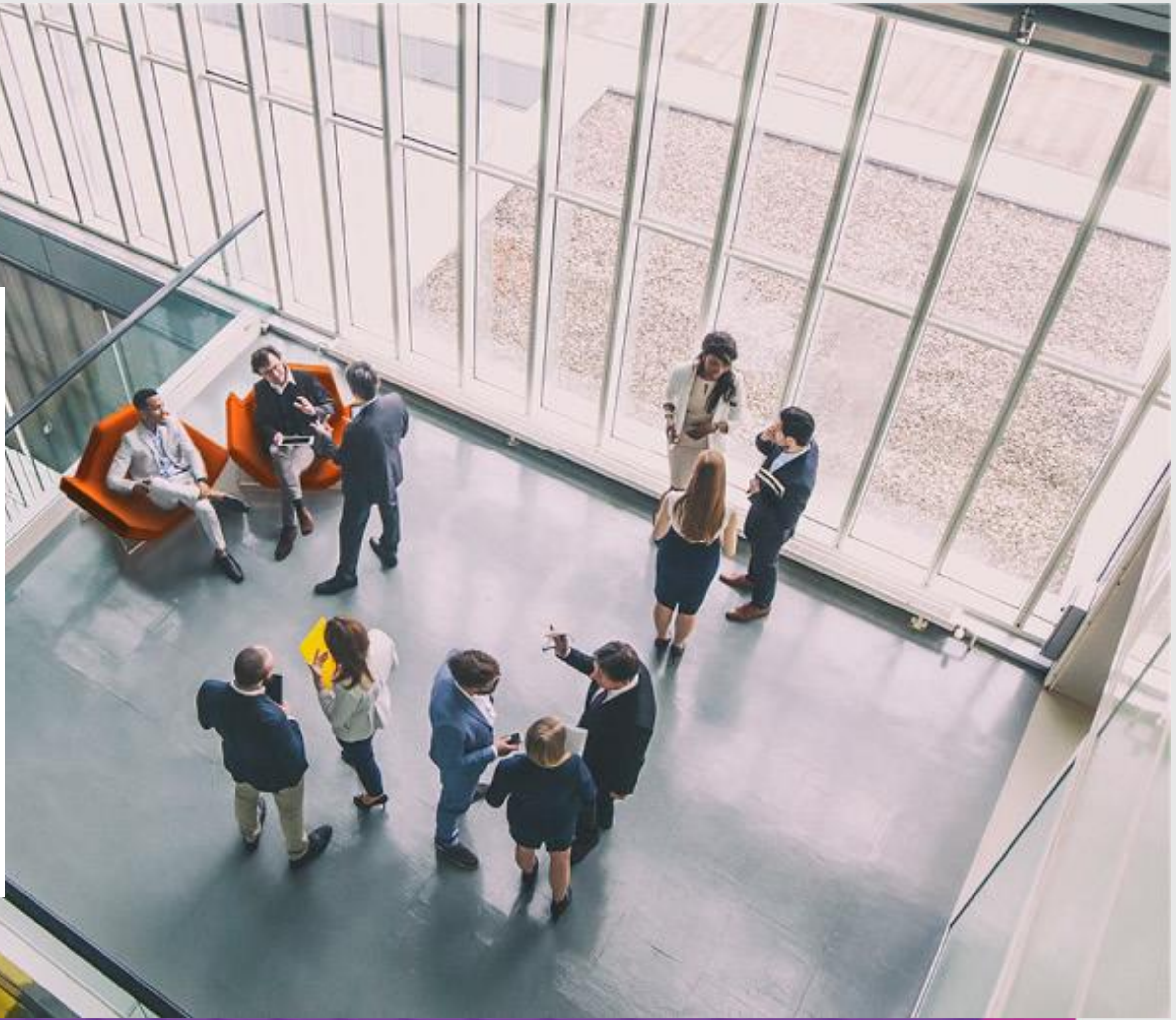
Indemnity cover for post six-year run off cover (PSYROC)



Comparison of options for future provision

Solicitors Regulation Authority

October 2022

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Introduction

Introduction

Background and context

The Solicitors Regulatory Authority (SRA) is considering policy options for consumer protection against loss caused by a solicitor's negligence, in circumstances where the law firm has been closed for more than six years with no successor practice at the point when a claim comes to light. Indemnity cover for post six-year run off cover (PSYROC) is currently provided by the Solicitors Indemnity Fund Limited (SIFL) on a claims-made basis. SIFL was due to close to new PSYROC claims after September 2022.

Following consultation by the SRA in 2021 on options for future arrangements for the provision of PSYROC coverage the SRA Board decided to seek an extension of the closing date of the SIFL until 30 September 2023 to enable further consideration of points raised in consultation responses and to explore options for future consumer protection.

The SRA has defined 4 main options for consideration and engaged Willis Towers Watson (WTW) to conduct analysis to assist its internal assessment of the options. The work carried out by WTW comprised the following:

- **Phase 1** - High level assessment of the 4 alternative policy options defined by the SRA to deliver appropriate consumer protection by reforming or replacing the current PSYROC coverage vehicle (SIFL).
- **Phase 2** - Further analysis into specific, identified areas of potential opportunity for cost improvement, focusing on claims management.

The analysis used as its reference points:

- Scenarios defined by the SRA with options for provision of future cover
- Feedback received by the SRA from the 2021 consultation and the SRA's analysis of this feedback
- The 2021 WTW report that was published alongside the 2021 consultation ("WTW 2021 Report")
- Information received from SIFL regarding its current operations and data from SRA and third party administrators (TPAs) relating to its operations and capabilities. Note that for the Phase 1 analysis, the SRA Compensation Fund was used as a comparator, whereas in Phase 2 the Assigned Risks Pool (ARP) was considered more appropriate.

This document summarises the findings from the WTW analysis conducted during August and September 2022, together with a description of the scope of the review, relevant areas outside the scope of the review and the associated assumptions and limitations.

Introduction

Scope of this report and work undertaken by WTW

The review considered the following 4 high-level scenarios for provision of future consumer protection, as defined by the SRA:

A. Reconfigured SIFL to operate at a lower expense level
B. A new indemnity fund managed within the SRA, delivering economies of scale based on a long-term operating model. Note that the comparator model for this scenario changed from phase 1 to phase 2: phase 1 used the SRA Compensation Fund model which had benefits but also challenges; for phase 2 analysis, the SRA ARP was used as this was considered a better model for comparison of potential benefits and risks.
C. Reconstitution of SIFL as a discretionary fund managed within the Compensation Fund infrastructure delivering economies of scale of both volume and on a long-term operating model
D. A discretionary "fund of last resort" within the SRA, limiting coverage and eligibility only to claimants who have pursued solicitors previously without success, delivering economies of scale of both volume and on a long-term operating model

The initial, high-level analysis was conducted on two bases:

- Consideration of the financial implications of each operational component independent of and across each of the options, above (for example, claims and coverage; infrastructure; governance; basis of provisioning; asset management and use of investment income)
- Aggregation of each of these components to assess the overall impact on each of the defined options.

Following the initial analysis and review by the SRA Board, WTW was asked to conduct more detailed analysis into the claims management component covering a sub-set of the scenarios (A, B and C) as this would form a key element of any future operational model.

The results of these two stages of analysis have been described in terms of their potential impact on the illustrative financial projections presented in the WTW 2021 Report, which has been considered as a starting point for this work, based on the assumption that any cost reduction identified would reduce the funding requirement. Therefore, it is essential that this report is read in conjunction with the WTW 2021 Report.

