



The Law Society

Client financial protection arrangements

The Law Society's response to the Solicitors Regulation Authority's
second stage consultation

January 2012

supporting
solicitors

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Q1. Do you have any comments on the SRA's decisions, set out in the Policy Statement, which form the basis for the changes?

1. We welcome the opportunity to respond to the Solicitors Regulation Authority's (SRA) second stage consultation on client financial protection arrangements.
2. We support, in principle, the SRA's decision to close the assigned risks pool (ARP) as an insurer of last resort and to introduce a requirement for an extension of existing policies by up to 90 days if an insured firm has not obtained a new policy at the end of an indemnity period. This policy is based on the Law Society's alternative approach outlined in our response to the SRA's first stage of consultation. We do, however, have concerns about some aspects of the SRA's proposed implementation of these policies, specifically the workability of the notice requirement and cost of the extended period. We also consider that the ARP should continue in some form in order to meet claims on pre-30 September ARP policies, run-off policies and that the ARP Manager should retain an ongoing role as a provider of cover for non-applied firms (albeit with suggested amendments to the scope of cover, discretion and delivery mechanism outlined at Q4 below). We have suggested alternative ways for the SRA's policy to be implemented, which will avoid certain unintended consequences that arise from the current draft amendments.
3. We have identified a number of practical difficulties that stem from a mandatory notice requirement and consider that, after the abolition of the ARP, there will be sufficient competitive pressures within the market and incentives within the extended indemnity period (EIP) itself to encourage insurers to provide timely notice to solicitors if they intend not to renew their cover. We consider that the SRA could assist by setting minimum acceptance periods for quotations and publishing indicative timings that solicitors should expect for insurers' responses prior to assuming that they should seek alternative quotations. We also recommend that the SRA bring forward its planned abolition of the single renewal date to the 2012 indemnity year as this will provide the market with

greater flexibility regarding length of cover and may, in some cases, prevent firms from entering into the EIP. It is also essential that the SRA finalise the minimum terms and conditions (MTC) well in advance of renewal to ensure that insurers are not prevented from offering early renewals or quotations.

4. The proposal for the profession to assume £30m of potential liability for the 2012 ARP is in accordance with the commitment from the Law Society Council on 4 May 2011 supporting the tiered funding arrangements for the 2012 ARP that appears in the SRA's Policy Statement, subject to transparency and dialogue about ARP management. This agreement was reached in the context of large number of firms in the ARP and claims at the high point reaching over £50m. The current number of firms in the 2011-12 ARP is significantly less than in previous years. This has led the Society to reassess the most appropriate way to *structure* the profession's contribution, without altering the level of our commitment. The Society considers that a more equitable funding arrangement would be to share the entire first £60m of liability on a 50:50 basis between qualifying insurers and the profession. Liability above £60m would fall solely to insurers, as per the SRA's original layering. This will ensure that, in the event that claims development for the 2012 ARP is not as severe as £10m, the profession is not bearing the entire burden but rather the liability and management costs for this single ARP year are shared equitably between insurers and the profession.
5. The Law Society has long supported the creation of an industry-wide source of information as a precondition for a fair and transparent open market system. In our response, we suggest ways that the SRA could implement this system and consider that insurers, the profession and the SRA's own regulatory functions will benefit from the introduction of a single source of information.
6. Another potential unintended consequence from the SRA's proposed implementation arises from the ability of insurers to limit the scope of the insurance arrangements that apply to the EIP and Cessation Period and the consequential increased exposure of the Compensation Fund. Potential difficulties stem from the inconsistent use of terminology between the MTC, the draft Compensation Fund Rules (CF Rules) and the work exclusions in the Cessation Period. We suggest a more consistent approach that treats existing and new insurers alike in respect to the type of cover that they must provide during the 90 day period. This approach is easier to administer, provides client certainty and does not erode public protection during this period. Our proposal also allows a simplified approach to backdating of policies so as to avoid 'double insurance'.
7. Similarly, while we agree with the policy intention behind requiring firms to cease legal practice if they are unable to obtain insurance following the extended indemnity period, we do not consider the SRA's proposed changes to the Authorisation Rules adequately implement this policy. The proposed amendments make it a condition on a firm's authorisation that a firm may not undertake new work during the cessation period. However, we do not believe that this enforcement mechanism is sufficient, as a breach of a condition does not necessarily lead to revocation of an authorisation. Although in some circumstances there may be indirect mechanisms by which the SRA could revoke an authorisation, we foresee potential difficulties with revoking authorisation immediately which may lead to valuable time being wasted. We

consider that there is a potential for the SRA's intention in its Policy Statement to be frustrated and, as such, have suggested alternative drafting in our response to Q3 that provides a simpler and clearer mechanism by which to ensure a firm ceases to practise at the end of the Cessation Period. Our proposal provides for automatic revocation of authorisation in the event of a breach of the rule within the draft SRA Indemnity Insurance Rules 2012 (SIIR) that a firm must cease to practise promptly or at least by the end of the cessation period. We also consider it important that the SRA ensures that there are sufficient grounds for intervention in the event that revocation of authorisation alone is not sufficient and a firm refuses to cooperate and cease to practise at the end of the Cessation Period.

8. We do not support the SRA's decision to transfer the role of the ARP for making payments in respect of uninsured firms to the Compensation Fund. We have outlined our reasons and an alternative proposal in our response to Q4. We consider that Compensation Fund is not the appropriate vehicle to deal with claims arising from the conduct of non-applied firms; this role should continue to be provided by insurers (which is consistent with the Motor Insurer's Bureau approach to uninsured drivers and other professional bodies). Furthermore, the ARP Manager is better suited to deal with the types of claims that arise from 'negligent acts' than the Compensation Fund. We suggest that this role could continue to be provided by the ARP while it is wound down and it is possible for the SRA to narrow the current scope of cover within the current arrangements by providing the ARP Manager with additional discretion. While we agree that the SRA should be seeking efficiencies in managing and winding down the remaining functions of the ARP, this can be achieved by appointing an ARP Manager that will have an ongoing role in the market. One potential option is to use a single entity to efficiently manage the various roles (e.g. SIF, the Compensation Fund and the ARP Manager). We consider that there are efficiencies to be gained in combining the administration and management of these roles without the need to alter the way the funding and liability arrangements are currently structured. In any event, we do not consider that the SRA should make any changes to the non-applied firms' role until it has conducted its comprehensive review of the workings of the Compensation Fund that it has flagged for 2012.
9. Furthermore, despite its stated intention to reduce the scope of cover provided to non-applied firms, the amendments to the CF Rules increase the scope for claims in a number of ways by not limiting liability to acts arising from private legal practice or legal work; inconsistencies between the wording of the new work exclusion and the scope of work in the MTC; the failure of the CF Rules to mirror MTC exclusions; and the extension of cover to defaulting licensed bodies and defaulting recognised bodies. We have suggested ways to limit the scope of cover, in accordance with the SRA's stated intention, while retaining the cover within the remaining functions of the ARP.

Q2. Do you have any comments on changes proposed to the QIA and SIIR?

Extended Indemnity Period and Cessation Period

Provision for 90 day extension if a firm is unable to obtain a new policy of qualifying insurance

10. The Law Society supports, in principle, the introduction of this extended period. However, we have comments about how the SRA proposes to implement this policy and its draft amendments to the QIA 2012 and SIIR 2012.
11. The proposed drafting treats the EIP and Cessation Period separately in terms of the insurance arrangements that apply in each. For example, existing insurers are entitled to exclude from the scope of the MTC policy any work done in breach of draft rule 5.3 (obligation to cease to take on new instructions during the Cessation Period).¹ However, any new insurer that provides a firm with a policy that is backdated to the start of the Cessation Period cannot exclude this work and must provide cover for all legal activities including those in breach of draft rule 5.3.²
12. There are also other ways in which these periods are treated as discrete periods; for example, although backdating is permitted to the start of the EIP (i.e. up to 30 days) and the start of the Cessation Period (i.e. up to 60 days), an insurer is not permitted to backdate a policy the full 90 days.
13. We do not consider it is necessary to create two separate policies and treat these periods differently in terms of the scope of insurance provided. Although we recognise that there may be a need to distinguish between these periods based on the requirement to cease to accept new instructions in the latter period, we do not consider this warrants any amendment to the scope of the MTC for the Cessation Period (especially as this results in inconsistent treatment of new and existing insurers). Similarly, a new insurer should be permitted to backdate a policy to cover this entire 90 day period if it chooses.
14. A simpler solution and a more consistent approach would be to require any insurer (i.e. existing or new) that is providing cover during the Cessation Period to cover all claims arising from work during this period irrespective of whether or not they arise from work done in breach of draft rule 5.3. It is the nature of the MTC policy to cover firms for a breach of professional obligations, therefore, it is appropriate for this work to remain within the scope of the MTC.
15. To avoid any potential incentive on solicitors to disregard their professional obligations, we would expect the SRA to enforce a breach of draft rule 5.3

¹ Draft clauses 5.3.2 and 6.11 of the MTC.

² Draft rule 4.2 of the SIIR.

through disciplinary procedures (as envisaged by rule 16.2.3 of the MTC)³ regardless of whether or not any claims arising from the breach is covered by the MTC policy.

16. It does not weaken this enforcement mechanism if both situations are covered by the MTC policy. There is no reason why a firm should be covered for a breach by virtue of their obtaining a backdated policy of insurance but should not if this breach occurs under a policy with its existing insurer. Similarly, there is no reason to distinguish between breaches by firms that may or may not continue to practise. The SRA has not provided any regulatory rationale for this inconsistent treatment of firms and consequently, we suggest it adopt a consistent approach in line with the better regulation principles in s. 3(3)(a) of the *Legal Services Act 2007* (LSA).
17. A consistent approach to the scope of MTC cover will remove the need for the current arbitrary distinction regarding backdating of policies. We consider that an easier and fairer way to avoid 'double insurance' is to permit backdating across the entire 90 day period, if there has been no notification of circumstances or claims. If there is a notification then the new policy could be backdated to the day after the claim was notified. This will result in the existing insurer being free of liability (provided there are no notifications) and the new insurer will assume this risk for the requisite reward. Any EIP/Cessation Period premium paid to the existing insurer could be refunded as per normal insurance arrangements on cancellation of policies.⁴ We consider this refund can be calculated based on pro rata basis of the time actually spent in the EIP/Cessation Period (see EIP costs below).
18. Another potentially unintended consequence of the SRA's proposed drafting stems from the use of inconsistent terms in the obligation to cease to undertake 'legal activities'⁵ and the scope of the MTC cover which is based on civil liability arising from 'private legal practice'⁶. Private legal practice is more broadly

³ This intention is also reflected in commentary to rule 4.4 and the inclusion of a breach of rule 5.3 in rule 16.2.3 (disciplinary consequences of failure to comply with these rules).

