



The Law Society

Future client financial protection arrangements

The Law Society's response

23 February 2011

supporting
solicitors

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Introduction

1. The Law Society of England and Wales (TLS) is the representative body of over 140,000 solicitors qualified in England and Wales. TLS negotiates on behalf of the profession and makes representations to regulators and government in both the domestic and European arena.
2. We welcome the opportunity to respond to the Solicitors Regulation Authority's (SRA) consultation on client financial protection arrangements. The consultation identifies that many of the perceived problems within the current PII system are the result of the large proportion of conveyancing claims resulting from recent events stemming from the global financial crisis and subsequent uncertainty of assigned risk pool (ARP) exposures. This has led to insurers either withdrawing from the market (or certain sectors) and/or raising premiums. While there is nothing that can be done about past claims, there are ways to limit solicitors' exposure to these claims in the future and to make solicitors' professional indemnity insurance (PII) more attractive to insurers and ultimately benefit the profession. TLS considers that it is important in an open market system to ensure that there is sufficient competition and fair, transparent underwriting so that all solicitors can obtain affordable PII insurance in order to maintain the current level of client protection and reputation of the legal profession.
3. The SRA identifies that any change needs to be part of an overall strategy of wider reforms. Although the SRA recognises a holistic approach is needed, TLS is concerned that the SRA's two-stage approach would appear not to be driven by an evidence-based, coherent vision for the solicitors' PII system. Inevitably, when change over a multi-stage process is declared, uncertainty is introduced into a market. We fear that this uncertainty will adversely affect all market participants and result in unintended consequences.

2011 proposals

4. Of the four proposals that the SRA has outlined for 2011, the financial institution exclusion is the most significant and will have detrimental consequences for both consumers and the legal profession. Fragmentation of the minimum terms and conditions (MTC) may leave clients, regardless of their level of sophistication, unable to protect themselves. Inability to clearly define particular types of clients and transactions is likely to result in unintended consequences and disputes. Exclusion of financial institutions will do little to target or solve the conveyancing problem or introduce better risk-management practices, it simply moves the issue elsewhere. The solution to reducing the impact of conveyancing claims is best addressed holistically outside of the PII system by improving conveyancing standards and risk-management and through better supervision and regulation by the SRA that avoids certain claims occurring in the first place. The SRA's proposal does not address historic claims which will continue to be notified and impact on the ARP.

5. Regarding the other 2011 proposals, TLS welcomes the SRA's introduction of variable renewal dates, which we have advocated. However, TLS has always recognised that this change in isolation is unlikely to have a material impact on the PII system. Furthermore, we consider that it may take some time for the benefits of variable renewal to be realised and that the SRA's proposed changes should not act as a barrier to the spread of renewal dates. We would welcome clarification in the drafting of the Qualifying Insurers Agreement (QIA) that renewal from 2011 will not be restricted to a 12 month contract and will be permitted for a longer or shorter period (see question 11). TLS also notes that the SRA may need to allocate resources to ensure that adequate systems in place to monitor firms under a variable renewal system.
6. TLS considers that the SRA's proposal to make insurers' reporting obligations mandatory will not have the desired effect of removing the current perverse incentive on insurers to not report firms to the SRA. To be effective this proposal must be backed by an effective enforcement tool as, these obligations, in our view, currently exist but are not adequately enforced against insurers. The SRA also needs to better and more rigorously enforce non-payment of premiums, fraud, material non-disclosure and misrepresentation through earlier and more robust regulatory action against solicitors in breach of their professional obligations. The SRA should confirm that this matter is considered to be, and will be treated as, a high priority risk to the regulatory objectives. This is a high risk area for the profession.
7. Similarly, the SRA's proposal to reduce the time firms spend in the ARP simply hastens firms' closure without alleviating ARP losses as claims still have to be met by the ARP whether they are notified during the six month period or later during the period of run-off cover. To the extent that this change can be viewed as a transitional step to the SRA's 2012 proposal, TLS questions whether it is appropriate to commence this transition without first deciding whether it is appropriate to abolish the ARP without introducing an alternative safety net.

2012 proposals

8. Many of the SRA's proposals for 2012 are dependent upon the approach that the SRA decides to adopt in its current consultation (and may actually become redundant if the SRA adopts the alternative approach we outline below). TLS strongly opposes the SRA's proposed changes to ARP funding which seek to transfer the entire risk onto the profession. The profession already provides funding for the current ARP through the loading on premiums. Perhaps as importantly the SRA's proposal would impact severely on the financial viability of many firms particularly small ones and is not a balanced or proportionate response. As such, it is contrary to the better regulation principles in s. 3(3)(a) of the *Legal Services Act 2007* (LSA).
9. TLS recognises the importance of promoting an insurance market that is competitive and sustainable. This does not warrant the SRA's extreme

proposals regarding the ARP. The SRA proposes to abolish the ARP as a provider of qualifying insurance in 2012 without introducing an alternative safety net. Under the SRA's proposal, it appears that if a firm cannot obtain open market insurance, it must close and either its existing insurer must provide run-off cover or this liability will fall on the profession.

10. It is clear that insurers have grave concerns about the current approach to funding the ARP shortfall. However, TLS considers that some form of safety-net is required to fulfil the regulatory objectives in subsection 1(1) of the LSA; at minimum, a three month period at the end of the policy to allow a firm to either seek alternative insurance or plan for orderly closure. TLS also considers that this alternative approach could address the core problem by removing unquantifiable pooled liability for the ARP and transferring the 'safety-net' role to individual insurers.
11. TLS does not support any client exclusion and considers that the SRA's proposed extension to corporate clients for 2012 will cause definitional debates and disputes, practical difficulties, uncertainty and unintended consequences.
12. Regarding the SRA's proposals relating to the Compensation Fund, we consider that the SRA has not articulated a regulatory need for any change to contributions or fund structure.
13. The SRA's stage-two proposals for restricting work within the ARP and fraud, misrepresentation or material non-disclosure are dealt with as part of the alternative approach outlined below.
14. On balance, TLS considers that the SRA's proposals have no coherent vision and fail to address the underlying cause of conveyancing claims which, given the cyclical nature of the insurance market, will ultimately create further problems and unintended consequences. A proportionate and targeted response (in line with the better regulation principles in the LSA) would focus on the areas of regulatory failure and develop specific measures to better regulate the market. When applying these regulatory principles, TLS urges the SRA to also consider the impact of these proposals on the SRA's regulatory objectives.
15. The SRA considers that removal of financial institutions from the MTC reflects a 'targeted' approach to regulation. However, when its impact is assessed from the perspective of the SRA's regulatory objectives it fails to protect the public interest by eroding the blanket protection of the MTC and restricting access to justice by increasing the cost to consumers and limiting competition in the provision of legal services through further reduction of lender's panels thereby increasing the cost to consumers. Further, it undermines the legal profession by introducing the concept of differential cover, at the same time as introducing changes intended to maintain the level playing field with current legal practice. Similarly, the SRA's proposal for the ARP without an alternative safety net will adversely affect the regulatory objectives, particularly, given that elsewhere in its consultation

paper the SRA agrees that disorderly closure of firms is not in the public interest. As such, the SRA should consider the following alternative approach that provides sufficient time for firms to engage alternative insurance or plan for succession or orderly closure after a policy is not renewed.

Alternative approach

16. TLS has developed a possible alternative approach to one aspect of the SRA's proposals contained in their consultation on client financial protection arrangements. This approach may be thought to better balance the interests of all stakeholders while, as a minimum, maintaining existing levels of client protection consistent with regulation in the public interest. We believe that this approach benefits from the fact that it can be implemented in October 2011 with appropriate transitional arrangements which could well avoid the possible unintended consequences of the SRA's two-stage approach, which increases the uncertainty surrounding the ARP. Uncertainty in the market will rebound to the disadvantage of solicitors.
17. The alternative approach makes PII more attractive to insurers in order to provide certainty and market stability in a manner that is consistent with the regulatory objectives in the LSA and in a way that will benefit the profession by creating conditions for a more competitive market. The centrepiece of the alternative approach addresses one of the main complaints of insurers; the fact that insurers are currently responsible for the pooled liability of firms in the ARP that they have never chosen to insure and, in some cases, refused to insure. In recent years, the cost and poor regulation of the ARP has been a factor in insurers' decisions to exit the market or reduce market share and also operates as a deterrent to new insurers looking to enter the solicitors' PII market.
18. TLS recognises that if the SRA decides to adopt this alternative approach, close consideration will have to be given to the details and the drafting, particularly, surrounding the transitional arrangements. We have outlined a broad concept that we consider to be sufficiently flexible to allow for changes in the detail.

Extended Renewal Period (ERP)

19. TLS considers that the ARP should cease its role as an insurer of firms who are unable to obtain insurance and thereafter gradually shut down and run-off those firms in the ARP. The transitional arrangements are outlined below. As an alternative safety net, firms must be given an extended renewal period (ERP) by their current insurer in which to either obtain insurance elsewhere or plan for orderly merger, succession or shut-down. The ERP is a minimum period of three months from the expiry of the existing insurance contract. The current ARP will 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'), but would otherwise be closed to new entry. As an essential precondition of this reform, we regard a need for better regulation and regulatory control by the SRA to

minimise the number of firms practising without insurance and failing to pay premiums. We are not persuaded that identifying the firms without insurance at the end of a renewal period is technically difficult.

Notice Period

20. An insurer must be required to give reasonable notice of its decision not to renew insurance for a firm. TLS considers that another precondition of reform should be the availability of a minimum period for firms to consider quotations and maximum processing times for insurers when responding to insurance proposals. Insurers would, in the usual course of events, be required to provide six months notice from the later of either the date of an unequivocal notice of an insurers' intention not to renew a policy (this does not mean an information request on an incomplete proposal form) or, in the case of economic declination, refusal or expiry of a final quotation from the existing insurer (the 'notice period'). This six month notice period can, but does not have to, be provided concurrently with the ERP. This would mean that an insured firm would have six months notice that their existing insurer was not prepared to renew cover and a transparent process to obtain responses and quote from alternative providers. This is consistent with the SRA's proposal to reduce the ARP from twelve to six months as it provides the same opportunity for rehabilitation. Consistent with the public interest regulatory objective, TLS considers that there needs to be a minimum three month period from the expiry of their existing policy to ensure orderly closure in the event that alternative insurance or succession is not an option.
21. For example, if the notice period is triggered three months before the end of the policy then the insurer's obligation to provide six month notice can include the three months of cover provided under the ERP. Where the notice period is triggered less than three months before the end of the policy, the ERP will need to be extended to ensure that six months notice is provided from the commencement of the notice period. Where the notice period is triggered in advance of three months prior to the end of a policy, the ERP will be the minimum three months because the six month notice requirement will have been satisfied by the early commencement of the notice period. This approach guarantees that firms will, in general, have six months in which to obtain quotes from other insurers and consider their options. TLS notes that, as a qualifying insurer (QI), the ARP would have to provide firms currently in the ARP with a similar extended renewal period and that this is reflected in the transitional arrangements.
22. As a condition of the QIA, the insurer should notify the SRA at the commencement of the ERP. This will enable the SRA to commence monitoring the firm with the view to approving a detailed action plan in the event that it does not obtain insurance on the open market. Further regulatory action by the SRA may be required.
23. The details of this notice period require careful consideration and scenario testing to avoid any unintended consequences. TLS also recognises that there will have to be subsequent amendments to the Rules to include

reporting obligations on insureds and insurers to notify the previous insurer in the event that alternative cover has been secured. TLS notes that it is ultimately for the SRA to determine who should retain the risk/benefit of the various scenarios. For example, it is open for the SRA to determine that if an Insurer is unable to provide a quotation due to delay on the part of the insured in submitting a completed proposal form, then it would be appropriate to deem that the insured has waived all or a proportion of the notice period to which it is entitled. However, we consider that a minimum ERP is required in the public interest by providing a safety net to allow for orderly closure. This is in contrast to the SRA's proposal for 2012 which will remove the safety net role of the ARP without providing an alternative mechanism for orderly closure.

ERP premium

24. Insurers will be able to charge an ERP premium that is pro-rata of the insured's existing annual policy premium but otherwise the insurer will be in the same position regarding liability to provide insurance¹ and run-off cover. In terms of non-payment of premiums, TLS considers that there are avenues available to insurers to adequately protect themselves and that no regulatory intervention is required. Thus, this approach maintains the current levels of public protection and the ability of insurers to collect premiums.
25. If the alternative approach is adopted then temporary cover will no longer be required to be provided by the ARP. If the firm obtains alternative insurance during the ERP, then the ERP policy with their existing insurer would be terminated by agreement at the point of inception of the new market policy and any pro-rata balance in ERP premium for the unexpired policy period would be returned to the insured.

Circumstances of fraud or fraudulent misrepresentation/non-disclosure on the proposal form

26. In general, TLS considers that non-payment of premiums, material non-disclosure, misrepresentation and fraud are serious regulatory and disciplinary issues that should be dealt with through better regulation by the SRA and risk management by firms. To ensure client protection, these events must remain covered by the MTC. However, in recognition of the fact that insurers will not be able to, in effect, transfer firms into the ARP, the alternative approach allows insurers to immediately place an insured in the ERP if fraud, misrepresentation or material non-disclosure (with an exception for honest mistakes) is discovered in relation to a proposal form. TLS notes that in order to ensure client protection and promote orderly closure, insurers will remain liable for the provision of the minimum three month ERP and run-off cover for these firms (n.b. this is another circumstance in which it would not be appropriate for the insured to benefit

¹ TLS proposes that the provisions relating to insolvent insurers and successor practice rules should remain unchanged.

from a six month notice period). Insurers should retain the right to claim any outstanding premium notwithstanding the early end of the policy.

27. As an alternative to prematurely ending the policy, insurers should have the ability to adjust premiums to place them in the position that they would have been in but for the misrepresentation or material non-disclosure. In the event of a dispute, this premium adjustment should be determined by an independent arbitrator and the dispute resolution clause in the MTC should be amended accordingly.
28. These amendments only relate to circumstances arising from the proposal form. TLS does not propose any changes to the fraud provisions of the MTC or their interaction with the Compensation Fund.

Transitional arrangements

29. TLS recognises that this alternative approach will require changes to the QIA, MTC and Solicitors Indemnity Insurance Rules (Rules). Variation of these instruments is provided for under clause 5 of the QIA. Unless there are exceptional circumstances, at least two months notice must be provided (clause 5.1.2 of the QIA); any changes will have to take effect as of 1 October 2011 (clause 5.1.1 of the QIA); and any changes must be made to all agreements with QIs and Run-Off Insurers (clause 5.1.3 of the QIA).
30. In the event that the SRA does not consider that there is sufficiently 'exceptional' circumstances to warrant variation of the current regime to introduce the ERP prior to the 2011/12 Indemnity Period, TLS proposes the following arrangements for a transitional ARP. The transitional ARP will provide an ARP Policy to firms that must expire by 31 December 2011; firms in the ARP will be provided with a three month ERP that will end on 31 March 2012. This effectively closes off the ARP to new entry as firms will be ineligible to apply for the ARP after 31 December 2011 and provides these firms with a six month 'notice period'. Importantly, in order to remove pooled liability in the transitional ARP, clauses 5 and 6 of Schedule 1 of the QIA will be amended to provide that individual insurers will be liable for firms that they previously insured (as at 30 September 2011) that were transferred to the ARP after 1 October 2011.

