Professional indemnity insurance: affirmative cyber cover

Responses and feedback to our consultation

Contents

Executive Summary

1. In this report, we present the responses to our consultation proposing a change to our minimum terms and conditions (MTCs) for the professional indemnity insurance (PII) that we require all the law firms we regulate to have in place.

2. Our proposal is to add a clause into the MTCs that clearly sets out what is and what is not covered in the event of a firm being subject to a cyber-attack/event. This is in line with the expectations that the Prudential Regulation Authority and Lloyd's of London have of insurers because the risk of cyber-attacks on individuals and businesses has increased. Our objective is to provide clarity for law firms, insurers, and consumers without altering the scope of consumer protection provided by our PII arrangements.

3. Respondents to our consultation provided a variety of views and detailed comments on the clause and its drafting, which will inform our approach going forward.

Background

4. Over the years, the risk of cyber-attacks on individuals and businesses has increased and, year on year, the size and scale of these attacks are changing. Law firms are a high cyber risk because they hold and transfer large sums of money and sensitive corporate and personal data.

5. We and other regulators have responded, providing a range of resources to support firms to address the risks. If a firm's clients do suffer loss through a cyber-attack, the firm is likely to make a claim on its PII policy.

6. The Prudential Regulation Authority which regulates and supervises a range of financial firms including insurers, expects insurers to be able to identify and manage the cyber insurance risk. Lloyd's of London, which runs one of the major insurance markets, is concerned that some insurance policies are not specific enough about exactly what cyber-related losses are, and are not, covered.

7. This means that firms might wrongly think they have PII cover for certain types of loss arising out of a cyber-attack, or that firms might be paying for the same cover through several policies (for example, the separate cyber insurance policies) when they have no need to do so.

8. The Prudential Regulation Authority and Lloyd's of London are therefore requiring insurers to take steps which includes making provision for cyber losses explicit in their insurance policies, including for PII. The detail of their requirements can be found in Annex One to our consultation document.

9. Supported by expert insurance lawyers, we developed a clause that is designed to provide clarity and meet our regulatory objectives, including consumer protection. In developing the clause, we engaged with the Law Society, and with insurers directly, and we took their drafting suggestions into account.

10. Our objectives in developing the clause were set out in our consultation document. They are to:

- maintain the current position on level of protection for consumers intended by our MTCs in the event a cyber act resulting in loss. Our aim is not to review the level of cover provided by the MTCs
- provide clarity for insurers and law firms as to the scope of cover for cyber risks that should be included in a PII policy
- put law firms in a more informed position when reviewing the potential benefit of purchasing a separate cyber policy for other risks.

Who did we hear from?

11. We received a total of 31 responses to the consultation, from the following types of stakeholders.

Stakeholder type	**Number of responses**
Law firm or other legal services provider	9
Individual solicitor	3
Law society (including the Law Society of England and Wales)	5
Representative group	1
Broker	3
Insurer	7
Software / regulatory provider	2
Individual student	1

Overall feedback on our proposals

12. We are pleased that some respondents, notably law firms, agreed we should be making changes to the MTCs to clarify the scope of cover in professional indemnity policies when a firm is subject to a cyber event.

13. Insurers argued that the clause should reduce the level of cyber cover that is currently within the MTCs. Some said that the current MTCs give them limited scope to manage cyber exposure and this will impact on insurers' risk appetites and pricing. Others argued alternatively that any losses caused by a cyber event should be subject to separate cyber insurance policies. One insurer said that while the clauses provided 'clarity' on what is covered, they did not provide 'comfort'.

14. Conversely, the Law Society argued that the level of cover should be extended to cover first-party losses.

15. The responses were mixed on whether the clause maintained the current scope or had changed (either reduced or increased) the scope of cover. While most law firms agreed that the drafting met our policy objectives of maintaining current protections, many insurers and brokers argued that it did not. Some insurers thought the draft clause in the proposed format is too ambiguous and open to interpretation

16. Nearly half the respondents therefore felt that there could be unintended consequences, and many provided comprehensive drafting alternatives in support of their view.

17. We have considered all the feedback and engaged further with respondents to better understand the points they raised. We have made one further clarificatory change to the new clause to help make sure that there is transparency for insurers, law firms and consumers about what losses our MTCs require insurers to cover through their PII policies. The new clause is attached at Annex 1. We will monitor the impact of the change including through our ongoing dialogue with insurers and others with an interest in the solicitors PII market and managing the impacts of cyber-attacks on law firms and consumers.

Comments and feedback on question 1: Do you agree with the proposed change to our MTCs?

18. Responses were split roughly evenly between those who agreed and disagreed with our proposed change.

19. Some respondents supported our proposals. Typical comments were:

> "We welcome the SRA's exercise in clarification for the benefit of the profession. In our experience, insurance policies and indeed the MTCs often have areas of doubt which result in coverage disputes between insureds and insurers. Any steps that the SRA can take to improve the understanding of all parties in this area are prudent and sensible… By making it clear that the civil liability provision under the MTCs covers consumer/third-party losses, but not first-party (law firm) losses, this will enable firms to consider and then arrange cover which suits their own business needs." (Law firm)

"It is important that the MTCs are amended to provide clarity and certainty as to the cover. The SRA has taken account of insurers' obligations while ensuring that regulated entities will continue to be afforded necessary coverage (and as such, ensure that law firms' clients remain protected even if the loss is due to a cyber event)." (Insurance broker)

