Confidential: for The Law Society and Solicitors Regulation Authority only.

Decision notice

Issued by the Legal Services Board under Part 3 of Schedule 4 to the Legal Services Act 2007

The Solicitors Regulation Authority application for approval of changes to its regulatory arrangements on Professional Indemnity Insurance Minimum Terms and Conditions of Cover

The Legal Services Board (LSB) hereby grants an application in part from the Solicitors Regulation Authority (SRA) which proposed alterations to the SRA Indemnity Insurance Rules 2013 (including the minimum terms and conditions of cover) and SRA Amendments to Regulatory Arrangements (Miscellaneous No.1) Rules 2014. The Law Society is an approved regulator and the SRA is the regulatory arm to which The Law Society has delegated its regulatory functions.

This decision notice sets out the decision taken which is to grant the application in part, including a brief description of the proposed alterations in the application which have been granted and those which have been refused. The notes at the end of this notice explain the statutory basis for the decision. The chronology for the LSB's handling of this application is set out at the end of this decision notice.

Context of the proposed changes

1. The SRA consulted on changes to its regulatory arrangements on compulsory professional indemnity insurance from 7 May to 18 June 2014. The consultation paper included five separate proposals that were consulted on simultaneously which included:

    - Reduce the level of mandatory professional indemnity cover to £500,000;
    - Introduce an aggregate limit on claims;
    - Require compulsory cover for claims by individuals, small and medium sized enterprises, trusts and charities;
    - Reduce run-off cover to a minimum of three years;
    - Require firms to assess the level of cover appropriate to their firm beyond the minimum.

2. As a result of the feedback received from the public consultation, a decision was made by the SRA Board on 2 July 2014 to delay the implementation of three of the proposals consulted upon, and progress with two of the proposed changes, namely those relating to (i) the level of minimum professional indemnity insurance cover and (ii) a requirement

for firms to assess the level of professional indemnity insurance cover appropriate to their firm. These proposals were submitted to the LSB as a rule change application on 15 July 2014.

3. Some of the consultation feedback received by the SRA on both the compulsory professional indemnity insurance changes and a separate consultation on eligibility criteria for the Compensation Fund also suggested that further information was needed before some proposals could be progressed. On 1 August 2014, the SRA issued a call for evidence to inform its work to further improve the way in which client protection is delivered through the Compensation Fund and professional indemnity insurance arrangements. The SRA was particularly interested in a number of specific areas of evidence, one area of which included the impact of the professional indemnity insurance minimum terms and conditions. The call for evidence closed on 30 September 2014 and the SRA is yet to publish the responses or its conclusions.[1]

Principal changes

4. The main purpose of compulsory professional indemnity insurance (or qualifying insurance) is to provide the public with a level of protection in the event that a firm is negligent or dishonest which results in a financial loss. The terms of the qualifying insurance must be compliant with the SRA's regulatory provisions, namely the SRA Indemnity Insurance Rules 2013 (SIIR) and Minimum Terms and Conditions of cover (MTC). Qualifying insurance is available through participating insurers who are required to sign a Participating Insurer's Agreement each year which also incorporates the SIIR and the MTC.

5. there are two principal proposed changes included in the application the first is a proposed amendment to the SIIR and MTC to reduce the minimum amount of professional indemnity insurance cover for any one claim to £500,000[2], this being a decrease from the current minimum sum insured of £2 million for any one claim for sole practitioners and partnerships and £3 million for any one claim for limited companies and limited liability partnerships and the second is to put in place a requirement for firms to assess and purchase an appropriate level of professional indemnity insurance cover. This requirement would be introduced as a new outcome in the SRA Code of Conduct 2011.

6. In its application (paragraph 1), the proposed level of minimum insurance cover is referred to by the SRA as "a proportionate fall-back protection". It attracted many, and many forcefully argued, responses to the consultation. The vast majority were against the proposal (92 were against the proposal, with only 34 in support). Further, this issue was a rare instance in which the opposition to the measure was found across a broad spectrum of stakeholders: bodies as diverse as The Law Society, many regional law firms, the Legal Ombudsman, the Legal Services Consumer Panel, the Sole

[1] SRA website: http://www.sra.org.uk/sra/consultations/client-protection-call-evidence.page

[2] Unless the claim relates to any insurance mediation activity in which case the limit relating to such activities is the amount required to comply with the requirements of the Insurance Mediation Directive applicable at outset, extension or renewal of the policy. This is currently € 1,120,200.