Benefits of the alternative approach

31. The alternative approach ensures that the pooled liability for the ARP is gradually reduced as existing insurers will provide PII cover for a reasonable period for a firm to obtain market insurance or consider other options.
32. TLS notes that the alternative approach is consistent with the SRA's characterisation of its role of setting the regulatory boundary by specifying the minimum PII requirements without managing insurance-of-last resort arrangements. It also aligns with the SRA's preference for removing unnecessary regulation and cross-subsidaries because, instead of mandating insurer participation in the assigned risks pool, insurers will be

responsible only for the risks that they write, effectively introducing the concept of 'polluter pays'. It also ensures that the current level of client protection is maintained and provides a safety net mechanism for orderly closure, consistent with the LSA's public interest objective.

33. This change will effectively 'close-off' the ARP to future risks and its current risks will diminish over time. It will make pooled ARP liability more certain for insurers and should eventually reduce premiums and encourage new market entrants by removing the ARP component currently included in all firms' premiums (estimated between 15%-20% for the 2010/11 renewal). TLS notes that the charge for the minimum ERP period — three months as a pro-rata proportion of the annual premium — would, in most cases, be less than the equivalent 27.5% of turnover that ARP currently charges. Additionally, a firm moving back to the market after one month in the ARP, is entitled to an 80% rebate (i.e. it costs 20% of the ARP Premium); under the ERP system, the charge is only equivalent to 8.5% (i.e. 1/12 of the annual premium. Given that insurers' obligation to provide run-off cover for insured firms is mandatory; the ERP will mean that the majority of run-off cover (and eventually all run-off cover) will be provided by individual insurers and not the ARP.
34. Under the alternative approach, insurers will only be liable for the risks of firms they have actually written; removing liability for pooled risks that they did not insure in the first place. This gives insurers an incentive to write risks in contrast to the current situation where ARP uncertainty exposes insurers to risks of others and provides a perverse incentive for insurers to limit market share. Removing the ARP's role of providing insurance means that insurers will no longer be able to transfer firms into the ARP but will remain liable for firms; therefore, it reduces the perverse incentive on insurers not to report firms to the SRA.
35. The alternative approach contains significant benefits for insurers by addressing one of their main complaints, the ARP. This should create a more predictable and stable PII market and encourage new entrants, creating competition and the incentive to write risks, reducing premiums for the profession. As such, the alternative approach is consistent with the better regulation principles and regulatory objectives in the LSA. It will also remove the SRA's concern about the 'relative disadvantage' created by certain pricing methodologies (such as 'flipping' and infill policies) that are employed by some insurers to minimise their share of declared premium in order to limit their ARP exposure.
36. We have conducted an equality impact assessment (EIA) on our proposals (**Attachment 1**). The EIA concludes that compared to the SRA's 2011 proposal, the alternative approach, will have a neutral equality impact on black and ethnic minority (BME) firms, sole practitioners, female practitioners and small firms. In terms of the SRA's 2012 proposal, the alternative approach may result in benefits for these firms by retaining some form of safety net.

Conveyancing work

37. TLS considers that the current issues surrounding conveyancing are best addressed holistically, outside of the PII system. The Law Society envisages that its Conveyancing Quality Scheme (CQS) will become the de facto benchmark standard for residential conveyancing work and will give insurers (and also lenders) more confidence in their risk assessment, complementing other TLS initiatives such as Lexcel. These measures will ensure better risk management when coupled with better regulation by the SRA to robustly monitor the profession and to promptly take enforcement action where necessary. We also offer to assist the SRA regarding its investigation of the conveyancing process to establish whether changes (including further regulation) are required to improve service delivery and reduce the cost of conveyancing claims. We hope to work with the SRA as part of this review and consider that there is scope for the SRA, TLS, lenders and the insurance industry to work more collaboratively to ensure that regulatory controls and risk management practices are in place before PII claims are generated. TLS' conveyancing initiatives will place a greater emphasis on risk-management, which will enhance the reputation of the profession and the level of service provided to clients.

Preconditions for a fairer PII system

38. TLS also considers that there are certain preconditions for a fairer PII system that require implementation irrespective of any other changes.
39. Firstly, better enforcement by the SRA is essential. As part of its holistic response, the SRA should further strengthen its enforcement strategy so that all firms that should not be practising are subject to regulatory controls and, if necessary, commence orderly shut-down. Furthermore, the SRA should take robust action to discipline solicitors who, in breach of their professional obligations, fail to pay premiums; omit to disclose material facts; or engage in fraud. TLS recognises the efforts that the SRA has undertaken over the previous six months, in order to improve its management of the ARP. It would be beneficial for the SRA to provide greater detail publicly about its enforcement actions; this aligns with the better regulation principles of transparency and accountability. Communication is also essential in order for enforcement by the SRA to be effective. This will act as a deterrent and raise solicitors' awareness of enforcement and PII issues.
40. Secondly, the SRA should introduce provisions in the QIA to provide that QIs in response to fully completed proposals must provide a response or quotations within maximum processing times (e.g. 28 days) and must give a minimum period for firms to consider quotations (e.g. 21 days).
41. Thirdly, as part of its examination of insurers' equality and diversity (E&D) policies in conjunction with the Financial Services Authority (FSA), the SRA should review insurers' underwriting criteria to ensure that it does not unwittingly discriminate against BME firms.

42. Fourthly, as an evidence-based regulator, the SRA (or another body appointed by the SRA) should be collecting and assessing claims data to classify cause, frequency and other characteristics so it can determine where losses are occurring and better target its risk-based regulation. The SRA should ensure its existing powers are sufficient to collect this market data and, if not, amend the QIA and Rules to that effect. As variable renewal dates are introduced, the SRA will need to introduce systems and procedures to monitor renewal dates and to review detailed action plans if a firm fails to obtain insurance or, if the alternative approach is adopted, enters the ERP. The SRA needs to ensure that any regulatory action is transparent in accordance with the better regulation principles and regulatory objectives in the LSA. To promote transparency and minimise pricing asymmetry, the market analysis should be provided by the SRA (or another appointed body) in an aggregated form to assist the profession and insurers in formulating risk-management decisions.
43. Finally, we propose the imposition of further obligations within the QIA requiring all QIs to regularly transfer statistical data about proposals, insured premiums and claims to the Solicitors Indemnity Fund (SIF). At least annually the SIF would publish an anonymous digest of annual data. All parties would be required to maintain the series of published annual data. In addition, the SIF would provide all participating QIs with their own data benchmarked against the data for the market. Over time, such a resource would become a valuable asset for the SRA and the profession. It could be made available to insurers considering entry to the market and would contribute to the operation of a transparent and efficient market to the advantage of both sellers and buyers. We consider the SIF to be the appropriate custodian of this data because since it has a continuing role in the process that serves the interests of insurers, insureds and the public.
44. TLS considers that these five preconditions must be satisfied, notwithstanding the ultimate approach adopted by the SRA, to create a fairer and more transparent open market system.

1 Do you agree with the Objectives and CRA's Principles?

45. If viewed in isolation the objectives and principles for a financial compensation system identified by CRA are non-controversial when adopted by a consultant; however, when considered in the context of the SRA's role as a regulator, they represent a serious and potentially damaging subversion of the SRA's regulatory objectives in the LSA. CRA's financial compensation system principles (CRA's Principles) must not supplant the regulatory objectives of the SRA. TLS is also concerned about how the SRA's consultation paper implements CRA's Principles without detailed examination of the LSA objectives or independent analysis.
46. The CRA report also inadequately considers the SRA's role as a regulator. The SRA is not bound by the principles identified in the CRA report, but instead must regulate with adherence to the better regulation principles and the objectives set out in the LSA which require consideration of the public

interest *in addition* to the SRA's other objectives which include access to justice, competition and diversity within the legal profession. The Law Society considers that the public interest objective requires the SRA to consider the impact of any proposal on all stakeholders. The Law Society is concerned that the SRA has taken the view that it should only introduce or maintain regulation if there is an identifiable market failure. The difficulty with this view is that removal of regulation may adversely impact on the SRA's regulatory objectives. While the Law Society would be the first to support the removal of unnecessary regulation, this should not occur at the expense of public interest, access to justice, consumers, competition, diversity within the legal profession or any of the other regulatory objectives.

47. For example, the SRA's proposed removal of financial institutions from the MTC *prima facie* reflects a 'targeted' approach to regulation. However, when its impact is assessed from the perspective of the SRA's regulatory objectives it fails to protect the public interest by eroding the blanket protection of the MTC and restricts access to justice by increasing the cost to consumers and limiting competition in the provision of legal services through further reduction of lender's panels. (Refer to questions 12 to 15 for more analysis).
48. The SRA refers to CRA's Principles by number through its consultation paper, often making broad statements that individual options will benefit various principles without providing any further analysis and explanation. Given that the SRA has identified that CRA's Principles are vital to a financial compensation system, a more detailed cost-benefit analysis of how each proposal best reflects these principles should be undertaken, in addition to considering whether this fits within the SRA's overriding regulatory objectives in the LSA.
49. TLS understands the important role that PII plays in client protection and believes this goal is achievable. However, the regulator must not create a system that fails to properly balance the interests of all stakeholders—solicitors, insurers and clients—something the SRA is required to do in the public interest as part of its regulatory objectives in the LSA.

2	Do you have any comments on our views about the future development of the financial protection arrangements?
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50. TLS does not wish to prematurely comment about inchoate developments. Our view will necessarily be shaped by the future PII landscape, prevailing market conditions and will heavily depend on whether the SRA uses the opportunity it has in this current consultation to adopt TLS' proposals. TLS agrees that any future changes proposed by the SRA require further consultation and impact assessment, although it considers that it is feasible and would be better to fully explore these proposals as part of the current consultation (see TLS' response to question 4).
51. Further consideration and consultation is required before the SRA applies an 'outcome-focussed' approach to PII. TLS does not support fragmentation

of the MTC for particular clients and the SRA has provided insufficient detail about how activity based regulation will be achieved for TLS to provide detailed comments on these future developments.

Aggregation clause

52. A potential future development that has not been foreshadowed by the SRA is examining the scope of the aggregation clause in the MTC in light of a case of which we have been made aware that arises out of the frauds of Mr Gilbert, who was a conveyancing partner at Willmetts and Co. solicitors (In liquidation). In particular, the interpretation being taken by the insurers arising out of this matter is of great concern to the Law Society. Broadly, the interpretation adopted by insurers is that the involvement of the same rogue solicitor in multiple transactions is sufficient to establish a 'series of related matters or transactions' under the aggregation clause. TLS considers that this is an incorrect interpretation of the meaning of the MTC. These were never intended to allow the aggregation clause to cover actions of a person who committed frauds in totally separate transactions albeit in a similar way. This is contrary to our understanding of the intention of the MTC which requires the transactions to be 'related'. The MTC may require clarification to prevent the future avoidance of such claims by insurers.

3 Do you have any comments on the wider regulatory issues addressed in this section?

Wider regulatory issues

Conveyancing

53. TLS supports the SRA conducting a detailed investigation into its regulation of conveyancing to improve standards and reduce the cost of conveyancing claims. TLS recognises the importance of dealing with conveyancing issues outside of the insurance system and has established the Conveyancing Quality Scheme (CQS) to recognise credible and competent firms in this field. CQS emphasises risk-management and aims to heighten competence, standards and client service levels in delivery of residential conveyancing work. We consider that raising standards through accreditation schemes like CQS and better targeted regulation by the SRA will best deal with the cause of the conveyancing issue and prevent claims arising in the first place. We do not consider that the SRA's proposed financial institution exclusion will have this desired effect (see TLS' response to question 12).
54. The SRA has identified that it is currently difficult for insurers to identify firms that undertake no conveyancing work because firms can change their business mix at any time [at 3.24 of the SRA's consultation paper]. The Law Society envisages that its CQS will become the de facto benchmark standard for residential conveyancing work and will give insurers (and lenders) more certainty and confidence in their risk assessment. Contrary to the SRA's assessment, TLS does not consider the SRA's proposed exclusion of financial institutions will result in lower premiums (see question 12). In contrast, by establishing better risk-management practices,

quality schemes, once proven, may result in a reduction of premiums for firms. The CML, BSA and the Association of British Insurers (ABI) are supportive of CQS and there is the potential that it will become a prerequisite for lender panel membership.

55. TLS is supportive of better regulation by the SRA. Early regulatory action and robust monitoring and enforcement procedures are necessary. This will be assisted by the SRA's mandatory reporting requirements proposal—although to be effective this will have to be backed by sufficient enforcement tools as, in our view, these obligations currently exist but are not adequately enforced (see question 18). Consistent with the better regulation principles and regulatory objectives, any enforcement action must be transparent and effectively communicated to the profession to act as a deterrence and educative tool. The alternative approach will also reduce the disincentive for insurers to report firms under the current model and the SRA's proposals.

Other issues

56. TLS supports the SRA examining the requirements to set up practice, however, evidence-based regulation requires the SRA to collect market data in order to validate its hypothesis that solicitors with three years PQE are more risky than those with five years PQE. We consider that reliable data is essential for assessing whether the SRA's proposed changes would have the desired effect. As such, TLS agrees that the impact of the new Qualified Lawyers Trust Scheme and the financial viability of start-up firms should be examined further by the SRA on an empirical basis.
57. TLS is also concerned about disproportionate outcomes for BME-owned and controlled firms in the open insurance market. We consider that the SRA should actively work to address this issue. The alternative approach has a neutral equality impact when compared with the SRA's 2011 proposal and the potential to result in greater benefits than its 2012 proposals (**see Attachment 1**). We have also taken steps to mitigate the effect on BME firms by suggesting numerous preconditions for a fairer PII system, including assessing insurers' underwriting criteria to ensure that it does not unwittingly discriminate against certain types of firms and providing minimum timeframes for firms to consider quotations. The SRA's proposed exclusion of financial institutions and corporate clients would be devastating for small firms and, by extension, BME firms (see TLS' response to question 12 and the EIA in Annex A of the consultation paper). The alternative approach avoids this adverse impact and maintains a safety net for these firms. This has wider implications for the public interest, diversity, consumer choice and access to justice, which directly affect the regulatory objectives in the LSA.

4 Do you agree with the SRA's two-stage approach to developing the financial protection arrangements?

58. The SRA itself recognises the need for a 'coherent and long term approach' to financial protection arrangements; however, its two-stage approach lacks a coherent vision. Although it has outlined its plans for 'future development'

(see question 2), the SRA has failed to articulate clearly the method by which it selected the four options proposed for 2011. The reason these proposals are prioritised over those selected for stage two is unclear. The consultation would have benefited from explanation of the SRA's underlying strategy and methodology supporting the case for immediate implementation of these options, particularly given that the SRA recognises that the implementation of stage-two proposals 'is dependent on the successful implementation of other changes proposed in this paper' [at 1.35 of the SRA's consultation paper].