20. However, other respondents did not agree, for example:

"I suspect this will confuse members with regards to the cover expected under their PII which would be better suited to a specialist cyber cover. There are additional exposures that won't be included under the MTCs and members are likely to be negatively impacted if they don't understand the limitations to their cover…" (Insurer)

21. Some respondents did not answer the question directly, but made other comments, for example:

"We agree with the need to bring clarification to the question of how much cyber cover is to be given under the PII policy. The problem lies with the SRA's need to give the consumer protection and the insurance markets requirements to quantify the coverage being offered and price it accordingly." (Law firm)

"We believe that the management of the impact of a cyber-event can be very different to a more traditional PII claim. A strong data response plan can mitigate the impact of a cyber-event considerably. Early investigation and intervention are key to the protection of the public and the reputation of the profession." (Insurer)

Comments and feedback on question 2: Does the draft clause, in your view, maintain, expand or reduce the current scope of consumer protection afforded through our PII arrangements?

22. Responses were split roughly evenly between those who felt the draft clause maintained the current scope, and those who felt it either expanded or reduced the scope. A typical comment from a respondent who felt the current scope is maintained was:

"We consider that the draft clause maintains (as it should) the current scope of consumer protection." (Local law society)

23. Respondents who felt that it expanded or reduce the scope said, for example:

"Our concern is that in attempting to clarify the situation, the SRA has inadvertently brought within the scope of cover exposures that are not related to the acts, errors and omissions of solicitor insureds acting in the course of private legal practice." (Insurer)

"It significantly reduces the scope of consumer protection because firms will focus on the resolution after the event rather than prevention ahead of the event." (Individual solicitor)

Comments and feedback on question 3: Does the draft clause bring about any unintended consequences and if yes, how might the draft clause be amended?

24. Nearly half the respondents felt there could be unintended consequences and provided comments on drafting. For example:

> "As an insurer, it is our obligation to ensure that we can explain the scope of cover afforded under the PII policy to our clients, the insureds. However, the draft clause in its current format is too ambiguous and open to interpretation. If the draft clause is to work practically then it must be more explicit in its meaning." (Insurer)

Comments and feedback on question 4: Are there any other impacts which you think we need to consider?

25. Only the Law Society of England and Wales responded to this question, stating:

> "While we appreciate the way that the SRA has attempted to 'future-proof' the wording of the new cyber exclusion clause, the only realistic hope for remaining on top of this issue is by continually tracking developments in the technology, reviewing arrangements to ensure they are keeping pace, and being prepared to consider changes."

Post-consultation roundtable with stakeholders

26. Given the technical nature of the consultation, and the detailed drafting comments in some of the responses, we held a roundtable in July 2021 with our external lawyers, attended by insurers, brokers and the Law Society. We wanted to ensure that we fully understood the aims of stakeholders' drafting suggestions, and to identify any potential unintended consequences of our proposed drafting.

27. The drafting feedback we received at the roundtable focused on two points.

    a. That there needed to be greater clarity around when 'defence costs' would be covered, which maintained the current position that does not include the business costs of managing the cyber incident.

    b. Some preference, particularly from brokers, for more positive drafting language to say when cyber is covered, rather than when it is not as set out in our draft clause.

Our response

28. Following the consultation responses and the roundtable, we have worked with our external insurance lawyers to review all the feedback in detail.

29. We remain clear that the objective of this exercise is to clarify the existing protections provided by our MTCs and not to review the policy of whether that level of cover is correct. Taking all the feedback into account, we propose to proceed with our proposed changes to the MTCs, but to add clarity around defence costs coverage, and make explicit that there is no intention to expand the scope of defence cover from that which is currently required by the MTCs.

30. We circulated the revised, post-consultation drafting to all the roundtable attendees for comment and to other insurers through our existing Insurance Liaison Committee, which we established to share information with insurers. We have received no new comments of significance.

31. We, and our external lawyers, remain of the view that our proposed drafting approach is appropriate and achieves our objectives. Because of the way that our MTCs are drafted, more positive drafting risks significant unintended consequences on other clauses, as well as a perception that the effect of change is to provide additional cover.

32. The changes to the MTCs will support our regulatory aims, protecting and promoting the interests of consumers. It safeguards against risks that uncertainty might lead to a reduction in consumer protection around cyber related losses, and it supports public confidence in legal services.

33. The new clause will help make sure that there is transparency for insurers, law firms and consumers about what losses our MTCs require insurers to cover through their PII policies.

34. While this exercise had been to add clarity, it has helpfully also bought into focus that a PII policy is primarily targeted at providing cover for firms where they are liable for losses to consumers and other third parties. Losses to the law firm (first-party losses), except for certain costs of investigating and defending a claim, are not covered. Separate cyber policies are available that go beyond the standard indemnification which offers firms the option of buying a policy to that will provide resources to both mitigate cyber threats as well as coordinate, investigate and remediate a cyber-attack.

35. We will work with the Law Society and the insurance market to better educate firms about the extent of cyber cover in PII policies so they are in a more informed position when reviewing the potential benefit of purchasing a separate cyber policy for other risks.

Next steps

36. We aim to introduce the change as soon as possible and with maximum lead-in time to the insurer reinsurance cycle, which happens at the beginning of each calendar year. We have submitted this change to the Legal Services Board (LSB) for approval. We will monitor the impact of the change and provide input on the wider issues raised about the level of cover for cyber incidents as part of the wider review of the PII market to be launched by the LSB.