Introduction

Important notes regarding the baseline used for this review (WTW 2021 Report) – 1 of 3

1. Assumptions and basis of the initial analysis in the WTW 2021 Report

- The illustrative funding scenario and levy indications contained within in the WTW 2021 report were intended to provide a prudent illustration of the scale of annual funding that could be required to fund a future scheme on a sustainable basis taking account of the long-tailed nature of the underlying claim exposure. The purpose of the illustration was to demonstrate the scale of the ongoing costs that could be required to finance the provision of the required future coverage on a robust financial basis. There is no suggestion that the illustrative costs are a recommended levy.
- This funding requirement took account of liability exposures that are not explicitly accounted for in the existing SIF coverage model in relation to future PSYROC claims from ceased practitioners that have not yet been notified. The current coverage model only recognises liability for claims once they are notified ("claims made" basis), whereas the WTW 2021 Report uses a 'best estimate' of expected annual PSYROC claims costs from ceased practitioners using a 'run-off' approach, based on analysis of the SIF historical claims experience.
  - It should be noted that for any future scheme, the liability exposure for the above claims exists whether or not these are recognised, accounted for and funded. This has implications for the overall funding model, the degree of equity between different generations of contributors, asset management and potential use of investment returns. To an extent, relative to the existing SIF coverage model, these issues were considered in the WTW 2021 report in the Claims Exposure Considerations section and the projections of Uncovered exposures in the liability projections on Slides 14,41 and 42 Additional, non-quantified claims exposure is also present relating to post-cessation future claims which will arise from the past activities of currently active practitioners.
  - Conceptually, the funding illustration is on the basis that SIF surplus funds are used to fund PSYROC cover extensions for ceased practices from 2000/01 up to indemnity year 2021/22 and the profession is subjected to levies for expected costs of PSYROC claims from ceased practitioners from 2022/23 onwards or shortly thereafter.
- The analysis excluded a number of factors that would have an impact on the funding of any future scheme, such as the potential impact of investment returns, allowance for marginal cost allocation of fixed operating costs and explicit allowance for the ongoing accrual of future PSYROC liabilities that arise from the activities of firms which are still operating but which are expected to cease in future.

Introduction

Important notes regarding the baseline used for this review (WTW 2021 Report) – 2 of 3

2. **Limitations of this review - significant factors to be considered that were outside the scope of the analysis contained in this report or should be subject to further analysis**
   - The initial, high-level review identified the potential for significant financial improvements to a future scheme. This could be achieved through a combination of changes to the current approach to the assessment and funding of potential exposures and a targeted asset-liability management strategy with defined criteria, including objectives and risk appetite. In accordance with the scope requested by the SRA, we have not quantified this during the current analysis, because a robust quantification would require a significant strategic and modelling exercise in order to establish realistic options. However, a high-level commentary is included in this report.
   - The analysis in this report has been limited by the data available to the project team within the review timeframe and therefore high-level assumptions and estimates have been made in these areas, which have high levels of uncertainty. These include:
     - Asset-liability management, availability of assets, and availability and use of investment income, which would be subject to future risk appetite and investment strategy decisions
     - Non-claims costs relating to a new scheme, such as infrastructure, legal framework and governance
   - Analysis and estimation of the following factors are outside of the scope of this review and are therefore not included in this report:
     - One-off infrastructure costs relating to the transfer to a new scheme or operation, or risks of such a transfer
     - Consideration of handling of residual liabilities within SIFL, including pre-2000 firm closures and existing notified claims
   - Detailed analysis of some aspects of the different scenarios can only be adequately assessed based on certain policy objectives and key principles, including attitudes to risk and potential volatility. In particular, additional analysis would be required to assess the detailed impact against SRA principles and on different stakeholder groups.

Introduction

Important notes regarding the baseline used for this review (WTW 2021 Report) – 3 of 3

3. Additional factors to be considered relating to the period following publication of the WTW 2021 Report

- In the period since the WTW 2021 Report there has been a significant change in the external economic environment, which may impact assumptions that have been made previously, for example:
  - Movements in capital markets have significantly weakened the value of many assets and we understand that the assets within SIFL have not been unaffected, in common with other asset-holders, with potential implications for future investment income
  - UK inflationary pressures have been increasing which could have an impact on claims and operational costs for any future scheme which have not yet been quantified
  - UK interest rates have also risen sharply
- Such fluctuations are normal and given the long term (long-tail) nature of the liabilities. Therefore, any long-term, strategic decisions regarding future management of liabilities, assets and funding should take into account the potential for short, or more extended periods of uncertainty or volatility. In this context it should be noted that the long-term average inflation assumption in the WTW 2021 Report was 3% per annum.

Executive Summary

Summary and conclusions

Covering findings from both Phase 1 and Phase 2

Overview

- This document sets out analysis conducted by WTW on behalf of the SRA considering alternative policy options to deliver appropriate consumer protection by reforming or replacing the current PSYROC coverage provided by SIFL
- The options are illustrated through three main scenarios, covering: (A) a reconfigured SIFL; (B) a new indemnity fund; and (C) a discretionary fund. A fourth 'what-if' scenario was also considered (D), based on providing limited protection on a 'last resort' basis. Each scenario comprises a number key operational components, which have also been assessed independently of the scenarios, where applicable.
- Scenarios were assessed against their potential impact on the illustrative ("baseline") SIFL funding requirement of £2.4m from the WTW Report dated 19 November 2021 entitled "PSYROC – Analysis of Options" ("WTW 2021 Report"). These could be positive (e.g. a reduced cost/funding requirement) or negative (e.g. cost increase or one-off transition or run-off costs). The analysis does not directly allocate the residual funding requirement to a levy structure.
- The analysis provides an estimated quantitative financial impact based on data, where this was available, or an illustration of potential scale based on assumptions where data was not available. In all instances, further analysis is recommended in order to verify the conclusions and develop more detailed recommendations. The scenario results in this report should be considered on this basis.

Summary of scenario results

- All scenarios resulted in potentially material reductions in the baseline funding requirement, largely driven by opportunities within two key operational components that apply to all scenarios, in particular:
  - Cost reduction in third party claim handling expenses
  - Optimisation of asset-liability management, based on the interaction and complementary modelling of PSYROC claim exposures, capital management and investment strategy
- Other potential benefits exist, which are generally of smaller scale and for some of which the level of potential benefit can only be determined based on further detail on preferred policy options.
- Each scenario will incur some additional one-off and recurring costs at different levels, largely depending on the scale of implementation changes required.

Summary and conclusions

Covering findings from both Phase 1 and Phase 2

Scenario results

- A summary of the individual scenario results (see also Slide 23) shows that:
  - Based on the initial data and analysis, each of scenarios A, B and C could involve a significant potential saving on annual running costs, once any new scheme is up-and-running through changing the basis of the third-party claims handling management, without reduction in consumer protection.
  - More detailed analysis in phase 2 estimated the greatest impact to result from scenario B (£300-400k); with scenarios A, C & D having £100-175k, £50-200k and £175-200k savings, respectively.
  - Illustrative potential savings for each of the three main scenarios (A, B & C) based on limited data, suggest that the greatest potential financial benefit to funding requirements, without impacting the current position on consumer protection, is likely to be a new indemnity fund managed within the SRA (scenario B). The illustrative financial impact on each is summarised below, and should be subject to further analysis:
    - **Reconfigured SIFL** (scenario A)

      There are two potential areas of 'high' (>5%) reduction on the funding requirement (provisioning; capital buffer and assets) but low (>2%) opportunity for infrastructure savings. It would also have relatively low implementation costs.
    - **New indemnity fund managed within the SRA** (scenario B)

      There are three potential areas of 'high' (>5%) reduction of the funding requirement (provisioning; capital buffer and assets; and infrastructure) as the SRA Client Protection Team should be able to accommodate the PSYROC requirements with some changes. Governance would also be merged to create an additional area of 'low' (<2%) reduction. However, this scenario would necessarily involve higher implementation costs than scenario A.
    - **Discretionary fund, having similar coverage to SIFL, managed within the SRA** (scenario C)

      There are two potential areas of 'high' (>5%) reduction on the funding requirement (provisioning; infrastructure). Assets and capital benefits are considered 'medium' (2-5%) as assets available will be subject to negotiation with The Law Society (TLS) resulting in only a portion of the current SUFL assets being available to the new fund, thus reducing potential investment income. Two areas of 'low' (<2%) reduction are Governance, as in scenario 2, and Coverage, due to the option of discretion. Implementation costs are expected to be lower than scenario B but higher than scenario A.
  - While options A, B & C aim to provide the same coverage, the option for discretion in scenario C may have implications for consumers, depending on how this would be applied.
  - In scenario D (last resort), it is assumed that claimants have exhausted all other avenues prior to a claim being considered and discretion would also be available. Therefore, in addition to the potential financial benefits of scenario C we would expect a high (>5%) reduction on the funding requirement due to reduced coverage, which may be off-set by the likely reduced assets to be made available by TLS to fund investments. Also, while the governance costs may also reduce further, the claim process may be more complicated and the potential impact on stakeholders would require further analysis.