⁴ This would fall under a permitted cancellation of the policy under clause 4.3(b) of the MTC.

⁵ *Legal activity* is defined in section 12 of the *Legal Services Act* as:

- a) Reserved legal activities; and
- b) Provision of advice or representation in connection with the application of law or with any form of resolution of legal disputes.

⁶ *Private legal practice* is defined in the MTC as:

- a) by reference to those services that a partnership is permitted to practise by the old Rule 12 in the Solicitors' Code of Conduct 2007 or by the SRA Practice Framework Rules; or the regulated activities of a recognised or licence body;
- b) the regulated activities of a licensed body, which includes reserved legal activities, legal activities **and any other activity** that is regulated pursuant to Part 5 of LSA (i.e. ABS); and
- c) **All professional services** of the firm (including personal representative, trustee, attorney, notary, insolvency practitioner **or any other role in conjunction with a practice** including pro bono public).

defined than legal activities. It seems anomalous that the firm should be permitted under draft rule 5.3 of the SIIR and insured under the MTC to perform certain types of new work and not others during the Cessation Period, particularly given the SRA's intention that a firm should 'cease practice promptly' in draft rule 4.2. We consider that both these obligations⁷ should apply to *any* work that firm is regulated to undertake, not just 'legal activities'. This is particularly a risk with a multi-disciplinary practice that may be an SRA-regulated entity undertaking both legal and non-legal activities. We recommend that the SRA adopt consistent terminology by defining the scope of the EIP/Cessation Period by reference to all work 'in connection with a private legal practice'. This will also assist the SRA's disciplinary processes by reducing the risk of disputes over 'legal work' and other regulated work. Adopting a broad definition will also reduce (but not remove) consumer confusion about the effect of giving instructions and the type of work that will be insured within this extended period. We consider this approach reflects the better regulation principles in s. 3(3)(a) of the LSA.

19. In any event, regardless of how the SRA defines the scope of work that can be undertaken during the period, this does not justify the exclusion of this work from the scope of the MTC insurance. It is the view of the Society that the level of MTC coverage should be unchanged during the EIP/Cessation Period.
20. The inconsistencies within the SRA's approach also has Compensation Fund ramifications (see Q4 below) as there is a potential for increased disputes about whether or not work relates to 'existing instructions' or falls within the scope of excluded 'legal activities'.

Comments on the solicitors' obligation to cease to undertake new instructions

21. We consider that a solicitors' general obligation to act in a client's best interests and treat clients fairly⁸ will require any firm that enters the EIP to warn clients that they may be forced to cease to practise after 90 days and, as such, may be unable to complete their existing instructions. This obligation would also extend to a duty to explain to clients that a firm is unable to take on new instructions during the Cessation Period and the practical effect of this for the client (particularly if the SRA permits this work to be legitimately excluded from the MTC). This conversation with clients is part of the proper winding down of the

⁷ i.e. the obligation to cease to undertake new instructions under rule 5.3 and to practise under rule 4.2.

⁸ Other relevant outcomes: Outcomes: O(1.3) when deciding whether to act, or terminate your instructions, you comply with the law and the Code; O(1.4) you have the resources, skills and procedures to carry out your clients' instructions; O(1.5) the service you provide to clients is competent, delivered in a timely manner and takes account of your clients' needs and circumstances; O(1.7) you inform clients whether and how the services you provide are regulated and how this affects the protections available to the client; O(1.8) clients have the benefit of your compulsory professional indemnity insurance and you do not exclude or attempt to exclude liability below the minimum level of cover required by the SRA Indemnity Insurance Rules; O(1.12) clients are in a position to make informed decisions about the services they need, how their matter will be handled and the options available to them.

practice. We recommend that the SRA consider including an express obligation to this effect in the SIIR or as an outcome in the SRA Code of Conduct.

22. In any event, the Society will advise the profession to be wary about accepting new instructions within the EIP as, even though it is permitted under the SIIR, solicitors should consider the length and scope of any new instructions, the likelihood of finalising the instructions within 90 days and the likelihood of the firm obtaining alternative insurance and continuing to practise.

Publication of firms' insurance details

23. We also consider that it is consistent with the SRA's policy to publish the insurer of firms,⁹ that it also publishes the names of firms in the Cessation Period and provides general guidance explaining the effect of this to current and potential clients of the firm. In order for the SRA to provide this notice to clients, it will need to exclude the information obtained under draft rule 17.3 (i.e. the requirement of solicitors to notify the SRA on entering the EIP and Cessation Period) from rule 17.4 of the SIIR as otherwise it will have to keep this information confidential. We consider there is a public interest in the SRA being able to notify clients (and the public in general) of the fact that a firm is unable to take on new instructions and is required to cease to practise imminently. This is also consistent with the SRA's obligations to protect the Compensation Fund,¹⁰ as if work in breach of rule 5.3 is a permitted MTC exclusion then these losses will fall on the Fund (see Q4 below). We also consider this reflects the better regulation principles in s. 3(3)(a) of the LSA.
24. It may also be useful for the SRA to notify the Law Society about firms in this situation so that we can provide services to our members regarding exit strategies and options.¹¹ We would appreciate the SRA clarifying its position regarding sharing this information with the representative arm of the Law Society.

Liability for EIP

25. There is also a potential inconsistency between the SRA's expressed intention in its consultation paper and its proposed drafting regarding liability for the EIP. The Consultation Paper states that 'the previous insurer retains the liability for the EIP to avoid issues of double insurance...because it is expected that QIs will price the risk or charge additional premium where an EIP is triggered' (at paragraph 2.3).
26. We do not consider the above drafting ensures that 'the previous insurer retains the liability' as under clause 5.1, the insurer will not have to provide cover for the

⁹ Para 40 of Annex A seeks to ensure 'the SRA has the ability to make public the insurer providing minimum terms cover to any firm'.

¹⁰ Section 36A(9)(c) of the *Solicitors Act 1974*.

¹¹ This may be permitted under rule 17.4, which allows confidential information to be disclosed to 'duly authorised employee of the Society or any of its subsidiaries' under the current rule 17.4, which may be sufficiently broad to cover Law Society employees.

EIP if the insured obtains backdated cover. We do not, however, recommend that the SRA oblige existing insurers to retain liability for the EIP as this would essentially create a position of double insurance where a new insurer backdates the policy to the beginning of the 30 day period.

27. There does not appear to be a regulatory need for the existing insurer to retain liability for a proportion of the EIP if another insurer is prepared to take on this risk. Indeed, it would be unfair to require them to do so given that the reason a firm enters an EIP is that its existing insurer no longer wishes to provide them with cover. We consider that a simpler way to avoid double insurance is to allow for the EIP premium to be refunded and the previous insurer retain no liability for this period if the new insurer is prepared to backdate (see above).

Notice of intention not to renew cover

28. After careful consideration, the Law Society considers that it is not practical for the SRA to require insurers to provide a notice of an intention to renew cover by a certain date. We consider that the EIP itself is the incentive for insurers to communicate early if they do not want to renew an insured firm. The EIP removes the ability of insurers to 'dump' firms in the ARP; that is, there is now an incentive for insurers to communicate an intention to not renew a risk early because if that firm is unable to obtain insurance elsewhere that insurer is liable to carry this risk for another six years.
29. The EIP has also created a greater incentive for solicitors to be proactive in getting quotes from other insurers if their existing insurer has not offered them renewal terms. We consider the potential threat of closure that is provided by the EIP is sufficient incentive for insured firms to submit proposal forms earlier and be proactive about seeking quotes from other insurers, notwithstanding the fact that they may not have received an offer of renewal from their existing insurer.
30. The increased competition created by the abolition of the ARP should also incentivise insurers to respond to proposals in a timely manner or else face losing risks they wish to renew to a more responsive competitor. A competitive market, which was the rationale for the introduction of the EIP, will also ensure that solicitors are able to access competitive quotations from other potential insurers. We are also aware of the safety net provided by the 90 day extended period. There is evidence that there is an active market within the current 30 day window in the ARP; the Society is of the view that this will continue with the introduction of the EIP. In that sense, solicitors will be provided with a 30 day notice period in which to obtain insurance as part of the EIP.
31. For these reasons, there is no need for the SRA to impose an arbitrary notification requirement that will be ineffective and unworkable for the reasons detailed below and which provides little benefit for solicitors other than an artificial blanket notification of declinature or economic declinature.
32. Instead the SRA should publish indicative response times and mandate minimum acceptance periods (see Q6.1 below) to assist solicitors in managing their relationship with insurers and brokers. The SRA could provide deemed notice to solicitors; for example, if a firm has submitted a completed proposal form and receives no response from their existing insurer by a certain date

(e.g. 21 days later), then the firm should assume that it may not receive an offer of renewal and that it is obliged to seek alternative insurance elsewhere in order to meet its regulatory requirements.

33. In addition to publishing indicative timetables, the SRA could advise all firms that if they have not received an offer of renewal by 31 August then they should seek alternatives. This advice could also outline the consequences in terms of restrictions on a firm's ability to practise if insurance is not obtained by 1 October.
34. We do, however, consider it to be reasonable for the SRA to require that an existing insurer that *does* notify a firm that it will not renew cover to provide the firm with information about the effect of failure to obtain insurance by the end of the indemnity period under the EIP system and the insured's notice requirements in the event that they enter the EIP.
35. We recognise that the SRA could consider the separate issue of introducing mandatory response times for all qualifying insurers in the future, if the incentives created by the EIP prove not to be sufficient to make solicitors submit timely proposal forms and insurers to respond within reasonable periods. However, the Law Society does not support that at this stage due to the practical difficulties in implementing any mandatory notice requirement and the potential unintended consequences that could cause more detriment than the benefit to the profession that notice is intended to provide.
36. To assist the operation of the open market under the EIP system, the SRA will have to ensure that there are no delays in the finalisation of the MTC and the QIA as otherwise insurers will be unable to provide early renewals or quotations to firms. It is imperative that under this new system, the SRA itself does not become a barrier or cause any delay.
37. To ensure maximum flexibility within the EIP process, we consider it to be essential that the SRA bring forward its planned abolition of the single renewal date to the 2012 indemnity year. The SRA currently proposes to implement variable renewal from 2013. We consider that introducing variable renewal in conjunction with the introduction of the EIP requirement may enable insurers and solicitors to agree to extend their existing policies for a period of less than 12 months to avoid the necessity to enter the EIP. We consider this flexibility should be available to insurers if, instead of declining to renew an insured and triggering the formal EIP requirements, the insurer would prefer to provide a more limited period of cover, for example, to adopt a 'wait and see' approach to how a particular notification or claim develops. This will also allow the firm to continue to practise as usual (with the necessary client protections afforded by the MTC), without the work restrictions and the requirement to cease to practise that accompany the EIP/Cessation Period. At the end of the variable indemnity period, as at the end of any indemnity period, the insurer will have to decide whether it will reinsure or decline the firm. In a declinature situation, if the firm is unable to obtain alternative insurance, the insurer will have to provide the EIP/Cessation Period as required under the MTC.

