

**SRA BOARD**

11 May 2020

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*This paper will be published*

### **Professional Indemnity Insurance – post six-year run-off cover**

#### **Purpose**

- 1 This paper discusses whether there is a need to reconsider the Board's decision made in 2016 not to extend post-six years run-off cover provided by the Solicitors Indemnity Fund (SIF) beyond September 2020.

#### **Recommendation**

- 2 The Board is asked to:

- a) consider whether there is a change to the environment that suggests a regulatory response is required to protect clients bringing claims from September 2020 onwards against firms which are outside the six year run off period
- b) if so, to request that the Solicitors Indemnity Fund Limited (SIFL) conducts an actuarial analysis of the potential exposure to post six year run off claims for a one, two and three-year period from 30 September 2020.

**If you have any questions about this paper please contact: Juliet Oliver on [Juliet.oliver@sra.org.uk](mailto:Juliet.oliver@sra.org.uk).**

#### **Equality, Diversity and Inclusion considerations**

<b>Consideration</b>	<b>Paragraph nos</b>
The Law Society noted in its professional indemnity insurance (PII) survey for 2017/18 that smaller firms are more likely to close without a successor practice and so enter run-off. We know that Black Asian and minority ethnic (BAME) solicitors are disproportionately represented in the group of sole practitioners/small firms. So any extension to post six-year run-off cover provided by SIF, or alternative arrangement to meet claims falling outside of the six year period, could have particular benefits to BAME solicitors and the communities they have provided services to in the event of a claim.	37
The cost of any extension or alternative arrangement is ultimately borne by the profession.	38

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**CLASSIFICATION – PUBLIC****Professional Indemnity Insurance – post six-year run-off cover****Background**

- 3 The Law Society established the SIF as a fund in 1987 for the purpose of providing compulsory professional indemnity cover to all solicitor practices in England and Wales.
- 4 The SIF was placed into run-off following the introduction of an insurance model in 2000 which requires firms to hold professional indemnity insurance with an insurer in the open market. The SRA Indemnity Insurance Rules require that this insurance must cover any claims made in the six years after a firm ceases business and closes without a successor practice ('six-year run-off cover'). This cover protects the firm's former clients and the firm's former ownership in relation to civil claims for professional negligence.
- 5 We most recently decided that this was the appropriate level of run-off cover to require, in December 2019, as part of the most recent review of our PII requirements. Six years matches the primary limitation period within which negligence claims must be made. However, limitation periods may extend beyond six years in some circumstances because, for example the negligence comes to light at a later date.
- 6 Upon moving to the open market system, the SIF was placed into run-off. The SIF maintained liability for historic claims. In 2004 the Law Society decided to use some of the residual funds that SIF had built up by that time to purchase post six-year run off cover for firms and that this should apply to claims notified before 30 September 2017. In 2012 the SRA Board agreed a three extension and the SRA Indemnity Rules 2012 provide that this applies to claims notified to SIF before 30 September 2020.
- 7 In 2014 the Law Society requested a three-year extension of the 30 September 2020 closure date. The SRA Board deferred any decision but re-visited the issue at the request of the Society in March 2016. The Board paper from 2016 is attached at annex 1. At that time, the Board decided not to extend the date, principally because;
  - a. an extension of post six year run-off cover did not align with the SRA's policy position on the proportionality of establishing a period of six years for run off cover as a regulatory requirement
  - b. there was uncertainty at that time about whether there would be sufficient surplus in the SIF to finance an extension
- 8 The Board minutes from that meeting reflect a recognition that any limits on the scope of post six year run-off cover would mean that some claims might not be covered. However, it was likely that some firms would be able to attain

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replacement post six year run-off cover while others would not, and this would be a matter for the market.

- 9 In reaching its decision the Board considered the proportionality of regulatory requirements to provide appropriate consumer protection. It also made a distinction between consumer protection and the so called “sleep easy” factor for retired solicitors, the latter being the interest of the Society as the professional body.
- 10 As the Board will recall, it heard from the Chair of the SIFL Board at its meeting in January 2020 and received a paper in March 2020 relating to the future of the Fund given its continuing administration costs, and level of ongoing claims. Following this, we have been working closely together with SIFL and the Law Society on forward plans to bring the SIF to a close. The work programme has been exploring the possibility of transferring the Funds liabilities to a third -party insurer and then winding up the fund. In March 2020 the Board considered issues relating to the release of any residual funds held by SIF at that time.