Practitioners Group, the Association of British Insurers (ABI)[3], the Building Societies Association and the Council of Mortgage Lenders, and the majority of participating insurers and insurance brokers who responded to the SRA's consultation were against the proposal.

Additional changes

7. In addition to the two main proposals set out in paragraph 5 above, the SRA proposes to amend the MTC to clarify that run-off cover is provided on a cessation (whether during the policy period, the extended indemnity period or the cessation period) and from the expiration of the cessation period.[4] The MTC will also be amended to introduce an international trade sanctions exclusion so that an insurer is not deemed to provide cover for a firm and will not be liable to pay out a claim, if the participating insurer is prohibited from paying out such a claim or providing such insurance due to an economic sanction, or a trade sanction law, of the United Nations, European Union, Australia or United States of America.

8. The SRA has also proposed to amend the SRA Handbook Glossary 2012 to update the definitions and terms contained within the Handbook and, as part of the SRA's proposed amendments, any amendments made to the SIIR, MTC and Glossary would be updated in all policies at the next inception, renewal, replacement or extension of a policy or 18 months after the date of the last required amendment or commencement of the policy.

LSB assessment process

9. The proposed changes in the application were assessed against the criteria set out in paragraph 25(3) of Schedule 4 to the Legal Services Act 2007 (the Act).

10. The Act requires that, if the LSB is considering whether to refuse an application, it issues a warning notice to the applicant. A warning notice was issued to The Law Society as the approved regulator on 18 August 2014 and a letter was sent to the Chief Executive of the SRA which set out in more detail the reasons for that notice being issued. The LSB was concerned in particular about the part of the application that, if approved, would reduce the minimum level of professional indemnity insurance from the current level of £2 million (£3 million if incorporated) to £500,000. This could be argued to be prejudicial to the regulatory objective of protecting and promoting the interest of consumers. The LSB's specific concerns included:

    - whilst it was noted that (according to the SRA) it provided the best data to support the application, without a specific survey and/or modelling exercise, it may not be sufficiently recent to be a reliable basis for the development of forward looking policy;

[3] While not expressly opposing the measure, it criticised the timing and lack of sufficient analysis, and suggested that it would both lead to a "two tier" market and that the SRA's assumption of any meaningful consumer benefit due to reduced premiums was "misguided".

[4] The cover does not extend to acts or omission of the insured firm that arise after the expiration of the cessation period.

- the consultation and the application both present potential cost savings as a key driver for change but there is limited evidence that this will be achieved. In particular the impact on the price of top-up cover does not seem to have been explored in any detail and the time that may be required for the market to adjust to the new regulatory requirements (in a way which may result in these potential cost savings) has not been explored sufficiently;
- the potential impact on the Compensation Fund has not been fully explored and consulted on.

11. The LSB invited the SRA to provide any further information in relation to the concerns set out by the LSB in the warning notice so that the LSB could conclude its assessment of the application. A letter was received by the LSB from the SRA on 5 September 2014. A further request for information was made to the SRA in light of its 5 September response to the warning notice, and further information was received from the SRA on 22 September and 10 October 2014.

Decision

12. The LSB has considered each proposed change set out in the SRA's application against the criteria in paragraph 25(3) of Schedule 4 to the Act and has made the decision to grant the application in part.

