

APPLICATION MADE BY THE SOLICITORS REGULATION AUTHORITY BOARD TO THE LEGAL SERVICES BOARD UNDER PART 3 OF SCHEDULE 4 TO THE LEGAL SERVICES ACT FOR THE APPROVAL OF:

- **THE SRA INDEMNITY INSURANCE RULES 2013 (INCLUDING THE MINIMUM TERMS AND CONDITIONS OF COVER)**
- **THE SRA AUTHORISATION, PRACTISING AND HANDBOOK GLOSSARY (AMENDMENT) RULES 2013**

A PROPOSED ALTERATIONS

1. This application involves changes to the Qualifying Insurer's Agreement (**QIA**) and the SRA's regulatory arrangements in order to implement the third stage of the SRA's financial protection policy which will come into effect on 1 October 2013. The three implementation stages are summarised in the Transition Plan attached at **Annex 1**. The principal changes are:
 - (a) the removal of the Assigned Risk Pool provisions;
 - (b) the introduction of the "extended indemnity period" (**EIP**) and the "cessation period" (**CP**);
 - (c) the introduction variable renewal dates to replace the single renewal of 1 October; and
 - (d) a change of name from **QIA** to "Participating Insurer's Agreement" (**PIA**) and from qualifying insurers to "participating insurers".
2. In addition there are changes to the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011, the SRA Practising Regulations 2011 related to the introducing of EIP and CP; and to the SRA Handbook Glossary (**the Glossary**) for the purposes of introducing new definitions and either amending or deleting some of the existing definitions contained in the Glossary.
3. All the changes will come into effect at the start of the next annual professional indemnity insurance period on 1 October 2013 (which will run until 30 September 2014).

B NATURE AND EFFECT OF THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

Qualifying Insurance

4. Principals in a firm carrying on private practice from offices in England and Wales are required to have compulsory professional indemnity insurance in compliance with the SRA Indemnity Insurance Rules (**SIIR**) and Minimum Terms and Conditions of cover (**MTC**). The SIIR apply to solicitors, registered European lawyers, registered foreign lawyers, and recognised bodies and

their managers, but for ease, the term “solicitors” shall be used in this application. The main purpose of the insurance is to provide the public with a very good basic level of protection in the event that a firm is negligent or dishonest which results in a financial loss.

5. The breadth of cover, and the inability of participating insurers to avoid cover, is unparalleled in the commercial professional indemnity insurance market. This is because the cover was designed to replicate as closely as possible the cover provided under the previous compulsory professional indemnity arrangements (in place until 31 August 2000) based on a statutory fund called the Solicitors Indemnity Fund (**SIF**).

Claims Made Basis of Insurance

6. Professional indemnity policies are written on a “claims made” basis rather than a “losses occurring” basis. This means that responsibility for paying a claim lies with the insurer at the time the claim arises, or circumstances which may give rise to a claim are notified, rather than with the insurer that was on cover when the alleged negligent act took place. This is a very important distinction between professional indemnity insurance and many forms of insurance. So long as there was a single compulsory scheme with one insurer, as with SIF, this distinction was relatively unimportant. Under the current market based scheme it is crucial.

Minimum Terms and Conditions

7. The key terms of the MTC include:
 - (a) Cover is for all civil liability arising from private legal practice, with only limited permitted exclusions;
 - (b) The insured includes the firm (and any prior practice) together with any current or former principal and employee;
 - (c) The definition of "firm" includes any "licensed body" in respect of its regulated activities;
 - (d) Cover extends to the practice as a whole including any body corporate;
 - (e) Cover extends to all activities permitted to a solicitor in England and Wales;
 - (f) The minimum sum insured is £2 million any one claim for sole practitioners and partnerships and £3 million any one claim for limited companies and Limited Liability Partnerships (**LLPs**);
 - (g) The minimum sum insured is exclusive of defence costs which are covered in addition without financial limit;
 - (h) Participating insurers are prohibited from avoiding or repudiating the insurance on any grounds whatsoever including non-disclosure, misrepresentation and failure to pay premium (although they may have rights of reimbursement against each insured);
 - (i) The dishonesty exclusion only applies to the dishonest member(s) of the firm so that innocent partners are covered. If all the principals of the firm have been dishonest then the claim falls to be dealt with by the SRA's Compensation Fund;
 - (j) If a firm ceases without successor practice then the policy is automatically extended by six years to provide run-off cover.

