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 in respect of the Minimum Terms and Conditions of Professional Indemnity Insurance in relation to cyber risks

Rule change application checklist	
Contact details for individual submitting application	✓
Details of proposed alteration	✓
Tracked version of changes included	✓
Nature and effect of proposed alteration (explain existing arrangements, current arrangements and why proposed change is being made)	✓
Explain impact on the regulatory objectives	✓
Explain how the proposed changes align with Better Regulation principles	✓
Explain desired outcome of the proposed alteration and plans to monitor and assess whether it has been achieved (include timeframe)	✓
Does the proposed alteration affect areas regulated by other approved regulators? If so, have you consulted them?	✓
Include intended implementation date of proposed alteration	✓
Full details of the consultation process (including responses and how you have addressed them)	✓
Accessibility checked	✓
Other relevant explanatory material	✓

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 in respect of the Minimum Terms and Conditions of Professional Indemnity Insurance in relation to cyber risks

A. Summary

1. This application is made by the Solicitors Regulation Authority (SRA) to the Legal Services Board (LSB) for approval of minor amendments to the SRA's regulatory arrangements in respect of our Minimum Terms and Conditions (MTCs) for solicitors' Professional Indemnity Insurance (PII) arrangements. The small changes will clarify the scope of PII cover when a law firm has been subject to a cyber attack/computer breach.

2. The Prudential Regulatory Authority (PRA) and Lloyd's of London (Lloyd's) have required insurers to put in place action plans to reduce unintended or unclear cyber exposures. This is to provide greater assurance that the risk of cyber losses are being properly managed and priced in premiums as the risk of attacks on individuals and businesses has increased. We developed a clause for the MTCs to clarify the protection provided currently to consumers and other third parties when they suffer a loss because of a cyber attack on a law firm, and consulted on this in Spring 2021 – see paragraph 17.

B. Background

3. Our PII arrangements, in combination with access to our Compensation Fund, ensure that there is a minimum level of financial redress available if a solicitor or an individual, working in a firm we regulate, is dishonest or incompetent. Access to these protections plays a key role in maintaining public confidence in using regulated law firms.

4. We previously consulted on whether these consumer protections remain appropriate, most recently in 2018. At that time, we proposed a package of changes, including lower indemnity limits. We asked stakeholders whether the proposals would achieve the right balance between our Regulatory Objectives. Following the consultation, we decided not to proceed with these changes, because we were keen to avoid unintended consequences in a hardening market and where we could not be confident that the intended benefits would be realised. In that context, we said we would monitor the efficacy and impacts of our insurance arrangements.

5. As part of this monitoring, we, as with other legal regulators, were made aware that the MTCs could be made clearer in respect of situations where law firms are subject to a cyber attack.

C. Details of the SRA's current regulatory arrangements

6. The MTCs do not prescribe the precise drafting of the insurance policies that firms must have in place. Rather, they set out minimum terms that must be met. Insurers can therefore draft their policies in any way that they wish, provided they maintain the cover required by the MTCs.

7. The existing MTCs require cover for losses to a client or other aggrieved third party caused by a cyber event that fall within scope of a claim for civil liability against a solicitor, supporting the Legal Services Act Regulatory Objectives to protect and promote the public interest, and to protect and promote the interests of consumers.

Losses to the law firm (first party losses), except for certain costs of investigating and defending a claim, are not covered.

D. Nature and effect of the proposed alterations to the SRA's regulatory arrangements

8. We consider that inserting an additional clause into our MTCs provided the best way of delivering clarity to the market allowing us to take action against law firms should their insurance cover fall below the MTCs.

E. Rationale for amendments

9. We are aware that the International Underwriting Association (IUA) have been developing a model clause for professional lines of insurance that could have narrowed the cover provided by our existing MTCs. This followed ongoing lobbying by the insurance sector to reduce the protections in our MTCs more broadly, in the light of external events impacting their risk appetites and profit levels. There is a risk that, without clarifying the position as to cover that must be included in the MTCs, insurers may introduce endorsements that have the effect of reducing cover and it would be more difficult to take action to address this.