13. In making its decision the LSB has considered whether the two principal proposals set out in the application are intrinsically linked and should be considered as a package, rather than separate proposals, and must therefore be either both granted or both refused. The LSB is of the view that the SRA consultation indicates clearly that the two issues were linked only by virtue of being part of a more comprehensive package of proposals. In so far as the SRA has subsequently sought to establish a link, its argument that the potential adverse impact on consumers of the reduction in the minimum level of cover (if firms under-insure) is mitigated by the existence of an obligation to ensure appropriate cover, is reasonable. However, the LSB does not agree with the SRA's view that the existence of an appropriate cover outcome necessarily involves the setting of a minimum level at all or a reduction in the current minimum. The LSB therefore considers that it has a justified reason (and the authority under the Act) to grant this application in part as it relates to the new outcome and to refuse to grant the application as regards the reduction in the minimum level of PII cover proposed. Therefore the LSB grants the proposal relating to the outcome on the grounds that it does not meet any of the refusal criteria set out in the Act.

14. Some additional proposed changes in the application have also been granted on the grounds that they do not meet any of the refusal criteria set out in the Act. Those changes include:

    a. amendments to the MTC to clarify that run-off cover is provided on a cessation (whether during the policy period, the extended indemnity period or the cessation period) and from the expiration of the cessation period, and the introduction of an international trade sanctions exclusion;

b. amendments to the SRA Handbook Glossary 2012 to update the definitions and terms contained within the Handbook;
c. all policies to be updated at the next inception, renewal, replacement or extension of a policy or 18 months after the date of the last required amendment or commencement of the policy, in light of any changes approved by the LSB to the SIIR, MTC and SRA Handbook Glossary 2012.

15. However, the LSB has decided not to grant the proposal to reduce the minimum level of professional indemnity insurance from the current level of £2 million (£3 million if incorporated) to £500,000 for the reasons set out below.

16. The Annex to this decision notice contains the rule changes approved by the LSB Board at its meeting on 26 November 2014.

Reasons for the decision not to grant the reduction in minimum PII cover

A. Overview

17. It is the LSB's view that this change would be prejudicial to one or more of the regulatory objectives. While the LSB has considered the impact on all the regulatory objectives the key prejudice is to the objective set out in Section 1(1) (d) of the Act - "protecting and promoting the interests of consumers".

18. The LSB does not consider that the argued countervailing benefits to this or the other objectives are sufficient or certain enough to justify an alternative decision.

19. By its letter of response dated 5 September 2014 the SRA suggested that the LSB was taking an unduly narrow view of "the consumer interest", and that this ought to include considerations of "access and value". The LSB has considered this argument carefully, especially in relation to access to justice, but considers that the evidence and analysis relied on by the SRA is insufficient to demonstrate a likely benefit.

20. In terms of one of the key elements of the application (paragraph 34), the SRA assessed the number of anticipated claims above £500,000 and stated that:

> *"34. No regulatory system can provide 100% protection for all clients in all circumstances, and any that tries to do so will lead to services being priced at a level that makes them inaccessible. There needs to be an appropriate balance between client protection and access. We consider that those with probate and conveyancing transactions over £500,000 are unlikely to form part of the most vulnerable client groups."*

21. The SRA accepts that a reduction to the level of £500,000 minimum will tend to reduce consumer protection, but argues that the reduction would be limited and would be further mitigated at least to some extent by the requirement to obtain top-up cover to an appropriate level (the LSB agrees with the latter statement, but does not consider that the former statement is established by the available evidence). Nonetheless, in essence it is apparent that the SRA sees this as an exercise in striking an "appropriate

balance" between client protection and "access" (the latter used in a broad sense). The LSB agrees that regulators need to balance the impact of proposals on different objectives before reaching a view and that an adverse impact in one area need not necessarily invalidate a decision to proceed in the light of countervailing benefits. However, the LSB will expect to see that kind of judgement informed by as data rich an assessment as possible on both sides of the argument.

22. There is also an implication that clients who are not in "the most vulnerable client groups" may be treated differently or are to be treated as less important under the regulatory objectives; the LSB does not agree as the Act does not relate (or limit) the regulatory objective of protecting the consumer to any particular class or classes of consumer.

