have an obligation under section 52 of the LSA to take reasonable steps to avoid regulatory conflict with the regimes of other approved regulators. This option gives rise to potential conflict, where there is duplication of obligations on a firm once another regulator authorises it.
49. It also requires a case by case consideration of the adequacy of the new cover to be put in place at the point at which a firm switches regulator. All this adds cost to both the regulator and the applicant firm.

### **Option two: Former and new regulators share responsibility for consumer protection**

50. One consultation respondent favoured a shared approach. Under this option, the new regulator takes responsibility for consumer protection arrangements for the legal services it regulates. If a firm moves to another regulator providing a narrower range of cover, it will not be able to carry out the previous full range of activities. This leaves the former regulator responsible for consumer protection in respect of the activities the firm can no longer carry out. Under this option, we would only waive the automatic six years run-off cover for the work the firm can no longer carry out, if we were satisfied that alternative consumer protection arrangements were put in place. For example, a firm could purchase run-off cover solely for the historical work it no longer plans to carry out. Under this option, the new approved regulator would be responsible for the insurance arrangements for new and historical work that the firm is authorised by them to carry out.
51. While this option may be attractive to the new regulator, it suffers from the same problems as option one. This is in terms of the additional costs to both the regulator and the applicant firm, and the inability of the former regulator to make sure that the terms of the waiver are met once the switch has occurred.
52. In addition, the cover for claims arising from historical work is likely to be uneconomic to maintain in two separate policies. This could be overcome if insurers were prepared to provide a single policy that met the requirements of both regulators. However, with shared responsibility, there is also a risk of dispute over which regulatory arrangement is responsible for and should cover a particular claim.

### **Option three: New regulator has responsibility for consumer protection**

53. Responsibility for consumer protection in respect of future indemnity insurance claims arising from past activities is the sole responsibility of the

new regulator. Under this approach, we, as the former regulator, would not need to make any checks on the level and/or scope of future PII cover. There may be differences in the level and scope of cover following the switch. This would be a matter for the new regulator and the LSB, as the oversight regulator, to make sure that appropriate consumer protection was in place for indemnity insurance claims. Our SIIR and PIA would be amended to make the position explicit and remove the need for individual case by case waivers (which would be necessary under the current SIIR). Under this option, there would likely be the need for the respective regulators and the firm to share information on, for example:

- its supervisory history
- its claims history
- the extent of its previous insurance cover as part of the switching process.

### Preferred option

54. We discussed the options with the other approved regulators. We argued that option three:

- provides a clean break between regulatory regimes
- provides clarity to consumers on which regulator is responsible for consumer protection for indemnity insurance claims
- avoids the uncertainties created by the first two options
- provides the most straightforward approach to achieving adequate consumer protection
- removes the potential for overlapping cover
- removes regulatory barriers to switching regulators, thereby facilitating open competition in the provision of legal services.

55. The responses received<sup>1</sup> were mostly in favour of the third option, while acknowledging there were implications for consumers. A number wished to discuss the matter further to make sure that appropriate systems were in place. They saw the benefit in making sure that authorisation and closure processes were aligned for regulators and consumers, and the information that could be made available to the new regulator was sufficient to assess whether adequate consumer protection was in place. The ICAEW stressed that their views were limited to regulators' PII arrangements only and requested separate discussion on the interplay between the compensation arrangements of each regulator. The BSB referred us back to their earlier consultation response.

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<sup>1</sup> We received responses from the BSB, CLC, Master of Faculties and ICAEW.

## Establishing a switching protocol

56. We think this approach should be supported by a switching protocol that:

- Clarifies that once a firm switches regulator, the new regulator is responsible for a firm's regulation and its indemnity insurance arrangements.
- Provides a framework to allow the switching of regulators. This includes the lawful sharing of information, to support consumer protection.
- Supports regulators in keeping consumers informed about who regulates which individuals and firms.

## Impact assessment

57. The approach set out in this document best supports the regulatory objectives of protecting and promoting the interests of consumers and promoting competition in the provision of services. It provides a clean break between regulatory regimes and clarity to consumers as to which regulator is responsible for consumer protection.

58. We have identified a potential negative impact on consumer protection where a firm switches to a new approved regulator. This concerns the level and extent of insurance coverage required by the receiving regulator, where there is the risk that it does not match that previously provided. This is explained in paragraphs 17 to 21.

## Mitigation

59. Under the changes, responsibility for consumer protection in respect of future indemnity insurance claims arising from past activities would rest with the new regulator.

60. It is the responsibility of the new regulator to assess all relevant risks to consumers, should the switch take place. It is also the new regulator's responsibility to make enquiries to satisfy itself that it can suitably regulate the firm seeking to switch.

61. Alongside this, the LSB has an oversight to determine whether the financial protection arrangements put in place by the approved regulators are fit for purpose. The switching protocol referred to in paragraph 16 would support mitigation of any negative impact on consumer protection.

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## **Annex A : SRA Indemnity Insurance Rules 2013 (Amendment) (No 2) Rules [2017]**

Rules made by the Solicitors Regulation Authority Board on [date made by Board] under sections 31, 37, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, and section 83 of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007.

Approved by the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007 on [date of approval by LSB].

### **Rule 1**

Amend the SRA Minimum Terms and Conditions of Professional Indemnity Insurance in Appendix 1 to the SRA Indemnity Insurance Rules 2013 as follows:

- a) at the beginning of clause 5.4, insert “Subject to clause 5.8,” and replace “The” with “the”;
- b) in the final paragraph of clause 5.4, after “clause 5.4” insert “and clause 5.8”;
- c) after clause 5.7 insert:

“5.8 Transfer to another approved regulator

Clause 5.4 above does not apply where the *insured firm* becomes an *authorised non-SRA firm* provided that the *approved regulator* of the authorised *non-SRA firm* is a signatory to the switching between *approved regulators* protocol.”

### **Rule 2**

These rules come into force on 1 October 2017 or on the seventh day following approval by the Legal Services Board, whichever is the later and replace the SRA Indemnity Insurance Rules 2013 (Amendment) Rules 2017 which never came into force.