59. TLS has previously raised concerns about the consultation timetable with the SRA. Despite stating it would publish its consultation as soon as possible, the SRA released it on 6 December 2010 and has not changed its 28 February 2011 end date. Conducting a review over the Christmas/New Year period essentially reduces the amount of realistic consultation time; TLS is concerned that many stakeholders may not have had adequate time to respond to the SRA's proposals.
60. This is particularly problematic in light of the two-stage consultation which itself appears to be predicated on the assumption that all of the stage-one proposals will be adopted. In this way, stage one proposals are de facto transitional arrangements, without the benefit of detailed consideration of whether any of the proposals fit holistically within the PII system because the SRA has deferred its decision on the bulk of proposals until 2012. If the SRA has identified the need for further research and consultation, then this should be undertaken as part of the current consultation to ensure that any proposal adopted in 2011 does not irreversibly alter or exacerbate the current situation or indeed create further problems. It is better to consult once properly and ensure that a coherent and long term approach is achieved; however, in this instance, TLS considers that the SRA can achieve this outcome without any further delay by adopting the alternative approach for 2011.
61. Of the four proposals that the SRA has outlined for 2011, the financial institution exclusion is the most significant and will have detrimental consequences for the profession and ultimately consumers (see question 12). It also does little to target the core of the conveyancing problem that must be fixed outside of the insurance system through better regulation by the SRA and increased standards. We consider that the alternative approach is more measured, better balanced and will actually improve the current PII system in contrast to the SRA's proposal. The alternative approach also benefits from the fact that it can be implemented in its entirety by October 2011.
62. A potential unintended consequence of deferring the decision about whether or not to abolish the ARP until stage two is that the SRA has created a disincentive for insurers to participate in the 2011 renewal period. Flagging the potential abolition of the ARP in 2012, may result in some insurers leaving the market in 2011 and/or waiting until after 2012 to enter a market without ARP liability. For this reason, the alternative approach is advantageous as it closes the ARP to new entry (and makes individual

insurers liable for any firm transferred into the ARP during the transitional period) to create certainty for market participants without any diminution in client protection.

63. Another reason not to delay the decision on the future of the ARP is that, with the introduction of Solvency II, insurers will have make capital provisions for this large unquantifiable variable. This will provide further disincentives for insurers to participate in the solicitors' PII market.
64. If the SRA persists with its two-stage approach, TLS calls on the SRA to issue clear milestones for additional action, research and consultation to ensure genuine engagement. TLS notes that we have previously argued for the SRA to adopt changes in a regularised way, similar to the parliamentary common commencement dates and that this should be factored into any of the SRA's timelines.

Maintenance of Current Arrangements

5 Do you agree with our conclusion that we should maintain an open-market system of PII?

65. Yes.

6 Do you agree with our conclusion that we should maintain a Qualifying Insurers Agreement?

66. Yes.

7 Do you agree with our conclusion that we should not place additional criteria on insurers in order for them to be eligible to be a Qualifying Insurer?

67. Yes. Given that Financial Services Authority (FSA) is implementing Solvency II it would seem to be inappropriate for the SRA to introduce additional conditions at this time.

8 Do you agree with our conclusion that we should maintain the function of the ARP in meeting claims against uninsured firms?

68. Yes. The alternative approach does not alter this function as it is essential for client protection; however, our precondition of better SRA regulation must be met to minimise the number of uninsured firms in the future (especially under a variable renewal date system).

9 Do you agree with our conclusion that we should maintain the function of the ARP in providing run-off cover to firms that do not have open-market run-off cover?

69. No. The alternative approach would ensure that firms are provided run-off cover by their current insurer rather than the ARP.

10 Do you agree that we should maintain the current approach to setting premiums for firms entering the ARP?

70. No. The alternative approach no longer permits firms to enter the ARP. Instead, firms unable to obtain insurance renewal are given a notice period and an ERP by their current insurer to either find alternative insurance or consider alternative options. The ERP premium would be a pro-rata amount of the firm's annual premium.

Proposed Changes for October 2011 and their Impact

Proposal 1: Single renewal date

11 Do you have any comments on the proposal to remove the single renewal date and the impacts identified? Are there any further consequential impacts of this change that you believe we should consider?

Variable renewal date

71. We support the SRA's proposal to abolish the single renewal date. As the SRA acknowledges, it may take some time before a large proportion of the market moves away from a 1 October renewal date, therefore, it may take some time for the perceived benefits of a variable renewal date (for example, to small firms and new entrants) to be realised. TLS encourages the SRA to consider whether further transitional measures are necessary to encourage a 'spread' of renewal dates and to support small firms until this positive impact is realised. This would be justified in the interests of achieving the SRA's regulatory objectives relating to access to justice, consumers interests, competition and diversity within the profession under the LSA. We note that provided the insurance market is sufficiently vibrant and competitive, the market may also develop innovative ways to encourage people to shift renewal dates.
72. While variable renewal dates may, in time, prove advantageous, this change in isolation will not resolve all of the current difficulties in the PII system. The issue of restricted capacity within the insurance market exists regardless of whether a single or variable renewal date system is employed. For this reason, the alternative approach attempts to make PII more attractive to insurers by removing one of their main complaints—the pooled nature of the ARP—and providing certainty and market stability that will benefit the profession without undermining the regulatory objectives in the LSA.

Comments on impacts identified by the SRA

73. The SRA has asked for comments on the impacts it identifies in its consultation paper. As a general comment, see TLS' response to question 1 which considers that the SRA should be applying the LSA principles and regulatory objectives instead of, or at least in conjunction with, the CRA's Principles. TLS considers it important to also consider the impact of the

totality of the SRA's proposals (including those flagged for stage 2) in order to fully assess the impact of each individual change (see TLS' response to question 2).

CRA's Principle 1—Transparency

74. TLS notes that the SRA did not consider the impact on its proposal to remove the single renewal date on transparency. Information asymmetry will be further exacerbated under a system of variable renewal dates as there will be less focus on solicitors' PII at a given point in time if renewals eventually spread throughout the year. If variable renewal dates are introduced, with contracts for less than or more than 12 months duration, the SRA will need to introduce systems and procedures to monitor renewal dates and to review detailed action plans if a firm fails to obtain insurance renewal. TLS also recommends the introduction of procedures to collect and assess claims data and publicise regulatory action as part of its preconditions for a fairer PII system outlined above.

CRA's Principle 2—Cost effective

75. The SRA has not included a detailed cost-benefit analysis of the cost of implementing variable renewal. As such, TLS disagrees with the SRA's impact assessment that this proposal is cost-effective as variable renewal dates will require increased administrative burden and regulatory oversight. Indeed, the only legitimate reason for maintaining a single renewal date is avoiding the additional administrative burden and cost of implementing a variable renewal date. We would welcome the SRA's estimates of the costs of implementing variable renewal in order to demonstrate its cost effectiveness particularly as it is unclear that the perceived benefits will be realised.

CRA's Principle 4—diversity & 5—targeted

76. TLS agrees that, subject to the benefits of variable renewal being realised, the removal of the single renewal date will benefit diversity and will be targeted, consistent with the regulatory objectives in the LSA. However, TLS refers to its response to the SRA's Equality Impact Assessment (Annex A) which recognises that transitional measures are required to ensure these objectives are achieved.

CRA's Principle 6—Unintended consequence

77. Even if the cost of implementing variable renewal is unknown, the benefits must be realised in order for the proposal to be worth implementing. If the practical effect of variable renewal and the resulting perceived benefits are not realised, for example, because the market voluntarily retains an October renewal date then it is possible that an unintended consequence of the SRA's proposal is increased administrative burden and need for greater regulatory oversight with no countervailing benefit. This is recognised by Lane, Clark & Peacock:

It would be important to ensure that renewal dates are spread sufficiently throughout the year. If this does not happen and a majority of firms keep the

*existing renewal date then the additional cost of the administration will be incurred with no significant benefit from staggering renewal dates.*²

78. In order to avoid this unintended consequence, the SRA should clarify its position on the length of policy period (see below) and adopt measures to encourage the spread of renewal dates.

Further consequential impacts

Length of policy period

79. It is unclear from the drafting of proposed amendments in Annex B, whether clause 4 of the QIA permits a Policy Period of less than 12 months. TLS considers that this should be clarified to give effect to the SRA's intention not to mandate a minimum Policy Period. Consistent with the targeted principle of better regulation and the SRA's objective to only regulate if there is a perceived market failure, it is more appropriate to allow the insurance market to determine the length of policy instead of mandating a minimum Policy Period. Furthermore, the spread of renewal dates necessary to achieve the benefits of variable renewal would be assisted by allowing firms wishing to change renewal dates to extend their existing policy for a shorter period, for example, 3 months.

Indemnity period

80. TLS acknowledges the advantages of maintaining the concept of an Indemnity Period (i.e. 12 months commencing 1 October) for reporting and calculating contributions to ARP funding (although the latter will not be necessary if the ARP is run-off under the alternative approach). However, the retention of the indemnity period for determining ARP liability may provide the perverse incentive for insurers to not write business in certain periods so as to avoid liability for particular ARP risks. This may potentially leave some firms without insurance through no fault of their own but due to insurers' desire to avoid ARP liability for a given reporting period. For this reason, an alternative approach that removes pooled liability is preferable as it avoids this issue.
81. Furthermore, the SRA needs to consider carefully whether there are any unintended consequences that flow from its proposed definition of 'Policy Period' in the MTC as the PII system moves to variable renewal dates. For example, as currently drafted, MTC variations occur on a 'rolling basis' because a variation is effective from the start of the Policy Period, rather than the Indemnity Period. TLS does not consider that a staggered adoption of MTC variations is appropriate as it will fragment the MTC and mean that different firms have policies under different MTC depending on their various policy periods. It will also cause administrative problems for the SRA that may require consequential amendments; for example, amendment to the requirement for the SRA to provide separate notifications for each firm under clause 5.1.2 when their policy period comes to an end i.e. when the

² Lane, Peacock & Clark report for TLS, 27 May 2009, at 2.7.9.

MTC variation is effective (see suggested amendment in TLS' response to Annex C of the SRA's consultation paper).

82. Instead of rolling changes, TLS would prefer the SRA to require systemic compliance with MTC variations subject to appropriate notice to affected parties. We have previously urged the SRA to adopt any changes in a regularised way, similar to the parliamentary common commencement dates. The ability for the SRA to mandate systemic compliance appears to be contemplated in the commentary on page 8 of Annex B of the SRA's consultation paper; 'the SRA can require policies to be amended at any time to reflect any changes to the Rules or to the MTC'. In TLS' view, the SRA should use this power for the majority of changes instead of 'in exceptional circumstances'. See further drafting comments on rule 4.2 of the draft Rules in Annex B and clause 5 of Annex C.

Practising certificates, Education & Enforcement

83. The SRA has recognised that variable renewal will have implications for the renewal of practising certificates which are currently linked to the renewal of insurance. Variable renewal dates will make it more difficult for the SRA to trace firms who are practising without insurance. It is an important precondition of any PII reform, including the alternative approach, that uninsured firms are immediately identified and subject to regulatory action by the SRA. We agree that the SRA will have to ensure that robust systems are in place prior to the introduction of variable renewal dates to capture and record information about each firms' qualifying insurance details including inception and expiry dates. It will need a computerised system to record the policy period of each firm (provided to the SRA in schedule 7) and to send automated reminder letters to firms when insurance is due to expire. TLS supports the SRA requiring more frequent information from qualifying insurers to facilitate better regulatory oversight and urges the SRA to consider whether any subsequent amendments to the QIA are required to include additional reporting requirements (see clause 6 of Annex C of the SRA's consultation paper).
84. Furthermore, there will be need for greater education of the profession throughout the year as the abolition of the single renewal date will lose the publicity surrounding a 1 October deadline.

Proposal 2: Financial institution exclusion

12	Do you have any comments on the proposal to make insurance cover for claims by financial institutions a permitted exclusion in the MTC and the impacts identified?
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General comments on proposal

85. TLS strongly opposes the SRA's proposed exclusion of financial institutions as it does not address the cause of the conveyancing problem. Exclusion from the MTC will not result in better risk-management but will simply move the issue elsewhere. The solution to reducing the impact of conveyancing claims is best addressed holistically, outside of the PII system, by encouraging risk-management, improving conveyancing standards and

better regulation by the SRA to avoid claims occurring in the first place. The SRA's proposal does not address historic claims resulting from the property collapse which will continue to be notified and impact on the ARP.

86. Even though there is no mandatory requirement to obtain insurance for permitted exclusions, financial institutions will insist on insurance outside of the MTC as a prerequisite condition of entry onto lenders' panels. The practical effect of fragmenting the MTC is that whether a firm can perform certain type of work will depend on its ability to obtain this additional insurance. The CRA report recognises that this will lead to uncertainty about whether a firm will undertake work for commercial clients from one year to the next [quoted at p.130 of the SRA's consultation paper]. This proposal will also have devastating consequences for small high street firms as they are unlikely to be able to afford the cost of the separate insurance policies that lenders will require as a condition of panel entry. Separate insurance for conveyancing work loses the benefits of diversification and given the potentially high-risk nature of this work is likely to be priced accordingly. Furthermore, it is not guaranteed that any 'saving' to MTC premium from removing financial institutions will offset the cost of the bolt-on or additional cover required by lenders, resulting in a net loss to the profession. The impact of the change is that it is likely to affect the freedom of consumers to instruct the solicitor of convenience and of their choice contrary to the LSA's regulatory objectives to promote competition, consumers and a diverse legal profession.
87. TLS recognises that conveyancing is the main driver behind any client exclusion although the SRA prefers to characterise the issue in terms of removing regulation for 'sophisticated' clients (see below). The rise in conveyancing claims and the uncertainty of ARP exposures has led to some insurers either withdrawing from the market (or certain sectors) or raising PII premiums. TLS agrees that a holistic solution is necessary to grapple with the problems caused by increased conveyancing claims in order to make PII more attractive to insurers and create a stable, competitive market that benefits the profession and ensures client protection; however, it does not support the SRA's proposal or its impact assessment.
88. The SRA's proposed exclusion fails to address the underlying cause of conveyancing claims and, given the cyclical nature of the insurance market, will ultimately create further problems within the PII system. A more proportionate and targeted response (in line with the better regulation principles in s. 3(3)(a) of the LSA) would focus on the area of regulatory failure, i.e. conveyancing, and develop specific measures to better regulate this specific sector of the market.
89. TLS recognises the importance of looking beyond insurance solutions to address the underlying cause of the level of conveyancing claims through better regulation and by improving conveyancing standards through risk-management and TLS' initiatives like CQS. Furthermore, if the alternative approach is adopted then the solicitors' PII market should become more attractive to the insurance industry, benefiting the profession and

maintaining client protection, without the need to resort to the drastic measures that the SRA proposes. The small percentage of unattractive risks need to be dealt with through more efficient and effective regulation by the SRA.

Exclusion is too broad

90. While we do not support any exclusion, in the event that the SRA adopts this proposal, then TLS considers that it should be sufficiently targeted to the perceived problem. Currently, the proposed exclusion of *all* work performed for financial institutions (and the stage-two extension to all corporate clients) is too broad and does not represent a proportionate or targeted response contrary to the better regulation principles in the LSA.
91. Any exclusion should be as limited as necessary to target the perceived problem. The CRA Report has identified that 50% of PII claims arise from conveyancing work and 25% arise from mortgage lender claims (at p. 39). The SRA also identifies that the giving of undertakings are a driver behind lender-based conveyancing claims [at 3.23 of the SRA's consultation paper]. In response to a similar but potentially more widespread problem, Ireland adopted a *more limited* financial institution exclusion. The Irish exclusion only targets certain types of undertakings given to lenders relating to commercial property transactions (i.e. undertakings relating to the protection of mortgages, certificate of title, title deeds, payment of stamp duty and registration of title or mortgage). This was based on a risk assessment that found this type of work was most likely to give rise to claims. The more limited response in Ireland is evidence of the extreme approach being proposed by the SRA and causes TLS to question the whether the SRA's proposal is proportionate or targeted.
92. As an evidence-based regulator, we would expect the SRA to fully explain its rationale for excluding all types of work undertaken for financial institutions, based upon an analysis of types of claims. This is important given that the CRA Report did not find any market failure to support an exclusion that is limited to financial institutions (at 6.1). We would also expect the SRA to consider the impact of excluding *other* areas of work performed for financial institutions in addition to conveyancing (see TLS' comments on the SRA's impact assessment below).