Summary and conclusions

Covering findings from both Phase 1 and Phase 2

Key limitations of the analysis

- The analysis represented in this report has been limited by two main factors:
  - Availability of sufficiently granular data to conduct the analysis more thoroughly, demonstrated by the areas which have not been able to quantified directly in the report
  - The time available to conduct the analysis which has restricted the level of quantitative modelling and follow-up analysis
- Detailed analysis of some aspects of the different scenarios can only be adequately assessed based on certain policy objectives and key principles, including attitudes to risk and potential volatility. In particular, additional analysis would be required to assess the detailed impact against SRA principles and on different stakeholder groups.
- The report highlights additional analysis that would be required in order to verify and generate more detailed recommendations in each area covered in this report.
- Additional limitations and reliances are provided in Appendix A.

Conclusions and key policy considerations

- There are opportunities for material cost improvements in the SIFL model, if planned on a going-concern basis assuming a long-term future. However, further significant cost improvements could be achieved by running an indemnity fund through the existing SRA infrastructure by benefiting from the resulting economies of scale.
- A discretionary fund with similar benefits to the existing SIF scheme would be likely to reduce the opportunity for cost improvements compared to an indemnity fund, incur a potential reduction in investment income if assets are withheld by TLS, and have an additional potential impact on stakeholders and their perceptions.
- There is potential for significant funding benefits under each option through more sophisticated asset-liability management. However, this has been assumed to be lower under discretionary fund scenarios due to the reduced assets that are likely to be made available to a new discretionary fund by TLS.
- Under each option, there is little evidence to suggest that the benefit of pursuing recoveries or excesses (through subrogation, insurance, etc) outweighs the cost which suggests that any decision on this may be more a matter of principle.
- Minor changes to coverage or use of discretion would not appear to generate a material level of saving, unless a more radical approach is taken or claimant costs are not covered. However, this could have wider implications on stakeholders.

Scenario comparison

Summary of scenarios

A broad range of scenarios could be considered as part of this review. Based on the data and information available to us within the project timeframe, we focused on scenarios A, B and C below, defined by the SRA for the analysis, with additional consideration at the SRA's request of scenario D.

A. Reconfigured SIFL to operate at a lower expense level ("SIF 2")

B. A new indemnity fund managed within the SRA delivering economies of scale based on a long term operating model

C. Reconstitution of SIF as a discretionary fund managed within the SRA delivering economies of scale of both volume and on a long term operating model

D. A discretionary "fund of last resort" within the SRA, limiting coverage and eligibility only to claimants who have pursued solicitors previously without success, delivering economies of scale of both volume and on a long-term operating model

Given the limitations in data available in this time period, and the imperative to be entirely transparent around the evidence base for conclusions, we undertook to analyse the above scenarios through the following lenses:

Evidence based conclusions	Support by data at an appropriate level of granularity to extrapolate future performance on the basis of simple assumptions derived from real-world examples.
Assumption based conclusions	Analysis which indicates a direction and/or magnitude of impact based on the level of data available, supplemented through discussion with the SRA; however not sufficiently supported by the data available to provide a robust indication of financial impact.

Overriding objectives informing scenarios

- Maintaining existing consumer protections (A, B & C only)
- Reducing the overall expense required to operate the fund (all scenarios)

Key assumptions applicable under all scenarios

- The introduction of a levy to support a fund is viable and acceptable to the industry

Scenario impact assessment against the estimated levy funding requirement based on the WTW report in November 2021

Within the WTW Report dated 19 November 2021 entitled “PSYROC – Analysis of Options” it was estimated that the overall annual costs of running SIFL and paying projected claims would be £2.4m. This analysis included a number of assumptions and simplifications, such as excluding the potential contribution to the funding requirement of investment income and recoveries. The illustrative funding requirement was then allocated fully as a levy, at £16 per solicitor, or £240 per firm based on 150,000 practitioners or 10,000 firms.

The analysis presented in this report considers four main scenarios, which the SRA has defined, together with a range of factors that can be viewed either within each scenario, or in some cases independently of the scenarios. For each scenario and component within each scenario, the potential scale of the impact on the overall £2.4m funding requirement has been either estimated, where data is available, or illustrated based on assumptions where data is not available. The impact can be either a positive contribution (which have been banded as high, medium or low) or a negative contribution. These are shown in the table below and used throughout the slides that follow, noting that there will also be one-off cost implications which will vary by scenario. The resulting funding requirement under each scenario has not been further allocated out to solicitors or firms.

NOTE: the financial analysis and assumptions have taken no account of changes to inflation or inflation assumptions since the previous report.

Banding	SIF funding implication	Illustrative cost impact
Illustrative additional cost	Additional cost	Any additional cost on top of original estimated funding requirement
Illustrative low impact	Reduction of 0-2%	- £0-48,000
Illustrative medium impact	Reduction of 2-5%	- £48,001-120,000
Illustrative high impact	Reduction of 5%+	- £120,001+

Key findings – comparison of scenario options

Summary of scenarios

We have considered the high-level scenarios below. In addition, we anticipate that a number of initiatives can be considered independently and implemented as part of each scenario, if required.

Illustrative additional cost
Illustrative low impact
Illustrative medium impact
Illustrated high impact

Scenario	Summary	Evidence-based conclusions		Assumption-based conclusions							
		Estimated potential claims management cost saving	Coverage limitation	Legal framework	Governance	Infrastructure	Assets and buffer	Provisioning	Funding	Coverage	Cost of change
Scenario A – Reconfigured SIFL	Continuing with SIFL at reduced cost	£100,000 - £175,000	£0								
Scenario B – New indemnity fund	New indemnity fund operating within the SRA	£300,000 - £400,000	£0								
Scenario C – New discretionary fund	New discretionary fund operating within the SRA providing full PSYROC cover	£50,000 - £200,000	£0								
Scenario D – Fund of last resort	New discretionary fund operating within the SRA as a “fund of last resort”	£175,000 - £200,000	£250,000								

Summary of Phase 1 findings

Key Phase 1 findings – comparison of options

Infrastructure and operation of SIFL and the SRA Compensation Fund

FINDINGS

- SIFL has been operating in recent years on the basis that it is about to be wound down. Therefore, it has not been possible or appropriate for it to make decisions considering anything other than a short-term planning horizon, which has both constrained the potential for efficiency improvements and impacted the investment strategy. We understand that the SRA Compensation Fund has undergone various policy and operational changes over the last 2-3 years which aim to provide better management of the fund and costs.
- Running two organisations which are both dealing with low volumes of complex claims creates additional cost by maintaining two sets of infrastructure. There is an administrative and non-claim related cost overhead in running SIFL which is low in absolute terms, but relatively high given the volume of claims. Much of this infrastructure appears to be broadly replicated in the SRA Compensation Fund / Consumer Protection Team. These SIFL non-claims costs are approximately £600,000 per annum (including £55,000 audit costs) but at this stage we do not have the information that would be needed to isolate the equivalent costs for Compensation Fund uninsured losses or to establish the additional equivalent running costs that would be required for the Compensation Fund to take over the equivalent functions.
- While there are significant differences in the legal and governance frameworks between SIFL and the SRA Compensation Fund, we understand from the SRA that any barriers to moving the management of PSYROC to within the SRA Client Protection infrastructure, either on an indemnity or discretionary basis, are surmountable. However, this would also incur one-off implementation costs, which would also need to include a solution for claims incurred pre-2000.

POLICY CONSIDERATIONS

- There are opportunities for material cost improvements in the SIFL model, if planned on a going-concern basis assuming a long-term future.
- Running two separate organisations with low volumes of complex claims requires some level of duplication of functions. There may be some opportunity of further merging of back-office functions but consideration should be given to the limit of how much these costs can be reduced on this basis.
- Any change will incur one-off costs, which will depend on the option chosen. The overall scale of these costs and their funding should be formally considered and accounted for.