**Impact of Covid-19 and recent correspondence from the Law Society**

- 11 The Chair of the Law Society Board wrote to the Chair of the SRA Board on Friday 1 May in light of the Covid-19 pandemic, setting out that in view of the current extraordinary circumstances the Society believes that it is both appropriate and necessary to extend the protection provided under the SIF scheme for a further three years. A copy of that letter is attached at annex 2.
- 12 The letter highlights the Society’s concern that the hardening of the PII market is likely to be exacerbated by the current Covid-19 crisis, and that its enquiries have identified that no insurers are developing post SIF products and are reluctant to extend cover to existing insured firms beyond six years. This reflects a risk averse approach which sees insurers reluctant to develop bespoke products or entertain a one-off premium in respect of unknown risks. The Society has also received feedback from members who have been unable to find post six year run off cover.
- 13 The letter highlights that the current situation may result over time in more claims, as well as a reduction in the assets available to retired solicitors to cover any personal liability to meet claims. As well as the impact on members of the profession, it reflects on the fact that this will result in claimants who will be left without redress.
- 14 This reflects our understanding, from our own discussions with insurers and brokers over the past months and confirmed in more recent weekly discussions.
- 15 Certain types of work are more susceptible to post six-year run-off claims. Its data demonstrates that the significant majority of claims relate to conveyancing or property transactions, where negligence might not emerge until the property is resold many years later. The other long-tail claims category is wills and

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trusts, where once again issues with the legal work involved may only arise at a considerable distance in time.

- 16 We have had informal discussions with insurers about whether there is a product that would help firms or if one is likely to be developed. Some insurers have indicated that they would consider an extension to the mandatory six-year run-off cover but only for firms that are on their PII book (existing business), on a periodic, and case by case basis. There is, however, reluctance to offer assistance to those firms that have not paid or will not pay the premium due for the mandatory six-year period<sup>1</sup>.
- 17 Some insurers have indicated that their business models are not set up for this type of work. This may be because the risks are new or untested. Some also said that they would be unlikely to make an offering on a case by case basis or as a standalone product because such run-off claims are generally more expensive to administer. It takes longer to obtain necessary information six years after a firm has closed, in order to support the claim or for example establish the statutory limitation period. Further, the risk exposure for certain types of work (wills and probate) can remain for an indefinite period.
- 18 Some insurers have also indicated that if a product was developed there may be barriers to making an offer to a firm that was insured with a provider that is not solvent. This is because there might be very little information about the practice and the insurers risk profiling of that practice.
- 19 The Board is asked therefore to decide whether the latest information suggests a material change to the position in 2016 which indicates that further consideration should be given to regulatory action in respect of claims brought after the six year run off period.
- 20 In summary, we have anecdotal information that suggests, as we approach the September 2020 deadline for the end of SIF's post six year run off cover, there are very limited options for purchasing alternative cover. This may mean that a larger proportion of firms are unable to get cover than assumed in 2016. This leaves clients reliant on recovering directly from individuals. The other change may be a reduction in assets resulting from the current economic situation, meaning individuals are less able to meet those liabilities.

#### **What are the financial implications of an extension beyond September 2020?**

- 21 If the Board decides that consideration should be given to further regulatory action, it will need to consider the viability of extending the SIF in order to provide indemnity cover, and the proportionality of the cost of maintaining the SIF to deal with these claims.

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<sup>1</sup> These firms would still be covered as the MTCs do not allow insurers to cancel annual or run-off cover for non-payment of premium

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- 22 In 2014, the Board noted that as the SIF continues to wind down and historical claims are concluded the only activity the SIF will be engaged in is handling post six year run-off.
- 23 In its correspondence, the Law Society addresses the issue of affordability, attaching a commercially sensitive and confidential analysis from SIFL. Due to the nature of these claims and the limited information that can be obtained to respond to a claim, the cost of processing a claim is expensive. In the SIF update provided in April 2020 (annex 3), it was also noted that these claims are generally slow to progress.
- 24 However, comparing the operating cost of the SIF to the cost of claims is difficult as SIFL has not completed work to identify the projected claims/liabilities arising out of any extension. If the Board is minded to agree an extension we anticipate it would need to take its own view on the proportionality of continuing to operate the SIF in order to meet post six year run off liabilities, based on an up to date and independent understanding of SIF's current and projected exposure to claims.