Sophisticated clients

93. TLS recognises that the SRA has adopted its proposal to exclude financial institutions based on the CRA report that suggests that client protection is not necessary for 'sophisticated' clients. We understand that, in theory, there may be compelling arguments to exclude firms who seem able to protect themselves. However, in reality, even highly sophisticated financial institutions may not be expert in relation to the risks under discussion here or able to guarantee their own protection without the existence of MTC cover. The Irish experience has revealed that there remains confusion in the lender community about the effect of exclusion from the MTC given the nature of the 'claims-made' system. Clients are only able to take sufficient steps to ensure that their solicitors have appropriate insurance at the date

of instruction. To be covered under a claims-made system, a policy must be in place when a claim is notified, therefore, the fact that a client has checked that their solicitor has insurance in place outside of the MTC at the date of instruction is irrelevant to ensuring there are appropriate client protections in place. Even sophisticated clients may find it difficult to protect themselves against this eventuality. The only way to guarantee client protection is to retain blanket MTC cover, suggesting that there is a regulatory need to retain the MTC for all clients.

94. Furthermore, TLS considers that by focusing on the sophistication of clients, the CRA report inadequately considers the SRA's public interest regulatory objective. The SRA is not bound by the principles identified in the CRA report, but instead must regulate in accordance with the objectives and principles of better regulation set out in the LSA. Regulation in the public interest requires consideration of the effect of the proposal on all stakeholders, access to justice, competition and diversity within the legal profession in addition to whether or not certain clients are able to protect themselves—all of these regulatory objectives are negatively impacted by the SRA's proposal. If excluded from the MTC, lenders will require firms to obtain additional insurance, potentially on specialised terms and conditions, as a precondition of panel entry. This separate insurance policy will be prohibitively expensive for small firms and will exacerbate the current situation where these firms experience significant difficulties obtaining PII and entry onto lender panels. This will lead to a reduction in competition in the legal services market and potentially an increase in prices for all consumers of legal services. Any increased cost to financial institutions as a result of the SRA's exclusion will increase cost to borrowers because lenders will inevitably pass these costs onto individual consumers. This adversely affects the regulatory objectives in the LSA.
95. As TLS has outlined above, it considers that better risk-management can be achieved not by excluding perceived problems but by improving conveyancing standards and better regulation.

The SRA's proposal for TLS—centralised database

96. The SRA suggests that in order to prevent a reduction in the number of small firms on lenders' panels due to its proposed exclusion of financial institutions, TLS or CML could consider providing a 'centralised database of firms that have insurance to undertake work for financial institutions' [at 3.35 of the SRA's consultation paper]. If the CRA's sophisticated client argument was in the public interest, then, in an open and fair insurance market, appropriate PII cover would become a point of product differentiation and competition between law firms and lenders should be sufficiently 'sophisticated' to ascertain firms who have appropriate cover. However, TLS is not convinced that this will occur due to the fact that CRA has mischaracterised the problem and the SRA's regulatory role.

Comments on the SRA's impact assessment

General comments on the SRA's impact assessment

97. The SRA's impact assessment states that 'the main impact of this proposal is expected to arise in the conveyancing area'. While this may be the area where the SRA *desires* to have an impact despite ostensibly targeting 'sophisticated' clients; given the broad scope of its proposal it is likely to also impact on other non-conveyancing work areas, resulting in unintended consequences. As an evidence-based regulator, we would expect the SRA to fully explain its rationale for excluding *all* types of work undertaken for financial institutions and consider the impact on all areas of work, not just conveyancing.
98. Although it does not support any client exclusion, TLS recommends that the SRA undertake a risk-based assessment of conveyancing (perhaps as part of its foreshadowed 2011 review) to identify the specific areas, actions and activities that most result in claims by mortgage lenders. After appropriate impact assessment, the SRA could then tailor an exclusion to target these specific circumstances (e.g. certain types of undertaking for specified situations in commercial property transactions) instead of adopting a wholesale carve out for financial institutions or corporate clients. As part of its preconditions for a fairer PII system, TLS considers that the SRA should be regularly assessing claims data to determine where losses are occurring as part of its regulatory oversight of the profession. An evidence-based approach would be more consistent with the SRA's goal of risk-based regulation and would represent a more transparent, targeted and proportionate response than its current proposal. However, TLS has presented an alternative approach that satisfies the regulatory objectives without the need for any client exclusion.

Impact on PII premiums

99. If the SRA adopts an exemption for all work undertaken for financial institutions, other sectors are likely to be affected. The SRA should particularly examine its conclusion that firms that do not conduct conveyancing will have lower premiums. The SRA was quoted in the *Solicitors Journal* on 6 December 2010 as stating that its proposal will not contribute to a further decline in high street firms because the new rules would be unlikely to disadvantage firms with a low claims record and that it would allow those firms not undertaking any conveyancing to negotiate lower premiums.
100. TLS strongly disagrees with this analysis. Firstly, the fact that a firm does not conduct conveyancing or has a low claims record is already factored into the risk-profiles used to calculate their premiums. Secondly, these firms may still be adversely affected by the SRA's proposal if they have to undergo the expense of obtaining additional insurance for any non-conveyancing work they currently provide to financial institutions (e.g. corporate contracting). Thirdly, while MTC premiums may reduce over time

because financial institutions' claims no longer fall on the ARP, they are unlikely to do so in the short-term as the back-log of claims resulting from the property crash that will be notified under the current system with the corresponding premium uplift. Lastly, it is not guaranteed that any 'saving' to MTC premium will offset the cost of the bolt-on or additional cover required by lenders, resulting in a net loss to the profession. In contrast, the alternative approach has the potential to benefit the profession by reducing the ARP component of premiums over time (currently estimated between 15-20% of premiums) without fragmenting the MTC.

Specific comments on the SRA's impact assessment

101. The SRA states that its proposal is consistent with CRA's Principles 2, 3, 4, 5 and 7. TLS considers that the SRA's proposal is inconsistent with principles it has identified and the regulatory objectives in the LSA.

CRA's Principle 1—Fair, transparent, accessible

102. In its analysis, the SRA did not consider the effect of its proposed financial institution exclusion on the creation of a fair, transparent and accessible system of financial compensation. TLS considers that it is not fair to treat financial institutions (or all corporate clients) differently. These clients are equally deserving of the same minimum level of protection afforded by the MTC.
103. TLS also identifies a number of unintended consequences for transparency of, and accessibility to, legal services resulting from uncertainty surrounding the boundary between 'individual clients'. See TLS' response to questions 19, 20 and 21.

CRA's Principle 2—Cost effective

104. While the SRA's proposal may be cost-effective in the sense that it carves out future claims from the MTC, it does not address future notification of claims that may arise from circumstances before 2011 that must still be borne by the ARP, insurers, the profession and, ultimately, consumers. Unlike the alternative approach, the SRA does not contemplate removing the ARP's role as provider of insurance until 2012. This means that the inefficient ARP, which accounted for around 15-20% increase in premiums in 2010/11, will continue to operate for at least another year. The SRA should consider orderly closure of the ARP for 2011 in accordance with the alternative approach.
105. Contrary to the SRA's view that its exclusion of financial institutions will reduce costs to the profession, there is no guarantee that any 'saving' from removing financial institution cover from the MTC will offset the cost of any 'bolt-on' or additional cover that lenders will require as a precondition of performing conveyancing work for their panels. Indeed, all indications to date suggest that the cost of this insurance will be more expensive (perhaps prohibitively so for small firms) as by separating out conveyancing risks as a stand-alone product, the SRA's proposal has made this risk less attractive to insurers who have lost the benefit of diversification provided by the MTC.

CRA's Principle 3—Competition

106. TLS disagrees with the SRA's competition assessment. Competition is not encouraged by excluding financial institutions from the MTC as it effectively reduces the availability of insurance resulting in a reduction in legal service providers. The Irish experience (with a more limited exclusion than proposed by the SRA) is that small firms are disadvantaged by any client exclusion as they are unable to afford insurance outside of the MTC to satisfy the requirements of lenders' panels. Different lenders may also seek to impose different limits, acting as an additional barrier to entry. These barriers will reduce competition in the conveyancing market resulting in higher cost and less choice for the ultimate consumer. These impacts were identified in the CRA report which recognised the potential for this proposal to exclude small firms and 'dabblers' from lenders panels. The Irish experience suggests that there may be benefit in having compulsory MTC cover for this work as an element of compulsion may actually increase the availability of insurance; thus, helping smaller firms and maintaining a competitive and diverse legal profession. Lack of competition also has wider implications for consumer choice and access to justice, directly affecting the regulatory objectives in the LSA. Therefore, it appears incongruous for the SRA to state that this proposal is 'consistent' with competition.

CRA's Principle 4—Diversity

107. TLS disagrees with the SRA's impact assessment on an independent, strong, diverse and effective legal profession. Contrary to the SRA's regulatory objectives in the LSA, diversity is not supported because of the adverse impact of the SRA's proposed financial exclusion on small firms. If cover is voluntary then lenders will only instruct and admit those firms to lenders' panels that meet *lenders'* minimum requirements of cover. It is likely that these requirements may differ from the MTC and will be prohibitively expensive for many firms, exacerbating the current problems where small firms experience significant difficulties with PII and lender panels. In order to try to protect themselves under the claims-made system (see question 12 under the heading 'sophisticated' client), lenders may be even more selective about panel entry in the future. This adversely affects the diversity objective in the LSA.
108. If lenders require cover that is equivalent to the MTC then insurers may be only willing to write this cover at a price that is prohibitively expensive for small firms. There is also a possibility that insurers will refuse to write some MTC elements (such as the provisions relating to fraud and material non-disclosure). This fragmentation of the market for legal services may result in lenders introducing separate representation to the disadvantage of many hundreds of firms of solicitors who do residential conveyancing and ultimately increasing borrowers' cost of conveyancing. This results in a potential unintended consequence that the SRA should consider as part of its regulatory objective to protect and promote the interests of consumers.
109. Many smaller firms derive a large proportion of their income from conveyancing and, even for those who do not, conveyancing can act as an

important client gateway. Regulatory concern about those who 'dabble' in insurance should be addressed by better regulation, not outright exclusion from the MTC with the resulting potential exclusion from the insurance market and practice in this area. The SRA considers its proposal will make it easier for small non-conveyancing firms to distinguish themselves and obtain insurance [at 3.32 of the SRA's consultation paper]. TLS disagrees with this assessment as the exclusion is too broad (see above) but nevertheless notes that there are other ways to satisfy insurers and lenders about a firm's risk-management, such as accreditation schemes like CQS.

110. The SRA has encouraged respondents to provide information about the E&D impact. The SRA as regulator is best placed to make this assessment. However, TLS considers that small firms (including BME firms) will be adversely affected by this change for the reasons outlined. TLS' specific comments on the SRA's Equality Impact Assessment are outlined in our response to Annex A of the SRA's consultation paper.

CRA's Principle 5—Targeted

111. TLS disagrees that the SRA's proposal is targeted. We consider the proposed exclusion is not consistent with the better regulation principles because it is not sufficiently targeted to the perceived market failure, i.e. conveyancing work and specifically the offering of undertakings, but instead the exemption is for *all* work undertaken for financial institutions. See TLS' specific comments outlining reasons why the 'exemption is too broad'.

CRA's Principle 6—Unintended consequence

112. TLS considers that fragmentation of the MTC via exclusion actually creates further problems and unintended consequences. Market participants have already flagged changes in the way that conveyancing is undertaken as a result of this exclusion. As outlined above, there is a danger that, if excluded from the MTC, lenders and insurers will negotiate cover that differs from the MTC and if lenders do not consider this cover to be satisfactory they may introduce separate representation for domestic conveyancing to the detriment of consumers.
113. TLS also notes that while, in general, specialisation may tend to create expertise, it is wrong to confuse current volume of work with expertise. It is perfectly possible for firms to only do a small amount of conveyancing work and to do that work extremely well. Many small high street firms use this type of work as a 'gateway' to attract clients for work in other areas. Regardless of whether or not dabblers are sufficiently skilled, contrary to the SRA's intention, instead of reducing the number of dabblers, the SRA's proposals may have the unintended consequence of forcing firms *into* unfamiliar areas of work. If established and specialised conveyancing firms are unable to afford the cost of additional insurance, then these firms may be limited to providing services that fall within their MTC policy. These firms may not have sufficient experience in these work areas, the SRA's main criticism of 'dabblers'. For this reason, TLS considers that better regulation of all solicitors by the SRA to increase overall standards is the key to this problem, not wholesale exclusion from the MTC.

CRA's Principle 7—Regulatory supervision

114. Firms may be forced by the proposed actions of their regulator to seek to become licensed conveyancers to take advantage of regulation by the Council for Licensed Conveyancers (CLC) and insurance under its Master Policy. This would remove these firms from the supervision of the SRA.

CRA's Principle 8—Risk Management

115. In its analysis, the SRA neglected to consider the effect of this proposal on risk management. Wholesale exclusion does nothing to address the underlying cause of conveyancing claims some of which could be avoided through appropriate risk management procedures. This has already occurred with stricter identification measures introduced to counter the rise of Land Registry fraud claims. TLS considers that its approach to conveyancing that focuses on increasing the standard of work via better risk management through initiatives such as CQS better reflects this principle than the SRA's exclusion.

13 Do you agree with the definition of “financial institutions” that we have proposed?

116. The SRA's proposed definition of financial institution is any undertaking or unincorporated association which carries on a business lending money (which may include mortgage lending) or otherwise providing or issuing credit including without limitation, any bank or building society [at 3.26 of the SRA's consultation paper].
117. TLS does not agree with the exclusion of financial institutions.
118. In terms of the definition proposed by the SRA, it is extremely broad and clearly extends beyond mortgage lending where the SRA has identified that the predominance of claims have arisen. As part of its risk-based assessment, the SRA should consider whether it would be more proportionate to simply target mortgage lenders rather than all institutions providing credit. The SRA may also want to examine the Irish exclusion which 'for the avoidance of doubt' excludes 'a Minister of the Government in the exercise of the functions, powers or duties of office'.³
119. TLS considers that any definition should reflect those used by the FSA in terms of its regulation of financial institutions. A test is needed to determine whether an undertaking 'carries on a business'; TLS considers reference could be made to the business test under the *Financial Services & Markets Act 2000*; see, for example, section 22 which requires a regulated activity to

³ Section 2 of *Solicitors (Professional Practice, Conduct and Discipline Commercial Property Transactions) Regulation 2101* SI No 366/2010 (Ireland).

be carried on 'by way of business' and guidance in the FSA's Perimeter Guidance Manual (PERG 2.3).

14 Do you agree with our proposed approach for implementing this change by way of a "permitted exclusion" from the MTC?

Permitted exclusion

120. Although TLS does not support any client exclusion from the MTC, it recognises that amending the 'permitted exclusions' in clause 6 is the most appropriate way of implementing exclusions. However, if the SRA determines that an exclusion is necessary, TLS urges the SRA to consider a more limited exclusion that is targeted to the perceived problem (see TLS' response to question 12).