Key Phase 1 findings– comparison of options

Claims management and costs

FINDINGS

- It appears that management and assessment processes for PSYROC and uninsured loss claims within the SRA Compensation Fund are broadly equivalent in scope and investigation. We understand that there is no discretion allowed by either third-party management company.
  - Rules differ between the two sets of claims, but they are each managed within a written framework
  - SIFL panel costs are based on hourly rates, whereas the arrangement with Polo is a fixed fee arrangement which has been recently renegotiated.
  - Assuming a similar arrangement and cost basis could be achieved for SIFL claims as for uninsured losses in the Compensation Fund, potential savings over the existing SIFL panel costs could be achieved due to engaging into a longer-term relationship with a claims provider.
  - See ‘Claims Considerations’ section.

POLICY CONSIDERATIONS / NEXT STEPS

- In principle, claims management costs could be reduced materially, by outsourcing or reviewing existing arrangements. However, more detailed analysis is required and the Phase 2 report has updated this analysis. See ‘Claims Considerations’ section.

- Each organisation in principle also seeks to make recoveries, either from insurance, subrogation of claims, or recovery of legal expenses. We understand that while the SRA Compensation Fund has a recoveries team, recoveries are not currently pursued in uninsured loss cases due to the low likelihood of success and cost of recovery. SIFL are able to make recoveries from third parties, but again, successful recoveries are in very low numbers. SIFL currently also purchases insurance, however, this has resulted in low recoveries to date and we understand that no insurance has been taken out for 2022-3. Consideration has been given to the potential for recovering claims excess from solicitors as a policy option for future claims; however, the potential recovery costs should be considered against size of potential excess and likelihood of recovery (which may vary in inverse proportion to each other) taking account of the lack of current direct evidence of successful recovery processes.

- Recovery amounts appear very small in both organisations, where these are pursued; however, these come at a cost. Policy decisions should consider the cost-benefit as well as the principle and public perception of these facilities among stakeholders.

Key Phase 1 findings – comparison of options

Funding basis (1 of 2)

FINDINGS

- Decisions on SIFL provisions and investment strategies are currently driven by the current closed / run-off fund and expected operational wind-down. Should SIFL continue as a going concern, we would expect the basis of these strategies to be fully revisited and modelled under revised assumptions and that there will be opportunities for optimising these, subject to the risk appetite for provisioning, investments and the volatility of any future levy. In particular:
  - SIFL's current investment strategy mirrors that of the Law Society, without consideration of either provisions or investing to provide income for funding, which we would expect to be key drivers for a future investment strategy. We understand that while the current strategy has generated reasonable returns over recent years, investment performance over the last year has generated unrealised losses in SIFL accounts.
  - Provisions are set on a 'claims-made' basis plus a capital loading based on 'insurance principles'. There are alternative methods, which we would expect to be considered in the modelling of future options.
  - We believe that there is a potentially significant opportunity to optimise asset-liability management, e.g. maximising the investment return contribution to the funding requirement subject to defined risk tolerance constraints. This would require further analysis and modelling, considering in combination the selected funding basis, capital buffer and investment strategy. In addition, consideration can be given to the amount of capital that is physically held in the fund and the extent to which guarantees or loans from the SRA and/or Law Society can contribute to the capital. There may also be an opportunity to take advantage of diversification benefit, depending on the potential for funds not needing to be ring-fenced

- The SRA Compensation Fund has recently adopted a new investment strategy, which is yet to show through into reported figures reviewed for this project (which are based on the prior strategy); however we understand that the new investment strategy is intended to deliver a return to keep pace with inflation, plus a small additional margin. We understand that the strategy is not intended to deliver a consistent income with the intention of supporting the levy by funding claims and costs to the fund. These claims and costs are currently funded entirely by the levy.

POLICY CONSIDERATIONS

- A combination of risk appetite and strategic considerations of the split in principle of funding mechanism between return from assets and levy – e.g. should claims be funded as much as possible by investments topped up by a levy, or vice versa?
- We understand that the SRA's expectation is that the 'claims-made' coverage and funding basis should continue unless there is a clear benefit of changing this. In our view there could be benefits to changing the funding basis to reflect run-off exposure because this could in principle provide greater opportunity to leverage asset returns as well as reduce cost volatility and potentially the targeted capital buffer.

- PSYROC is the key reason for SIFL being in place, whereas uninsured claims are an insignificant portion of the wider CF. Therefore the question of the CF being an appropriate comparator arose and for the Phase 2 analysis the ARP was chosen as a more appropriate start point for the comparative analysis.

Key Phase 1 findings – comparison of options

Funding basis (2 of 2)

FINDINGS

- The provisions for the Compensation Fund are set based on the expected costs at the outset of an intervention by the SRA. The minimum reserve is established based on expectations for the number, nature and scale of interventions expected in the year, with an additional buffer (typically 1.5x) applied across the top. Grants are not "reserved" in the same way as a SIF claim.

- The Compensation Fund is funded by levy – the funding basis is underpinned by an established set of principles which govern the decision-making in setting the levy.
  - These principles reflect the need to protect the fund for the benefit of the profession
  - The levy itself is reviewed annually and approved by the SRA Board. The current levy structure is subject to relatively material percentage changes year on year (and potentially inter-year). The levy for the last two years was:
    - 2021: £50 per solicitor, £950 per firm
    - 2022: £40 per solicitor, £760 per firm

- The level of assets available to each organisation will be a key determinant of the potential investment returns and contribution to funding into the future.
  - As noted on the previous page, the Compensation Fund investment strategy has been revised recently, and is expected to generate greater returns than the previous cash fund basis, however they may be more volatile as a result. This return is not targeted with specific funding goals in mind.
  - In the event that SIFL is closed and not re-established on an indemnity basis, SIFL assets are not guaranteed to come across to the new fund, and are required to be returned to the Law Society. It is expected that it will be possible for the SRA to discuss the level of assets required to support any new fund, and negotiate the retention of some portion of the existing assets.

POLICY CONSIDERATIONS

- If PSYROC claims were to be managed through compensation fund basis, consideration should be given to whether the CF provides the basis for a good model for setting provisions for PSYROC claims, since there are clear differences, both in approach and focus.

- As the Compensation Fund levy can be volatile from year to year, policy decisions should consider the tolerance by different stakeholder groups for the level of volatility of any levy for PSYROC claims, set alongside the appetites for provisioning and investment risks.

- Should the option of a discretionary fund be favoured, the level of assets available to fund claims is uncertain. The extent to which the SRA would be able to retain these assets will depend on the purpose of these assets (e.g. to support funding, other purposes) and further discussion and agreement with the Law Society, which may result in lower potential for investment income.

Key Phase 1 findings – comparison of options

Claim payments, scope and basis of coverage

FINDINGS

- While SIFL operates on an indemnity basis and the SRA Compensation Fund on a discretionary basis, we understand that:
  - This discretion has always existed as a matter of public law but was codified for the first time in the rules in 2021.
  - Discretion can be applied negatively (e.g. to reduce or deny any grant from the fund) or positively (e.g. to allow claims reported beyond limitation periods where reasonable to do so).
  - It is expected that discretion will only be applied in exceptional circumstances and/or to protect the viability and integrity of the fund. Through discussion with the SRA, we understand that discretion is rarely applied to claims in which there are no exceptional features or conduct and that no uninsured loss claims have had discretion applied to date.
  - We have not seen any evidence to date of financial impact to applying discretion to uninsured losses in the Compensation Fund, and we understand that SRA intends that this would not differ for PSYROC-type claims.

POLICY CONSIDERATIONS

- We understand that the SRA intends that there would be no financial impact to applying discretion to PSYROC-type claims. In order to establish the impact on stakeholder groups, the policy should be clear on what enabling discretion aims to achieve and the principles and circumstances under which it would be likely to be used.