10. We were also aware that some law firms were unclear about the precise cyber cover provided by the existing MTCs when being sold additional cyber policies. By clarifying the position as to what cover we require this allows law firms to consider better what additional cover they would like to purchase for example in a separate cyber policy.

11. Therefore, our objectives in making this change to our regulatory arrangements are to:

- maintain the current position on level of protection for consumers intended by our MTCs in the event a cyber attack resulting in loss
- provide clarity for insurers and law firms as to the necessary 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.

F. Statement in respect of the Regulatory Objectives

12. Our change to our regulatory arrangements will have the following impacts on the Regulatory Objectives in s.1(1) of the Legal Services Act 2007.

Regulatory Objective	**Impact**
Protecting and promoting the public interest	The change is in the public interest as it will both maintain the current position on level of protection for consumers, and provide clarity for insurers and law firms alike.
Supporting the constitutional principle of the rule of law	There is no change to our policy approach to PII or the MTCs. We have therefore identified no specific impacts in respect of this Regulatory Objective.

Improving access to justice	There is no change to our policy approach to PII or the MTCs. We have therefore identified no specific impacts in respect of this Regulatory Objective.
Protecting and promoting the interests of consumers	The change will maintain the current position on level of protection for consumers, providing a better level of certainty than is currently the case and not diminishing cover. It means law firms are better informed about the scope of cover for losses following a cyber incident and to consider the option of purchasing additional standalone cover for business losses.
Promoting competition in the provision of services	Our approach is in line with that taken by other legal services regulators providing a level playing field for firms operating in the legal services market.
Encouraging an independent, strong, diverse and effective legal profession	There is no change to our policy approach to PII or the MTCs. We have therefore identified no specific impacts in respect of this Regulatory Objective.
Increasing public understanding of the citizen's legal rights and duties	There is no change to our policy approach to PII or the MTCs. We have therefore identified no specific impacts in respect of this Regulatory Objective.
Promoting and maintaining adherence by authorised persons to the professional principles	There is no change to our policy approach to PII or the MTCs. We have therefore identified no specific impacts in respect of this Regulatory Objective.

G. Statement in respect of the Better Regulation Principles

13. We consider that in making this change to our regulatory arrangements, we have fulfilled our obligation under s.28 of the Legal Services Act 2007 to have regard to the Better Regulation Principles, as follows.

Proportionate	This change to our regulatory arrangements is a proportionate response to an increasing risk. It provides clarity for law firms, insurers and consumers in response to that risk.
Accountable	We have consulted and engaged extensively with all types of stakeholders, and taken on board their views and their responses to our consultation.

Consistent	The change to our regulatory arrangements is consistent with our wider approach to regulation, aiming to provide clarity and certainty.
Transparent	We have consulted and engaged extensively with all types of stakeholders, openly sharing our proposals throughout the process.
Targeted only at cases in which action is needed	The change to our regulatory arrangements is targeted at an identified, and increasing, risk of cyber attacks on law firms, and aims to maintain the existing level of cover under our MTCs in such cases.

H. Statement in relation to desired outcomes

14. We will be monitoring the effects of the change to ensure that it delivers:

- maintenance of the current position on level of protection for consumers intended by our MTCs in the event a cyber act resulting in loss
- clarity for insurers and law firms as to the scope of cover for cyber risks that should be included in a PII policy
- an informed position for law firms, when reviewing the potential benefit of purchasing a separate cyber policy for other risks.

15. We will monitor and evaluate the change within the wider context of any LSB review of the policy aims.

I. Stakeholder engagement

16. Given the technical nature of the proposal and complexities of our existing MTCs, we instructed expert insurance lawyers to draft a clause that best meets our regulatory objectives, to share with stakeholders through our public consultation. Prior to the consultation, we also engaged the relevant Law Society Committees on behalf of the profession, as well as insurers directly, taking their drafting suggestions into account.

