Meeting: Legal Services Board

Date: 26 April 2022

Item: Paper (22) 22

Title: Financial protection arrangements for consumers

Author(s): Sally Al-Saleem, Regulatory Policy Manager

Status: Official

Introduction: Purpose of the paper

1. This paper presents the Board with the aims, scope, and plan for the financial protection arrangements for consumers project[1], following the presentation and discussion at the 1 March 2022 Board meeting.

2. The purpose of the project is twofold:

    - To develop policy options supported by evidence (claims data analysis and research) which will facilitate regulators to strike the right balance between an appropriate level of financial protection for consumers and ensuring the costs to the profession and consumers (with its associated impact on access to justice) is affordable and sustainable in the long term.

    - To enable regulators to use their regulatory levers to address the root causes of the risks in the legal sector which may be leading to high insurance premiums (e.g., high volume/value of claims, holding client money) or claims on the compensation fund (e.g., dishonesty with respect to client money).

Recommendation(s)

3. The Board is invited to

    - **Agree** the aims, scope and approach of the project.

    - **Discuss and agree** next steps.

[1] This is a key workstream in the LSB Business Plan 2022/23.

Timing

4. We plan to publish a short paper setting out the purpose, intended outcomes and outputs of the project, inviting stakeholders to comment on its scope. We intend to publish this after the April Board meeting, alongside the Public Panel research. Given the scope, planned activities, and intended outcomes of this programme of work, we envisage that the work will conclude in Q2 2023/4, but there will be a series of outputs and milestones between now and then.

Why we are undertaking this project

5. The increasing cost of consumer protection is putting new pressures on the economics of legal service delivery. The recent hardening of the PII market, driven in part by insurers' perceptions of global risks has manifested in a sharp rise in premiums in 2021 and a rise in insurance excess fees. With less capacity in the legal services market as fewer insurers are prepared to service the legal services sector and look to more profitable sectors, if this trend continues it could result in increased costs for consumers. It could also reduce the number of legal professionals operating in the market, potentially impacting on choice and access to services. Further, a reduced risk appetite by insurers may be stifling innovation as there is anecdotal evidence of cover being refused for some innovative activities that could improve outcomes for consumers. We are also concerned that some regulators are finding it increasingly difficult to secure adequate insurance-backed compensation scheme arrangements.

6. Therefore, it is imperative that the LSB and the regulators that we oversee, ensure that an appropriate level of consumer protections exist and that the cost to the profession is affordable and sustainable in the long term.

Outcomes

7. The outcomes we are seeking are:

    - All regulators have sufficient evidence and tools to (a) carefully consider whether to implement new or recalibrated financial protection arrangements (PII and compensation schemes) to protect consumers from harm while ensuring the costs to the profession and ultimately consumers (with its associated impact on access) is affordable and sustainable in the long term and (b) start to address the root causes of the risks in the legal sector which may be leading to higher costs.
    - The trade-off between costs and protection of Professional Indemnity Insurance (PII)[2] are better understood and more transparent, which *may* have an impact on the price of PII.
    - PII supports innovation in legal services.

[2] Where relevant this should include run-off cover.

What we have done so far

8. The project involves two phases: (i) evidence gathering, econometric analysis and research and (ii) the development of policy options.

9. We have already initiated some evidence gathering activities and one aspect of our research is complete. The Public Panel research, which involved a mix of deliberative and quantitative research to improve our understanding and evidence base in relation to consumer appetite for risk and preferences in respect of the trade-off between levels of protection and affordability in the legal services market, has now concluded (see **Annex A**). We have also put into effect our plan for data gathering on premiums, excess fees, and insurance pay outs for claims[3] segmented by area of law from insurers. Insurers have agreed in principle[4] to share their data and we have commenced joint working with the SRA ahead of a formal data request to insurers in mid-April (see **Annex B**).

10. Given the array of interested parties, regular and wide-ranging stakeholder engagement will be a key element of this project. We have already had positive early engagement with other professional services regulators whose regulated communities have been impacted by the hardening of the PII market, as well as the FCA and the CMA. We will continue to engage with stakeholders, to gather their views, and test our emerging thinking throughout the life of the project.

What we intend to do

Evidence gathering

11. We intend to gather data initially from the SRA and The Law Society (TLS) on premiums and excesses (we may extend this to other legal service regulators) to help to determine:

- Which characteristics of a firm (including area of law, business model, turnover etc) insurers take into account when setting PII premiums and the extent to which insurers have a common approach to certain characteristics[5]
- The most significant driver of PII costs; and
- Whether certain activities by the firms (such as notifying potential claims to insurers) or the regulator sharing information on firms with insurers (subject to consent from the firms) may mitigate premiums.