Trigger date

121. The SRA proposes to use the date of the act, omission or error that gave rise to the claim to determine whether a particular claim is covered or not (i.e. actions relating to financial institutions post-1 October 2011 will not be covered by the MTC). The SRA has asked for views on an alternative trigger date such as the date of instruction to determine whether a claim is covered [at 3.28 of the SRA's consultation paper]. Although it does not support any client exclusion, TLS considers that the trigger date should be made by reference to the date of instruction as this is more certain and will allow for appropriate client disclosure.
122. Although the SRA's proposed exclusion does not address claims arising from past conduct that will be notified post-1 October 2011, TLS does not consider that a retrospective exclusion is appropriate and therefore agrees that the SRA should limit its proposal to claims arising from post 1-October 2011 conduct.
123. In terms of a trigger date, it may be difficult to determine the exact date of the conduct giving rise to a claim, particularly if there is a series of negligent transactions. For this reason, the date of instruction may provide a more certain trigger date, particularly as it is at this point that the client must be made aware of the fact that its particular instruction is not covered by the MTC. It will also be important to note, and for solicitors to make clients aware, that even if a solicitor has appropriate insurance coverage at date of instruction, under a claims-made system, it is more pertinent for solicitors to have appropriate insurance in the future when a claim is notified. This distinction can become confusing even for relatively 'sophisticated' clients. It appears that even sophisticated clients may find it difficult to ensure that their solicitor will have appropriate cover in place when they actually need it (see question 12). This is a key client protection that is lost by the SRA's fragmentation of the MTC.
124. If the SRA extends its exclusion to all corporate clients in 2012, it should also consider whether the identity of client can be determined at this trigger date. See TLS' response to questions 19 and 21 where it is noted that clients may change from individuals to corporations during the course of a

transaction and therefore a trigger date based on the date of instruction may assist in communicating to clients whether or not they are covered by the MTC. TLS notes that a potential unintended consequence from the SRA's proposal is that clients may be uncertain about whether or not they are covered by MTC throughout the period of instruction and solicitors, as part of their duty of disclosure, will have to continually review the position and update clients about their MTC status.

15 Are there any further consequential impacts of this change that you believe we should consider?

125. Given the potentially disastrous consequences for small firms (outlined at question 12 and Annex A of the SRA's consultation paper), if the financial institution exclusion is adopted, then the SRA should consider transitional measures to assist small firms to continue to provide this work. These measures are justifiable in accordance with the LSA's regulatory objectives. The SRA needs to adopt a long-term view of the conveyancing issue; its proposed exclusion, comes at too high a cost and is inconsistent with its regulatory objectives. It sounds the death knell for an unquantified number of high-street conveyancing firms with resulting consequences for competition, diversity, access to justice and the price ultimately paid by consumers.
126. The SRA will also need to consider other potential transitional measures such as information and education to make lenders and solicitors alike aware of these radical and extreme changes to cover that has previously offered blanket protection.

Proposal 3: Reduction in time spent in the ARP

16 Do you have any comments on the proposal to reduce the time a firm may be permitted to remain in the ARP to 6 months and the impacts identified? Are there any further consequential impacts of this change that you believe we should consider?

127. The proposed reduction in time spent in the ARP is a superficial change that does not substantially reduce the level of ARP claims. Whether claims are notified in the 12 months or after six months, as part of run-off cover, these claims are still dealt with by the ARP. The SRA's proposal simply hastens firms' closure without addressing the underlying cause of claims. The CRA report has identified that there is little chance of rehabilitation of firms to the extent it is unlikely that the SRA's proposal will have any effect on assisting firm 'attempt successful exit' at the end of six months. TLS notes that the SRA's proposal will require better management and regulatory action by the SRA to ensure that firms are orderly shut-down within this shorter timeframe.
128. TLS supports the removal of the ARP's role as provider of qualifying insurance; however, only if it is implemented as part of an alternative

approach which provides a safety net for the public alongside its preconditions for a fairer PII system. The alternative approach provides solicitors with a reasonable opportunity to find alternative insurance an ERP provides a minimum three month period to ensure orderly closure in the public interest. This will remove pooled liability as existing insurers will provide cover during the ERP and run-off. In this way, the alternative approach provides at least an equivalent, if not better, chance of rehabilitation when compared with the SRA's proposed reduction in time spent in the ARP for 2011. TLS' notice provisions ensure that firms, in the usual circumstances, are given a minimum of six months to seek alternative insurance or consider their options (see detail outlined in the introduction above). As such, the EIA on the alternative approach considers there to be neutral equality impact between the SRA's 2011 proposals (see **Attachment 1**) and for reasons outlined above, the alternative approach better encourages competition and balances stakeholder interests and provides maintains a safety net in contrast to the SRA's 2012 proposals.

129. The SRA's proposal defers the actual decision on whether to abolish the ARP to the stage 2 consultation. While it may be possible to be viewed as a transitional measure, it fails to consider the full impact of delay and the uncertainty caused by this approach. TLS expresses concerns about the unintended consequences of the SRA's two-stage approach in response to question 4.

Impacts identified

130. TLS agrees that it is important to weigh the potential benefits gained by the proposed tighter controls on the ARP with the potential adverse impact on BME firms [3.53 of the SRA's consultation paper]. TLS' preconditions for a fairer PII system, coupled with the benefits of variable renewal dates (if realised) will hopefully go some way to redress imbalances within the PII system that have led to a disproportionate number of BME firms within the ARP. TLS' specific comments on the SRA's Equality Impact Assessment are outlined in our response to Annex A of the SRA's consultation paper and the EIA on our own proposal is at **Attachment 1**.
131. The SRA claims that this proposal alone will reduce the volume and value of claims which must be met by the ARP; TLS considers that the SRA's proposal is unlikely to have that impact. The CRA report notes that only 9% of claims are generated whilst firms are in the ARP, the vast majority arise from circumstances prior to ARP entry, therefore, reducing the time spent in the ARP, does not reduce its claims burden for reasons outlined above. Consequently, the alternative approach better addresses the core problem by ensuring claims are not transferred to the ARP and improving conveyancing standards to prevent claims occurring in the first place.

Consequential impacts of change from 12 to 6 months

132. The SRA recognises that it will be some time before the benefits of removing the single renewal date can take effect. TLS agrees that, during this transitional period, it may be difficult for firms to obtain insurance part way through the year until the rest of the market adopts variable renewal

dates [3.52 of the SRA's consultation paper]. For this reason, the SRA should encourage a spread of renewal dates in order to avoid any unintended consequences (see question 11).

133. Capacity issues may be further exacerbated by the perverse incentive created by retaining the ARP alongside variable renewal (see question 11). This may potentially leave some firms without insurance through no fault of their own but due to insurers' desire to avoid ARP liability. For this reason, the alternative approach is preferable as it closes the ARP to new entry avoiding this issue.
134. Another potential unintended consequence of uncertainty surrounding the ARP is that insurers may 'dip out' of the market for the 2011 renewal period (see question 4). Reducing the time firms spend in the ARP does not provide sufficient incentive for insurers to remain in the market to counterbalance the detriment caused by the uncertainty caused by ARP liability.

17 Do you have any comments on the proposal to require detailed planning by firms in the ARP and the impacts identified? Are there any further consequential impacts of this change that you believe we should consider?

135. TLS supports the requirement for firms to plan for succession, merger or closure; however, considers that this proposal does not necessarily have to be linked to the ARP which has out-lived its purpose. Detailed planning is an integral part of the better management of ARP firms by the SRA that TLS has been advocating for some time now. However, TLS does not consider it necessary for the SRA to adopt a two-stage process to implement these changes, particularly as it appears that the abolition of the ARP is inevitable. TLS considers that the ARP's role of providing insurance to firms should cease immediately and that the SRA should be responsible for overseeing orderly shut-down of firms in the ARP if they are unable to obtain market insurance. TLS notes that, as a qualifying insurer, the ARP would have to provide these firms with a six month notice period with a minimum three month ERP. Going forward, those firms who are unable to obtain insurance will be given an ERP by their current insurer under the alternative approach. As part of this process, the SRA would be notified at the commencement of this ERP and firms would be required to submit to the SRA a detailed action plan.
136. TLS has made specific comments about the drafting of 'special measures' to include a rehabilitation plan in its response to Annex B of the SRA's consultation paper. TLS agrees with the proposal to require firms to submit plans to the SRA; however, questions whether a 'special measure' is the best mechanism by which to achieve this outcome. TLS would prefer these plans to be routinely submitted to the SRA rather than from 'time-to-time'.

Impacts identified—CRA's Principle 1—Transparency

137. Transparency was not considered by the SRA. TLS agrees that requiring explicit planning by ARP firms is a step in the right direction. TLS has been supportive of the SRA's recent enforcement strategy; however, TLS considers that the SRA's enforcement methods could be more transparent. Currently, the SRA states it is 'monitoring firms'; it would be useful for greater detail to be provided in addition to the SRA's enforcement statistics. Effective communication with the profession is essential in order for enforcement by the SRA to be respected and to act as a deterrent. The SRA needs to send appropriate adequate signals to the entire legal profession to dispel the myth that the ARP is a 'soft' option where cover is provided irrespective of non-payment of premiums and without consideration of underwriting criteria.
138. TLS also considers greater transparency about the SRA's expectations of a 'robust and credible plan' is essential (see discussion of consequential impacts below).

Consequential impacts of detailed planning in the ARP

139. TLS agrees that orderly shut-down is essential as otherwise client protection will be eroded. The SRA may have to provide additional support and assistance as part of its regulatory function to ensure plans actually deliver orderly shut-down, particularly as this requirement falls on ARP firms who may already experience difficulties in practice management. The SRA may need to allocate resources to ensure these plans are reviewed and approved in a timely manner, particularly during the transitional period where it will have to review a large number of plans given the number of firms in the current ARP.
140. TLS considers that the SRA will have to publish guidance about the contents of 'a robust and credible plan' and the level of detail that the SRA expects these plans to contain. The SRA should publish template plans; TLS notes that multiple templates may be needed to reflect different firm sizes and structures that will affect the requirements for orderly shut-down.

Proposal 4: Increased reporting requirements

18 Do you have any comments on the proposal to clarify the reporting requirements on Qualifying Insurers and the impacts identified? Are there any further consequential impacts of this change that you believe we should consider?

141. TLS agrees that early identification of risks is clearly in the interests of clients and the public. However, TLS does not consider that the SRA's proposal to make clause 6.2 of the QIA mandatory will have the desired effect of removing the current perverse incentive on insurers to not report firms who fail to pay premiums to the SRA. Clause 6.1.5 which requires insurers to report fraud or material misrepresentation is currently drafted in

mandatory terms. The fact that a perverse incentive not to report fraud or misrepresentation exists notwithstanding this mandatory drafting suggests that the SRA's proposal will have little or no practical effect on insurers' behaviour.

142. The SRA has rejected CRA's recommended financial penalties for insurers who fail to report, preferring instead to 'monitor' whether firms should have been reported earlier as part of its interventions [3.62 of the SRA's consultation paper]. TLS suggests that there is little point in the SRA 'monitoring' non-reporting if the SRA does not have an appropriate, targeted and proportionate enforcement tool sufficient to change insurers' behaviour. Currently, the only 'penalty' for non-reporting within the QIA is termination; which is too 'big' a stick to be used in a single instance of non-reporting.
143. TLS has proposed different incentives to those in the CRA report to ensure that the SRA's proposed mandatory reporting requirements have the desired effect. The alternative approach would give insurers the ability to end a policy for fraud or material non-disclosure (except if the insured can prove no fraudulent intent), place a firm immediately in the minimum ERP to provide for orderly closure and retain the right to premiums under the policy. Alternatively, insurers can continue with the policy and adjust the premium to reflect the position they would have been in but for any material non-disclosure. The ability for insurers to obtain redress in the event of fraud or material non-disclosure is also an important part of ensuring fairness, given that the alternative approach removes the ability of insurers to transfer firms to the ARP and makes them responsible for ERP and run-off cover for their individual underwriting decisions.
144. Furthermore, even if the SRA's proposal does result in increased reporting, this information is only beneficial if the SRA uses this information to take action against solicitors who are in regulatory breach by failing to pay premiums or making material non-disclosures. Better enforcement by the SRA is one of the essential preconditions of the alternative approach and consistent with the SRA's regulatory objectives.

Impacts identified

145. The SRA considers the proposal is consistent with its Primary and Secondary objectives and brings the PII requirements in line with Principle 7 (supporting regulation) and Principle 8 by encouraging better risk management. TLS considers that these reporting requirements already exist in the QIA and therefore this proposal will have no impact without additional incentives on insurers to report or increased enforcement by the SRA.

Possible Future Changes for 2012

Future change 1: Corporate client exclusion

19 Do you have any comments on whether we should permit a wider exclusion from the MTC such that cover is only required in respect of work done for “individuals”?

146. TLS does not support any form of client exclusion and urges the SRA to reconsider the scope of its proposed exclusion. Exclusion from regulation is a decision that should not be taken lightly and only if absolutely necessary after having assessed the full impact of consequences and all of the regulatory objectives in the LSA. In TLS' response to question 12, TLS considered that exclusion of financial clients was not sufficiently targeted to the identified conveyancing problem; wholesale exclusion of corporate clients is even more extreme and proves to be especially problematic given the definition of 'individual'. Some clients may cease being 'individuals' during the course of instruction as a result of the transaction; for example, a merger between two micro-enterprises or an individual client who instructs that a property should be purchased by a company for tax purposes.

147. TLS has addressed the 'sophisticated' client argument (at questions 12 and 14). The position remains the same in relation to the SRA's proposed extension to corporate clients. TLS would also make the following additional points. Firstly, not all corporate clients are large sophisticated entities (particularly if a narrow definition of 'individual client' is adopted, see TLS' comments on question 20). Secondly, while corporate clients may be highly skilled in business transactions, they may not have a sophisticated knowledge of the need for professional indemnity insurance, particularly given the fact that they have previously been afforded the blanket protection of the MTC. TLS refers to the Irish experience above. A more proportionate and targeted response (in line with the better regulation principles in s. 3(3) of the LSA) would be to focus on the area of regulatory failure, i.e. conveyancing, and, as evident in the alternative approach, develop specific measures to better regulate this sector of the market.

20 Do you have any suggestions on the definition of “individual client” that we should consider?

148. The SRA has asked whether small corporate entities are sufficiently sophisticated and whether there will be disputes along the boundaries of this definition [4.6 of the SRA's consultation paper]. TLS has grave concerns about the level of sophistication of some corporate clients and indeed the ability of sophisticated clients to protect themselves to the same degree as under the MTC (see question 12).

149. TLS also considers that it is inevitable that there will be disputes about the boundary of any definition, resulting in unintended consequences if the SRA adopts this proposal. The SRA itself appears to recognise that CRA's proposed definition of 'individual' is too narrow. CRA's proposed definition

only includes micro-enterprises i.e. less than 10 staff and turnover of under €2 million and therefore excludes small and medium-sized enterprises (SME). If adopted, this means that all SME clients will be excluded from the MTC. Even adopting the SRA's 'sophisticated' client approach, this goes too far. TLS would argue that SME clients are deserving of the protection of the MTC as, while they may be highly skilled in business, they may not have the requisite degree of sophistication when it comes to engaging a solicitor and ensuring sufficient levels of professional indemnity insurance are in place to cover any claim when notified.