Consultation and stakeholder views

17. Our public consultation ran from 14 April to 24 May 2021. We received 31 responses, including from law firms, insurers and brokers. Our summary of the responses is attached at Annex 2.

18. Different stakeholder groups had different views:

- insurers argued that SRA should reduce the level of cyber cover that is currently required within the MTCs, and/or that any losses caused by a cyber attack should be subject to separate cyber insurance policies.
- conversely, the Law Society argued that the level of cover should be extended to cover first party losses.

19. Most law firms agreed that the drafting met our policy objectives of maintaining current protections, many insurers and brokers argued that it did not.

20. The purpose of this change is to clarify the existing protections provided by our MTCs and not to review the policy of whether that level of cover is correct. As explained below we sought to understand the points raised in more detail and made further clarification changes to the clause, but our core proposals remain unchanged. Any review of our policy in relation to the level of cover would be considered as part of any subsequent review of the policy aims of the MTCs more broadly.

Post-consultation engagement

21. We decided to hold a roundtable in July with our external lawyers attended by insurers, brokers and the Law Society. This was to make sure that we fully understood respondents concerns and that any potential unintended consequences of our proposed drafting were identified.

22. The drafting feedback we received at the roundtable centred on two points:

- that the clause could be clearer around when 'defence costs' would be covered, with a view that the draft consulted on could be interpreted as extending existing cover to include the business costs of managing the cyber incident
- 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.

23. We worked with our external insurance lawyers to review the drafting feedback that we received on consultation and at the roundtable. We have added further clarificatory language around defence costs coverage, and to make explicit that there is no intention to expand the scope of defence cover from that which is currently required by the MTCs.

24. In the light of advice from our external lawyers, we remain of the view that our proposed drafting approach is appropriate and achieves our objectives

25. The wording of our MTCs specify the minimum terms of cover to which all insurers subscribe. It is open to insureds to negotiate commercially extensions of cover beyond the minimum and it may be that firms seek additional cover to be included either in their PII policy or as a stand-alone cyber policy for the aspects of cover that are excluded under the proposed amendments. Also, the wording of our MTCs does not set a policy approach for insurers. It is open to insurers and brokers to include endorsements that are positively drafted.

26. 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 received no new comments of significance, and we are therefore proceeding with our final version of the drafting. See our summary of the consultation responses (Annex 2) for more details of the engagement process and stakeholder input.

J. Statement in relation to impact on other Approved Regulators

27. We have regularly engaged with other Approved Regulators as they have proposed their own changes to their regulatory arrangements to be clear about the cover related to cyber incidents. We do not think there are any impacts on other Approved Regulators.

K. Implementation

28. Our aim now is 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.

29. We have engaged with Lloyd's of London and the PRA, who whilst urging that we proceed as quickly as possible, agreed that it was appropriate to take the time to properly understand the drafting proposals put to us and engage the industry on these. They are also content that our drafting approach meets their requirements. Ahead of introducing the change, we are monitoring the market and will be preparing communications, Q&A and other information.

30. Insurers will be writing policies for the October renewals based on the current MTCs. We sent out the Participating Insurers Agreement for 2021/22 on this basis. We have kept the insurance market and law firms informed about the timescales for this change. We have been monitoring the market and have not seen an impact from the revised timescales.

31. This is our planned timescale for introducing the change to the MTCs.

Action	Date
Submission to LSB	October 2021
LSB approval	November 2021
Implementation	December 2021 (ahead of the start of the reinsurance cycle in January 2022)

L. SRA Contact

Emma Tunley, Policy Manager, Solicitors Regulation Authority

emma.tunley@sra.org.uk

Annexes

Annex 1 – Clarificatory changes to the SRA Minimum Terms and Conditions (MTCs) of Professional Indemnity Insurance

Annex 2 – Summary of consultation responses