23. In its letter of 5 September 2014 in response to the warning notice, the SRA made a related point: that the minimum insured level should be set as low as possible in order to protect "most" consumers in "most" circumstances:

> *"In our view the minimum level of compulsory cover (which is clearly a minimum in our proposals as combined with the outcome replaces the arguably arbitrary aggregate level currently in force) should be set at the lowest level that secures protection for most consumers in most circumstances."*

24. The LSB accepts that the aim of PII is *not* 100% protection in all circumstances (which is likely to be unachievable). However, in the absence of detailed data on current claims history, fuller and more evidence-based attempts to model the potential impact of the changes and consideration of consumer understanding of and willingness to pay for cover, the LSB does not accept that the benchmark adopted by the SRA - "the lowest level that secures protection for most consumers in most circumstances" – will necessarily produce the right answer in defining a minimum limit if one is to be set.

25. The LSB therefore does not agree that the SRA has balanced objectives appropriately for a number of reasons. First, the SRA makes unduly optimistic assumptions as to the number of claims that are likely to be over the £500,000 threshold (the only basis, absent more detailed data, on which to attempt to assess the prejudice to consumers). Secondly, as regards *benefits* (such as cost savings, enhanced access and better value in legal services), the evidence is of a potentially small saving for the lower minimum level of cover, with little analysis of the extent to which a lower minimum would either encourage market entry (in either the PII or legal services markets) or ultimately lead to lower prices for consumers. The LSB also notes the potentially increased costs of "top up" cover following a change to the lower minimum level of cover, which may lead to little or no net benefit across the sector as a whole . One participating insurer indicated in their consultation response that they would not be likely to insure below £1 million if the current minimum was reduced to £500,000 since it believed £1 million is the minimum limit that would be considered as reasonable or commercially viable for firms to purchase. This suggests that potential new entrants would not add to the amount of cover in the market as a whole.

B. The assessment of number of claims over £500,000 and consumer impact

26. The LSB has considered information provided in the consultation responses which included from The Law Society, the Legal Services Consumer Panel, other respondents and, in our view most critically, the report commissioned by the SRA itself from *Charles River Associates* (CRA) in 2010 as a "root and branch" review of the PII market states, to assess whether consumer impact has been properly considered by the SRA in making its application. We have also looked at the information provided by the SRA on the assessment of the number of claims over the proposed £500,000 minimum PII threshold.

27. Our overall view is that the SRA's conclusions are weakened by its reliance on outdated information, relative lack of consideration of more recent and comprehensive data, and lack of consideration of whether the effectiveness of the principle of "self-assessment", enshrined in the outcome, might be vitiated by a lowering of the minimum level creating a false impression of a "safe" level for some practitioners.

28. The LSB shares the concerns raised in a number of the submitted responses to the SRA's consultation and the correspondence received by the LSB, about the lack of evidence and the use of out-of-date evidence, notably the reliance on Solicitors Indemnity Fund (SIF) figures for conveyancing which are 15-25 years old, which necessarily gave little indication of the likely level of claims over £500,000 given the subsequent rise in property prices and developments in the personal injury sector. Using the SRA's own assumptions and Land Registry figures provided to the LSB on 22 September 2014 as additional information to the original application, it may imply that not only will there already be a large number of *transactions* (particularly in London) over the £500,000 threshold, but that the average property price may exceed this within two years and the average conveyancing *claim* exceed the threshold by 2022. If a minimum level is to be set, the LSB considers that one factor to be considered, alongside cost impact and consumer expectations, is the need for a mechanism for 'future proofing' any minimum level of cover to be identified, such as to provide regulatory certainty and encourage market entry. It is far from clear that the present proposal has considered the issue of future-proofing to any material extent.

29. In accepting that low numbers of claims will exist above the threshold, the SRA refers to the anticipated response by firms affected to in fact have taken out higher levels of cover (see for example paragraph 27 of the SRA's application, and paragraph 36, which again, and in our view improperly, refers to the likely *circumstances of clients* who may suffer from insufficient insurance as relevant to the "impact" of insufficient insurance[5]). The SRA gives the same response as regards the concerns raised about catastrophic injury claims in its application (paragraph 37 of the SRA's application): firms operating in this area are "expected" to take out higher levels of insurance due to the proposed outcome (i.e. assess the need for higher insurance and take out "top up" insurance).