150. For the reasons outlined in question 12, TLS considers that all clients are in need of protection and that the SRA should not adopt any client exclusion. If the SRA does decide to exclude corporate clients, TLS would encourage the SRA to adopt a more suitable definition of 'individual client' that reflects the level of sophistication and bargaining power that the SRA considers is necessary to ensure appropriate PII cover is in place. TLS considers that it will be difficult to compose a test to assess whether a corporate client is sufficiently 'sophisticated' as this may not necessarily be reflected in the usual definitions of 'small business' or 'small company' that are linked to entity size or turnover.⁴ As outlined above, even large corporations may not be sophisticated purchasers of PII. Although it does not accept that any of these clients should be excluded, TLS considers that any definition used in the SRA's exclusion should satisfy its notion of a 'sophisticated client' otherwise it will have unintended consequences and impact adversely on the primary objective identified by the SRA—client protection.

21 What impacts do you consider such a change would have?

151. As outlined in TLS' response to question 12, there are a number of unintended consequences resulting from such a broad exclusion that covers all work done for all corporate clients. This proposal significantly reduces the scope of the MTC and fragments the solicitors' PII market to regulated and unregulated sections. This will have far-reaching consequences for the future provision of legal services and may result in an erosion of the SRA's primary objective of client protection.
152. There are also unintended consequences flowing from the specific exclusion of corporate clients because, some clients may change from 'individuals' to 'corporations' during the course of instruction as a result of the transaction (see question 19 above). This will lead to uncertainty for clients about whether or not they are covered by MTC throughout the period

⁴ For example, the Financial Services Authority (FSA) handbook defines small companies by reference to section 382 of the *Companies Act 2006*. The qualifying conditions for a 'small company' are two or more of the following requirements: turnover less than £6.5 million; balance sheet total of less than £3.26 million; and/or less than 50 employees. The FSA defines a small business as a partnership, body corporate, unincorporated association or mutual association with an annual turnover of less than £1 million (or its equivalent in any other currency at the relevant time) and a large partnership as 'a partnership or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time)'.

of instruction, and whether they need to ensure non-MTC cover is in place to cover future notification of claims. Solicitors, as part of their duty of disclosure, will have to continually update clients about their insurance status.

Future change 2(a): ARP's role—removal of the ARP

22 Do you have any comments on whether we should remove the role of the ARP as a provider of policies of Qualifying Insurance?

Rehabilitative role

153. TLS contends that there is a need to provide rehabilitation for firms and a safety net in cases of market failure. As the ARP has not been properly managed it is failing in this role, the alternative approach would see the ARP cease its role as insurer of firms who are unable to obtain insurance and will gradually shut-down those firms in the ARP. As an alternative to ARP entry, firms will be given an ERP by their current insurer in which to either obtain insurance elsewhere or consider alternative options (in addition to the notice period outlined in the introduction above). TLS considers that the SRA should be notified once a firm enters into the ERP so that it can commence monitoring the firm and helping it prepare its detailed action plan and, if relevant, better make its case to insurers to obtain cover. Further SRA regulatory action may be required. TLS notes that its approach is also consistent with the SRA's role and regulatory objectives (see introduction to TLS' response).
154. TLS considers that the SRA's proposal to abolish the ARP without a safety net is contrary to the public interest that requires firms to close orderly. The alternative approach provides a minimum three month ERP that is intended to fulfil this function.

Temporary cover

155. TLS does not agree with CRA and the SRA that demand for temporary cover is inextricably linked to single renewal date and will decline under a system of variable renewal [3.8 and 4.33 of the SRA's consultation paper]. Even with a variable renewal date, temporary cover may still be useful as firms may experience short-term difficulties in obtaining insurance from the commercial market; for example, if a frivolous notification is received immediately before the Policy Period or if a firm's past claims record does not reflect subsequent improvements made to a firm's risk management processes. Therefore, even if the rehabilitation role is no longer needed due to positive changes to the broader PII system (as recommended in TLS' preconditions); there is merit in retaining a 'grace period' commensurate with the current 30 day period.
156. If the alternative approach is adopted then temporary cover will no longer be required to be provided by the ARP as it will, in effect, be provided by the ERP.

TLS' comments about the SRA's proposal about fallback arrangements

157. The SRA considers that it should not interfere with the market's risk assessment and that the 'additional flexibility' created by its 2011 reforms will enable firms that are not 'unacceptable risks' to get appropriate open market coverage [at 4.25 of the SRA's consultation paper]. It suggests TLS could provide any 'fall back' arrangements [at 4.26] but that it is not the role of the regulator to mandate this cover.
158. TLS disagrees with the SRA's assessment of the impact of its 2011 reforms. TLS considers that three of the SRA's proposals will have very little impact by 2012 and that the financial institution exclusion will have a damaging and irreversible impact on small firms' ability to obtain affordable insurance despite being 'not unacceptable risks'.
159. TLS strongly disagrees with the SRA's assessment of the impact of its 2011 reforms and that TLS should be a fall-back insurance provider. It is not appropriate for TLS to be a fall-back insurer for the same reason that the SRA is ill-equipped to be an insurer of last resort. Indeed, this is the reason the profession moved away from SIF to the current open market model (see question 26).
160. TLS considers that it is the role of a regulator to consider the effect of forcing firms unable to obtain insurance on the open market to cease to practice immediately in light of its regulatory objectives. SRA has itself recognised that disorderly closure is not in the public interest and TLS considers that some form of safety net is necessary to provide orderly closure in the interests of consumers and protecting the public.

23 What impacts do you consider such a change to the ARP's role would have?

161. The SRA considers the removal of the ARP's role better aligns with CRA's Principles 2, 3, 5, 7 and 8 but may pose a risk to principles 4 (diversity) and 6 (unintended consequences). It is unclear what the SRA means by its statement that 'as with the proposal to end the rehabilitation role, additional information flows would be necessary between insurers, firms and the SRA' [at 4.38 of the SRA's consultation paper]. If the SRA is suggesting that it will provide greater information about its enforcement strategy to market participants then TLS is supportive of this measure as this is part of TLS' preconditions for a fairer PII system. TLS makes specific comments on the SRA's impact assessment below.
162. TLS supports the removal of the ARP in the context of its approach which replaces the ARP with an ERP in which firms can either seek alternative insurance or consider their alternative options. The SRA's proposal does not fully consider the transitional measures required to allow orderly shut-down of firms. The alternative approach provides firms with a notice period and ERP during which time their current insurer provides cover replacing the pooled liability of the ARP. This ensures that clients are sufficiently

protected and that firms are given as much of chance at rehabilitation as they are given under the SRA's 2011 proposal (which reduce the time spent in the ARP from 12 to six months) and greater protection than under the SRA's 2012 proposal which does not even provide for orderly closure. As such, the alternative approach will have neutral, if not beneficial, equality impact (see **Attachment 1**).

CRA's principle 4—E&D impact

163. The SRA considers the adverse impact on BME firms from the removal of the ARP's role as insurer of last resort will be mitigated by the removal of the single renewal date and its work with ABI and the FSA to establish the effectiveness of insurers' E&D policies [4.39 at of the SRA's consultation paper]. TLS supports examination of insurers' E&D policies by the SRA and FSA but also considers that an examination of underwriting criteria is also necessary to ensure that insurers are not unwittingly discriminating against BME firms. This is part of TLS' preconditions of a fairer PII system that must be realised regardless of a single or variable renewal system; these preconditions include the introduction of minimum periods to consider quotations and maximum processing times.
164. Given their disproportionate numbers in the ARP, it is extremely important to consider the impact of specific ARP proposals on BME firms (see TLS' comments on the SRA's initial impact assessment). As outlined in its response to question 11, TLS considers that it will take time for a sufficient spread of variable renewal dates to occur in practice; therefore, it will be some time before any benefits from the removal of the single renewal date will be realised. As such, the SRA cannot solely rely on this measure to mitigate the impact on BME firms of removing the ARP without providing an alternative safety net.
165. TLS supports any action by the SRA that will contribute to achieving a spread of variable renewal dates (see question 11). Given that the SRA itself recognises that it may take time for these benefits to be realised, TLS urges the SRA to engage in further measures to support small firms in the interim. These measures are justified by the SRA's regulatory objectives relating to access to justice, consumer interests, competition and diversity within the profession under the LSA.
166. TLS has conducted an equality impact assessment on its alternative and considers that its proposals have neutral equality impact on small firms, BME, female and sole practitioners when compared with those proposed by the SRA for 2011 (see **Attachment 1**). The alternative approach is advantageous as it attempts to mitigate the risk to these groups through its preconditions for a fairer PII system and will provide a safety net beyond 2012.

CRA's principle 6—unintended consequences—disorderly closure

167. TLS notes that the SRA's concerns about 'disorderly closure' [at 4.40] are genuine and considers that there is a regulatory need to provide a safety net that allows for orderly closure in the public interest. For this reason, the

alternative approach provides a minimum three month ERP in all cases. As part of any safety net mechanism, the risk of disorderly closure can be mitigated by better regulatory action and close monitoring and supervision of firm's detailed action plans (see question 17). It is because of the concern about disorderly closure that TLS disagrees with some of the SRA's proposed restrictions on firms during this period of orderly shut-down, particularly any restrictions that will lead to the cessation of all new work and restrictions on handling client money. TLS considers that these restrictions are not conducive to orderly shut-down, maintaining financial viability of firms and are not in the interests of existing clients of those firms (see question 24).

168. The alternative approach would also avoid the unintended consequences of the SRA's two-stage approach outlined in question 4.

Future change 2(b): ARP's role—restrictions on work in ARP

24 Do you have any comments on whether we should implement these restrictions on firms in the ARP?

169. The SRA's proposed restrictions will require firms to not accept new instructions and/or not hold client money. TLS agrees that it may be appropriate for firms in the ARP to decline new work that may extend beyond the minimum time a firm can spend in the ARP (or ERP if the alternative proposal is accepted). However, TLS does not support any restriction that would prevent acceptance of *any* new work or place restrictions on handling client's money as these measures are not conducive to orderly shut-down or maintaining the financial viability of firms. Indeed, these restrictions may result in disorderly shut-down and prevent proper completion of work currently being undertaken by the firm. The SRA itself has recognised the risk of disorderly closure is not in the public interest (see question 23—unintended consequences). TLS considers that restrictions on handling client money and preventing any new work are not conducive to orderly shut-down and are not in the interests of existing clients of those firms.

25 What impacts do you consider such a change (restrictions on work) would have?

170. TLS does not consider that restrictions on work conducted in the ARP will greatly impact on the number of claims in the ARP. The CRA report notes that only 9% of ARP claims in the indemnity year 2008/09 were generated while firms were in the ARP; therefore, restrictions on work on firms whilst in the ARP will have minimal impact and some may have the unintended consequence of creating disorderly shutdown (outlined at question 24).
171. For this reason, it is better to address this issue through the alternative approach that examines conveyancing standards and requires the SRA to work collaboratively with the insurance industry and collect appropriate information to ensure that firms are subject to regulatory controls and risk

management practices are in place before problems occur that necessitate extreme action such as shut-down.

Future change 3: ARP funding

26 Do you believe that we should change the way in which the ARP shortfall is funded? Please set out your reasons and any areas of agreement or disagreement with the analysis of the issues set out in this paper.

172. TLS strongly opposes any change to the funding of the ARP that transfers the risk from insurers onto the profession. As such, TLS does not support either option proposed by the SRA. It was a fundamental part of the introduction of the market-based insurance arrangements in 2000 that TLS no longer bore directly the risks arising from the insurance market. TLS will not be prepared to continue with a market-based approach unless that principle is maintained.

173. TLS agrees that the current arrangements may to a very small extent provide an incentive for insurers to restrict their market share, at least by avoiding business anticipated to be of marginal profitability. This is also evident by the pricing methodologies employed by some insurers during the last renewal period to avoid a large share of the ARP. TLS also recognises the importance of ensuring the insurance market is competitive. The alternative approach addresses these issues, not by changing the way the ARP is funded, but by removing its pooled nature and reducing the role of the ARP over time (see introduction for details).

174. The SRA's proposal reallocates the risk of ARP funding from insurers to the profession and by refusing to mandate an alternative safety net, it undermines its public interest regulatory objective. Similarly, the SRA does not consider the impact of transferring the risk onto the profession on the financial viability of firms. The alternative approach better balances the interests of the profession and insurers and reduces the role of the ARP, while at the same time maintaining the integrity of the primary objective of client protection by providing a safety net for orderly closure.

175. Under TLS' proposal, the question of ARP funding will eventually become a moot point. The effect of paying insurance premium tax and brokers' commissions on the ARP component of premiums will also reduce in significance if the ARP were to operate on a much smaller scale.

27 In your view, what would be the impacts and the advantages and disadvantages of maintaining the current approach to funding the ARP shortfall?

176. It is clear that insurers have presented a number of concerns about the MTC but none greater than that concerning the current approach to funding the ARP shortfall. The ARP is no doubt one contributory reason why some insurers have exited the market or reduced their market share in recent

times and is also a minor deterrent to new insurers looking to enter the solicitors' PII market.

177. TLS recognises the importance of ensuring the insurance market is competitive and sustainable; however, this does not warrant the SRA's extreme proposals regarding ARP funding. Currently, insurers' main complaint with the ARP is that it is an unquantifiable liability that arises from the pooling arrangements which makes insurers liable for firms that they have chosen not to insure. This unknown variable is inevitably passed onto solicitors in the sense that insurers take it into account in pricing decisions generally. In this way, the profession is already indirectly partly funding the ARP and there is no need to change the ARP funding arrangements as the SRA proposes.

178. As outlined in our response to question 26 and the introduction, our approach better targets insurers' main complaint by removing the pooling of risks and allowing insurers to only be responsible for providing an ERP and run-off cover to firms that they have chosen to insure.

28 In your view, what would be the impacts and the advantages and disadvantages of the two possible alternative approaches to funding the ARP shortfall set out in this paper?

Option 1: Direct levy on the profession

179. TLS strongly opposes a direct levy on the profession. The profession already indirectly pays for the ARP; therefore, option 1 merely reassigns the entirety of this risk to the profession which is ill-equipped to fund the entire ARP. The SRA's proposal fails to mitigate the risk of ARP shortfall going forward. As outlined in our response to question 26 and the introduction, the alternative approach better balances the interests of all stakeholders.

Option 2: Levy as percentage of insurance premium

180. TLS also opposes a wholesale levy on the profession expressed as a percentage of the insurance premium to fund the ARP shortfall as it is an inappropriate allocation risk (as outlined in our response to question 26). Although TLS opposes both options, it considers a levy as a percentage of insurance premium would be easier to administer than a direct levy.

29 Are there other approaches to funding the ARP shortfall which you believe the SRA should consider?

181. Yes. The SRA should consider adopting the alternative approach, as discussed in our response to question 26 and detailed in the introduction, which reduces the level of the ARP over time and removes the ARP's role in the future. Alternatively, the SRA should leave the current arrangements in place.

Future change 4: Non-payment of premiums, fraud, misrepresentation

30 Do you have any comments on whether we should permit the cancellation of policies for non-payment of premiums?

182. TLS does not support the cancellation of policies for non-payment of premiums. Insurers can already adequately protect themselves from this eventuality by requiring payment of premiums up-front or via credit arrangements.
183. TLS' response to question 18 supports the SRA requiring insurers to immediately notify it about non-payment of premiums but suggests that without additional enforcement measures this change will not have the desired effect. As part of TLS' preconditions for any reform, TLS considers that the SRA should take stronger action against solicitors in regulatory breach due to non-payment of premiums.