- Other options for restricting coverage have been considered, for example:
  - Limiting eligibility to claim – further analysis is required to identify and understand the profile of SIF claimants in order to model the impact of eligibility. This data is not available at this stage.
  - Applying excesses – references previous in relation to recoveries, the theoretical impact of applying an excess can be modelled, however further analysis would be required to understand the "credit risk" of the solicitor cohort in question, and the likelihood of any excess being recovered in full. Any evidence-based assumptions on this recovery profile would also require additional data.
  - Capping claims – mirroring the Compensation Fund approach of a maximum coverage limit of £2m (in line with MTC) would represent a cap for a proportion of solicitors who have optionally purchased above this level. However, we understand that no claim has ever been incurred by SIFL which would have breached this cap and unless this changes in the future, there would be no impact. For illustrative purposes, we have taken an extreme example of capping past claims at £100k of the indemnity – this would have impacted a small number of open and closed claims, saving £270,000 (if claimant costs in addition to the cap) or £465,000 (if claimant costs are subject to the cap, over the last 10 years, impacting 20 claims of which 16 remain open.

- Any restriction of cover - even an extreme example - would appear to have a financial impact of low materiality. Policy decisions should therefore consider the objectives for taking this approach, the principles required to achieve the objectives and take into account the detailed impact on customer protection based on the chosen approach.

Claims considerations: Phase 2 analysis

Phase 2
Scope and approach

PSYROC Phase 2 – claims analysis

Scope - overview

The focus of this section is on Phase 2, following Phase 1 work, together with the key activities set out by the SRA following discussion with the SRA Board.

The work focused primarily on three of the four scenarios assessed in Phase 1. These are:

- Scenario A - Reconfiguring existing SIFL on a forward-looking sustainable basis.
- Scenario B - New indemnity fund operating within the SRA.
- Scenario C - New discretionary fund operating within the SRA providing full PSYROC cover.

The work comprised two stages:

- Stage 1: update and further analysis for the SRA September Board meeting .
- Stage 2: create a final report, covering the Phase 1 and Phase 2 work, to accompany the forthcoming SRA consultation.

The Phase 2 review covered the key priorities below.

1. Confirm likely scale of savings from outsourcing claims handling and consider potential cost differences from scenario A (ongoing SIFL) – is the cost of handling post six-year claims likely to be significantly higher than handling Compensation Fund claims?
2. Confirm scale of likely difference in overall cost savings between scenarios B and C – focusing on the scope for greater granularity in 'high' assumed operational model savings (e.g., can we distinguish between 'high' and 'very high' areas of opportunity with bands of monetary value, within the scope of the quantitative analysis?).
3. Firm up WTW assumptions in the initial draft Phase 1 report where possible and explain the reasoning behind them; review material data gaps in the report and agree with the SRA an approach to closing these gaps in the report as far as feasible; standardise terminology in the report and harmonise with SRA language, in preparation for report publication alongside consultation.

Our approach to the work took into account key dependencies, including:

- Reliance on input from the WTW team that contributed analysis for the previous consultation paper and Phase 1 of this project.
- SRA resources to contribute to provision of background information, closing data gaps from Phase 1, analysis and decision-making.
- Appropriate access to stakeholders.

PSYROC Phase 2

Approach – claims review

We undertook a series of activities to support items 1, 2 & 4 of the project scope for phase 1, including the following:

1. Conducted interviews with key claims stakeholders, including SIFL;
2. Completed a claim walkthrough of representative claim/s procedure;
3. Reviewed core business process documents;
4. Appraised claims data and MI to assess current claims performance and measures;
5. Carried out high-level analysis of current claims data.

Our work looked to assess current business operating models, key to which included building further understanding in the following areas:

- Claims Handling Structure - understanding the insource and outsourced service structure;
- Case level comparison – understanding the claim footprint and the variation across the operating structures;
- Fees & Expenses – exploring how claims are paid, expenses charged, and what suppliers are used;
- Frequency & Severity – high level consideration of current portfolio, recent/material changes, and any development trends;
- Indemnity spend – considered current settlement profile and any potential change trends;
- Case management – evaluating key business levers, KPI’s and development activity;
- Case Reserving Strategy – reviewing the strategy, formulation and application of “case reserves” by operating structure/scheme;
- Nil Claims Analysis – assessing the frequency and impact of nil claims, how they are “managed to zero”, no coverage and fee only cases.

We analysed the available financial information, costs, and associated operational data to forecast potential future claims costs for the proposed new scheme. Our analysis of potential claims’ management operating expense savings, are based on information and assumptions provided by SRA regarding the overall future operating model and potential parameters. Expectations and assumptions of any one-off/transitional implementation costs were not considered by us, for instance data, IT, residual & run-off liabilities (e.g., pre-2000).

We completed a high-level gap analysis (see Claims assessment framework) which considers the individual claims business processes and the operational claims capabilities of the current SIFL arrangements against the proposed solution where the SRA Claims team in partnership with their chosen TPA would manage the claims as a partnership.

Summary findings and opinion from Phase 2

High-level analysis and opinion on the future Claims solution costs

Analysis:

We have estimated the potential Claims costs for scenarios A, B & C and provided a comparison to the current SIFL solution below.

We have used and relied on information provided during the interviews, documentation, data and supplier cost estimates to form the basis of our financial calculations and we have assumed that all that information was correct. Where there are unexplained variance/s we have formed opinions on what is reasonable for the purpose of this financial assessment.

We have estimated the cost projections on a full annual run-rate basis i.e. for when new claim volumes reach maturity, and we have provided a high and low range. We have based the calculation on historical/current claim volumes and have made no allowances for any potential change in claim type or volume submitted, or inflationary elements within these costs.

Conclusions:

- Scenarios B & C - have the potential to operate at a materially lower cost (claims and non-claims) than the current SIFL Claims arrangements.
- Scenario B - offers greater potential opportunity to achieve lower claims related costs than scenarios A & C.
- Scenario A - has the potential to operate at a lower cost than current, but potential savings to both claim and non-claim costs contain constraints. These scenarios are outlined on the next slide.

Summary Opinion:

There is the greatest potential for significant Claims cost advantages for the SRA if scenario B is implemented effectively, compared to the current SIFL operating costs.

Financial Impact Assessment

Current arrangement		Scenario A – reconfiguring existing SIF			Scenario B – new indemnity fund within the SRA		Scenario C – new discretionary fund within the SRA	
Cost Type	Utilised figure for scenario comparison	New fee agreement with Legal Panel, no change to insource model	Additional insourcing & new agreement with Legal Panel	New Third Party claim handling arrangement	High Cost Estimate	Low Cost Estimate	High Cost Estimate	Low Cost Estimate
Claims costs (internal and outsourced claims handling costs, legal panel costs, defence/counsel costs, external claims audit*)	**£800,000**	£700,000	£665,000	£625,000	£500,000	£400,000	£750,000	£600,000
Potential saving per annum against **Claims costs** on a full run rate basis (when claim volumes reach maturity) estimated at:		**£100k to £175k**			**£300k to £400k**		**£50k to £200k**	
Non-Claims Costs (infrastructure costs, legal framework, Governance, IT, non-claims staffing cost etc)	**£550,000**	Low cost saving impact anticipated against non-claims costs			Potential for high non-claims infrastructure and associated cost savings			

* Within our more detailed claims analysis, the current and ongoing cost of external claims auditing has been included within our claims costs calculations

Scenario A – Possible claim handling expense reduction opportunities

Reconfiguring existing SIFL on a forward-looking sustainable basis, to be wholly/partly funded by levy operating at reduced expense.