12. We will also commission econometric analysis on the data to determine (some of this analysis will be jointly commissioned with the SRA):

- The main risks to insurers that increase PII costs, which regulators can influence

[3] We may also be able to obtain some of this data through the SRA's Anti-Money laundering survey which it intends to run from April to June 2022.
[4] The SRA already has historic claims data which insurers shared with them for a ten-year period (2004 to 2014) which provides insights into the areas of law which generate the most claims.
[5] Using the PII survey and SRA firm level data on premiums should enable analysis to calculate the average weightings insurers put on different factors for setting premiums.

- The cost of PII and compensation schemes to firms
- The proportion of PII costs and compensation scheme costs which are passed on to the consumer for commonly used legal services such as conveyancing, divorce, and wills and
- The elasticity of consumer demand for legal services
- The areas of law which are considered high risk.

13. We will ask the regulators to provide data on the number and value of applications for grants, and data on grants made from their compensation schemes (or where relevant data on claims and made on fidelity insurance held by individuals[6]) and data on the costs to the profession of maintaining these schemes, where we are not already in possession of this data[7].

14. We intend to publish high-level findings from our data and econometric analysis in Q3 2022.

Development of policy options

15. In the second phase of the project, we will use the findings of our research, analysis and other evidence gathering activities to inform the development of a framework or toolkit[8] to facilitate regulators to identify:

    - how they can have an impact on the provision of PII, such as considering policy options on requirements for the provision of PII in the long term (ensuring there are no unnecessary regulatory barriers), implementing the most appropriate arrangements for the context in which they regulate, and how to make use of their regulatory levers to mitigate the risk factors that may be driving higher premiums and

    - policy options for adequate and affordable compensation scheme arrangements and how to mitigate the risks which are leading to claims.

16. We will develop our policy thinking in discussion with stakeholders.

Next steps

17. Given our concerns about the impact of the increasing costs of financial protection arrangements for consumers, we wish to make rapid progress on this project. However, there are a number of complex issues, considerable evidence to gather and a need to engage with and build consensus with numerous stakeholders. Therefore, we expect to conclude our review and publish all outputs by September 2023. A timetable of our next steps is below.

[6] Assuming this information has been captured by the regulator.

[7] We are already in possession of some historic claims data from the SRA and data on the annual levy on the profession (as the LSB must approves the annual levy for the compensation fund contributions for those regulators which operate a compensation fund).

[8] This will include an analysis of minimum terms and conditions versus more flexible requirements.

April 2022	Make formal data requests from insurers
April 2022	Publish Public Panel research findings and short paper setting out the purpose, intended outcomes and outputs of the project, inviting stakeholders to comment.
Q3 2022/3	Publish high level insights from data gathering activities and some econometric analysis
Q4 2022/3	Develop policy options and framework/toolkit and publish consultation
Q2 2023/4	Publish the final framework/toolkit in September 2023.

Risks and mitigations	
Financial:	N/A
Legal:	N/A
Communications and engagement:	This will be the first outline of the aims, scope, and approach of the project to be published, following publication of the LSB Business Plan 2022/23. We will shortly publish the research accompanied by the paper explaining the review and inviting stakeholders to comment.
Equality and diversity:	We will assess the equality impact when developing the policy options and the framework/toolkit and reflect this in the consultation document.
Resource:	N/A

Annexes

Annex A – Professional Indemnity Insurance in legal services – Consumer research
Annex B – Joint plan for the LSB's and SRA's data gathering activities from insurers
Annex C – Short paper for publication setting out the LSB review and invitation to comment

Freedom of Information Act 2000 (FoI)		
Para ref	**FoI exemption and summary**	**Expires**
Annex A and C	Section 22 – information intended for future publication	May 2022

Annex B

Joint LSB and SRA data collection plan

Objective:

This document outlines the data that the LSB and the SRA will request from insurers. To summarise, we will only need to collect data that we cannot get from anyone but the insurers. This is primarily claims, excess, and payment data.

The International Underwriting Association has agreed in principle to help us ask for this data and consolidate insurers thoughts and actions.

Previously asked for:

Previously, the SRA asked for ten years of data in the following areas. This was from the period of 2004-2014.

- Claims made
- Payments made
- Area of law it comes in
- Block claims
- Defence costs
- Reason for claim

To be asked 2022:

We will ask for the same data again, again for a ten-year period. On top of this discussions have highlighted additional areas where we would like data (in bold).

- Claims made
- Payments made
- Area of law it comes in
- Block claims
- Defence costs
- Reason for claim
- **Excesses (for both claims paid and not paid)**
- **Claims data from other professions**
- **Date of claim**
- **Date of incident**