31 Do you have any comments on whether we should permit the cancellation of policies for fraud or misrepresentation in proposal forms?

184. The alternative approach would allow the ERP to commence immediately in the event that fraud or material non-disclosure is discovered on a firm's proposal form. The provision of ERP and run-off cover by the insurer in these circumstances remains essential for client protection.
185. TLS considers that there should be an exemption if the insured can prove that there was no fraudulent intent in making the material non-disclosure or misrepresentation. This is similar to the current provisions in the CLC's Master Policy that prevent insurers cancelling the policy for honest mistakes.
186. As an alternative to ending the policy, insurers should also be given the ability to adjust premiums to place them in the position that they would have been in but for the misrepresentation or material non-disclosure. The dispute resolution clause in the MTC that provides for negotiation and arbitration (clause 4.9) should be extended to assessing disputes over adjustments of premiums (it currently only provides for disputes over whether a practice is a successor practice).
187. Removing the ARP's role of providing insurance means that insurers will no longer be able to transfer firms to the ARP because insurers will remain liable for firms; therefore, the alternative approach reduces insurers' incentive not to report. Consequently, the SRA's concern about the effect of cancellation of policies on the ARP is irrelevant if insurers are required to provide these firms a 3 month ERP in which to either obtain insurance from another provider or consider its alternative options. In recognition that there

remains an incentive for insurers to 'turn a blind eye' if they think that the firm will get its insurance renewed by another insurer at the end of the policy, in the event that the policy is ended early, the insurer is entitled to retain the right to claim the balance of premiums including ERP and run-off (although it is recognised that run-off premiums are rarely recovered in these situations).

188. TLS' response to question 18 supports the SRA requiring insurers to immediately notify it about any suspected misrepresentation or fraud but suggests that without additional enforcement measures this change will not have the desired effect.

Future change 5: Compensation Fund

32 Do you agree with our approach of having a single Compensation Fund which covers all regulated organisations, i.e. both traditional law firms and ABS?

189. The SRA has adopted the findings in the CRA report that differentiation on the basis of legal structure for the compensation fund is not appropriate as there is no reason to believe that different legal structures conducting the same work pose different risks [4.78]. There is a logical (and administrative) simplicity in the notion of a single compensation fund for non-ABS firms and those with alternative business structures, if it is assumed that most ABS firms will be in fact ordinary law firms which either have a non-lawyer partner or external investment. In such cases, it would not necessarily be appropriate to treat these firms any different to other law firms in a way that is similar to the approach taken regarding limited liability partnerships.

190. However, TLS considers that the SRA will have to re-examine this issue in light of its final approach to regulation of multi-disciplinary practices (MDPs). The SRA intends to permit ABS firms to carry out work which is outside the permitted scope for a solicitors' firm which work is not intended to be covered by the Compensation Fund. This will inevitably result in uncertainty and disputes over the boundary of regulation. Although TLS agrees that it would be inappropriate for the Compensation Fund to cover work which is not the subject of regulation by the SRA, there will be strong pressure for the SRA to adopt a conservative approach to defining this boundary and err on the side of protecting consumers particularly if the type of work performed is wholly unregulated and there is no other recourse in the event of fraud. Consequently, there is significant risk that the compensation fund would be vulnerable to wider claims as a result of the inclusion of ABS firms. The SRA should therefore consider a separate fund for these firms. There is a risk of damage to the SRA's reputation if claims are not met by a compensation fund, or if they are met from the fund subsidised by solicitors if the claims emanate from ABS firms.

33 Do you have any comments on the interaction between the scope of cover provided by the MTC (i.e. with the proposed permitted

exclusion of work done for financial institutions) and the Compensation Fund?

191. The SRA intends to have the same client scope for the MTC and the Compensation Fund i.e. the SRA will apply a similar financial institution exclusion to the Compensation Fund [at 4.80]. Although TLS does not support any client exclusion from the MTC, it agrees that the level of coverage should be the same for the MTC as the Compensation Fund.

34 What are your views on the basis for assessing contributions to the Compensation Fund? Should we seek to establish a contributions formula that is more risk reflective and, if so, what approaches should we consider?

192. The SRA wants to make the method of assessing contributions to the Compensation Fund risk-reflective. The SRA has not provided any evidence to justify changing the method of calculating contributions. TLS would expect the SRA, as an evidence-based regulator, to identify some need before the arrangements for assessing contributions are changed.
193. Even if a need is identified, TLS considers that it will be difficult for the SRA to distinguish between different activities performed by firms. The SRA itself has recognised that it must be confident that it had sufficient information regarding the activity of firms in order to undertake risk-based assessments [at 1.24]. At present, the SRA does not even have reliable data of firms conducting conveyancing to formulate a complete Equality Impact Assessment. As such, TLS does not consider it realistic for the SRA to consider adopting a risk-reflective formula for compensation fund contributions.
194. There may be a need to reassess contributions to the Compensation Fund if the SRA decides to include ABS firms and non-ABS firms in a single fund. There is an argument that while it may be acceptable for solicitors who convert to ABS status to have access to the lower contributions made possible by the Compensation Fund's reserves (as their previous contributions have made those reserves possible), it is not appropriate to assume that new external owners of ABS firms should have the same benefit. The SRA may have to consider requiring additional payments towards the Compensation Fund reserves for non-solicitors who may be covered by the fund. In this respect, TLS notes that the CLC was able to obtain sufficient contributions to create a separate compensation fund at the commencement of its regime.

35 If the purpose of the ARP was changed so that it no longer provided policies of Qualifying Insurance, do you believe that the ARP and Compensation Fund should be combined into a single fund?

195. No. 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

Compensation Fund provides a discretionary remedy to protect consumers in the event of a solicitor's dishonesty or failure to account for money which has come into their hands where such risk cannot be covered by insurance.

196. If the alternative approach is adopted or the ARP's role was changed, the ARP will be reduced over time, however, TLS sees no need to combine these into a single fund.

Annex A - Initial Equality Impact Assessment

36	Do you have any comments on the initial Equality Impact Assessment?
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197. The SRA has only undertaken an initial equality impact assessment (EIA). TLS considers that a full EIA is necessary as part of the current consultation, particularly given the potentially devastating impact of the financial institution exclusion on small firms who contain proportionally more BME solicitors. TLS recognises that the SRA is conscious of the possible adverse impacts. TLS believes that the SRA should undertake a full impact assessment and consult extensively with the groups likely to be adversely affected by their current proposals in order to establish a means of attempting to mitigate any adverse impact. This is important to fulfil the SRA's regulatory objective to support and strong, effective and diverse legal sector.

2011 proposals

Proposal 1—single renewal date

198. TLS agrees that, if a sufficient spread of variable renewal dates is achieved, then there may be positive impacts on small firms and indirectly on BME firms. TLS considers a spread of renewal dates will allow insurers to give proper consideration to proposals by small firms. However, if in practice, there is not a sufficient spread of variable renewal dates, for example, because the market voluntarily retains an October renewal date, then it is possible that these firms will continue to be disadvantaged and, without TLS' preconditions for a fairer PII system, any benefit may occur too late for the survival of small firms many of which may be forced to close as a result of the SRA's proposed financial institution exclusion.
199. Given that the SRA itself recognises that it may take sometime for these benefits to be realised, TLS urges the SRA to engage in measures to support small firms in the interim. The alternative approach sets out certain preconditions for a fairer PII system that must be realised regardless of whether the system has a single or variable renewal, including reviewing insurers' underwriting criteria and introducing minimum periods to consider quotations and maximum processing times. These measures are justified in the interests of achieving the SRA's regulatory objectives relating to access to justice, consumers interests, competition and diversity within the profession under the LSA.

Proposal 2—financial institution exclusion

200. As outlined in our response to question 12, TLS notes that the SRA's assessment on the impact of the financial institution exclusion is incorrect as its impact will not simply depend on whether firms undertake conveyancing because the breadth of the SRA's proposed exclusion will mean that firms will be affected if they undertake *any* work for financial institutions.
201. The SRA states that it does not have reliable data about the equality breakdown of firms conducting conveyancing and seeks input from the profession and other stakeholders in this consultation. TLS considers that this is the type of information that the SRA should be collecting as a matter of course and pursuant to its powers under the QIA. As part of its review of conveyancing in 2011, the SRA should collect this information and share it with the profession. As an evidence-based regulator, it is unwise for the SRA to adopt any proposal that has potentially devastating consequences to small conveyancing firms without first collecting reliable data to sufficiently assess the impact of this change.
202. TLS considers that firms only doing a small amount of conveyancing will be unable to find cost-effective insurance under the SRA's proposal. TLS considers that the problem of 'dabblers' is best solved by regulation and increasing the standard of conveyancing work across the entire profession rather than by adopting the drastic measure of excluding financial institutions from the MTC that effectively mean that this work can only be performed by a few large firms. TLS also notes that while, in general, specialisation may tend to create expertise, it is possible for firms to only do a small amount of conveyancing work and to do that work well and that many small high street firms use this type of work as a 'gateway' to attract clients for work in other areas. TLS also notes (in response to question 12) that excluding conveyancing from the MTC may cause firms to 'dabble' in other areas of law.

Proposal 3 – increasing controls over the ARP

203. The consultation would have benefited from the publication of the rehabilitation rate figures for 2009/10 that the SRA foreshadowed at paragraph 52 of Annex A of the SRA's consultation paper. TLS does not consider the proposed reduction from 6 to 12 month will greatly impact on rehabilitation of firms as it appears that this role has had limited effectiveness in the past. TLS considers that a better way to ensure the SRA's proposals do not adversely impact on BME firms is to adopt TLS' preconditions of a fairer PII system and the ERP proposal which maintains a safety net mechanism (outlined in introduction above).

Proposal 4 – clarifying reporting requirements

204. TLS has no comments on the SRA's impact assessment of this proposal.

2012 proposals

205. By flagging its intention to make further change in 2012 as part of its two-stage process, the SRA has inadvertently made the solicitors' PII market less attractive to insurers for the 2011-12 period. The fact that the ARP may be abolished in 2012 may make some insurers reluctant to participate in the 2011 renewal period to avoid exposure to potentially large ARP risks. As the SRA has recognised, BME firms are disproportionately represented in the ARP, which means that the SRA's two-stage approach may further exacerbate this situation and make it more difficult for small firms, BME, female and sole practitioners to obtain insurance due to the period of uncertainty surrounding the SRA's approach to the ARP.

Removing the ARP

206. The SRA itself recognises that the benefits of variable renewal will not be fully realised until after a substantial period of time has elapsed. Therefore, contrary to the SRA's conclusion in the EIA, it is unlikely that the removal of single renewal date will have had the opportunity to 'change the position [of BME firms regarding PII offers] considerably' [at paragraph 65 of Annex C of the SRA's consultation paper] by 2012 when the SRA proposes to remove the ARP's rehabilitative role. Therefore, this proposal will adversely affect BME firms unless the SRA adopts transitional measures to assist these firms; TLS' preconditions for a fairer PII system and maintains a safety net similar to the ERP proposal (see question 15 and introduction).

ARP funding

207. TLS does not support changes to ARP funding as these proposals are not acceptable to the general profession. If the SRA is genuinely concerned about the financial viability of firms, it should consider the impact of transferring this risk onto the profession (see response to question 26).

Premium default

208. TLS supports the SRA's policy to better enforce premium defaults as this will benefit the entire profession, including BME firms. There is no evidence to suggest that this proposal will have a specific impact on BME firms.

Annex B – draft SRA Indemnity Insurance Rules

37	Do you have any comments on the draft SRA Indemnity Insurance Rules 2011 or the draft Qualifying Insurer's Agreement 2011
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Rule 3—Definitions

209. The definition of 'Firms in default' has been amended to recognise variable renewal dates. TLS considers that it is better for this drafting to refer to 'policy period' rather than the current drafting which specifically refers to 'expiry' or 'early termination'.

210. See TLS' comments about including rehabilitation plan or plan for closure in the definition of 'Special measures' at question 17. TLS considers these plans should be submitted to the SRA as a matter of course and not from 'time-to-time'.
211. See TLS' comments about the definition of 'financial institution' in question 13.

Rule 4.2

212. The SRA needs an express power to order compliance with variations to the QIA, MTC or Rules at an earlier date. TLS agrees that the SRA should be able to require compliance with variations by an earlier date than the end of the Policy Period with appropriate notice to affected parties. This appears to be contemplated by the SRA in its commentary on page 8 of the draft Rules; 'the SRA can require policies to be amended at any time to reflect any changes to the Rules or to the MTC'. This amendment could be achieved by adding 'or as the SRA otherwise directs' to the scope of the policy in clause 2.3 of the QIA. See also our response to Question 11 where TLS does not consider that 'rolling' variations are appropriate or administratively practical and its discussion on clause 5 in Annex C of the SRA's consultation paper.

Rule 4.4

213. Instead of deleting 'before the end of an Indemnity Period', TLS considers it better drafting to refer to 'Policy Period' in this rule.

Rule 19

214. The SRA's amendments potentially broaden the scope of the waiver in the Rules by stating that any application must be made 'as soon as reasonably practicable' instead of by a specified date. TLS questions whether this is intentional and suggests that the SRA should consider making the requirement to apply for a waiver as soon as reasonably practicable 'or in any event no later than three calendar months from the occurrence of any event or circumstances first giving rise to the obligation on the person under the relevant Rule or part of any Rule in respect of which the waiver application is made'.

Annex C – draft QIA

Clause 4 – Indemnity Period

215. TLS considers that the SRA should consider changing the heading of this clause as it is now predominately relates to 'policy period' instead of 'indemnity period'. Similarly, the SRA could refer to 'Policy Period' instead of a 'multi-year Policy' for consistency.
216. It is unclear whether the current drafting of clause 4 permits a Policy Period of less than 12 months. In its response to question 11, TLS suggests that this be clarified as it does not appear that the SRA intended to mandate a minimum policy period.
217. The SRA may also want to reconsider whether the restriction on backdating policies during the period between 1 October and 30 October (clause 4.2) is necessary in a variable renewal environment where the Policy Period is no longer the same as the Indemnity Period.

Clause 5 - Variation

218. The SRA should consider amending the notification requirement in clause 5.1.2 because it is currently linked to the date that the variation 'comes into effect' which is now linked to Policy Period (as opposed to Indemnity Period). As this clause is currently drafted, separate notifications will have to be given at the end of each individual policy as under a system of variable renewal there is the potential for each Policy Period to be different. TLS does not consider that 'rolling' adoption of the MTC is appropriate (see TLS' response to Question 11 and rule 4.2 in Annex B of the SRA's consultation paper). If, however, the SRA disagrees with the TLS and considers that the staggered adoption of MTC is appropriate, then it should avoid the problematic administration of clause 5.1.2. TLS suggests that variations could be effective (and notified) two months after the day they are made but only have to be incorporated into individual insurance contracts for the next Policy Period or if the contract is extended, renewed or replaced.
219. As outlined in relation to rule 4.2 in Annex B of the SRA's consultation paper, TLS agrees that the SRA should be able to require compliance by an earlier date with appropriate notice to affected parties; indeed, TLS prefers a single adoption date for changes rather than staggered adoption of the MTC. This is contemplated in the commentary on page 8 of the draft Rules; therefore, the SRA should give itself the express power to make this order under the QIA.

