

SRA BOARD

3 March 2020

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This paper will be published

Solicitors Indemnity Fund

Purpose

- 1 This paper updates the Board on the plans for bringing the work of the Solicitors Indemnity Fund (SIF) to a close and looks at what will happen to any residual funds it holds at the point it closes its books.

Recommendation

- 2 The Board is asked to agree that any residual funds should revert to the Law Society to be used for the benefit of the profession.

If you have any questions about this paper please contact: Juliet Oliver, General Counsel juliet.oliver@sra.org.uk

Equality, Diversity and Inclusion considerations

Consideration	Paragraph nos
This paper is about a particular aspect of arrangements for clients to recover against civil claims for professional negligence. Therefore, it is relevant to those suffering loss – which may include people with vulnerabilities – and small firms including sole practitioners, which have a higher representation of Black, Asian and minority ethnic solicitors. However, this paper is proposing no change to our existing policy position and therefore does not have any specific impacts on particular groups.	

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Solicitors Indemnity Fund

Background

- 3 At its January meeting the Board heard an update from the Solicitor Indemnity Fund Limited (SIFL), the company established by the Law Society to manage and administer the Solicitors Indemnity Fund (SIF). The Board considered the future of the SIF at that meeting.
- 4 SIFL outlined that the costs of operating the SIF were becoming increasingly disproportionate as the number and value of new notifications and claims that it deals with continues to reduce over time. It is therefore taking forward plans to transfer its outstanding liability to a third-party insurer, and subsequently to wind down the company. This raises the question of what will happen to any residual funds held at the time it does so.

History

- 5 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.
- 6 The SIF was established under section 37 of the Solicitors Act 1974, which allows the Society to make rules concerning civil liability incurred by a solicitor or former solicitor (or their employees/former employees) in connection with their practice or a trust of which they are a trustee. All firms in England and Wales were required to contribute to the SIF. Cover extended to claims against a practice or trust after it had ceased, without any further contribution being collected.
- 7 The Society's indemnification arrangements were subsequently delegated to the SRA following our establishment in 2006, alongside the Society's other regulatory functions, and the operation of the SIF is currently governed by the SRA Indemnity Rules 2012.
- 8 The role of the SIF has changed over time. In 1999 the Law Society Council voted to abolish the Fund and move to an open market insurance system. Since 1 September 2000 firms have been required to hold professional indemnity insurance (PII) with an insurer operating in the open market. These requirements are now set out in the SRA Indemnity Insurance Rules and have been subject to review and consultation over the years. Firms must have adequate and appropriate insurance and must purchase insurance on the open market that meets the minimum terms and conditions that we set.
- 9 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.

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- 10 This means that run-off insurance is necessary if a firm is to have cover for claims against that firm after it has ceased for work done before it closed. When moving to the open market insurance system in 2000 the Society required that if a firm ceases without a successor firm, they must purchase six years 'run-off cover'. This cover protects the firm's clients and the firm's former ownership in relation to civil claims for professional negligence.
- 11 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.
- 12 Our rules maintained this position, which continues to be reflected in the Minimum Terms and Conditions of professional indemnity insurance under our new Standards and Regulations introduced in November 2019.
- 13 Upon moving to the open market system September 2000, the SIF was placed into run-off. The SIF maintained liability for historic claims. These are made up of:
 - Claims made during the period a firm was covered by the SIF (1 September 1987 to 31 August 2000)
 - Claims made after the SIF closed on 31 August 2000 by practices that closed while covered by the SIF.
- 14 By 2004 the SIF had built up residual funds and the Law Society decided that some of these residual funds would be used to purchase post six-year run off cover for firms that ceased after the closure of the SIF and did not have a successor practice after the SIF closed. The Law Society decided that this post six year run-off arrangement should run from 1 September 2007 (the point until which firms would be covered by their own six-year run off cover) to claims notified before 30 September 2017.
- 15 In 2012 the SRA Board agreed a three extension of the post six year run off provided by the SIF from 30 September 2017 to cover claims notified before 30 September 2020, with the cost of the additional cover to be met from the available residual funds.
- 16 In 2014 the Law Society asked us to extend the post six-year run off cover provided by the SIF by a further three years, to 30 September 2023. In December 2014 the Board decided not to grant this request at that time, in light of concerns around the levels of residual funds and the fact that it was due to consider wider reforms to the professional indemnity insurance arrangements.
- 17 We subsequently issued a discussion paper in July 2015, "Protecting clients' financial interests", which included a question about whether the SIF post six year run-off cover should be extended beyond 30 September. There was

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consensus that the issue should be urgently addressed to provide certainty to the profession. However, there were mixed views about whether this should be extended or not, and if so for how long. This discussion paper also raised the question of reducing the level of run-off required on the open market under our Minimum Terms and Conditions from six years to three, in order to make it more accessible for the profession¹.