Problems with the proposed mandatory notice requirement

38. We consider that there are problems with the SRA's current drafting of the notice requirement. Firstly, the requirement to give notice is not linked to receipt of a

proposal form. This means that an insurer is placed in the artificial position of having to notify an insured by 31 August 2013 or offer terms regardless of whether or not it has received a proposal form. This is not desirable as the notice may be artificial as the insurer may still want to quote this business on receipt of proposal form or additional information to supplement a proposal form that was not fully completed. If the notice is not given, then the insurer must offer terms perhaps without having sighted a proposal form. For this reason, the Society's proposal in the first stage consultation had a reciprocal obligation on solicitors to provide insurers with a fully completed proposal form. We consider that a reciprocal obligation on solicitors is essential to the success of any regulatory option; however, we do not support regulatory intervention in this instance.

39. Secondly, the SRA has provided an incentive for insurers to give economic declinature. The SRA's proposed drafting will frustrate its policy intention and lead to economic declinature as the current drafting does not provide an incentive for insurers to genuinely comply with the notice requirement. Under the SRA's current proposal, the effect of non-compliance with this notice requirement is that the insurer must 'offer terms to that insured firm to renew cover' for the next indemnity period (draft 4.13 MTC). However, the SRA's proposed notice period is meaningless as, in order to avoid the possibility of providing an additional 12 months cover to a firm that they are unwilling to insure, insurers can 'comply' with this requirement by either:

- a) 'offering terms' quoting an overinflated premium that amounts to economic declinature; or
- b) blanket non-renewal notifications to insured firms on 31 August.

40. We consider that blanket notification is the third major problem with the SRA's proposal. The Law Society has looked at ways to redress these perverse incentives, however, it concludes that any regulation to address these concerns is more detrimental than beneficial to the profession given the dynamics of the solicitors' PII market. As such, we recommend that the SRA implement a policy of non-intervention and rely on the incentives and increased competition created by the EIP to encourage existing insurers to be responsive and solicitors to be proactive in seeking alternative quotes.

Other issues

Identifying firms in the EIP

41. The SRA requires insurers to report any firm that they no longer insure as at 1 October, no later than 5 October 2013 (clause 6.8.2 of the QIA). This reporting requirement does not assist insurers in identifying whether or not they must provide the insured with cover in the form of an EIP because firms may have obtained insurance elsewhere without notifying their current insurer. Hence, the need for draft rule 17.3 which requires a firm to notify the SRA and its insurer if it enters into the EIP and the additional requirement to notify on entering the Cessation Period.

42. We recommend that the obligation on insurers in clause 6.8.2 should also extend to the Cessation Period i.e. insurers should also have to report to the SRA any insured that would have ordinarily entered into the Cessation Period as soon as possible or within 5 business days. This will provide an important cross-reference for the SRA, if a firm fails to notify the insurer and/or the SRA in accordance with rule 17.3. It will also assist the SRA in identifying firms in breach of this reporting obligation and potentially give rise to the ability for the SRA to revoke a firm's authorisation under rule 22.1(iv) of the Authorisation Rules.

Cost of EIP

43. In our response to the SRA's first stage consultation, the Law Society considered that it was fair that the cost of any extended period should be pro-rata of a firm's current annual premium. A set figure provides market certainty and consumer transparency about cost. We considered that this proposal had broad insurer support. We considered that a cap on the amount of premium charged was necessary to prevent insurers charging inflated premiums for the EIP or requiring upfront payment of this contingent amount that would affect the general affordability of premiums.
44. In the SRA's Policy Statement, it agreed with our proposal that additional premium payable should be based pro rata on the previous year's premium.¹² However, this requirement has not been included in the SRA's consultation paper or draft amendments which are silent about the cost of the EIP other stating: 'it is expected that QIs will price the risk or charge additional premium where an EIP is triggered'.¹³
45. The SRA's consultation paper does not explain the rationale behind this change in policy and its decision to no longer require pro rata premium for this extended period. We consider that it is unacceptable for the SRA to depart from its stated policy position in the April Policy Statement without providing adequate justification. We assume that the decision by the SRA to not cap the amount of premium charged by insurers is that it does not wish to intervene with market mechanisms. This is an unacceptable position for the SRA to adopt as without setting a regulatory limit it is possible for premiums for this period to be set at monopolist levels.
46. Without regulation of this amount, the Law Society is of the view that there is the potential for insurers to 'play games' around the EIP. For example, the EIP may be used as a pressure tactic to obtain greater premium on marginal risks. We do recognise the flipside of this argument, however, which is that regulation may stifle innovation (e.g. insurers may choose to not charge any premium for the EIP as they have an incentive to assist firms obtain insurance elsewhere to avoid providing run-off cover). For this reason, we only propose that the SRA cap the *maximum* amount that can be charged for the EIP premium and otherwise leave the pricing of this amount unregulated.

¹² At paragraph 29 of the SRA, Policy Statement, Annex A.

¹³ At paragraph 2.3 of the SRA's consultation paper.

47. We also seek assurance from the SRA that insurers will *not* require payment of this amount upfront. The SRA could achieve this by including a requirement in the QIA that insurers can only request payment for the EIP/Cessation Period premium at the end of the indemnity period when it is evident that this cover will be required.
48. In the alternative, given the SRA's current policy to allow retrospective commencement of run-off cover from the end of the indemnity period, the Law Society considers that insurers should not be permitted to charge an additional premium for the EIP/Cessation Period. The SRA's retrospective run-off cover, essentially reduces the length of mandatory run-off cover by three months. Arguably, existing insurers should not be allowed to charge any additional premium for the EIP/Cessation Period because this is already covered by the run-off cover premium.
49. The SRA may consider that there is a need to reflect the additional risk caused by insured firms being able to work during run-off cover, which is usually a period when a firm has ceased to practise. If this is the case, then it is only the EIP premium that needs to reflect this additional risk as it is only during the EIP (i.e. the first month) that a firm can accept new instructions and consequently expose insurers to additional liability that they would not otherwise have been required to cover under a normal run-off policy. Any work performed in the Cessation Period is merely a continuation of existing work that would have been covered by the run-off policy in any event. As such, we suggest that the premium for the EIP should be capped at 1/12 of *annual premium* (i.e. 8.3%) paid by the firm and no further premium be charged for the Cessation Period if the firm goes into run-off.
50. It is only if a firm successfully exits the Cessation Period and does not require run-off cover that the Cessation Period needs to be separately calculated. Given our analysis above about the type of work undertaken in this period, we suggest that this should be based on a pro-rata of the *run-off cover premium*. Assuming run-off premium is three times annual premium for six years of run-off cover, then two months of this cover would be 8.3% of annual premium. We suggest that this is an appropriate figure to charge for the Cessation Period. We would also expect this premium to be cheaper if run-off premium was set at less than three times in MTC policy.
51. Similar to our recommendations above, we consider that the SRA should only impose a cap on the maximum percentage that insurers can charge for EIP and the Cessation Period. This will provide an opportunity for innovative insurers to engage in price-based competition and ensure that there is minimal (albeit necessary) regulatory interference.

Consumer transparency re: EIP and run-off costs

52. As a minimum, if the SRA does not adopt our proposals above and decides not to regulate the cost of EIP contrary to its position in its Policy Statement, then we consider that it should require insurers to insert a 'consumer notice' alerting solicitors to the cost of the EIP on quotations and in MTC policy documentation. The Society supports the inclusion of measures that require insurers to be transparent about the cost of EIP and is disappointed that this requirement, at least, was not included in the SRA's current consultation document.

53. We also recommend that the SRA adopts a similar approach to the Law Society of Ireland to increase transparency of run-off costs. The Irish Law Society's minimum terms and conditions requires all policies, proposal forms, renewal notices and quotes for cover provided to solicitors to display with prominence and in clearly legible script, size and typeface the following statement:

NOTICE TO PROPOSERS FOR INSURANCE: YOU SHOULD BE AWARE THAT BY ACCEPTING A QUOTATION AND TAKING OUT A POLICY, THIS INSURER BECOMES OBLIGED:

(A) SHOULD YOUR PRACTICE CEASE DURING THIS POLICY YEAR WITHOUT A SUCCEEDING PRACTICE; OR

(B) SHOULD YOUR PRACTICE CEASE DURING THIS POLICY YEAR WITH A SUCCEEDING PRACTICE WHERE SUCH SUCCEEDING PRACTICE HAS INSURANCE IN PLACE AND AN ELECTION IS MADE TO OBTAIN RUN-OFF COVER IN RESPECT OF YOUR CEASING PRACTICE

TO PROVIDE RUN-OFF COVER FOR A TWO-YEAR PERIOD AT THE PREMIUM RATES CALCULATED IN ACCORDANCE WITH THE PROVISIONS OF THIS POLICY. CONSEQUENTLY, YOU SHOULD ENSURE THAT THE RUN-OFF PREMIUM TERMS ARE SATISFACTORY TO YOU BEFORE ENTERING INTO A POLICY.

Solicitors' profession contribution to the ARP in respect of 2012 indemnity year liabilities

ARP funding in 2012/13 to be shared between the profession and QIs. SRA to levy the profession if necessary.¹⁴

54. As stated in its public response to the SRA's Policy Statement, the Law Society supports sharing of the potential £30m liability for the 2012 ARP subject to the SRA being transparent about its ARP management strategy and being open to suggestions about how to better control and manage the ARP. We consider it appropriate that the Society should be able to attend Liaison Committee meetings given its share of liability and we also request the same rights as qualifying insurers to appoint a representative to attend meeting with Capita's claims managers.