Change area	Arrange a new fee agreement with Legal Panel	Arrange a new fee agreement with Legal Panel on reduced volume with additional claim insourcing	Implement a new Third Party claim handling arrangement to handle all claims
Legal Framework	▪ No change to legal framework would be necessary		
Governance	▪ No change to governance structure		
Infrastructure (Claims)	▪ Claims handling; to arrange new fixed cost agreements with panel with no change to process or outsourcing procedure	▪ Claims handling; to arrange new fixed cost agreements with panel on reduced volume of cases, with retention of higher proportion of cases in-house	▪ Claims handling; to agree new clam handling outsource arrangement with third-party (TPA) with fixed fee to handle all PSYROC claims
	▪ Employee profile remaining unchanged	▪ Addition of in-house claim handling resource in order to reduce reliance and spend on legal panel defence fees	▪ Some reduction in internal claim handling and administration possible

Claims assessment framework – summary

Summary of high-level claims assessment framework gap analysis

We have considered scenarios A, B & C; the potential impact of the possible claim handling expense reduction opportunities we have highlighted within a reconfigured SIFL, and a go-forward claims solution which the SRA, in partnership with a TPA, could deliver for scenarios B & C.

Based on our high-level claims assessment, we consider the SRA, in partnership with a TPA, could provide a fit-for-purpose solution to either scenarios B & C.

In some instances, small changes or workarounds may be required to integrate the new claims (e.g. some small coding updates to ensure system reporting for these new claim types). The development of a ring-fenced reporting suite would enable delivery of MI & reporting internally and to stakeholders in a go-forward solution.

Non-claims areas that should be considered as part of the SRA's strategic decision-making, are included within the Claims assessment framework – general considerations.

Summary Opinion:

If the SRA were to create a new claims handling solution from 1 October 2023 as proposed, we have identified no material claims operational gaps for either scenarios B & C.

Future model gap analysis:

- High
- Medium
- Low
- None/minimal

Scenario	Summary		Claims solution conclusions							
		Estimated potential claims management cost saving	Claims Process	Claims Governance	IT & Systems	People Resourcing	Supplier Manag.	Technical Capability	MI & Reporting	Financial Manag.
Scenario A – Reconfigured SIFL	Continuing with SIFL, operating at reduced claims management expense	**£100k-£175k**								
Scenario B – New indemnity fund	New indemnity fund operating within the SRA	**£300k-£400k**								
Scenario C – New discretionary fund	New discretionary fund operating within the SRA providing full PSYROC cover	**£50k-£200k**								
Scenario D – Fund of last resort	New discretionary fund operating within the SRA as a "fund of last resort"	Not assessed								

Claims assessment framework (scenarios B&C) – business process (1/2)

This provides a summary opinion of claim processing capability required to manage the claims

Component	Description	Current	Proposed	Proposed detail	SRA Capability	TPA Capability	Possible Gaps	Gap Materiality	Comments/Recommendations
Notification	Receipt, processing and allocation of new claims	SIFL	SRAC	Claims would be notified to the SRA Claims team and they would be set up on their claims system.	Yes	Yes	Some process enhancement may be required to route/direct the new claims	Minor	SRA Claims may need to make some minor updates to contact information to ensure claims are reported correctly into the new channel. In particular, they may need to review those claims which have been reported directly to SIFL and what information was used to achieve that. There should not be a route directly into TPA which could cause challenges to business operations and financial accounting.
Administration	General management of data, post, email and other business activity.	SIFL	SRAC & TPA	SRA Claims & TPA would both have elements where they would need to manage this.	Yes	Yes	None identified	N/A	
Philosophy	General approach to management of a scheme (indemnity vs compensation) and settlement of cases	SIFL	SRAC	Indemnity involves fewer decision-making steps, and also allows scope for early negotiated settlement of claims (which can benefit both the fund and the claimant). Unlike an indemnity scheme, a compensation fund cannot usually negotiate a part-payment to settle the case.	Yes	Yes	None identified	N/A	Cost implications exist related to administering claims under the respective schemes.
Coverage Validation	Assessing the validity of the claims under the current settlement regime	SIFL & SRA	SRAC/SRA & TPA	The SRA Claims team will validate the claims with other parts of the SRA.	Yes	Yes	None identified	N/A	SRA may need to agree the investigation elements with TPA to avoid duplication of potential investigations into whether there is a successor practice or that the mandatory six year run-off has expired.
Reserving	Establishing, setting and maintaining accurate financial assessments of the claims costs	SIFL	SRAC & TPA	SRA will reserve on their system, and TPA will provide routine updates as specified/agreed in business processes.	Yes	Yes	Some minor business or process enhancements may be required	Minor	SRA Claims will need to agree with TPA the way in which reserves are maintained, and the mechanism for how/when any change to those are communicated back to the SRA.

Claims assessment framework (scenarios B&C) – business process (2/2)

This provides a summary opinion of claim processing capability required to manage the claims

Component	Description	Current	Proposed	Proposed detail	SRA Capability	TPA Capability	Possible Gaps	Gap Materiality	Comments/Recommendations
Investigation	Reviewing the claims presented, and associated documentation, and the potential independent valuation of any presented heads of claim	SIFL & Legal Panel	TPA & Legal Panel	TPA will manage the majority of the claims internally. Legal panel (incl. counsel) may be required for contentious cases or where an independent legal opinion is needed.	Yes	Yes	None identified	N/A	
Litigation	Managing litigated claims which could not be settled through negotiation.	SIFL & Legal Panel	SRA & Legal Panel	Litigated cases will be managed by the SRA and their existing legal panel arrangements.	Yes	N/A	WTW have not assessed the SRA legal panel within this review.	-	It is recognised that these are likely to be extremely few in volume, but WTW would recommend that the SRA Claims team validate that their legal panel has the capacity and capability to manage any potential claims.
Settlement	Processing of settlement payments for indemnity or fees associated to the claim	SIFL	SRAC & TPA	SRA will make payments on their system, and TPA will provide payment requests as specified/agreed in business processes.	Yes	Yes	Some minor business or process enhancements may be required	Minor	SRA will need to agree with TPA the way in which settlements are achieved, and delegated authorities (DA) that may be required, or in absence of DA how settlements would be authorised. TPA are proposing an escrow account, which was not suggested by the SRA.
Closure	Formal closure of settled or rejected claims.	SIFL	SRAC & TPA	SRA Claims & TPA would both need to maintain their respective systems, with TPA providing updates to the SRAC where specified in business processes.	Yes	Yes	None identified	N/A	

Claims assessment framework (scenarios B&C) – claims operations (1/2)

This provides a summary opinion of claim operational capabilities required to manage the claims

Component	Description	Current	Proposed	Proposed detail	SRA Capability	TPA Capability	Possible Gaps	Gap Materiality	Comments/Recommendations
People & Resourcing	Finding recruiting and retaining people who are capable to manage the solution, including sickness and holiday.	SIFL	SRAC & TPA	SRA & TPA believe that they could manage these utilising/reallocating existing resources, but there would need to be an agreed cost framework between them.	Yes	Yes	None identified	N/A	
Claims Management	Routine claims activities which sit around the processing of the claims.	SIFL	SRAC & TPA	Mixture of both SRA & TPA resources would be managing the claims	Yes	Yes	None identified	N/A	SRA would retain overview management of TPA portfolio
Claims System	System/s which process the claims from notification to settlement & closure	SIFL	SRAC & TPA	SRA & TPA have claims platforms which could be used for this solution.	Yes	Yes	None identified	N/A	
Financial Processing	Making payments & recoveries, which integrate with other business financial records (i.e. accounting, banking records, etc)	SIFL	SRAC & TPA	SRA & TPA have systems which could be used for this solution, with small adaptations or work arounds to segment the losses for reporting purposes etc.	Yes	Yes	Some minor business or process enhancements may be required	Minor	SRA will need to agree with TPA how claims payments will be issued and who will raise those, including which system SRA or TPA's generates any payments.
Telephony	Making and receiving telephone calls	SIFL	SRAC & TPA	Both the SRA & TPA would manage these through their current telephone options.	Yes	Yes	None identified	N/A	

Claims assessment framework (scenarios B&C) – claims operations (2/2)

This provides a summary opinion of claim operational capabilities required to manage the claims