[5] Paragraph 36 of the SRA's application: "36. In any event, should firms not maintain appropriate cover, the impact is likely to be relatively small **because those affected will be the subset of clients whose circumstances give rise to a claim**; where that claim falls between £500,000 and £2/3 million; and where the solicitor concerned has not taken out cover in excess of the minimum" (emphasis added). This statement appears to reflect the view expressed that such clients are "not in the most vulnerable consumer groups".

30. However, in the absence of detailed information about the size and nature of the "top-up" market, these statements cannot be taken as sufficient assurance that inadvertent under-insurance will not occur as a result of a minimum level being set which, by being read as "safe," might undermine the incentive to self-assess correctly.

31. The SRA did not gather further data before conducting its analysis as to the number of claims or value of claims. Absent a project-specific approach to gathering this information, the LSB considers that the SRA should have placed greater reliance on the figures compiled by CRA, in particular in light of the fact that the report was both relatively recent, and relied on a broad range of evidence.[6]

32. The CRA report specifically analysed claims data with a view to determining whether the minimum of £2/3 million was set too high, and compared it with a situation in which the minimum was £1 million. At page 147 the report sets out in tabular form its analysis of ABI data (Figure 30).

33. The CRA data suggests that 23% of claims in the period 2005-2008 fell within the £1 million minimum PII threshold (and so would not be covered by the proposed reduction to £500,000 while they are currently), and some 39% of claims fell within the range £100,000-£1 million (this latter suggesting that a significant percentage would fall in the range £500,000-£1 million, such that the figure of 23% would be a substantial underestimate of claims affected by the proposals).

34. Further, in light of inflation since the assessment period used by CRA (in particular but not exclusively property prices), the figures would again be more likely to be an *underestimate* of claims that would fall outside the proposed minimum.

35. However, the SRA states in its application at paragraph 33 that consultation responses suggest that the impact on consumers is likely to be less than the CRA data (derived from the ABI data) suggests and the SRA's analysis is that the consumer detriment will be lower than the 23% figure in the CRA report. While this conclusion is not fully explained, the LSB assumes it is because several (not all) insurers suggested that there would only be a small decrease in premiums (i.e. in the region of 5%). This is also the suggestion of Marsh Insurers. The (expressed) rationale for a small reduction is that the vast majority of claims fall within the £500,000 limit. But this information is far from complete (and clearly not as complete as the CRA analysis); nor is it uniform. [redacted] This is close to and consistent with the CRA figures, and as it is provided by the largest single provider of PII to solicitors, might be given more weight than other insurers' figures.

[6] Under "Methodology" CRA describe conducting over 50 interviews including with 15 lawyers, 8 insurers, 7 brokers, and 3 lenders including their respective representative organisations. Interviews were also held with the Legal Services Board, the Legal Services Board Consumer Panel, the Office of Fair Trading, representatives from comparable schemes and individuals within the SRA. In addition to the interviews with individual stakeholders, the SRA hosted a roundtable discussion with an External Reference Group, which included the representatives of all the key stakeholders. CRA report they gathered considerable amounts of data from the Assigned Risks Pool (ARP) and from insurers.

36. In summary, as regards the assessment of the evidence as to consumer impact of reducing the minimum level of cover to £500,000, the LSB considers that the latest and most reliable[7] evidence available is as set out by CRA in its report. The CRA figures are also supported by the response of QBE, the largest provider of PII in this market, reporting approximately a fifth of the total PPI market for solicitors in the UK in 2014.[8] Hence, whilst noting that there is not complete consensus on the issue, the LSB considers that the evidence shows that reducing minimum PII levels to £500,000 is more likely than not to incur a prejudice to the interest of consumers.

C. The assessment of purported benefits and changes

37. When it comes to assessing whether the likely prejudice to consumers (identified above, on the basis of incomplete, but the most recent and best available data) is outweighed by benefits alleged to accrue, the absence of robust analysis of current data causes real problems in justifying the proposal to decrease the minimum level of PII to £500,000. In summary of what follows, the LSB believes that:

- the evidence of any direct cost benefit is inconclusive, but *at best* suggests there may be a marginal reduction in PII premiums (in the region of 5%) for those taking out insurance at only the minimum level;
- while the LSB does not discount the value of any cost reduction, the SRA goes too far in assessing the potential benefits of this potential cost reduction;
- there are reasons to be concerned that costs for some may well increase and that therefore any suggested benefits are either unlikely to arise or will be of minimal impact when aggregated at the market level when set against the potential consumer prejudice.