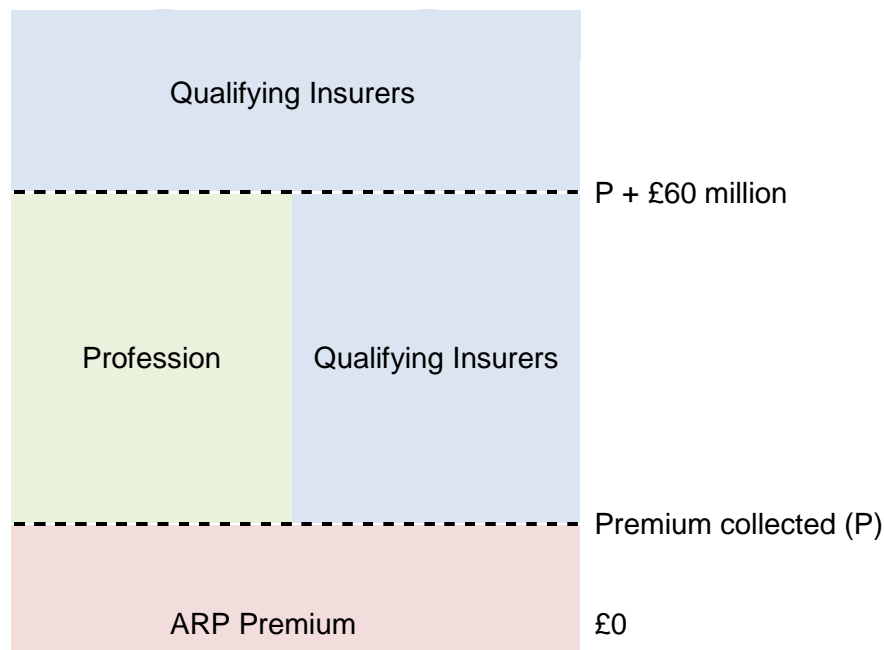
55. This agreement was reached in the context of large number of firms in the ARP and claims at the high point reaching over £50m. The current number of firms in the 2011-12 ARP is significantly less than in previous years. This has led the Society to reassess the most appropriate way to *structure* the profession's contribution, without altering the level of our commitment. We consider that we

¹⁴ Para 2.8-2.10 of SRA consultation paper.

have agreed to share liability with insurers, not assume the whole of the liability ourselves.

56. In terms of the way the 2012 ARP liability is shared, the Society considers that instead of the layered approach, a more equitable funding arrangement would be to share the first £60m of liability on a 50:50 basis between qualifying insurers and the profession. Liability above £60m would fall solely to insurers, as per the SRA's current approach. Our proposal does not change the amount of liability (£30m) that the profession has agreed to undertake, it simply restructures the way that it is shared. This will ensure that, in the event that claims development is not as severe as £10m, the profession does not bear the entire burden but that the liability remains shared between insurers and the profession in accordance with the 'spirit' of the SRA's Policy Statement.
57. We consider this alternative to be more equitable across a range of potential claims development scenarios. It ensures that insurers have 'skin in the game' from the beginning of the 2012 ARP and will have a greater incentive to oversee claims management by the ARP. An equal distribution of liability across the period also removes our concern about the non-equal apportionment of management costs that exists under the SRA's current draft amendments.¹⁵

Alternative proposal for sharing 2012 ARP liability



58. We also note that the SRA is in ongoing discussions with the Society about the best mechanism for delivering the funds required for the Profession's

¹⁵ 'Profession's Contribution' is defined in clause 1.2 which refers to 'ARP Liability' which includes all of the QIs' liability to pay claims and meet management costs (under clause 6). Because the profession is liable for the first £10 million of this amount, then it is possible that the management costs will not be evenly distributed throughout the entire period.

Contribution and we support the inclusion of clause 1.2 of Schedule 1 of the QIA and the inclusion of rule 13 in the SIIR to ensure that the SRA has the requisite power to levy the profession for this purpose if required. We look forward to engaging in further discussions with the SRA about these arrangements.

ARP Policy cut-off and run-off cover

ARP closed to new entry by October 2013 – no extensions; except for continued provision of run-off cover incepted before 30 September 2013.

59. The Law Society supports the closure of ARP as an insurer of last resort and the continuation of its run-off cover for firms that ceased to practise in the ARP before 30 September 2013. In our initial extended reporting period proposal, we suggested that the ARP would have to be run-off and maintained (in some form) to continue in its role of providing cover for uninsured firms (i.e. 'the Motor Insurer's Bureau role'), despite being closed to new entry. As such, we do not consider it necessary to close the ARP to non-applied firms and do not support the SRA's proposed transfer of this risk onto the Compensation Fund for the reasons outlined in Q4.
60. Furthermore, the SRA amendments do not clearly state who will be providing run-off cover for future indemnity years.¹⁶ We seek clarification from the SRA that it is the QIs who were participating in the market in the indemnity year that the ARP Run-off Policy *first* incepted i.e. when the firm ceased to practise that must provide the full six years of run-off cover. This will ensure that any run-off cover relating to past ARP years is met by the relevant QIs and not the profession. The Law Society considers that the profession's commitment to partially fund the final ARP year only extends to providing run-off cover to those ARP firms that ceased to practise in the 2012/13 indemnity year.

¹⁶ There is a potential anomaly arising from the drafting of clause 7.3 of Schedule 1 of the QIA (ARP Policy) that states that 'each ARP Run-off Policy shall expire at the end of an Indemnity Period irrespective of the date on which it is written or incepts'. See discussion below.

Comments on Rule 12.6 of the SIIR

61. The amendments to rule 12.6 of the SIIR removes the power of the SRA to grant a waiver to provide an extension of time to firms in the ARP past 30 September 2013, except to allow them to enter into an ARP Run-off Policy. We agree with the SRA's proposal that there should be no waivers to extend the time spent in the 2012-13 ARP. The SRA should also consider a consequential amendment to the commentary of Rule 19 of the SIIR which deals with the general waiver powers of Council to mirror this inability to waive this aspect of the SIIR.
62. We also expect the SRA to continue its strict ARP enforcement strategy and engage in effective management of ARP firms to ensure that all firms from the 2011-12 ARP enter into run-off within the 2011-12 indemnity year and do not permit any waivers to extend time in a way that would mean run-off cover incepts within the 2012-13 indemnity year.

Run-off cover

63. The SRA proposes the following amendments to the run-off requirements. Firstly, the SRA's amendments allow the scope of run-off cover to be limited to reflect the type of work that can be legitimately conducted within the Cessation Period.¹⁷ We consider that it would be more consistent for insurers to remain liable for all work performed during the Cessation Period (even if breach of rule 5.3 – see above)¹⁸ and therefore do not consider this amendment to the scope of run-off cover necessary.
64. Secondly, the SRA gives run-off cover retroactive effect from the commencement of the EIP.¹⁹ We disagree with this approach and note that it is easier and more in line with current insurance principles for run-off cover to commence when a firm ceases to practise. Our view is that six years run-off cover should commence when a firm ceases to practise or at the end of the Cessation Period (whichever is earlier).
65. The effect of the SRA's proposal essentially reduces the mandatory six years run-off protection under the MTC by up to 90 days. Because some work can still be performed within the 90 days, the mandatory run-off cover is no longer aligned with the six year limitation period for torts. The Law Society considers this to be unsatisfactory as it transfers this risk from insurers to the profession's collective provision of supplementary run-off cover.²⁰ We consider that the SRA should not permit a deterioration of the mandatory level of run-off cover. We note that no change to the length of cover was recommended by Charles Rivers Associates (CRA) as part of the first stage consultation.²¹ This supports the Society's view that six years run-off cover should commence when a firm ceases to practise or at the end of the Cessation Period (whichever is earlier).

¹⁷ Draft clause 5.5 of the MTC.

¹⁸ In accordance with the better regulation principles in s. 3(3)(a) of the LSA.

¹⁹ Draft clause 5.4 of the MTC.

²⁰ That is, run-off cover provided by SIF after the mandatory six years of cover in the MTC expires. The rationale for the profession providing this cover is to provide 'peace of mind' for solicitors who have retired.

²¹ CRA report at p. 154.

66. The retroactive provision of run-off cover may have other unintended consequences as, in accordance with common insurance principles, firms have not been allowed to practise during run-off. As such, the SRA may want to consider including an express provision in clause 5.5.1 stating that the scope of run-off cover includes work performed in the EIP and/or Cessation Period. We recognise however that the SRA may not consider this to be necessary because of clause 5.5.1 states that run-off cover must be provided 'in accordance with the MTC' which extends the period of insurance for up to 90 days and it has stated that run-off cover will be retroactive.

Compensation Fund for non-applied firms and scope of cover

67. See drafting comments and Q4 below.

Q3. Do you have any comments on the changes proposed to the SRA Authorisation Rules?

Authorisation rules amended to reflect the 90 day extension

68. The Law Society supports, in principle, the amendment of the Authorisation Rules to allow the SRA to withdraw the authorisation and intervene into a firm that has reached the end of its Cessation Period. We consider that the EIP policy requires swift effective action by the regulator in order to succeed. However, we are concerned that the SRA's proposed amendments to the Authorisation Rules are not the most efficient and transparent mechanism to achieve this outcome.
69. While we support the SRA's current enforcement strategy that does not seek to intervene in a firm unless it is necessary because their lack of cooperation in an orderly wind-down process, we do consider that the SRA needs to ensure that it has sufficient grounds for intervention if a firm does not comply with its obligation to cease to practise at the end of the Cessation Period. One of the grounds for intervention under Schedule 1 of the *Solicitors Act 1974* is that the SRA is satisfied that a solicitor has failed to comply with the SIIR (para 1(1)(c)). Another potential ground for intervention is if it is necessary to intervene to protect clients (including former and potential clients) (para 1(1)(m)). We consider that latter provision is now relevant given that the SRA's proposals reduce the scope of cover afforded to clients during the Cessation Period and remove (and ostensibly reduce the scope of) the client protection afforded by the ARP side-policy for non-applied firms. Therefore, we suggest that the SRA ensures that its amendments are sufficient to trigger these provisions and provide grounds for intervention if it considers this additional step to be necessary. We consider that the current drafting should be made clearer to ensure that the SRA can avail itself of this option.
70. The obligation to cease to practise is placed on the *firm* under draft rule 4.2 of the SIIR. This can be contrasted with the obligation to cease taking on new instructions in the Cessation Period under draft rule 5.3 of the SIIR which applies to both the *firm* and any *principal* of such a firm. In order to have the ability to exercise this ground for intervention under the *Solicitors Act* in the event that a

firm fails to cease to practise at the end of the Cessation Period, we recommend that rule 4.2 be extended to apply also to 'any person who is a principal of such a firm'.