Component	Description	Current	Proposed	Proposed detail	SRA Capability	TPA Capability	Possible Gaps	Gap Materiality	Comments/Recommendations
MI & Reporting	Access and analysis of business data, and the tool with which you need to do that.	SIFL	SRAC & TPA	SRA & TPA have established MI capability which would be used for this solution.	Yes	Yes	Development of a ring-fenced reporting suite is required	Moderate	Development of a ring-fenced reporting suite would enable the SRA to analyse and report upon claims performance to stakeholders in comparable ways to that undertaken by SIFL in order to align with historical reporting.
Supplier Management	The suppliers/vendors required to deliver claims service/s	SIFL	SRA	SRA have broad panel structure and TPA are proposing a dedicated team to manage these cases.	Yes	Yes	TPA fee model & fee details are indicative only at this stage	Low (utilising existing TPA)	Discussions around TPA outsource handling cost need to be undertaken with the preferred partner (or alternatively through wider market RFP process). If initially established with a single preferred partner, WTW recommend a formal supplier review and tender process in the next 2-3 years.
Claims Governance	Business reporting, meetings, and oversight (formal/informal) which provides adequate transparency on business activity.	SIFL	SRAC & TPA	SRA & TPA have established operational capability which could be used for this solution. SRA would retain oversight of TPA's governance of the scheme.	Yes	Yes	None identified	N/A	New arrangements will need to dovetail with SRA's other consumer protection arrangements.
Business Processes	Formal processes, training documents and/or equivalent material which demonstrates adequate levels of competency within business activities.	SIFL	SRAC & TPA	SRA & TPA have established business processes which could be used for this solution.	Yes	Yes	Some minor business or process enhancements may be required	Minor	Alignment and formalisation of rules and procedures will be required.
Audit	Routine audit of claims, suppliers, financial accounts, escrow funds, and business operations to ensure compliance with business processes and outcomes.	SIFL / External auditor	SRA / External auditor	SRA internal and external audit procedures will need to extend to this scheme (including audit of outsource arrangements) and report results independently.	Yes	N/A	None identified	N/A	This needs to be a ringfenced audit process which stands up to external validation. Supported by an external audit company. External audit of scenario C would require expanded criteria to assess the discretionary element.

Claims assessment framework (scenarios B&C) – general considerations

The following are further considerations which are outside the primary scope of the claims review/assessment

Component	Description	Current	Detail/Gaps	Comments/Recommendations
Regulatory Compliance	The requirement to which the compensation vehicle may be subject to independent regulation by one of more regulatory bodies (e.g. FCA, ICO, etc) and the need to meet those obligations.	SIFL	Not reviewed (out of scope)	If additional regulatory oversight is applicable (e.g. FCA, PRA, etc) the SRA will need to consider the extent to which their proposed solution includes regulatory considerations and requirements. The SRA may need to either discuss that directly with the possible regulator/s or seek independent legal opinion.
Business Governance	Governance requirements inside and outside claims, and the way that is managed, recorded and reported (if appropriate).	SIFL		The SRA will need to consider the extent to which they need to maintain strong business governance and reporting around the Claims operation, and whether their existing structure could absorb that functionality.
Board Function	The oversight of all functions associated to the scheme/operation.	SIFL		We understand the SRA intends to establish regulatory arrangements with the same governance oversight as their other arrangements, managed by their executive team which reports to the SRA Board. This may require engagement with other external bodies (e.g. The Law Society) to demonstrate how this will work in practice.
Actuarial Assessment	The regular and independent financial review of the business performance, and the wider impact on areas such as capital allocations.	SIFL		The SRA would need to engage Actuarial services to continue to monitor/manage areas such as financial development, financial modelling and capital allocation etc.
IT & Systems	Any/All business equipment, systems and architecture to maintain the business. That might include hardware (i.e. computers, servers, telephones,) or software (Microsoft, Claims systems, etc) or any routine business support or maintenance.	SIFL		The SRA should review of all systems used by SIFL, which should include a gap assessment with possible future IT solutions (e.g. SRA or TPA claims systems). They should also assess the contracts for all suppliers and the ongoing support they may require while those systems need to remain active. The SRA may also need to separately assess the transfer of open & closed claims and any associated documents held by SIFL or their suppliers.
Data Migration	The transfer of any data, documents or other material which could be relevant to the ongoing management of the business (incl. claims).	SIFL		The SRA should review all the data which SIFL holds, and the ability for other parties to access/process that data. The review should include current and historical data in all forms, including documents (e.g. contracts) for both claims and non-claims areas. This should include a formal legal review to ensure their proposed solution is compliant with current legislation (i.e. GDPR).
Knowledge Transfer	The transfer of any information written or unwritten which may be required to continue to manage the business, the claims (open or closed) and any associated risks.	SIFL		The SRA will need to consider the risks associated to undocumented business processes and/or activity, where the only capability is within existing SIFL business personnel, and consequentially the risks should they leave as part of this review, or before the claims have been fully concluded.
Run off Plan	Detailed run off plan to the point of anticipated closure.	N/A		If the SRA decide to close the SIFL scheme, they will require a detailed run off planning for the legacy portfolio.
Open case assessment	Case by case assessment of open & closed cases to understand financial and non-financial impact criteria.	N/A		If the SRA decide to close the SIFL scheme, it may be more prudent to undertake a more detailed case assessment prior to completing any portfolio transfer, to ensure that there are no underlying risks within the actual cases (e.g. unreserved financial liabilities).

PSYROC Asset-liability Management considerations

Asset-liability management

Summary of initial findings

Conclusions and hypothesis

- We consider that there is potential for significant funding benefits under each option through more sophisticated asset-liability management, which may also benefit from diversification, subject to the approach taken regarding segregation of funds
- However, we understand that the use of a discretionary fund with similar benefits to the existing SIF scheme may result in the potential for loss in investment income as the assets available to transfer to the new scheme assets may be lower that that of an indemnity scheme as some may be withheld by The Law Society.

Current SIFL approach regarding Assets and Liabilities

- Decisions on SIFL's willingness to extend PSYROC cover have been driven by an expectation of an operational wind-down and closure without recourse to additional funding.
- Provisions are set on a 'claims-made' basis and SIFL aims to maintain surplus capital based on 'insurance principles'. This implies a 'risk appetite' for SIFL of setting capital to withstand losses in excess of a 1-in-200 year event.
- While we would expect alternative approaches for coverage and risk assessment to be considered in the financial modelling of future options for the operating model, we understand SIFL's current approach to its investment strategy to be largely independent of its liabilities.
- We understand that SIFL's current investment strategy mirrors that of TLS, without explicit consideration of the liability profile or subsidising future required funding, which we would expect to be key drivers for a future investment strategy. The investment strategy set in 2017 reflected a short-term approach aligned to that of TLS:
  - The Fund's investment strategy is to hold a varied and diversified portfolio to maximise returns at a level of risk agreed by the Directors of the Company.
  - The Fund holds an investment portfolio consisting of equities, sovereign and investment grade bonds as well as other securities and cash. This provides the Fund with income and capital returns from the investments
- We understand that while the current strategy has generated reasonable returns over recent years, investment performance over the last year has generated unrealised losses in SIFL accounts. We consider this to be part of a normal cycle and should be a factor in any future investment strategy, which we would expect to include consideration and definition of risk appetite for volatility of the assets and investment returns.

Asset-liability management

Summary of initial findings

Potential areas of opportunity for a future model

- Introducing a levy on the profession significantly changes the income profile to the fund and limits the need to draw down on assets to pay claims and expenses. If desired, assets can then become more productive for generating additional income to supplement and reduce any levy required.
- There is a potentially significant opportunity to optimise asset-liability management, maximising the proportion of assets that could be used to generate investment returns to contribute to the funding requirement:
  - The significant asset base and surplus could potentially generate an annual income to support a portion of funding requirements, reducing levy rates which would be payable by solicitors. A new investment strategy should be created to target defined objectives. Such objectives could be, for instance, maximising the long term returns generated, taking account of constraints such as requiring the generation of a stable 'base' level of income and requiring asset volatility to remain below a defined threshold
  - In turn, the capital buffer can also be reduced by acknowledging the income of the levy which can be varied to cover a proportion of claim payments.
  - In our view there could be benefits in a future fund using a run-off basis of coverage and assessment of liabilities, which could, in principle, provider greater certainty of costs over a longer period of time, reducing unexpected volatility and increasing the lead time available for securing funding, which has the potential to enable a smaller buffer to be held.
- In addition, consideration can be given to the amount of capital that is physically held in the fund and the extent to which guarantees or loans from the SRA can contribute to the 'capital' available to support the liabilities.
- While in principle there could also be an opportunity to take advantage of risk diversification if the fund is run within the SRA, this depends on the funds not needing to be ring-fenced. However, we understand that the SRA expects the fund to be ring-fenced and therefore this option would not be available.