Run-off Cover

8. To ensure adequate public protection the scheme provides for automatic run-off cover for at least six years following the closure of a firm in the following ways:
 - (a) If a firm closed without successor practice on or before 31 August 2000 then the SIF continues to provide run-off cover in accordance with the arrangement then was in place until the Qualifying Insurance scheme came into place from 1 September 2000;
 - (b) If a firm closes without successor practice on or after 1 September 2000 then the qualifying insurer / participating insurer (or the ARP) on risk at the date of closure is required to provide cover for the balance of the indemnity year and for a further six years thereafter. At the end of the six years so called "post six year run-off cover" is provided by SIF currently until 30 September 2020;
 - (c) If a firm closes due to a succession by a successor practice then any future claims arising from the ceased firm will be covered by the qualifying insurer / participating insurer on risk for the successor practice at the date the claim is made.

Participating Insurers

9. Qualifying Insurance is available through qualifying insurers, in future called participating insurers. Firms that cannot get cover on the commercial market can apply to be covered, for a limited period, through the ARP. All insurers authorised to conduct business in the UK can become a participating insurer provided they sign a Participating Insurer's Agreement (**PIA**) each year which incorporates the SRA Indemnity Insurance Rules and MTC. Under the PIA participating insurers have to agree to:
 - issue policies that comply with the MTC;
 - report suspected dishonesty to the SRA; and
 - arbitration arrangements for disputes between insurers.
10. There are currently 25 qualifying insurers. Individual qualifying insurers / participating insurers are under no obligation to offer terms to all firms. For example some insurers will offer terms to sole principals and small firms (up to three principals) while others will choose not to.

Assigned Risks Pool

11. The ARP was created as an integral part of the current arrangement to provide cover for a limited period to those firms that find it difficult to obtain cover from the commercial market. These provisions are not included in the PIA.

C. NATURE AND EFFECT OF AMENDMENTS TO THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

12. A copy of the PIA 2013 is attached at **Annex 2** and a copy of the PIA 2013 showing all the changes as compared to the QIA 2012 is attached as **Annex 3**. A copy of the SIIR 2013 is attached at **Annex 4** and a copy

showing all the changes as compared to the current SIIR is attached at **Annex 5**. A copy of the SRA Authorisation, Practising and Handbook Glossary (Amendment) Rules 2013 is attached at **Annex 6** which sets out the amendments to the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011, the SRA Practising Regulations 2011 and to the SRA Handbook Glossary 2012.

13. The key changes in the PIA, SIIR and MTC as compared to the QIA 2012 are as follows:

- (a) **closure of the ARP** - the removal of the Assigned Risk Pool provisions including what were Schedules 1 and 2 of the QIA. These were two parts of the QIA that formed part of the SRA's regulatory arrangements and previously any changes required Legal Services Board (**LSB**) approval. Changes have been made in the QIA (clause 2.2, and Schedules 1, 2 and 7) and in the SIIR (rules 9 to 12, 14, 15 and Appendix 2);
- (b) **the introduction of the EIP and CP** - policies issued by participating insurers will be required to include additional coverage for a period of 30 days from the end of the policy period (the Extended Indemnity Period (EIP)) and an additional 60 days thereafter (the Cessation Period (CP)), during which period the firm must obtain alternative policy of qualifying insurance or cease to practise. The SRA will be taking positive steps to ensure that firms do not continue to practise beyond the end of the CP. Firms may not take on any new instructions during the CP, but may continue to undertake existing instructions. Changes have been made to rule 4.2 of the SIIR and to clause 5 of the MTC which form Appendix 1 to the SIIR;
- (c) **backdating of cover** - it is a requirement that participating insurers who insure a firm that is in the EIP or CP backdate cover to the commencement of the EIP. Changes have been made to clause 4.2 of the agreement;
- (d) **variable renewal dates** - unlike all previous QIAs, under the PIA participating insurers will be permitted to issue policies of qualifying insurer not ending on 30 September (which is the end of the annual indemnity period). Participating insurers will be entitled to issue policies at any time with policy periods of any length, though all policies must still contain the EIP and CP coverage;
- (e) **reporting entry into the EIP and CP** - to ensure the SRA is fully apprised of firms that have entered the EIP and CP, the reporting obligations on both participating insurers and firms have been expanded. Changes have been made to rule 17 of the SIIR;
- (f) **disputes as to insurer** - any dispute as to which insurer is required to take conduct of a claim may be resolved by the direction of the SRA (as the regulatory body of the Law Society) rather than by the ARP Manager as was the case in prior years. Until any such dispute is resolved, the participating insurer to whom the claim was first notified must take on conduct of the claim; and