38. The LSB has to take a view on the best available information, but before proceeding it is only proper to note that there is a disjunction between, on the one hand, the responses from those participating insurers and brokers to the SRA's consultation which suggest a very limited (if any) drop in premiums (implying that £500,000 covers most cases) and on the other hand the conclusions of the CRA report [redacted] It is of course possible that most of the participating insurers simply do not want to indicate any large degree of anticipated discount in advance of the change for commercial reasons (namely future re-negotiations with their clients), or it is possible that insurers assess a firm's risks on the basis that they may face a number of claims, such that reducing the threshold for any single claim would not have a significant impact on premiums. Whatever the reason, however, the absence both of consensus of view in the consultation exercise and the lack of a full impact assessment backed by specific and up-to-date data undermines the validity of the SRA's assumption that premiums will fall. The SRA's statement of expected benefits is therefore similarly weakened.

39. By letter of 5 September 2014 the SRA states:

[7] Given both the robust methodology and the independence of the report.
[8] Source: http://www.qbeeurope.com/documents/professional-financial/solicitors/QBE%20Professional%20Indemnity%20Insurance%20for%20Solicitors.pdf

"We received clear statements from some insurers that they would expect to see prices fall, and our expert advisers gave us clear advice on costs of cover at the revised minimum level as well as for top up cover […]"

40. [redacted]:

[redacted]

41. [redacted]

42. The SRA in its letter of 5 September 2014 described the position of Chancery PII in the following terms:

> "Furthermore, in the period between our application and your warning notice, we saw some market activity that supported our expectations. For example, Chancery PII (which focuses on firms with 1-4 partners – the very firms we expect to benefit from our proposals) was advertising cover at below £2m at reduced prices and continuing cover at £2m/£3m at the MTC for those firms that wanted it. In fact, Chancery PII confirms this even now, saying:
>
> > '…*we were able to offer a solution (with a reduced premium) for firms who wished to purchase a lower limit as well as an offer for those who wished to maintain coverage up to the expiry minimum terms and conditions.*'
>
> In our view this answers your concerns squarely. Even before your decision has been made the PII market has adjusted and shown signs of innovation as the insurance market responded to the potential of greater freedom and the removal of barriers."

43. The LSB understands that the stated position of Chancery PII is that while it may offer insurance at the £500,000 level, this was only likely to be appropriate in exceptional cases. It has expressly stated that it does not believe the financial limit is adequate and would normally anticipate insurance cover at the level of £1 million minimum in most cases. Likewise, Zurich (one of the largest participating PII insurers) states in clear terms that they would not offer insurance cover of £500,000 even if that was the minimum regulatory requirement.[9]

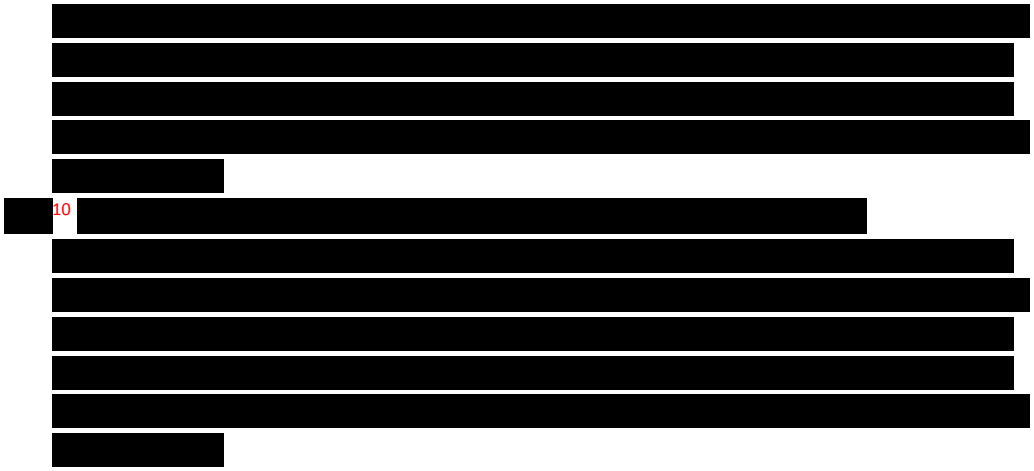
44. Further, none of the insurance brokers responding to the SRA's consultation supported the reduction in the minimum requirement, one stating for example that:

> *"Reducing the compulsory limit to £500,000 is a retrograde step. If the purpose of the compulsory limit is to protect the public, then this proposal appears to be contrary to this policy. The limit was last at this level in the mid 1990's and since then claims inflation, house price inflation and the general value of estates would mean that this limit would be inadequate in many circumstances".*

45. Based on the LSB's analysis of the SRA's consultation responses, the evidence shows a general aversion in the insurance industry to the proposals: of the 10 consultation responses from participating insurers, five disagreed with the proposal, three supported it but only one of these suggested there would be any cost saving, two did not express a view.

[redacted]

[9] Source of information from the responses to the SRA consultation; respondents indicated that the response was not confidential.



46. The LSB accepts the point that any cost savings – however small - cannot be discounted. However, in the absence of an overall package of measures which may add up to a more significant impact, it can only take the view that the small and uncertain level of saving on PII would not outweigh the clearer consumer prejudice arising from having a minimum threshold which (on the best evidence) will not cover a substantial proportion of claims and may inadvertently give an incentive towards weaker self-assessment.

47. Aside from the (incomplete) nature of the evidence, there are other reasons to be cautious about the level (if any) of reductions in premiums. For instance, we note the point made by the Zurich that when the minimum threshold went up from £1 million to £2 million in 2005, the increase in premiums was only 0.45%. The rationale for those stating that the reduction will not decrease at all or significantly is typically that the risks of any particular firm have already been factored into premiums: lower risk firms will already have lower premiums.[11] The LSB considers that this point has merit and has not been considered thoroughly enough by the SRA.

48. In response to the concerns relating to the Compensation Fund, the SRA commented that it did not have much to add to what it had already set out in its application. The SRA highlighted that it was looking further at the wider financial protection regime following the call for evidence and that there should be no concern about subsequent reductions in consumer protection at this point because the SRA's proposals would be subject to a future consultation and a separate application to the LSB.

49. The LSB welcomes the SRA's efforts to complete a call for evidence on its wider financial protection regime, but we remain concerned about approving the new minimum cover of £500,000 without the SRA first being in a position to consider the outcome of the call for evidence which could highlight negative impacts on the Compensation Fund. The changes have the potential to have a detrimental effect on consumers of legal

[10] [redacted]

[11] Source of information from correspondence received by the LSB on 28 July 2014; see LSB website for further details on the full response: http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/2014/20140715_SRA/Zurich.pdf

services, in particular on payment of claims. For example, it is not clear how historic claims (which might total an amount exceeding the new reduced level of cover) will be dealt with if a firm decides to decrease its level of cover to a level closer to the new minimum.

50. The SRA application suggests that the following further benefits will arise from the proposed reduction in minimum PII:

    a. Access to justice will be increased as costs will be reduced and it will be easier for new (law) firms and insurers to enter the market (see paragraph 23 of the application).

    b. "It is at least arguable" that BME consumers will gain from improved access (paragraph 39 of the SRA's application, expanded on at paragraphs 40-43).

    c. Competition will be promoted by reducing barriers to entry (paragraphs 44-49 of the SRA's application).

    d. An independent, strong, diverse and effective legal profession will be encouraged (paragraphs 50-60 of the SRA's application).