Clause 6 - Reporting

220. The SRA should draft additional reporting requirements to allow it to effectively monitor firms under a variable renewal date system. The SRA will need to introduce a sophisticated computer system to monitor renewal dates and to review detailed action plans if a firm fails to get insurance renewed. The SRA must undertake a high-level assessment of claims data

to classify cause, frequency and other characteristics so it can determine where losses are occurring and better target risk-based regulation. The SRA should require this information from insurers to assist with more effective and targeted regulation.

Other comments

221. TLS considers that it is not necessary to delete 'was renewed' from clause 6.3.3 as renewal is still contemplated by clauses 2 (scope) and 5 (variation).

222. See comments about 6.12 in TLS' response to question 18 above.

Schedule 1 – ARP

223. With variable renewal dates, may need to consider whether rules need to explicitly allow entry into the ARP mid-indemnity period.

Clause 3 – basis of participation in the ARP

224. The amendments to the drafting will not capture all policies once a variable renewal date is introduced. The definition of '*Reference Indemnity Period*' in paragraph 3.1 is 'policies incepting on 1 October of that Indemnity Period'. This date will only capture policies beginning on 1 October. A better definition would be 'policies in force on 1 October' or 'policies incepted in the previous Indemnity Period (which is defined as the period of 1 year starting on 1 October)⁵'. The former requires premium to be attributed to a specific Indemnity Period as, under a system of variable renewal, it can not be assumed that the premium of a policy which is in force on 1 October relates to the entire Indemnity Period (i.e. the Policy Period may span across numerous Indemnity Periods). The latter needs to be retrospective as going forward policies may not be locked in for a year and therefore, premiums for the whole year may be unknown as at 1 October. TLS recommends the latter method.

225. The definition of *Reference Indemnity Period* has flow on effects for various clauses, including subparagraph 3.8.1(a) which should just refer to 'Reference Indemnity Period' instead of 'incepting on 1 October of the Reference Indemnity Period'.

226. The definition of *premium payable* is the premium due 'in respect of the whole period of cover under a policy'. For the avoidance of doubt, this should be specified as the premium attributable to the Reference Indemnity Period and *not* the premium attributable to a Policy Period. The current drafting could be interpreted as referring to a Policy Period which would result in an unintended consequence.

Other comments:

⁵ Another way of expressing this is 'policies incepted in the period 1 October 2011 to 30 September 2012'; however, this will require amendment every year.

227. The reporting date adopted in clause 3 should be consistent. Paragraph 3.1 requires insurers to report 'by no later than 30 October'; Paragraphs 3.4 and 3.5.2 refer to '31 October'. TLS recommends a reporting date of 31 October.

Clause 7 – ARP Indemnity period

228. The SRA should consider redrafting clause 7 in light of its proposal to only allow firms to be in the ARP for 6 months, although TLS recognises that paragraph 7.3 may save the SRA's proposal as the 6 month criterion is an eligibility requirement.

Schedule 2 – ARP Policy

229. The expiry date for the *period of insurance* should be 31 March 2012 (not 30 September 2011) given the SRA's proposal to reduce the time spent in the ARP to 12 months. The SRA may need to reconsider this expiry date in light of variable renewal dates—see also comments above regarding clause 7 of schedule 1. In this respect, TLS notes that Annex B of the SRA's consultation paper deletes reference to rule 4.12 *Period of Insurance* for the Rules and suggests that the SRA should mirror the deletion for the ARP policy in schedule 2.

Attachment 1: Equality Impact Assessment

Initial Equality Impact Assessment: TLS' alternative approach compared with the SRA's proposal

1. TITLE	The SRA's consultation on Client Financial Protection Arrangement		
2. AIMS & OUTCOMES	Providing a new model client protection arrangements for professional indemnity insurance (PII)		
2b. Who will be affected by the activity (intended stakeholders) ?			
The whole profession, the SRA, the insurance industry, particularly small-medium firms and firms undertaking Conveyancing, Immigration and other "high risk" areas of the law			
3. Does the activity have a positive effect on equality groups? ?			<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
3a. If yes, please describe the positive impact			
4. On the basis of existing knowledge, available data & best estimates, is this activity likely to have different or adverse impact on any equality group? ?			
Equality group (diversity strand)	Yes	No	Don't Know
Age	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Disability	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Gender	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Race	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Religion	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Sexual orientation	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Transgender	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Please note that where the 'don't know box' is ticked, reasons for this should be provided.			

Socio-economic background		<input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>	
4a. Describe the different or adverse impact:			
<p>The current PII system has numerous problems and results in the following equality impacts:</p> <p>1: BME firms face apparent indirect discrimination when being "risk assessed" by insurers</p> <p>2: BME led small firms have more difficulty in gaining suitable PII quotes</p> <p>3: BME and female practitioners are disproportionately affected by the large liability the insurance industry carries for the assigned risks pool (ARP). This creates a more "risk averse" insurance market resulting in higher premiums and a reluctance to insure small firms. These tend to be BME or Female led and therefore there is significant Equality Impact</p> <p>4: Small firms are currently over-represented in Conveyancing, Immigration work and matrimonial/childcare/family law. These areas of the law are considered "higher risk" by some insurers</p> <p>5: There is some evidence that older solicitors face similar challenges when trying to renew PII cover</p> <p>6: Firms that can not find PII cover are generally not admitted to TLS Accreditation schemes and therefore find it harder to achieve the quality marks which can be useful in winning business and risk-management</p> <p>The SRA's proposals in its consultation on client financial protection arrangements include:</p> <p>Proposal 1: Reduction of time in the ARP from 12 to 6 months (from 2011)</p> <p>Proposal 2: Close the ARP (from 2012)</p> <p>Proposal 3: Restrictions on work in the ARP</p> <p>Proposal 4: The SRA proposes a direct levy on the profession to cover the liabilities created by the ARP.</p> <p>The Equality Impact of the SRA's proposals has been reviewed and a disproportional impact will still be felt by BME and Female practitioners.</p> <p>For 2012, the SRA is considering changes to ARP funding and both its options result in the entire ARP risk being transferred from insurers to the profession; its preferred approach is a direct levy on the profession. We believe that any change to ARP funding that transfers the entire risk of the ARP onto the profession is not in the best interests of the profession. TLS has not seen evidence that the profession carrying the liability would lead to reduced premiums, more equitable risk evaluation or better insurance processes including reasonable quote timeframes.</p>			
5. Are there any changes that could be introduced to this activity at this stage which would remove or significantly reduce the risk of any negative impact you have identified?		<input checked="" type="checkbox"/> Yes (go to q5a) <input type="checkbox"/> No (go to q6)	
5a. If yes, please provide details of changes recommended		TLS' alternative approach developed in response to the SRA's consultation will address some of the core issues	

which exacerbate the disproportionate Equality Impact of the SRA's proposals and suggests ways in which the issue of large liability for the ARP can be eliminated.

1: The introduction of an ERP (Extended Renewal Period) would eliminate the pooled liability carried by insurers in the ARP (a sector wide liability) and replace it with individual liability related only to firms which are directly insured by insurers. This could greatly reduce the liability and risk for insurers which **should** encourage a more open and competitive market. The proposal has the **potential** to reduce the adverse impact generated on BME and Female firms under both the current and proposed SRA models by reducing insurers' liabilities and after the period of run-off for the ARP could potentially benefit BME, Female, Sole practitioners and small firms in terms of reduced net premiums. Net savings cannot be quantified; however, with only 18% of firms being rehabilitated within the ARP (*source: SRA EIA of Assigned Risks Pool April 2010*) it is envisaged this proposal, at worst, would be neutral in terms of adverse impact for minority groups.

This proposal would mean closing the ARP from October 2011 and would have an impact on BME/female/small firms and sole practitioners (SP) if criteria for securing insurance remains hidden and without Equality based scrutiny. Actions are being taken to mitigate the impact of potentially discriminatory insurance criteria. This work is on-going.

As part of the transitional arrangements, firms already in the ARP could remain in the ARP for a defined period until they have secured insurance on the open market or decide to close. As such, this proposal would not further disadvantage BME, female, small and sole practitioner firms any more than the current model or any of the proposals suggested by the SRA. For this reason, TLS consider its proposal at worst to be neutral in regard to Equality Impact as compared with the SRA's proposals for 2011 and more advantageous when compared with the SRA's proposal for 2012 which removes the ARP and expects firms to close immediately (see analysis at point 5 below).

TLS would also propose a form of "positive action" in assisting BME and female firms to secure insurance with targeted workshops, guidance and support for these groups in securing insurance under the new model.

2: ERP to be provided for a minimum of 3 months should an insurer decide against renewing a firm's insurance. By ensuring ERP and run-off cover are part of any new model, firms will have some time to find replacement insurance. Insufficient time to acquire new insurance and/or pressure to accept expensive premiums due to

the fixed renewal date for PII has been utilised by insurers to take advantage of smaller firms requiring insurance. TLS' proposal would produce greater certainty to the timetable and help in minimising these exacerbating factors.

Insurers would be obliged to give a reasonable period of notice (a minimum of 3 months) if they were not going to renew a policy. This notice period, when added to the minimum 3 months ERP provision, equals the six months that firms will be given in the ARP under the SRA's 2011 proposal. If an insurer gives less than 3 month notice of intention not to renew, they must give an extended ERP. This guarantees that firms will effectively be provided with six months in order to obtain alternative insurance.

As such, TLS expects this to have a neutral impact in terms of Equality compared to the SRA's proposals for 2011.

3 Utilising TLS Accreditation schemes CQS, LEXCEL and Immigration and Asylum Accreditations to moderate risk for insurers and practitioners. The CQS scheme has a risk matrix process for evaluating a firm's readiness to undertake the CQS scheme. This approach could help with reducing the "risk averse" approach by insurers to conveyancing work and result in more equitable quotes for BME, Female, sole practitioners and small-medium firms. This proposal does have the ability to assist firms already in the ARP who may not be able to qualify for the accreditation schemes, as objective criteria have been produced which will ensure that firms who are in the ARP or have been in the ARP are not automatically ineligible for TLS' Accreditation Schemes. This is to ensure that any firms in the ARP who seem not to be a "risk" and have not been able to find insurance through any malpractice, risk, or identifiable fault of their own have an increased ability to be rehabilitated.

The CQS Evaluation Matrix has a sophisticated approach which could be applied to other accreditation schemes and used as a tool to demonstrate reduced risk to insurers. If this approach were agreed with insurers then impact in this area of securing insurance for BME, Female SP, and small firms could be reduced.

Due to additional provisions built into the qualifying criteria for TLS accreditation schemes to ensure no catch-all criteria that eliminates firms for simply being in the ARP, we believe any adverse impact will be mitigated for BME, female, small firms, and sole practitioners.

4 Work with the EHRC, FSA, ABI and SRA to ensure transparency around risk evaluation criteria for firms. This work needs to reach a satisfactory conclusion for all parties. Proposals for an ERP will not be as effective

without Insurers being proactive in tackling aspects of indirect discrimination which may be present within their risk evaluation policies/methodology. This is recognised in TLS' preconditions for a fairer PII system.

At present, it is recognised that although the insurers will need to open up their risk criteria for scrutiny by the EHRC it is unlikely this will result in a major change of focus which would further enable sole practitioners and small firms to be sustainable in the long run. Some change may be likely, however, market forces are making it more difficult for sole practitioners and small firms to remain financially viable. In light of this it is important that as much is done as possible in assisting these firms to remain sustainable. We believe that reducing insurers' pooled liability for the ARP is the best option available.

5: Close the ARP to new firms. The SRA proposes to close the ARP from 2012, meaning that firms who are unable to obtain insurance must immediately close down. TLS proposes to close the ARP from 2011 but introduce an ERP to act as a safety net that will give firms a reasonable notice period and minimum three month policy extension in which to seek alternative insurance, consider merger/succession or provide for orderly closure. Firms currently within the ARP would not face any more disadvantage under TLS' proposed transitional arrangements than under the SRA's proposals. Over time, non-sustainable practices would close, rehabilitated practices could move to new insurers under the ERP model and the liability for the ARP would reduce over time.

Although it is understood that TLS' proposal does not remove the adverse impact for BME and Female groups that will occur under the SRA's proposals, the proposal is neutral in its short term Equality Impact when compared to SRA's 2011 proposals. When compared with the SRA's 2012 proposal which seeks to close firms immediately, TLS' proposal has the benefit of providing additional time for orderly closure (see analysis below).

In the long term, TLS' alternative approach provides the impetus for a more open market with reduced uncertainty for insurers. This could/should potentially create a more open and competitive market. Open and competitive markets generally lead to cost reduction and in the long run we would hope this would be achieved.

Assessment of estimated impact of the SRA's proposal to close firms immediately

If we consider there are 293 firms in the ARP as of January 2011, and apply the SRA's figure of an 18%

rehabilitation rate annually (approx 52.7 firms based on a figure of 293 in total), that would mean approximately 240 firms would face immediate closure in 2012. If we assume the representation of firms within the ARP will remain somewhat static, using available data, we can estimate the approximate impact on BME, Female and Sole practitioner firms as follows:

BME firms represent 41% of ARP firms (SRA report ARP 2010) therefore under the SRA's ARP proposals for 2012 approximately 98 BME firms would potentially face immediate closure.

Sole practitioners represent 59% of firms in the ARP (SRA Report ARP 2010) therefore under the SRA's proposal approximately 141 firms would face immediate closure.

Female led firms represent 24% of the ARP (SRA report ARP 2010) therefore approximately 57 firms would face immediate closure.

It is important to note that TLS' proposals for the ERP would not require **any** firms to immediately close but would instead provide firms with a 6 month notice period and a minimum 3 month safety net at the end of the policy. The SRA's 2012 proposal seeks to shut down the ARP without providing for orderly closure and therefore TLS' proposal both mitigates the impact of a high number of immediate and disorderly closures whilst providing minimum adverse impact to BME, female and Sole practitioner firms.

6. Removing the proposed levy on the profession to pay for the ARP and instead of pooling risks, making insurers provide ERP and run-off cover for only those firms that they insure.

Putting a levy on the profession, in terms of an additional fee on the practicing certificates for solicitors, is not an acceptable solution to address issues with funding the ARP. This levy would have a disproportionate effect on small firms (BME and female solicitors are over-represented in small firms and as sole practitioners) as there would be considerable disproportionality in the % of turnover and/or salary that levy fees would represent for sole practitioners and small firms compared with large Corporate/Commercial firms.

TLS' proposal to allow the insurance industry to underwrite the risks only for those they insure whilst running off the ARP would reduce the impact the additional levy proposed by the SRA would have. It also

	<p>maintains some form of safety net to provide for orderly closure. In this aspect, TLS' proposal delivers a potentially positive Equality Impact for BME and female practitioners compared to the SRA's proposals.</p> <p>Overall, it is judged that the alternative TLS approach has a neutral Equality Impact compared to the SRA proposals and that a potentially positive Equality Impact can be realised through removing the need for a levy on the profession as proposed by the SRA. Full Impact Assessment should be undertaken should the proposal be considered for implementation.</p>
<div data-bbox="217 701 1082 801"> 6. Does the activity require a full impact assessment? ? </div> <div data-bbox="1090 701 1404 801"> <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No </div>	
6a. If yes, please provide details on how the full EIA process will be managed	<p>It is recommended that should the TLS approach be accepted that a full EIA be conducted including consultation with BME, Female, Disabled, Small firms and Sole practitioner solicitors to gain feedback on the proposals and to further investigate any potential for adverse Equality Impact.</p>