- (g) **change of name** - a change of name from Qualifying Insurer's Agreement to "Participating Insurer's Agreement" and from qualifying insurers to "participating insurers". Appropriate changes have been made in the agreement, the SRA Indemnity Insurance Rules and the Glossary.
14. On 25 October 2011 a second client financial protection review consultation paper was issued that proposed amendments to the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011 which would give effect to the policy changes proposed. In October 2011 it was expected that, at the time of the implementation of these changes, an order under section 69 of the Legal Services Act 2007 would have been made allowing the SRA to regulate sole practitioners as recognised bodies under the Authorisation Rules. This is not yet the case, and sole practitioner firms continue to be regulated under the SRA Practising Regulations 2011. The amendment rules attached at **Annex 6** therefore include provisions amending the SRA Practising Regulations. These are equivalent to the amendment provisions in the Authorisation Rules which were originally intended to apply in relation to all SRA regulated firms.
15. The key change to the SRA Authorisation Rules for Legal Services Bodies and Licensable Bodies 2011 is the introduction of a new general condition on authorisation such that when an authorised body becomes subject to cover under the cessation period it must cease carrying out legal activities other than competing work under existing instructions. A new rule 8.11 has been added and the Guidance note to rule 8 has been amended by the introduction of a new note at (xv)(a)(F).
16. The equivalent change in the SRA Practising Regulations 2011 relating to recognised sole practitioner firms is brought about by the addition of a new regulation 4.15 and the amendment of Guidance note to regulation 4 by the insertion of a new note at (xii)(a)(E).
17. The key changes to the Glossary are as follows:
- (a) the insertion of the new definitions of "participating insurer" and "participating insurer's agreement";
 - (b) the deletion of redundant definitions following the removal of the ARP provisions; and
 - (c) a number of minor corrections and updates to existing definitions have been made as set out in **Annex 6**.

D. RATIONALE FOR THE CHANGES TO THE CLIENT FINANCIAL PROTECTION ARRANGEMENTS

18. The rationale for the changes arising from the review of financial protection arrangements are set out in the April 2011 [SRA financial protection policy statement](#) issued in April 2011 which is attached as **Annex 7**. The policy agreed by the SRA board followed the [independent review of client financial protection](#) undertaken for the SRA by Charles River Associates (CRA) in 2010 and the extensive consultation undertaken by the SRA on its own client financial protection reform proposals published in December 2010. The

transition plan annexed to the policy statement summarises the three year programme of change.

19. The changes set out in the attached documents are necessary to deliver on the changes required for the 2013/14 indemnity period which will be the final year of the three year transition as shown in **Annex 1**.
20. The only change that has not arisen from the review is the change of names. In order to be eligible to be a "qualifying insurer" an insurer must be an "authorised insurer" as defined by section 87(1A) of the Solicitors Act 1974. "Authorised insurers" are regulated by the Financial Conduct Authority (prior to 1 April 2013, by the Financial Services Authority) either directly or through passport arrangements. The SRA does not impose any additional qualifying criteria.
21. It is clear from correspondence received that some firms have inferred from the term "qualifying insurer" that the SRA has undertaken some additional checks on the financial stability of an insurer before it is eligible to become a "qualifying insurer". The SRA website makes it clear that is not the case as follows:

The Solicitors Regulation Authority does not regulate, vet or approve insurers. In order to be eligible to be a Qualifying Insurer an insurer must be an "authorised insurer" as defined by section 87(1A) of the Solicitors Act 1974. "Authorised insurers" are regulated by the Financial Services Authority. (For more information, see appendix 1 [What does it mean to be a Qualifying Insurer?](#)) see [Appendix 2 for information about "EEA insurers"](#)

22. The name of the agreement has been changed from "Qualifying Insurer's Agreement" to "Participating Insurer's Agreement" (**PIA**) to reduce the risk of the SRA's role being misunderstood. The term "qualifying insurers" has been replaced by "participating insurers" but policies governed by the agreement will still be referred to as "qualifying insurance".

E. STATEMENT IN RESPECT OF THE REGULATORY OBJECTIVES

Protecting and promoting the public interest

23. The changes proposed as part of the review of client financial protection are intended to maintain a high degree of financial protection which is in the interest of all stakeholders but particularly the consumers of legal services, for whom the security afforded by the arrangement is of a very high order. The phasing out of the ARP will help create more stable and sustainable conditions in the professional indemnity market for solicitors to the benefit of consumers of legal services.