51. As a general point, however, the LSB's position is that the potential reduction in PII premiums in the region of 5% for some firms is simply not of an order of magnitude sufficient to have any significant positive impact on the regulatory objectives. Based on The Law Society's analysis cited by the SRA at paragraph 52 of the application, small firms still spend a greater proportion of gross fee income on PII than larger bodies; sole practitioners paid a median 5.6% compared with 4.6% across all firms . A reduction of 5% would amount to less than 0.3% of a small firm's gross turnover. To the extent obtaining PII is a cost of entry to the legal profession, it is only a part of total costs and a reduction of 5% is virtually de minimis in terms of likely impact on market entry and consumer pricing. Equally, even if it were to be assumed that the cost reduction is not reflected in any increase in net profit (which is relevant to encouraging market entry) but that the entirety of any cost savings were passed on to consumers, a reduction in legal fees of 0.3% is unlikely to materially affect access to justice.

Supervision

52. The LSB also raised concerns over the SRA's ability to supervise a firm's assessment of the level of PII that is appropriate for its business and whether this considers past as well as current and future activities. The SRA advised that supervision activity would include a review of the level of cover but it has not explained the criteria that it would use when conducting this review. The LSB considers that greater work will need to be undertaken in this area, not least in assessing how effectively firms are implementing the new outcome. Development of a suitable supervisory methodology, as part of a wider programme of reform, may well provide more effective assurance of the adequacy of cover than the blunter instrument of setting a minimum level.

Chronology

- The LSB confirmed receipt of an application from the SRA on 15 July 2014.
- The 28 day initial decision period for considering the application ended on 11 August 2014.
- The LSB issued a notice extending the initial decision period to 10 October 2014 as the last working day before the deadline of 12 October 2014.
- The LSB issued a warning notice on 18 August 2014; this extended the decision period to 17 August 2015.
- This decision notice is effective from 26 November 2014.
- The decision notice will be published on the LSB's website on 27 November 2014.

Chris Kenny, Chief Executive
Authority granted by the Board of the Legal Services Board
26 November 2014

*Notes***:**

1. The LSB is required by Part 3 of Schedule 4 to the Act to review and grant or refuse applications, in whole or in part, by approved regulators seeking to make alterations to their regulatory arrangements.

2. Paragraph 25(3) of Schedule 4 to the Act explains that the LSB may refuse an application setting out a proposed change to the regulatory arrangements only if it is satisfied that
    (a) granting the application would be prejudicial to the regulatory objectives
    (b) granting the application would be contrary to any provision made by or by virtue of this Act or any other enactment or would result in any of the designation requirements ceasing to be satisfied in relation to the approved regulator
    (c) granting the application would be contrary to the public interest
    (d) the alteration would enable the approved regulator to authorise persons to carry on activities which are reserved legal activities in relation to which it is not a relevant approved regulator
    (e) the alteration would enable the approved regulator to license persons under Part 5 [of the Act] to carry on activities which are reserved legal activities in relation to which it is not a licensing authority, or
    (f) the alteration has been or is likely to be made otherwise than in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration.

3. The designation requirements referred to in paragraph 2(b) above are set out in paragraph 25(4) of Schedule 4 to the Act and are
    (a) a requirement that the approved regulator has appropriate internal governance arrangements in place
    (b) a requirement that the applicant is competent, and has sufficient resources to perform the role of approved regulator in relation to the reserved legal activities in respect of which it is designated, and
    (c) the requirements set out in paragraphs 13(2)(c) to (e) of Schedule 4, namely that the regulatory arrangements are appropriate, comply with the requirements in respect of resolution of regulatory conflict (imposed by sections 52 and 54 of the Act) and comply with the requirements in relation to the handling of complaints (imposed by sections 112 and 145 of the Act).

4. In accordance with paragraphs 20(1) and 23(3) of Schedule 4 to the Act, the LSB has made rules[12] about the manner and form in which applications to alter regulatory arrangements must be made. Amongst other things, the rules highlight the applicant's obligations under section 28 of the Act to have regard to the Better Regulation Principles. They also require applicants to provide information about each proposed change and details of the consultation undertaken.

5. If the LSB is not satisfied that one or more of the criteria for refusal are met, then it must approve the application in whole, or the parts of it that can be approved.

[12] Rules for Rule Change Applications – Version 2 (November 2010)