71. We also consider that, instead of the SRA's proposed amendments to the Authorisation Rules, which appear to rely on indirect methods of revoking authorisation, there is scope for the SRA to adopt a simpler and more transparent mechanism. The revocation of an authorisation should be automatic on a firm reaching the end of the Cessation Period without either ceasing to practise or obtaining qualifying insurance.
72. The SRA amendments make it a condition of authorisation that when an authorised body enters into the cessation period they must 'desist from carrying out any legal activities' except in connection with existing instructions (draft rule 8.11). The SRA's consultation paper suggests that its amendment to include rule 8.11 in the Authorisation Rules will 'essentially require a firm to cease its legal practice after the 30 day EIP' as it will no longer be able to carry out legal activities except in relation to existing instructions. We disagree with the SRA's assessment of the effect of this drafting. The obligation on a firm to actually cease to practise at the end of the cessation period is provided for in rule 4.2 of the draft SIIR 2012 (not the draft rule 8.11). Therefore, it seems anomalous that the SRA has not included a reference to rule 4.2 in the Authorisation Rules, given its stated intention. We consider that the simplest way to achieve this, is to include a provision to allow automatic revocation of the authorisation (i.e. amend rule 21.3) in situations where rule 4.2 of the SIIR is breached.
73. We consider that the SRA's proposed amendments, particularly the reliance in its consultation paper on rule 21.3(iii) and rule 22.1(a) for enforcement, do not adequately achieve this objective or provide a clear way for the SRA to act quickly in the event that a firm has not ceased to practise. Any reliance on rule 22.1 requires adherence to the 28 day process set out in rule 22.2. We consider that this is not necessary in the context of the EIP/Cessation Period as the firm has already been put on notice about the possibility of closure and will be aware of the potential consequences if they continue to practise.
74. We assume that the SRA is not concerned about any additional requirements for natural justice in this period because its consultation paper expressly refers to rule 21.3(c) which is an automatic revocation provision that states an authorisation ceases to have effect 'if the body is wound up or for any other reason ceases to exist'. However, contrary to the SRA's intention, we do not consider that this provision will apply in the case of the EIP/Cessation Period. It is doubtful that a legal entity i.e. the body 'ceases to exist' simply because it can no longer continue an aspect of its legal practice.²² Therefore, we do not consider the SRA's current amendments to be sufficient to allow for automatic withdrawal of authorisation and consequently have proposed a more straight-forward mechanism above. Nor do we believe that there is a natural justice issue, as it can be made clear to firms at the start of the cessation period that authorisation will be automatically revoked where they continue to practise at the end of this

²² Indeed, the concept of the cessation period is predicated on the fact that the relevant firm 'has not ceased practice' (see definition in Appendix 4 of draft SIIR). Even the obligation to cease to practise under rule 4.2 of the SIIR is not caught by this as the body itself would still exist even though it must cease to practice 'promptly'.

period. We envisage that as part of this process, the SRA will also inform firms that enter into the EIP/Cessation Period about the possibility that they may be liable for intervention costs if they fail to cooperate with the SRA and comply with the requirement to orderly wind-down their practice.

75. If the SRA does continue with its current proposal to make rule 8.11 a condition on a firm's authorisation, then we recommend that it clarify what it considers to be the consequence of a breach of this condition i.e. include an express amendment to permit the SRA to revoke a body's authorisation if 'it is satisfied that a condition imposed on the body's authorisation under rule 8.11 has not been, or is not being complied with'. Express inclusion of rule 8.11 from rule 22 is consistent with current drafting which specifically refers to other conditions such as rule 8.5 and 8.6. This makes it clear that the SRA can revoke an authorisation if a body continues to practise during the cessation period otherwise than under the 'existing instructions' exception. We note that this provision may not often be used as rule 22 is subject to a 28 day notice period and given that the cessation period only runs for 60 days it will be difficult for the SRA to use this mechanism to withdraw authorisation. The SRA would have to be aware that the body was taking on new instructions fairly early in the cessation period for this ground to be triggered. However, as outlined above, the Society prefers a more transparent and direct mechanism of automatic revocation if a firm has ceased to practise or obtain qualifying insurance at the end of the cessation period. We recommend that the SRA ensuring that there are clear grounds for intervention, even though we support the SRA continuing to exercise its discretion to intervene only when necessary.

Suggested consequential amendments

76. We would also recommend including reference to the automatic revocation of an authorisation and the SRA's potential grounds for intervention in the commentary following Rule 4.4 of the SIIR where the SRA states that it 'will work with the firm to ensure that it has ceased to practice prior to the expiration of the 60 day period'. This would assist to provide firms with transparency about the SRA's intended enforcement strategy. As previously stated, a rigorous enforcement strategy is required by the SRA to avoid increasing the number of non-applied firms and the subsequent exposure of the Compensation Fund.

Q4. Do you have any comments on the changes proposed to the SRA Compensation Fund Rules?

77. We consider that the SRA's objectives to limit the scope of non-applied firms can be met by retaining the side policy and current Rule 14 without transferring this role to the Compensation Fund. We would support the SRA making amendments to limit the scope of the existing side policy that QIs provide to non-applied firms in Schedule 8 and give the ARP Manager more discretion to avoid claims in particular circumstances.
78. In terms of the continued administration of this role, the SRA could simply consider the most appropriate body to be appointed as ARP Manager. As such,

we recommend amending, not deleting these provisions and maintaining the role of non-applied firms within the arrangements provided by the ARP Manager with the suggested amendments to the scope of cover detailed below.

Transferring the role of the ARP in 2012/13 for making payments for uninsured firms to the Compensation Fund.

79. In our response to the SRA's first stage consultation, we stated that if the ARP's role was changed, it would not be appropriate to combine this role with the Compensation Fund. We consider that the ARP and the Compensation Fund have separate and distinct roles that should be maintained. Unlike the ARP, the Compensation Fund is not designed or equipped to provide general insurance; rather the Fund provides a discretionary remedy to protect consumers in the event of a solicitor's dishonesty or failure to account for money where such risk cannot be covered by insurance. As such, the Fund may not have sufficient expertise to assess whether a claim arises from a 'negligent act or omission', notwithstanding the SRA's assertion that it will have the discretion to require an applicant to pursue a civil remedy to establish negligence before being obliged to pay.²³ The Law Society considers that it is more appropriate for this assessment to be made by the ARP Manager, which is used to and better equipped to assess and handle these types of claims.
80. The SRA has attached draft Compensation Rules to give effect to the changes in its Policy Statement. In its Policy Statement, the SRA considered that after removing the role of ARP as insurer of last resort, the remaining ongoing role would be cover for non-applied firms and therefore, it expressed an intention to transfer responsibility for these arrangements onto the Compensation Fund from the 2012/13 indemnity year. The SRA provides the following reasons for this transfer:
- a) The scope of cover for non-applied firms is currently too broad;
 - b) This role is more suited to compensation than insurance; and
 - c) This role is disproportionate to maintaining the resource and infrastructure required to manage the ARP.
81. We consider each of these arguments in detail below. The Law Society considers that the ARP could be maintained in this limited form in order to continue to provide this cover and, as such, we do not support the SRA's proposed changes to the CF Rules for the following reasons:
- a) If the SRA wishes to make payments of claims arising from non-applied firms more discretionary,²⁴ there is scope within the current arrangements to give this discretion to the ARP Manager. We agree that it may be desirable to have greater discretion surrounding payment of non-applied

²³ Paragraph 4.10 of the SRA's consultation paper.

²⁴ The SRA's Policy Statement at 51 states 'at present claims are paid in respect of authorised firms that have not taken out insurance and non-authorised firms purporting to be firms of solicitors. Given this, it is not apparent that all claims should automatically be paid as against the MTC provisions and it is possible that a discretionary system, as applying in the Compensation Fund might be more appropriate.'

firms' claims. However, we disagree that this can only be achieved via transfer to the Compensation Fund. The SRA has a broad discretion to amend this cover already as rule 14 of the SIIR states that "the ARP Manager on behalf of the Society shall make arrangements with qualifying insurers" regarding claims from non-applied firms. There is no requirement that the 'arrangements' need to mirror the MTC provisions. Consequently, we consider there is scope for payments to non-applied firms to be more discretionary and for the SRA tightening the scope of cover as it foreshadowed in its Policy Statement (see suggested amendments under scope of cover below) without transferring this role to the Compensation Fund.

- b) We consider that the SRA's proposed drafting *expands* rather than limits the scope of non-applied firms to make claims on the Fund by:
 - (a) not limiting claims to those that arise *from private legal practice or legal work*;
 - (b) using different wording in the exclusions and scope of work covered in the MTC;
 - (c) not mirroring permitted MTC exclusions in the CF Rules; and
 - (d) including a firm that 'should be authorised but is not' i.e. defaulting licensed and recognised bodies.

As such, we question whether the SRA's drafting supports its intention to limit the scope of this cover. We also require clarification from the SRA that its statement that the non-applied firms' role covers 'non-authorised firms purporting to be firms of solicitors'²⁵ does not extend to sham 'firms' established by fraudsters that would never be eligible for authorisation by the SRA.

- c) The Law Society disagrees with the SRA's submission that this role is more suited to compensation than insurance. This role should remain funded by insurers and not be placed on the profession by transferring it to the Compensation Fund. The non-applied firms' role is akin to the Motor Insurer's Bureau (MIB), which makes payments for claims caused by negligent uninsured drivers. The MIB is funded by insurers *not* drivers. If a company wishes to start underwriting compulsory motor insurance in the United Kingdom, it is obliged by virtue of the *Road Traffic Act 1988*, to be a member of MIB and to contribute to its funding. Therefore, applying this analogy to solicitors' PII, this role should remain funded by insurers and not be placed on the Compensation Fund.

The nature of the Compensation Fund also needs to be considered. It is a discretionary fund and currently will only make grants in limited circumstances, that is, dishonesty or failure to account. It is not appropriate to extend this role to negligent acts or omissions. The CRA report²⁶ undertook an analysis of the various compensation schemes operating across professions in the United Kingdom. This overview

²⁵ SRA, Policy Statement, paragraph 35.

²⁶ Appendix A, p. 164 of the CRA report.

supports the Law Society's view that it is unusual for Compensation Fund schemes to include cover for negligence.²⁷

We recognise that maintaining the status quo will require ongoing contributions from QIs. However, we do not consider this to be an onerous requirement of the QIA. This role traditionally costs around £1-2 million, which would not cause any market repercussions; in contrast to the level of funding required to provide the insurer of last resort role. Indeed, if the SRA takes genuine steps to limit the scope of non-applied firms cover (in accordance with its stated policy aim) then this will further reduce QIs' potential liability.

- d) We agree that there may be more efficient management arrangements than maintaining the current ARP management structure to only cover future claims arising from non-applied firms. However, the ARP will have to continue in some form for at least six years and, as it is appropriate that this role rests with insurers, we recommend that the SRA consider other mechanisms that are better equipped to provide this cover than the Compensation Fund. In any event, we do not recommend that the SRA make any change to Compensation Fund structure until it has conducted a comprehensive review of the current arrangements. Part of this review could include consideration of the creation of a single entity to manage and administer the distinct roles identified below (see ARP Manager section).
- e) Another reason provided in the SRA's Policy Statement²⁸ justifying the need to remove QIs' current pooled arrangements is that it would 'remove a current incentive on insurers to constrain or manage their market share'. We consider that the SRA has already successfully removed this incentive with its 2011 amendments to the market share calculation.
- f) The SRA has flagged a comprehensive review of the Compensation Fund prior to the 2012/13 indemnity year²⁹ and we consider that until this review is complete that it is not appropriate to place any additional roles onto the Fund.