Supporting the constitutional principle of the rule of law

24. The SRA considers that the changes to the QIA and the various rules will be neutral towards this objective.

Improving access to justice

25. The Qualifying Insurance market for one to three partner firms is limited. The key risks of not making the proposed changes to the QIA and the SIIR now are increases in premium rates and a lack of capacity particularly for small firms. This is a segment of the market that a number of Qualifying Insurers have exited in recent years. Two and three partner firms are considered to be the most difficult to underwrite, particularly in relation to cover for fraud and dishonesty. Following the announcement of the proposed changes in the April 2011 policy statement, particularly the closing of the ARP in 2013, the market for solicitors professional indemnity insurance has eased with evidenced by a dramatic fall in the number of firms in the ARP in 2011 followed by a further significant reduction this year to the lowest number since the ARP was created in 2000.
26. It is therefore reasonable to assume that taking no action would potentially have a disproportionate impact on BME and small firms. These firms often provide a very specialised and localised service sometimes within a particular community with a higher population of people from BME communities. Reducing the impact of renewal upon BME and small firms, and seeking to ensure that a competitive professional indemnity insurance market remains in place for this sector of the profession in particular safeguards the public's access to such firms. The new PIA and SIIR will maintain access to justice.

Protecting and promoting the interests of consumers

27. Consumers of legal services are entitled to expect a good quality service from their solicitor, and they should be able to have confidence that if something does go wrong resulting in a financial loss to them that there is in place a source of financial redress. The Rules and the changes proposed this year are aimed at providing those consumers with continued assurance and confidence that comprehensive financial protection arrangements remain in place after the ARP is phased out. The introduction of the EIP and CP will ensure firms that have difficulty in obtaining professional indemnity insurance remain covered whilst they seek replacement cover and/or undertake an orderly closure. One of the drivers for our root and branch review of our financial protection arrangements was that the arrangements for client financial protection were under strain and the public interest would not be served by a collapse of those arrangements.
28. The various client protection rules and the MTC clearly do protect and promote the interests of consumers and the wider public interest, the amendments are being made to ensure that the arrangements are sustainable.

Promoting competition in the provision of services

29. The SIIR will promote competition in the provision of services within the context of the Qualifying Insurance arrangement and the changes will have a positive impact. At present there are 25 Qualifying Insurers. We anticipate that, as in previous years, there will be some insurers that will stop writing new business and there will be new entrants. The changes, particularly the phasing out of the ARP, seek to strike the balance between providing excellent protection for consumers of legal services and fostering a

competitive market for solicitors. The changes proposed aim to strike the right balance and to create conditions so that those firms most vulnerable at renewal (such as small firms) will still have a market, rather than having to close due to the lack of available insurance.

30. The closure of the ARP will remove a barrier to new insurers entering the market for solicitors professional indemnity insurance which will promote competition.

Encouraging an independent, strong, diverse and effective legal profession

31. The phasing out of the ARP in particular will help create the conditions for a more competitive market for solicitors professional indemnity insurance which will particularly benefit small firms, a sector in which BME firms are over represented. The changes to the QIA and SIIR will thereby help to encourage a diverse and independent legal profession.

Increasing public understanding of the citizen's legal rights and duties

32. The SRA considers that the changes will be neutral towards this objective.

Promoting and maintaining adherence to the professional principles

33. The SRA considers that the changes will be neutral towards this objective.

E. STATEMENT IN RESPECT OF THE BETTER REGULATION PRINCIPLES

Proportionality

34. The SRA has to balance the demands of the participating insurers who underwrite the compulsory professional indemnity scheme with the differing needs of the profession and consumer protection. The SRA has responded in a proportionate way to these conflicting requirements and to developments imposed by the state of the market, including the growing concerns of the participating insurers in order to preserve for the immediate future the SRA's compulsory professional indemnity insurance arrangement.

Accountability

35. The SRA is accountable to all its stakeholders in relation to client financial protection matters: consumers; the profession; the participating insurers; BME groups. The SRA has to provide arrangements that are effective but sustainable. Ineffective client financial protection arrangements will impact on all these stakeholders, and the larger public interest.
36. The justification for the changes arising from the review of client financial protection arrangements is set out in the [SRA financial protection policy statement](#) issued in April 2011.

Consistency

37. The new PIA and rules are consistent with previous rules but are in the process of evolving in accordance with the [SRA financial protection policy statement](#) in order to meet changing needs and market conditions. They

have adapted, and will have to do so again in the future, to the introduction of firm based regulation, outcome focused regulation and licensed bodies.