**Recommendation:**

**The Board is asked:**

- (a) **to consider whether there is a change to the environment that suggests a regulatory response is required to protect clients bringing claims from September 2020 onwards against firms which are outside the six year run off period**
- (b) **if so, to request that SIFL conducts an actuarial analysis of the potential exposure to post six year run off claims for a one, two and three-year period from 30 September 2020.**

**Next steps and alternative options**

- 25 We will communicate the Board's decision and next steps accordingly.
- 26 If the Board agrees with the recommendations in this paper, we propose to bring the matter back to the earliest possible meeting of the Board in order that a decision may be reached in sufficient time before the September cut-off date to provide clarity to the public and profession. If at that time the Board considers that protections should be put in place for consumers, but that the proposed extension of SIF is not a proportionate solution, then it may wish to consider at that time whether there are any realistic alternative options.
- 27 The letter from the Law Society identifies the challenges it faces in setting up an alternative arrangement to address the post six year run off liability to its members. This includes the fact that indemnity arrangements are, under section 21 Legal Services Act 2007 a regulatory arrangement and therefore must be delegated to the SRA. In addition, any hardship fund for members

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would not guarantee redress for consumers and would require infrastructure and administrative resources.

- 28 One possible alternative to an indemnity solution, which may be appropriate as a proportionate regulatory response given the potentially limited number of claims, would be to use the existing resources available in the SRA's Compensation Fund to meet a new category of claims. This could be limited to those falling outside of the mandatory six year run off period in circumstances where the firm or individual has been unable to insure against its exposure to such claims. This could also be limited in time to help address the particular concerns around Covid-19, for example to claims brought within a three year period.
- 29 If it wishes to adopt this approach, the Board would need to agree to an amendment to the SRA Compensation Fund Rules following an appropriate period of consultation. These would need to be approved by the Legal Services Board. We would ask them to do so on an expedited basis given that the aim would be for any such change to be in place on or as soon as possible after 30 September 2020. Before doing so, the Board would need to consider the potential cost to the Compensation Fund. In order to do that, we would need to understand the claim projections in more detail. Depending on the number of claims, we would also need to understand the likely administrative costs of processing these.
- 30 We propose to bring a further analysis of the costs and potential benefits of this potential alternative to the Board when it reconsiders the matter.

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**Supporting information**

**Links to the Corporate Strategy and/or Business Plan**

- 31 This work aligns with two of the five strategic aims/objectives outlined in the SRA Corporate Strategy 2017 to 2020:
- We will make sure our regulatory requirements are proportionate, providing solicitors and firms the flexibility to innovate and better meet the needs of members of the public and businesses, while maintaining appropriate levels of public protection.

**How the issues support the regulatory objectives and best regulatory practice**

- 32 The purpose of run-off cover is to provide consumers with financial protection and therefore, the objective to protect and promote the interests of consumers is likely to be most relevant. If Board agreed not to reopen the discussion and reconsider its previous decision, the protection consumers get through current “open market” insurance provisions would continue.

**Public/Consumer impact**

- 33 The Law Society note that at least 40 per cent of claims are made in the first three years of a firm closing.

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

- 34 We would communicate any decision to the Law Society and other key stakeholders.

**What equality and diversity considerations relate to this issue**

- 35 The Law Society noted in its PII survey for 2017/18 that smaller firms are more likely to close without a successor practice and so enter run-off. We know that BAME solicitors are disproportionately represented in the group of sole practitioners/small firms. So any extension to post six-year run-off cover provided by SIF, or alternative arrangement to meet claims falling outside of the six year period, could have particular benefits to BAME solicitors and the communities they have provided services to in the event of a claim.
- 36 The cost of any extension or alternative arrangement is ultimately borne by the profession.

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**Annexes**

**Annex 1** SRA Board paper – March 2016

**Annex 2** Letter from Chair of TLS Board to SRA Chair with information from SIF - 1 May 2020 (*not for publication because of commercially sensitive and confidential content*)

**Annex 3** Information on claims from SIFL – April 2020 (*not for publication because of commercially sensitive and confidential content*)