Scope of cover

1. Claims are not limited to acts arising from private legal practice or legal work.

82. The SRA considers that it has limited the scope of cover that is currently available to non-applied firms because in addition to allowing claims for dishonesty and failure to account, its amendments to rule 3 of the CF Rules specify 'loss due to a negligent act or omission' rather than the broader 'civil liability arising from private legal practice' currently used in MTC (clause 1.1).

²⁷ According to CRA's overview, only the Council for Licensed Conveyancers' Compensation Fund Rules permits claims for fraud *and* negligence where clients are unable to obtain redress elsewhere.

²⁸ At paragraph 52.

²⁹ SRA April Policy Statement at paragraph 37.

83. While it may have been the SRA's intention to limit the scope of cover, there may be an unintended consequence arising from the drafting that actually expands the scope because the CF Rules do not link the scope of cover to liability 'arising from private legal practice' or 'legal work'. As such, while it may have narrowed the scope by referring to 'negligent act or omission' instead of 'civil liability' used in the MTC, the SRA amendments expand the scope of the negligent acts covered by the Fund.
84. Similarly, the use of 'in connection with the insured firm's practice' (clause 1.1 of MTC) is not mirrored in the amendments to rule 3 in the CF Rules. Given that the subject matter is non-applied firms, it may be incorrect to apply the phrase 'insured firm's practice' but nonetheless removing the reference to 'in connection with a practice' potentially broadens the scope to solicitors who are on a frolic of their own outside of any 'practice' to which they purport to belong.³⁰

2. Difference in wording used in the exclusions in the MTC and scope of work covered in the MTC

85. Amendments to clause 6.11 which allow exclusion of new instructions in the cessation period from the scope of MTC cover only permit exclusion of "civil liability for *any legal activity*". This may cause two potential 'gaps' in cover given that the MTC applies to 'civil liability *arising from private legal practice* in connection with the insured firm's practice' (clause 1.1).
86. Firstly, there is a gap due to mismatched definitions of private legal practice and legal activities (outlined above). This also has consequential effects on the ability of clients to obtain redress i.e. under the MTC policy or via the discretionary Compensation Fund. Clients will not necessarily make this distinction between instructions or legal work. It will also result in increased disputes between insurers and the Fund.
87. Secondly, there is an uninsured loss in the gap between 'civil liability' and 'negligence' that the SRA is obviously prepared to accept given its limited statutory powers to make compensation arrangements³¹ and its stated intention to limit the exposure from non-applied firms. However, the mismatch of definition may result in the blurring of the boundary between the MTC and Compensation Fund, another reason why we do not support the transfer of this role.
88. Paragraph 4.7 of the SRA's consultation paper states that 'no grant will be payable for claims that will be covered by the extended cover arrangements: namely, in relation to all work undertaken in the extended indemnity period, or permitted work (on existing instructions in accordance with rule 5.3) undertaken in the cessation period.' The corollary of this is that the SRA *may* allow grants from the fund to cover 'new' work performed in breach of cessation period requirements.
89. We do not agree with this approach. Even though the SRA has the discretion to refuse grants under the CF Rules, there is an increased potential for disputes

³⁰ This may give rise to further disputes, similar to *Zurich v Barnes* [2010] EWHC 3300.

³¹ Section 21, *Legal Services Act 2007*.

over whether work was conducted in connection to existing instructions or not between insurers and the Fund. A simpler solution is outlined in Q2, that is, the MTC should continue to provide cover for all claims arising from work during this period irrespective of whether or not the work was performed in breach of rule 5.3. This will protect the Compensation Fund from disputes with insurers and requests for grants in this situation.

3. Permitted MTC exclusions are not mirrored in the Compensation Fund

90. The SRA states that it will provide guidance about any relevant exclusions that applied to the ARP policy (e.g. claims for death / bodily injury) as well as criteria to ensure that where a claim on an insurance policy may be made, that this is pursued.³² We consider this further guidance is essential and would welcome the SRA clarifying this as part of this consultation, otherwise, there is the potential for industry uncertainty and an increased Compensation Fund exposure.
91. The amendments make clear that Fund grants may only be made in circumstances where 'the loss is not covered by a policy of qualifying insurance'.³³ However, the scope of amendments do not mirror the MTC exclusions which exclude cover for negligent acts that are not connected with legal work or private legal practice.³⁴ The current drafting of the CF Rules is too broad because it does not link the negligent act or omission to liability arising from legal practice or legal activities. This effectively expands the potential for claims that arise outside the MTC as they currently stand. Therefore, it is important for the Compensation Fund to mirror the exclusions if the SRA wants to meet its objective of limiting the scope of non-applied firm's coverage.

4. Compensation Fund amendments apply to a firm that 'should be authorised but is not' i.e. defaulting licensed and recognised bodies.

92. The current scope of the side policy for non-applied firms is limited by the use of the word 'firm' which includes:
- (a) recognised bodies
 - (b) sole practitioners (except those who are a non-SRA firm)
 - (c) partnerships that is eligible to become a recognised body (except those who are a non-SRA firm), or
 - (d) any licensed body.

³² At paragraph 4.9 of the consultation paper.

³³ Draft rules 3.1 and 3.6 of the CF Rules.

³⁴ A number of the current MTC exceptions have the potential for negligent acts to arise but exclude acts that do not relate to the performance of 'legal work'. See MTC 6.2 (liability for death or bodily injury), 6.3 (property damage), 6.9 (directors' or officers' liability) and 6.10 (war, terrorism and asbestos), which provide 'except that the insurance must nonetheless cover liability for such damage, destruction or loss which arises from breach of duty in the performance of (or failure to perform) legal work'. Clause 6.10 also refers to the 'failure to discharge or fulfil any duty incidental to the insured firm's practice or to the conduct of private legal practice' which is not mirrored in the CF wording. For the sake of completion, we note that negligent acts also have the potential to arise under 6.1 prior cover but this is excluded from the CF because SIF is listed as a 'policy of insurance'.

93. Unlike limbs (a) and (d), the definition of sole practitioners in (b) is not limited to 'recognised sole practitioners' and the definition of partnerships in (c) above is limited to those 'eligible' partnerships but who have not necessarily become a 'recognised body'. As such, the current non-applied firms' policy covers those sole practitioners or partnerships that were eligible to be recognised by the SRA but did not become recognised. This broad wording is not replicated in the definition of recognised or licensed bodies, as such the current non-applied firms' policy does not cover defaulting recognised bodies or defaulting licensed bodies.
94. This can be contrasted with the draft rule 3.7 of the CF Rules which provides that a grant may be made where a firm *should be authorised but is not*, whether or not they have taken out qualifying insurance. This is expressly stated to apply to defaulting recognised bodies and defaulting licensed bodies 'who were eligible to become a recognised body or a licensed body respectively, but had not been authorised by the SRA'. Therefore, the SRA has expanded the scope of the cover rather than reduced it in its draft CF Rules. This is contrary to its stated policy.³⁵
95. The Law Society does not support the expansion of the scope of non-applied firms. Indeed, it is our view that the SRA (in keeping with its intention to reduce the scope of cover) should look to limit the scope of the existing non-applied firms cover to those firms that *the SRA* holds out as being authorised firms (as opposed to those firms that hold themselves out to be authorised). We do not consider it is necessary for the non-applied firms' cover to extend to those firms who have not made any attempt to be recognised or licensed by the SRA. Therefore, we do not consider it necessary to include those who would be *eligible* to be recognised or authorised but are not. This approach would also remove the current inconsistent treatment between sole practitioners/partnerships and other types of legal practice that currently exists in the definition of firm and would fulfil the SRA's stated policy intention to reduce the scope of cover.³⁶
96. For the sake of completeness, we have also considered the other potential way to reduce the scope of cover outlined in the SRA's policy statement, which considers that a sophisticated user of legal services should be able to undertake a cursory check to establish whether a 'firm' is authorised by the SRA and/or insured. The SRA has not, however, included any amendments to reflect this in its current consultation paper.
97. The Law Society does not consider it appropriate to exclude 'sophisticated clients' as it is difficult to define what is meant by this concept.³⁷ Rather we consider that the scope of cover should be limited to those firms that the SRA holds out as authorised firms. We consider that the SRA's publication of firm data should act as a definitive record of authorised bodies, particularly given its

³⁵ SRA, Policy Statement, at paragraph 36.

³⁶ SRA, Policy Statement, at paragraph 36.

³⁷ For further reasoning on this point, we refer to the Law Society's submission to the first stage of consultation on client financial protection arrangements in response to the proposed exclusion of 'sophisticated clients' from the MTC.

commitment to publicise the insurer of all law firms³⁸ and our recommendation that the SRA publish firms who enter into the Cessation Period. The availability of this information in an accessible format (e.g. on SRA's website) will assist clients and other solicitors to undertake these checks. We would support the SRA/ARP Manager exercising its discretion to exclude claims from clients that failed to take adequate steps to protect themselves by ascertaining whether a firm was listed as authorised on the SRA's website.

Conclusion on scope of cover

98. We agree, in principle, that the scope of potential exposure for non-applied firms should be limited, particularly if the SRA maintains its current intention to transfer this role to the Compensation Fund. In which case, the policy objective to limit the scope of non-applied firms' cover is consistent with the SRA's role of 'protecting' the Compensation Fund.³⁹ We consider that a limited fund established through contributions from members of the profession needs to take active steps to protect itself from claims.
99. The Law Society does not agree that the SRA's policy objective must be achieved by transferring non-applied firms to the Compensation Fund. We consider that the scope of the current provisions for non-applied firms can be limited while continuing the pooled arrangements for the provision of this cover by insurers.
100. In any event, we urge the SRA to consider the potential unintended consequences of its drafting that have expanded rather than limited the scope of this cover. We have suggested ways that the SRA should fulfil its policy intention and limit the scope of cover provided to non-applied firms.

