

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC



Professional indemnity insurance - post six year run-off cover

Purpose

- 1 To deal with the Law Society's proposal to extend the final end date for the post six year run-off cover provided by the Solicitors Indemnity Fund (SIF).

Recommendation

- 2 The Board is asked to:
 - a) agree that there should be no change to the final end date of the post six year run-off cover provided by the Solicitors Indemnity Fund (SIF) under the SRA Indemnity Rules 2012, of 30 September 2020 (paragraphs 3 to 22).

If you have any questions about this paper please contact: Crispin Passmore, Executive Director, crispin.passmore@sra.org.uk.

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC



Professional indemnity insurance - post six year run-off cover

Background

- 3 Since 1 September 2000 SRA regulated firms have been required to hold professional indemnity insurance (PII) with an insurer operating in the open market. Our rules require that this insurance covers any claims made in the six years after a firm ceases business, if the firm closes without a successor firm ('run-off insurance'). This matches the primary limitation period within which negligence claims must be made. It is possible to bring a claim outside of the primary limitation period in certain circumstances. However, there is 15-year long-stop date from the date of the negligent act or omission giving rise to a claim¹.
- 4 Professional indemnity policies are generally written on a "claims made" basis rather than a "losses occurring" basis. This means that responsibility for paying a claim lies with the insurer at the time the claim arises, or the circumstances giving rise to a claim are notified, rather than with the insurer that provided cover when the alleged negligent act took place.
- 5 Prior to moving to the open market system on 1 September 2000, the solicitors' PII market operated on the basis of a statutory fund, called the Solicitors' Indemnity Fund (SIF) set up by the Law Society under section 37 of the Solicitors Act 1974. SIF was, and still is, managed by Solicitors Indemnity Fund Limited which is a company limited by guarantee set up for that purpose.
- 6 Although it does not participate in the open market, SIF continues to underwrite the following, with the relevant provisions set out in the SRA Indemnity Rules 2011:
 - historical claims i.e. those made during the period a firm was covered by the SIF master policy (1 September 1987 to 31 August 2000)
 - run-off claims - claims made after 31 August 2000 by practices that ceased while covered by the SIF master policy
 - post six-year run off cover - claims made on or after 1 September 2007 by firms that ceased without a successor practice on or after 1 September 2000. This is limited to claims notified up until 30 September 2020.
- 7 As stated above (bullet 2), SIF continues to provide run-off cover to any firm that ceased without a successor practice on or before 31 August 2000. SIF has

¹ <http://www.pinsentmasons.com/PDF/Limitation.pdf>

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC

set aside sufficient reserves to meet current and future expected liabilities in respect of this cover. This part of SIF's function should be concluded for all practical purposes by around 2017. The 15-year long stop went to 31 August 2015 so there is little prospect of any new claim in respect of these historic SIF claims.

- 8 Since 2007 SIF has also provided post six year run-off cover to firms that ceased without successor on or after 1 September 2000, with a current end date of 30 September 2020 (bullet 3). The cost of this cover is met from surplus within SIF. The 30 September 2020 end date means that SIF cover will not be available to existing or future firms closing without a successor.
- 9 In February 2014 the Law Society asked the SRA to extend the 2020 date by three years. In December 2014 the SRA Board, taking into account the financial projections provided by SIF and its actuaries, decided not to extend the 2020 end date by three years. It considered that there were insufficient funds in SIF to do so. It deferred any decision on further options of extending by either one or two years, or ceasing before the current September 2020 end date. The Board decided that it would be better to tackle this issue at a later date, taking into consideration the latest SIF financial information and the results of our planned wider consultation on PII reform.
- 10 The Law Society, the SIF Board and the profession all now require certainty to assist with their future plans. In July 2015 we issued a discussion paper called *Protecting clients' financial interests*. One of the topics raised was whether the post six-year run-off cover provided by SIF run-off cover should be extended beyond 30 September 2020. There was consensus that the issue must be addressed as a matter of urgency. However, there were mixed views over about whether it should be extended - either until the SIF funds were exhausted or for a pre-determined period (e.g. until 2023).
- 11 If the Board agrees that post six year run-off cover should not be provided by SIF beyond 2020, no rule change is required. There will be no need to consult on this decision as it does not change our current position. However, we ask the Board to make a formal decision to enable us to respond to the Law Society's request for clarification.
- 12 The main reasons against any extension are:
 - this would not align with our position on the run off cover required under PII policies procured on the open market;
 - there is uncertainty about whether there is sufficient surplus within SIF to finance any extension;

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC



- the disproportionate costs of administering the fund to support any extension.