Transparency

38. The changes to the SIIR, SIR, Authorisation Rules, Practising Regulation and the Glossary will be published on the SRA website as part of changes to the SRA Handbook to be introduced on 1 October 2013. The PIA 2013 will also be published on the website. Comparison software on the website will enable all the changes to be identified by means of comparisons with existing documents.
39. The phasing out of the ARP will significantly reduce (if not remove altogether) the need for insurers to factor into their premiums a loading to cover their exposure to ARP liabilities. This will mean that premiums payable by firms should more accurately reflect the risk posed by those firms.

Targeted

40. The changes arising from the client financial protection review are targeted at addressing the primary risk to the stability of the SRA's client financial protection arrangements which is the ARP and the replacement of the protection provided by the ARP with alternative arrangements involving extended policy periods.

F. STATEMENT IN RELATION TO DESIRED OUTCOMES

41. The changes with respect to the client protection review are being made in accordance with the programme of reform set out in the [SRA financial protection policy statement](#) issued in April 2011. The changes are a necessary final step in the process of change to give effect to the outcomes set out in the policy statement.

G. STATEMENT IN RELATION TO IMPACT ON OTHER APPROVED REGULATORS

42. The PIA and rules are aimed at solicitors, registered European lawyers, registered foreign lawyers, recognised bodies, licensed bodies and their managers. We have not identified any adverse impact on people regulated by other approved regulators.

H. IMPLEMENTATION TIMETABLE

43. The annual compulsory professional indemnity insurance period runs from 1 October to 30 September each year, with the new rules coming into force on 1 October 2013.
44. As well as publicising the new rules on our website the participating insurers have to be informed in advance, usually in June, to enable them to adapt the wording of their policies which have to meet the requirements of the MTC. Participating insurers start to send out proposal forms in July and the profession start to return these completed in August. The single deadline for

renewal of 1 October 2013 means that huge numbers of proposal applications have to be completed and processed by Qualifying Insurers or their brokers in a very short time. Hence the need for the renewal process to start during July. There is an urgent need for the approval process to be completed as quickly as possible to enable insurers to have certainty as the terms of the QIA and the MTC in particular.

45. All the changes to SIIR, SIR, Authorisation Rules, Practising Regulation and the Glossary set out in the annexes to this application will come into force on 1 October 2013.

I. STAKEHOLDER ENGAGEMENT

46. The changes this year are the final stage of a three year programme of change that has been the earlier consultations. The SRA carried out a full public consultation between 25 October 2011 and 17 January 2012 regarding the implementation of the changes to indemnity insurance and compensation arrangements announced in April 2011. The consultation was published on our website in the usual way. A total of 38 responses were received from a range of stakeholders including a very detailed response from the Law Society. A copy of the [report on consultation responses and SRA conclusions](#) is attached as **Annex 8**.
47. We held meetings with the Chief Executive of the Law Society and other Law Society staff on 16 December 2011 and 19 March 2012 to talk through the proposals and the issues raised by the Law Society. A further meeting with the Law Society was held on 23 March 2012 to go through detailed points. In addition to our regular Liaison Committee meetings with qualifying insurers and the Association of British Insurers (ABI) attended by representatives of the Law Society, on 23 March 2012 we held a meeting with the ABI and qualifying insurers to discuss the proposed changes including the changes to the structure of the ARP.
48. We listened to stakeholders and where we felt that valid points had been raised which merited amendment of our proposals we made amendments.
49. The change of names from the QIA to PIA and from "qualifying insurer" to "participating insurer" was a proposed by the Law Society at a Liaison Committee meeting and has been welcomed by the qualifying insurers.

J. FURTHER EXPLANATORY INFORMATION

50. There is no further explanatory material that the SRA wishes to submit.

ANNEXES

- Annex 1:** Transition Plan
- Annex 2:** Participating Insurer's Agreement 2013
- Annex 3:** Participating Insurer's Agreement 2013 showing all changes since the Qualifying Insurer's Agreement 2012

- Annex 4:** SRA Indemnity Insurance Rules 2013
- Annex 5:** SRA Indemnity Insurance Rules 2013 showing all changes as compared to the SRA Indemnity Insurance Rules 2012
- Annex 6:** SRA Authorisation, Practising and Handbook Glossary (Amendment) Rules 2013
- Annex 7:** SRA financial protection policy statement - April 2011
- Annex 8:** Report on consultation responses and SRA conclusions

SRA CONTACT FOR MATTERS RELATING TO THIS APPLICATION

Andrew Darby
Policy and Strategy Directorate, Solicitors Regulation Authority, The Cube,
199 Wharfside Street, Birmingham, 1 1RN

Tel: 0121 329 6242

Email: andrew.darby@sra.org.uk

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