Suggested next steps

- The potential contribution of this opportunity would require further analysis and modelling, which would also need to be considering in combination the coverage and funding approach, capital buffer and investment strategy options.
- We have set out some policy considerations which would be required to guide the analysis and define overall objectives and potential scenarios.

Asset-liability management

Summary of initial findings

Policy considerations

- A combination of risk appetite and strategic considerations of the split in principle of funding mechanism between income from assets and levy – e.g.
  - Should claims be funded as much as possible by investments topped up by a levy, or vice versa?
  - Should the level of the levy be kept relatively stable where possible (e.g. within certain thresholds or how frequently it should move) or subject to unrestricted change
  - What level of risk appetite would be appropriate for provisions and capital-setting in a new operating model? E.g. should either or both of these be equivalent to the current SIFL approach or consider different objectives?
- We understand that the SRA's expectation is that the 'claims-made' basis for coverage and funding should continue unless there is a clear benefit of changing this. In our view there could be benefits through changing to a run-off basis of coverage and funding because this could in principle provider greater certainty of costs and offers the opportunity for increased investment leverage.
- We understand that the current expectation is that The Law Society would make all current SIFL assets available for a new indemnity scheme (subject to assets required for remaining liabilities and approach to running these off) but not for a discretionary scheme. Therefore, a decision on the type of scheme will have an impact on the assets available for investment.

Asset-liability management

Summary of initial findings

Key assumptions, data gaps and requirements for further analysis

- Detailed analysis of the size of the opportunity, subject to risk appetite and tolerance of volatility, to generate investment income, while maintaining growth and liquidity objectives.
- Additional analysis and discussions would be needed to consider potential mechanisms to access additional capital on a defined basis and the appetite or commercial terms to provide this among different institutions
- Assumptions or decisions would also be required in relation to the SRA's risk appetite for the fund and assessment of whether insurance or use of recoveries should form part of the risk mitigation and cost management strategies .
- In accordance with the requested scope of this work, we do not include detailed consideration and illustration of the implications for the SRA's proposed indemnity fund of alternative coverage/funding and asset-liability management configurations. We understand that the SRA plans to consult on the structure and mechanics of any levy for post six-year consumer protection before collecting a levy for the first time. We expect the SRA to undertake a further consultation on this matter at an appropriate time.

Appendices

Appendix A

Reliances, Disclaimers and Limitations

Purpose, Reliances and Limitations

Purpose

- This document was prepared by Towers Watson Limited (“Willis Towers Watson” or “we”) for the Solicitors Regulation Authority (“SRA”) to use in the context of its consideration of options for the future arrangements for post 6-year run-off cover for UK solicitors in accordance with the terms of our Statement of Work dated 31 May 2022.
- This document is not intended nor necessarily suitable for any other purposes and we accept no responsibility for any such use.
- This document must be considered in its entirety as individual sections may be misleading if considered in isolation.
- We are available, with instruction from the SRA, to answer any questions that may arise regarding this document. We assume that the reader of this report will seek such explanation on any matter in question via the SRA.

Purpose, Reliances and Limitations

Reliances

- In developing this document, we have relied on historical data and other quantitative and qualitative information supplied by SIF Ltd (SIFL) and the SRA. We have not independently audited nor verified this information; however, we have reviewed it for general reasonableness and consistency with our knowledge of the insurance industry. We have assumed that the information is complete and accurate.
- The accuracy of our findings is dependent upon the accuracy and completeness of the underlying data. Therefore, any material discrepancies discovered in this data should be reported to us and this report amended accordingly, if warranted.

Purpose, Reliances and Limitations

Limitations

- At your request, we have provided you with advice on PSYROC options. You understand that this advice has been developed within a limited timeframe and with limited access to data and as a result may not be as comprehensive as it might have been had we had more time to consider the matters raised.
- This document was prepared for use by persons technically competent in the areas addressed and with the necessary background information. We are available to answer the SRA's questions that may arise regarding this document. We assume that the SRA will seek such explanation on any matter in question.
- The user should take note of additional limitations discussed in the report. In particular, we have developed a number of assumptions which our based on our experience and the limited data available to us during the compressed timeline for this project. In a number of cases, we are relying on information and data available in published annual reports and accounts for SIFL and the SRA, and not the underlying detailed performance management information. However, from an overall perspective, we consider that the projections provide a reasonably representative indication of expected outcomes.
- In accordance with the SRA's instructions we have only considered future running costs of the scenarios and not transition costs. WTW has not assessed any SIFL closure elements or the ongoing management of SIFL should the scheme close. Therefore, our analysis does not include any change components for example - the transfer of any cases, future management of the "run-off" account, any cost/s for closure arrangements, or similar.
- This advice has been given in a compressed timeframe and as a result may not be as comprehensive as it might have been had we had more time to complete the review.

Purpose, Reliances and Limitations

Limitations (cont.)

- We have provided no opinion about the current SIFL structure &/or its future viability.
- We have used and relied on information provided during the interviews, documentation, data and supplier cost estimates to form the basis of our financial calculations and we have assumed that all that information was correct.
- We have analysed the available financial data, where there are unexplained variance/s we have formed opinions on what is reasonable for the purpose of this financial assessment.
- We have not independently validated any of the financial information we were provided or reviewed any open or closed claims.
- We have not spoken to any current legal suppliers as part of this review, which in particular makes the figures we have included for scenario A highly indicative and subject to further validation.
- Non-claims costs are not within the project scope for the Phase 2 claims analysis, but there is likely to be an operational cost to scenarios B & C.
- For “Scenarios B & C” we have assumed comparable claims handling structure to the existing SIFL arrangements.
- Should the SRA choose to create a new claims scheme, there may be a period where the old & new schemes run as parallel operations. These have not been included in the calculations.
- We have not included any pre-activation set-up costs for the new scheme in advance of the 1st October 2023 commencement.
- We have not allowed for any inflationary component/s in any of the financial calculations.
- Our damages and fee projections are based on a full run-rate basis, without any allowance for potential changes in claims volumes.

Appendix B

Jargon buster

Terminology and definitions

Term	Definition
PSYROC (post six year run-off cover)	Cover for consumer protection against loss caused by a solicitor's negligence, in circumstances where the law firm has been closed for more than six years with no successor practice at the point when a claim comes to light
Solicitors Indemnity Fund (SIF)	The fund used to provide PSYROC cover
Solicitors Indemnity Fund Limited (SIFL)	The organisation currently providing PSYROC cover
Third Party Administrator (TPA)	A nominated independent claims handling company which manages claims on the behalf of the SRA's claims team
Risk Appetite	The amount and type of risk that an organisation is willing to take in order to meet their strategic objectives
Asset Liability Management (ALM)	The process of systematically coordinating investments (assets) to obligations (liabilities) to enable assets and liabilities to be aligned to the risk strategy
Provisions	A reserve of money set aside by a company to meet future claim payment obligations
Claims-made coverage	PSYROC claims which are ***notified*** at a point time for ceased practitioners; this is the basis of the indemnity coverage provided by SIFL
Run-off coverage	PSYROC claims which have ***occurred*** at a point time for ceased practitioners; this is the exposure to claims-made coverage above plus all costs from future PSYROC claims notifications from ceased practitioners at that point in time

Terminology and definitions

Term	Definition
Claims made funding basis	Funding approach which targets funding sufficient to meet PSYROC claims made coverage exposures plus a capital buffer
Run-off funding basis	Funding approach which targets funding sufficient to meet PSYROC run-off coverage exposures plus a capital buffer; this could be either on a ceased practitioner run-off exposure basis or alternatively on a basis that reflects exposures from both active and ceased practitioners
Capital buffer	A capital margin in excess of the targeted funding level to intended to allow for adverse unforeseen contingencies.