- 18 In March 2016, our Board returned to this issue. The Board decided that there should be no change to the final end date of the post six year run off cover provide by SIF beyond 30 September 2020. A key reason for this was because of our policy position that run-off cover should be set at six years on the open market for existing authorised firms (or possibly three years as floated in the discussion paper). The Board decided that it would be inconsistent with that position to provide mandatory post six-year cover through SIF.

Residual funds

- 19 From October 2020, following the end date of 30 September 2020, the claims arising from post six year run off cover will have crystallised. SIFL anticipates that its continuing administration costs, given the level of claims, will be disproportionate to the level of claims. Therefore, we are working closely together with the SIFL and the Law Society on forward plans to bring the SIF to a close. The work programme includes exploring the possibility of transferring its liabilities to a third party insurer and then winding up the fund.
- 20 This is likely to release substantial residual funds. All the funds held within SIF are an accumulation of historic annual and additional shortfall contributions paid by the profession between the period 1987 and 2000 and which have been retained by SIFL for the purposes of providing indemnity as well as for the costs of the ongoing management and administration of SIF. All retained funds are invested and actively managed, with the returns on those investments also contributing to the amount of the funds retained.
- 21 Rule 21 of the SRA Indemnity Rules 2012 allow us to reach a decision that the Fund is no longer necessary for the purpose of providing indemnity, and for the residual funds to be released to be used.... "if and to the extent the Society considers it reasonably practicable for the purpose of providing indemnity in any other way permitted by section 37(2) of the SA and otherwise for the overall benefit of the solicitors' profession in such manner as it may decide."
- 22 The indemnity arrangements permitted by section 37(2) provide us with two alternative options to establishing and maintaining a fund of this kind. The first option allows the SRA to take out and maintain an insurance policy with an authorised insurer (a Master Policy Type arrangement), and the second is for the SRA to require solicitors and firms to take out and maintain insurance with authorised insurers. As stated above, we anticipate adopting the first option

¹ This built on a proposal to reduce the MCT run off cover requirement from six years to three years in a 2014 consultation. Following this consultation, the Board decided that further research and discussion was needed before progressing this proposal.

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solely for the purpose of providing cover for the SIF's outstanding liabilities at the time it closes. In respect of the second option, our policy position has for some time been to adopt this approach: This arrangement operates on the open market requiring no additional funds from SIF's residual funds.

- 23 Our most recent consultation on our professional indemnity requirements concluded in June 2018. Following this consultation the Board confirmed its view that six years run off cover provided the appropriate level of protection to be covered by our mandatory indemnification arrangements. The consultation paper highlighted that "our data analysis shows that a significant proportion of run-off claims continue to arise until the sixth year...". Furthermore, the paper highlighted that the end of the SIF's post six year run-off cover in September 2020 may help create "a viable market for post six year run-off cover". To use the SIF residual funds to create an alternative post six year run-off insurance policy of our own would cut across these policy decisions.
- 24 We therefore recommend that the residual funds at the point that the SIF is wound up should be passed to the Law Society. These funds are originally monies collected from the profession and with indemnity insurance now provided through other means, must be used for the overall benefit of the profession, as stated in the SRA Indemnity Rules. Such purposes are for the Society in their representative role, rather than for us: We act in the public interest in our exercising regulatory functions, in line with the regulatory objectives set out in the Legal Services Act 2007.

Recommendation: the Board is asked to agree that any residual funds should revert to the Law Society to be used for the benefit of the profession.

Next steps

- 25 We will come back to the Board to agree final recommendations arising from the SIF working group, towards the end of this year. The Board will be asked to consider and agree any third party insurance arrangement and make the necessary rules to put this in place, as well as the arrangements to close the fund, wind up SIFL and release the residual funds.

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Supporting information

Links to the Corporate Strategy and/or Business Plan

26 The paper deals with an aspect of how to wind up a legacy provision in SIF and the proposals are consistent with recent policy decisions around PII under the second objective of our Corporate Strategy:

- 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

27 We consider that the proposal supports the regulatory objective to protect and promote the interests of consumers. The current PII arrangements, along with the proposal that any residual SIF liabilities are covered by third party insurance, provide appropriate and proportionate consumer protection in relation to indemnification for civil liability.

Public/Consumer impact

28 The proposal maintains the current consumer protection arrangements that we consider to be proportionate and appropriate.

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

29 The recommendation is to maintain the existing position in relation to the SIF cover. We are working closely with the Law Society and will need to communicate the impact of the SIF closing and support those that are affected.

What equality and diversity considerations relate to this issue

30 This paper pertains to arrangements for clients to recover against civil claims for professional negligence. Therefore, it touches on those suffering loss – which includes those with vulnerabilities – and firms including small firms and sole practitioners, which have a higher representation of Black, Asian and minority ethnic solicitors. However, this paper is proposing no change to our existing policy position and therefore does not have any specific impacts on particular groups.

How the work will be evaluated

31 N/A

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