ARP Manager

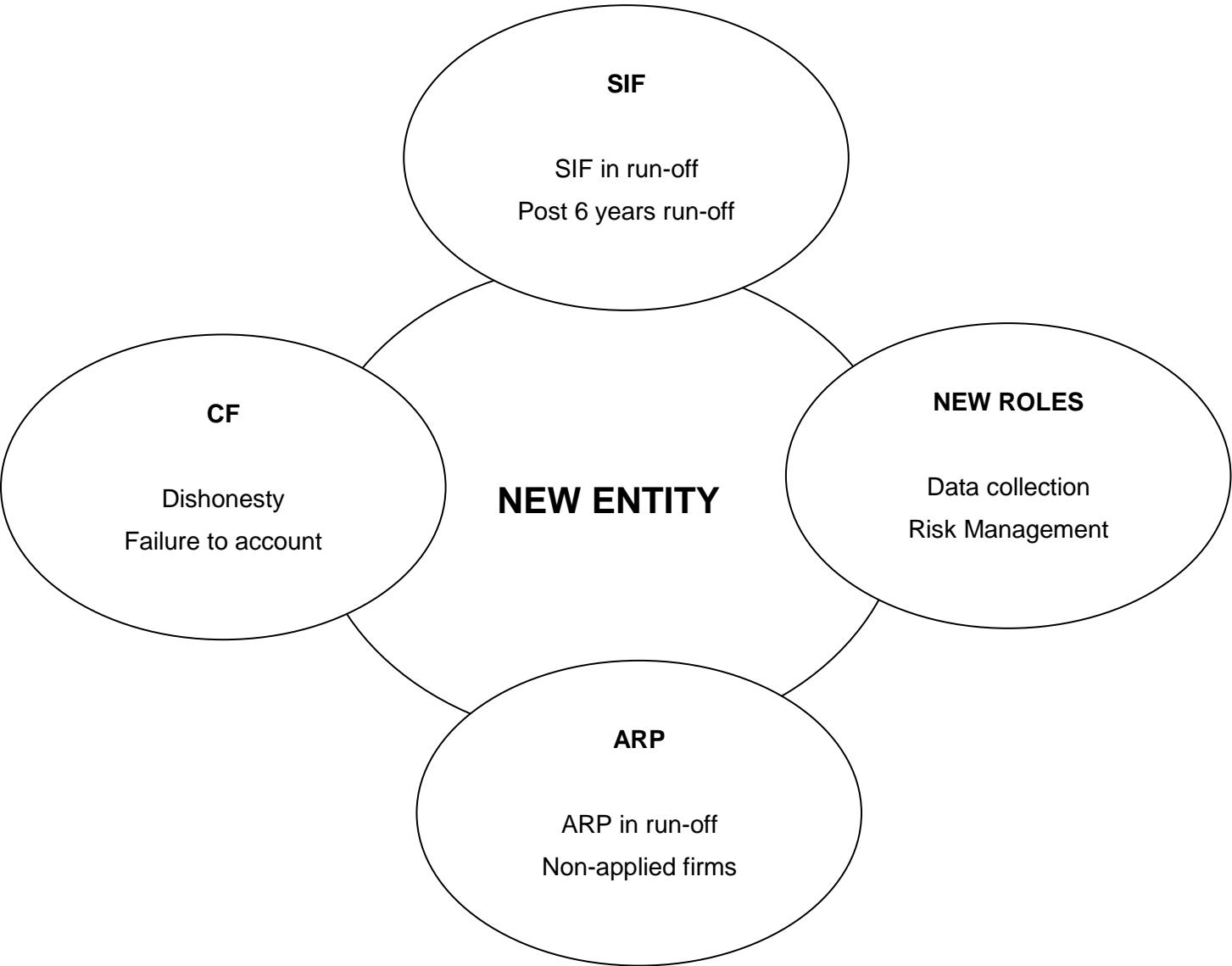
101. We understand that the SRA is looking to create efficiencies by transferring the only ongoing ARP role after it ceases to be an insurer of last resort (i.e. non-applied firms) to the Compensation Fund. While we wish to encourage efficient ARP management, we do not consider the Fund to be the best equipped mechanism to deal with claims caused by non-applied firms as it lacks the expertise of dealing with negligence claims outlined above. The Compensation Fund is already experiencing delays in administering claims and giving it additional roles without addressing systemic management issues will only exacerbate these problems. We recommend that no change is made to the Compensation Fund structure until the SRA undertakes a comprehensive review of its administration and management.
102. As part of this review, the SRA could consider whether efficiencies could be gained through the creation of a single management entity to administer the various ongoing roles that reside in Solicitors Indemnity Fund (SIF), the ARP Manager and the Compensation Fund as outlined in the diagram below. We consider that there are efficiencies to be gained in combining the administration

³⁸ From 2011/12, SRA, Policy Statement, at paragraph 40

³⁹ Section 36A(9)(c) of the *Solicitors Act 1974*. See also sections 36 and 36A of the *Solicitors Act 1974*.

and management of these roles without the need to alter the way the funding and liability arrangements are currently structured.

Potential efficient management structure



103. The Law Society and others have raised concerns about management of the ARP and the Compensation Fund in the past. If the SRA was not minded to continue with the current ARP management arrangements (given that Capita will have no ongoing role in the market after ARP run-off claims) then it could consider appointing a new ARP Manager, an entity that will have continued presence in the market. Similarly, after reviewing the current Compensation Fund arrangements, the SRA may form the view that it should outsource the management of the Fund. We also consider that there are also potential efficiencies in combining the claims handling role of SIF with the claims handling role of the ARP Manager, given that both of these entities are dealing with insurance vehicles in run-off. As outlined above, we consider that the administration and management of the non-applied firm role is better placed in an entity with requisite insurance experience and skills.
104. If a separate entity is created or these roles are transferred to an existing entity, such as SIF, provided it is given additional resources to manage these additional roles, then the SRA may also want to consider further additional roles that may support its regulatory functions. In our response to the first consultation, the Society raised the possibility of establishing an industry-wide source of information to address the information asymmetry that exists in the solicitors' PII market. Since moving from SIF to an open market system, there has been no single source of management information (MI) that can be used to analyse industry trends in terms of premium levels, risk areas and claims development. While individual QIs will have their own sets of MI, the profession is unable to access this information resulting in market failure.
105. The SRA has the power to request information from QIs that can be centrally-controlled by an outsourced provider which could aggregate this information to protect commercial confidentiality. We understand that the SRA is currently redesigning its computer systems and examining information collection as part of the development of its Risk Assessment and Designation Centre. The SRA already collects a large amount of information that would enable the creation of this source of information (e.g. practice and principal data, policy and premium data, disciplinary data) and it could supplement this information by also requesting up-to-date claims data and summaries from the qualifying insurers or, indeed, directly from the insured. We believe industry-wide MI would greatly assist the SRA to achieve its regulatory objectives. There are risk management benefits that could be considered by the SRA flowing from this industry-wide source of information. A deep understanding of the causes of claims is in the interests of the SRA as a risk-based regulator. It could also increase transparency within the solicitors' PII market and create efficiencies as currently there is no central depository of claims summaries that are required for submission each renewal. This role could be outsourced to a separate management entity as outlined above.
106. Until it has consulted on these proposals further, we consider that it is appropriate for the SRA to delay any decision to move the non-applied firm role from the ARP Manager with the view to reach a comprehensive solution to the management of the current PII regime. Under the SRA's current proposals, the ARP will still continue in some form for at least six years in order to fulfil its run-off obligations. Arguably, the non-applied firm role could remain with the ARP until it is completely wound-down or until a more efficient entity for managing this role has been established.

Proposed changes not included in the April 2011 Policy Statement

Q5. Do you have any comments the proposal to require QIs to disclose their credit ratings?

Credit ratings of qualifying insurers

107. The SRA proposes to require insurers to disclose any credit or financial strength rating and the identity of the rating agency. The Law Society supports the SRA's attempts to increase transparency and reduce the information asymmetry within the market.

108. We agree with the SRA that holding a particular rating should not be a mandatory requirement to enter the market at this stage.⁴⁰ It is not appropriate for SRA to impose additional barrier to entry or seek to regulate insurers beyond the requirements imposed by the Financial Services Authority (FSA). However, the SRA should make its position clear as currently there exists a perception within the profession that the SRA 'does more' and to some degree vets or approves qualifying insurers. Solvency II may also assist in addressing solvency concerns and render additional regulation by the SRA unnecessary.

109. However, we are concerned that the disclosure of a rating alone without any further explanation may simply add to consumer confusion. For example, an explanation may need to be given as to why some insurers are not rated. The fact that an insurer is unrated does not necessarily reflect on its creditworthiness. The following extract is from the Moody's website:

Where no rating has been assigned or where a rating has been withdrawn, it may be for reasons unrelated to the creditworthiness of the issue.

Should no rating be assigned, the reason may be one of the following:

1. An application was not received or accepted.
2. The issue or issuer belongs to a group of securities or entities that are not rated as a matter of policy.
3. There is a lack of essential data pertaining to the issue or issuer.
4. The issue was privately placed, in which case the rating is not published in Moody's publications.

110. Furthermore, information about reinsurance arrangements may be necessary to provide a 'complete picture', as even though a firm is unrated itself, it may be backed by an A-rated reinsurer. For this reason, we recognise the importance of solicitors obtaining professional and independent broking advice.

111. Given that there are a number of different rating agencies with different categories of ratings,⁴¹ the SRA may want to consider requiring only certain

⁴⁰ This issue was comprehensively considered by the CRA report (pp.133-135) which recommended no change to the eligibility criteria for QIs.

⁴¹ The four main providers are: Standard & Poor's (S&P); Moody's, Fitch, and AM Best. There are also different ratings for credit and financial security; the SRA proposes to

independent credit rating agencies to avoid potentially misleading information. If the SRA does not mandate which rating to disclose then it is likely that QIs will choose the rating provider and type that puts their company in the most advantageous light. This will also erode consumers' ability to compare ratings.

112. Finally, it is important to be aware that the fact that an insurer is rated does not provide a guaranteed safeguard against failure. Insurers with very good ratings experienced difficulties in the recent credit crisis; other insurers with good ratings have subsequently gone bankrupt; while many insurers without good ratings have fared well. Credit rating agencies are considered to have failed during the crisis; first, to reflect early enough in their credit ratings the worsening market conditions, and second, to adjust their credit ratings in time following the deepening market crisis.⁴² Therefore, it is difficult to rely on this factor alone as a measure of financial stability.

Conformity of ARP Policy and MTCs

113. We understand and support the rationale for this amendment. We have two drafting comments on this provision. Firstly, the reference to 'extended insurance period' should be 'extended indemnity period' in 4.10(a). Secondly, we suggest redrafting of the phrase 'expressly different' to cover circumstances where the MTC and ARP Policies are impliedly different based on the context, circumstances and/or policy intention. Without this change, the SRA may have to insert drafting notes to any clauses in the ARP policy that it considers to be different in order to express an intention to depart from MTC.

Q6. Do you have any comments on the issues raised in paragraphs 6.1 and 6.2?

6.1 Acceptance Periods

114. The Law Society welcomes the SRA's decision to examine this issue. We consider that imposition of a minimum period in which quotations must remain open is a step forward in creating fairer market conditions.
115. This renewal period, we wrote to all industry participants expressing our concern about certain practises that we considered hampered the proper operation in the market. This was in response to reports that we received from the Law Society's PII helpline that as little as 24 hours were given to some solicitors to consider a quotation. We were also aware that several other insurers were providing solicitors with ten or fewer days in which to accept quotes.
116. We consider that the FSA's 'treating customers fairly' provisions require quotations to remain open for a reasonable period to allow for proper

require disclosure of both, although the latter seems more appropriate in assessing QIs.