Analysis

- 13 Our policy position on PII Run-off cover serves two principal purposes:
 - it provides continuity of client financial protection
 - it provides indemnity cover for retired solicitors, sometimes referred to as the 'sleep easy' factor .
- 14 The first purpose is a matter of regulatory policy for the SRA, and raises the question: do we think that run-off cover should be greater than six years? If we do, then a secondary issue is how that cover should be funded. If we do not, it would be inconsistent to extend current post six year run-off cover beyond 2020. The issue for the Law Society is different. It primarily wishes to provide benefits to its members in terms of greater protection from negligence claims.
- 15 Reform of PII is part of our wider programme of regulatory reform. Our direction of travel is towards greater proportionality and less prescription.
- 16 In May 2014 we consulted on reducing compulsory run-off cover from six to three years. We took the view that limiting compulsory run-off cover to three years was proportionate and targeted regulation that struck the right balance between the protection of those consumers of legal services that need protecting and the cost of providing that protection. High costs can deter providers entering (and exiting) the market and impact on the price of services available to consumers and potential consumers.
- 17 The proposal received a mixed reception. A majority of respondents favoured no change but a sizable minority were supportive of the proposed reduction. In the light of this mixed reception the Board deferred the matter to enable further work to be carried out as part of a wider review of our compulsory PII arrangements.
- 18 It would be inconsistent to, on the one hand, seek to maintain the current six year run-off cover (or even to reduce this to three years) and on the other to extend the life of the post six year run-off cover provided by SIF. If the Board agrees with this policy position, the decision not to change the 2020 final end date can be made now, providing certainty for all involved and minimising on-going administration costs.
- 19 This decision would not prevent any solicitor purchasing additional run-off cover itself or the Law Society establishing an alternative product as part of its professional representative role. We are ready to assist the Law Society to

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC



develop a long-term solution to the issue of run-off cover as a service to its members if it chooses to pursue this option.

Uncertainty over sufficiency of funds in SIF to finance an extension

- 20 Since the Board previously considered this issue on December 2014, there have been developments that make it seem less likely that SIF has sufficient funds to finance an extension. There has been a higher than predicted increase in claim notifications received during 2014/15 under the existing post six year run off cover arrangements. To deal with this, the SIF Board took action to increase provision within their reserves.

Disproportionate costs

- 21 As SIF continues to wind down and historical claims are concluded the only activity SIF will be engaged in is handling post six year run-off. With reducing numbers of claims the scheme becomes less cost effective to run, due to base infrastructure costs incurred regardless of the number of claims. The cost of running and managing SIF now equals the amount it is paying out, at the current level of payments.

Future policy

- 22 We now intend to consult on our substantive PII reform proposals in Autumn 2016. The consultation will be based on claims data that has been provided to Mazars, an independent consultancy, to analyse on our behalf.

Recommendation: he Board is asked to agree that there should be no change to the final end date of the post six year run-off cover provided by the Solicitors Indemnity Fund (SIF) under the SRA Indemnity Rules 2012, of 30 September 2020 (paragraphs 3 to 22).

SRA BOARD
9 March 2016

CLASSIFICATION – PUBLIC



Supporting information

Links to the Strategic Plan

- 23 This is a decision on when and how to wind up legacy provisions rather than being driven by our strategic plan.
- 24 However, the proposal would provide the greatest consistency with our wider policy reform programme, driven by the first objective in the [Strategic Plan](#) which is as follows:

We will reform our regulation to enable growth and innovation in the market and to strike the right balance between reducing regulatory burdens and ensuring consumer protection.

How the issues support the regulatory objectives and best regulatory practice

- 25 We consider the proposal to be neutral in respect of the regulatory objectives. As continuity of financial protection is a policy purpose of run-off cover, then protecting and promoting the interests of consumers is likely to be most relevant. However, we are proposing no change to the current SIF arrangements and the preferred option most closely aligns to the protection consumers get through current “open market” insurance provisions.
- 26 The proposal improves transparency of regulation by providing clarity and certainty with regards future SIF provision. It is proportionate given the costs of running the scheme and the likely future trend towards reducing run off cover. It is consistent given the cover provided to firms and clients under current open market arrangements.

What engagement approach has been used to inform the work (and what further communication and engagement is needed)

- 27 The Standards Committee considered the issues raised in this paper on 10 June 2014, and agreed with the analysis above. The new Policy Committee confirmed this view at its meeting on 10 February 2016.
- 28 If the Board agrees not to make a rule change to extend post six year run-off cover by three years to 30 September 2023, it will be necessary to publicise the fact to two main groups:
- firms that have already ceased without successor;
 - firms that are contemplating closure without successor.

SRA BOARD

9 March 2016

CLASSIFICATION – PUBLIC



- 29 The Board's decision would be communicated through a range of media including SRA Update which is sent to all those with a mySRA account including retired practitioners who remain on the Roll and on the SRA website and subsequently alongside the 2016 consultation on related PII reforms.

What equality and diversity considerations relate to this issue

- 30 It is the smallest firms that are most likely to close without a successor and so enter run-off. BME solicitors are disproportionately represented in small solicitor practices so the proposal should have particular benefits to BME solicitors and the communities they serve. The provision of post six year run-off cover comes at a cost which has to be met in some way. Currently the cover has been provided through SIF from available surplus within the Fund. However, it is uncertain whether there would be sufficient funds to go beyond the 30 September 2020 final end date for the provision of post six year run-off cover. Past the end date firms closing without successor can decide whether they need run-off cover beyond six years and they will be able to avoid any additional cost of cover that they may not want or need.

Author Crispin Passmore
Contact Details crispin.passmore@sra.org.uk
Date 25 February 2016