⁴²

This prompted the introduction of EU Regulations No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies implemented in UK by The Credit Rating Agencies Regulations 2010.

consideration. We maintain that acceptance periods of less than 21 days are insufficient for solicitors to properly consider whether a quote is competitive, particularly at the commencement of the renewal period.

117. We accept that some 'deals' are necessarily time limited. We also appreciate that some insurers opt to impose acceptance periods of less than 21 days to help ensure that the value of active quotes does not exceed their premium income limit. Nevertheless, we would expect that until this limit is reached or until the time remaining until the renewal deadline makes it impossible, insurers should be willing to reinstate quotes for a further period of time upon request from a solicitor. This should be without increasing the level of the quote, assuming no underlying change in the circumstances underpinning that individual proposal form. A number of insurers have been prepared to do this in previous renewals.
118. We recognise that pressurising solicitors with unreasonable time limits is not a widespread practice and that the majority of the industry demonstrates a high level of commitment to customer care. On that basis, we would welcome the SRA's inclusion of a minimum period in the MTC.
119. We consider that the SRA's introduction of a minimum period may also assist in gaining broker support for service standards as they may be more willing to commit to similar time limits for responding to solicitors if insurers are bound to provide a certain minimum period for acceptance.

6.2 Cancellation of Policies

120. In its Policy Statement and as an outcome of its first stage consultation, the SRA did not consider that it was necessary and, to date, has not proposed any change to allow for cancellation of the policy for misrepresentation or non-payment of premium. Similarly, the Law Society does not support the cancellation of policies for misrepresentation or non-payment and considers that these events must remain within the MTC to ensure client protection. We consider that insurers can already adequately protect against non-payment by requiring payment of MTC premiums up-front or via credit arrangements. We do however, consider non-payment of premiums, material non-disclosure, misrepresentation and fraud to be serious regulatory and disciplinary issues that should be dealt with through better regulation by the SRA and risk management by firms.
121. The SRA has already demonstrated a commitment to pursuing regulatory breaches arising from non-payment of premiums as part of its ARP Enforcement Strategy. We would encourage the SRA to use the information obtained through its mandatory reporting requirements (introduced as part of its 2011 changes) and extend this strict regulatory approach to non-payment of MTC premium.

Further issues

Aggregation clause

Clarification of aggregation clause

122. In our first stage consultation response, we identified the need to clarify the scope of the current aggregation clause in the MTC.
123. The SRA and the Law Society are jointly intervening in the High Court to make oral and written submissions about an insurer's interpretation and application of the aggregation clause in the MTC (specifically, clause 2.5 in Appendix 1 to the Solicitors' Indemnity Insurance Rules 2008-9). The interpretation of this clause has potential wide-ranging significance to the profession as a whole. A wide construal of the aggregation clause also has the potential to increase the level of Compensation Fund claims by virtue of the fact that the more individual claims involving fraud are aggregated into a single claim under the MTC, the more likely the limit of indemnity will be exhausted. This will also leave partners of a firm exposed to a liability and potential bankruptcy in respect of frauds of which they are wholly innocent. The profession desires clarity in order to ensure its insurance arrangements will provide sufficient coverage in the event of a claim.
124. We consider that its current consultation is an excellent opportunity for the SRA to clarify the intended scope of the aggregation clause. We consider that there is scope for the SRA to clarify within the rules when it is (or more likely is not) appropriate to apply aggregation. This will avoid the current ambiguity and, as far as possible, the need for future litigation on this issue.

Common proposal form

125. The Law Society considers that there are benefits in the SRA examining the experience of the Law Society of Ireland, which, last renewal, mandated the use of a common proposal form. While we recognise that obtaining agreement on the content of a form is a difficult task, there are benefits to be gained from such a change. The Irish experience found that a greater number of solicitors were able to easily access the available market and received more quotations as a result.

Impact analysis

126. We have reviewed the SRA's updated equality impact assessment (EIA) and consider that it is justified in light of the equalities evidence. The EIA considers the impact on black and minority ethnic (BME) firms who have historically been disproportionately represented in the ARP and therefore would be disproportionately impacted by the plan to replace the ARP. In its last EIA, the SRA considered that this adverse impact was, on balance, proportionate and legitimate to its policy aim. Figures from the 2011/12 ARP in Appendix 1 conclude that BME firms are not disproportionately represented in the current ARP.⁴³ This indicates that the SRA's proposed abolition of the ARP has 'played a part in improving the availability and cost of PII for small firms'.⁴⁴
127. We note that the EIA does not include specific data on the following protected characteristics: disability; gender re-assignment; religion/belief; and sexual orientation. However, we recognise that it is likely to be difficult for the SRA to obtain evidence about these protected characteristics.
128. We agree with the steps that the SRA have taken to mitigate the potential adverse impact and consider the data about the make-up of the 2011 ARP to be encouraging from an equality and diversity standpoint.

⁴³ Paragraph 11 of Annex E.

⁴⁴ Paragraph 12 of Annex E.

Drafting notes

Comments on the definition of cessation period

129. The new definition of “Cessation Period” in the QIA and in Appendix 4 (“Definitions”) of SIIR states:

cessation period means, in respect of a *firm* and its *policy of qualifying insurance*, the period commencing on the expiry of the *extended indemnity period* in circumstances where the relevant *firm* has not ceased *practice* or obtained a *policy of qualifying insurance* for a *period of insurance* or, if prior to 30 September 2013, the remainder of the *indemnity period* (as the case may be) that immediately follows the *period of insurance* to which the relevant *policy* relates, and ending on the date which is the earlier to occur of:

- (a) the date, if any, on which the *firm* obtains a *policy of qualifying insurance* incepting with effect on and from the commencement of the *cessation period*;
- (b) the date which is 90 days after the commencement of that *extended indemnity period*; or
- (c) the date on which the *insured firm’s practice* ceases.

130. This definition is overly complex due to the fact that it incorporates cessations that occur outside of any extended period, that is, in the normal course of an MTC policy. Hence, the inclusion of the second limb ‘or, if prior to 30 September 2013, the remainder of the *indemnity period* (as the case may be) that immediately follows the *period of insurance* to which the relevant *policy* relates’. We consider this to be an unnecessary complication and that it should be deleted from the definition. The situation regarding mid-year cessations is unchanged by the introduction of the EIP and therefore can be left to the general definition of ‘cessation’. The definition ‘cessation period’ is best used solely in conjunction with the EIP.

Refinements to the obligation to cease to practise promptly

131. The use of the word ‘promptly’ is meaningless as without an obligation to cease to practise prior to the end of the Cessation Period it is unlikely that firms will do so. Therefore, the SRA may want to rephrase to ‘cease to practise by no later than the expiry of the cessation period’.

132. If the SRA is concerned about creating the conditions for orderly wind-down of a business, then it could include an obligation that firms that enter the EIP/Cessation Period must submit a plan to the SRA, similar to its current power to require ‘special measures’ under the ARP policy.

Amendments to the QIA

133. Paragraph 5.1.1 should refer to the ‘Profession’s Contribution’ not ‘ARP Liability’. Clause 5.1 allows insurers to share all premiums received by the ARP Manager subject to the listed exceptions including proposed paragraph 5.1.1 which states ‘the application of any premium or the deduction of any sum in payment of any *ARP Liability in accordance with paragraph 1.3*’. Paragraph 1.3 is the new paragraph inserted to allow for the *Profession’s Contribution* to only be demanded after application of premiums received from 2012 ARP policies. As

such, paragraph 5.1.1 should refer to the 'profession's contribution', not 'ARP Liability' which is defined as the aggregate share of all QIs.

Comments on para 7 of Schedule 1

134. We seek clarification from the SRA about the drafting of the technical amendments relating to paragraph 7 of Schedule 1 (Assigned Risks Pool policy). The SRA may need to reconsider the effect of the drafting of clause 7.3 of Schedule 1 of the QIA. It currently states that each ARP Run-off Policy 'expires at the end of an indemnity period irrespective of the date on which it is written or incepts'. The intention of its Policy Statement and amendment to clause 7.2 is 'that an ARP Policy that is in run-off...and/or an ARP Run-Off Policy as at 30 September 2013...will continue until their natural expiry at the end of their six years term'. We prefer clearer drafting which states that these policies 'shall expire at the end of the six years period of run-off cover under clause 5.2'.

Amendments to the CF Rules

135. In order to implement its proposed transfer of the non-applied firms' role to the Compensation Fund, the SRA has deleted existing rule 14 (arrangements in relation to uninsured firms) and the side policy for non-applied firms in Schedule 8 of the QIA (paragraph 2.12 of the SRA's Consultation Paper). We consider that the SRA's objectives can be met without deleting these provisions and retaining the non-applied firms' function within the arrangements provided by the ARP Manager.
136. If the SRA does not agree with our approach, then we suggest that in order to give effect to its Policy Statement, it should make further consequential amendments to remove all references to arrangements made pursuant to paragraph 2.8 from the QIA, SIIR and MTC. Paragraph 2.8 of Schedule 1 (ARP policy) permits the ARP Manager to make arrangements for non-applied firms. The SRA should clarify that the ARP Manager cannot 'make arrangements' for non-applied firms after 30 September 2012 if the SRA proceeds with its proposed transfer to the Compensation Fund. For example, there is no need for this role to be funded from the 2012 ARP and therefore, clause 1.3 schedule 1 of QIA should remove reference to paragraph 2.8. The SRA should also consider amendments to clause 7.1 of Schedule 1 of the QIA to limit the paragraph 2.8 arrangements to 30 September 2012 and the provisions relating to 'firms in default'.

Consequential amendments stemming from changes to the Authorisation Rules

137. Rule 4.3 of the CF Rules provides that a grant may still be made if the applicant was unaware of the revocation of authorisation. As such, if the SRA adopts our proposals about automatic revocation (see Q3), in order to fulfil its obligation to 'protect' the Fund, we would expect the SRA to take positive steps to notify the clients of a firm who reaches the end of its cessation period that the firm's authorisation has been revoked and it must cease to practise.
138. Similarly, if the SRA maintains its current proposal that allows grants to be made for work done during the cessation period in contravention of draft rule 5.3 of the

SIIR, the SRA should also take positive steps to notify clients that the firm cannot accept new instructions during the cessation period as part of its obligation to protect the Fund.

Consequential amendments if the SRA adopts the Society's recommendations

139. If the SRA adopts our recommendation and decides not to transfer the non-applied firms role to the Compensation Fund, then paragraph 7.1 of Schedule 1 of the QIA will have to be amended to exclude any arrangements pursuant to paragraph 2.8 from the guillotine requirements in order to allow this cover to continue to be provided by the ARP Manager.