SRA Proposal: “Protecting the users of legal services: balancing costs and access the legal services”

A response from Miller Insurance Services LLP

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Questions & responses

Q1. To what extent do you think the proposed changes to our PII requirements provide an appropriate minimum level of cover for a regulated law firm?

Miller response: **Strongly disagree**

We agree with the proposal to remove the current differential limits based on the legal structure of the firm since we do not see what practical purpose this serves. However, we strongly disagree with the proposal to reduce the minimum level of cover to £500,000 other than for conveyancing work where the minimum limit would be £1,000,000:

a. We have no confidence in the analysis of the claims data and the conclusions reached on the basis that there are inconsistences between the analysis and the data:

1. P10 of "Reflecting on Solicitors Professional Indemnity Insurance (PII): market trends and analysis of historic claims data" states that there were around 142,000 negligence claims notified in the period 2004 to 2014 and P15 of the same document states that that 98% of all claims where an indemnity payment was made were settled for less than £580,000. These figures suggest that there were 2,840 claims where the limit would be inadequate. In contrast, PARA 16 of "Protecting the users of legal services: balancing cost and access to legal services" suggests that there were 442 claims where the limit would be inadequate.

2. P15 of "Reflecting on Solicitors Professional Indemnity Insurance (PII): market trends and analysis of historic claims data" states that 98% of all claims where an indemnity payment was made were settled for less than £580,000. In contrast, p10 of "Protecting the users of legal services: balancing cost and access to legal services", reducing the claims limit - states that that 98% of all claims where an indemnity payment was made were settled for less than £500,000. Given the significant contradictions between the figures presented in the consultation papers themselves we do not believe that the figures can be relied upon and / or conclusions made.

b. Regardless of whether 98% of all claims where an indemnity payment was made were settled for either £580,000 or £500,000, we are concerned that the figure is understated. Our understanding is the claims data was collected in 2015. This means that the incurred position for years 2009 to 2015 would not have developed fully – but no adjustment has been made to reflect this. Whilst we do not have the raw data to undertake a meaningful analysis ourselves, we estimate that if an adjustment were made to the figures to take into account the development of claims, the incurred position for years 2009 to 2015 would be 35% higher than the stated figures. On this basis we feel that a more representative figure would be £783,000 or £675,000.

c. Furthermore, the whole basis of the statistical argument has been centred on the average claim value. However, P11 of "Reflecting on Solicitors Professional Indemnity Insurance (PII): market trends and analysis of historic claims data" lists 17 types of claim (excluding block-claims), and the maximum payment value for each. Not one claim type has a maximum payment value below £1m and, of the 17 types of claim listed, 70% having a maximum payment value in excess of £2m. On this basis the proposed limits look inadequate.

d. Whilst the minimum limit has been chosen to reflect damages payments, it does not appear that any thought has been given to defence costs, save that they will continue to be in addition to the limit. Policies include a proportionality clause which means that whilst defence costs are paid in addition to the limit they are proportional to the limit purchased in the event of the limit being exceeded. Given that proportionality has been overlooked, our view is that the proposed reduction to the minimum levels of cover would expose firms to a higher defence cost spend and result in them being under-insured.

e. The data only covers 75% of the market and excludes data from insurers who had withdrawn from the market by 2015. f. It is difficult to comprehend how a reduction in the minimum limit below the level offered by SIF nearly two decades ago can be justified and viewed as anything other than a backward step.

f. Benchmarked against our own portfolio of clients as a whole, we do not offer limits below £1,000,000 to any non-solicitor firm.

Q2. To what extent do you agree that our minimum PII requirements do not need to include cover for financial institutions and other large business clients?

Miller response: **Somewhat agree**

On the basis that, from the SRA perspective, the primary driver for compulsory PII is public protection we broadly agree with this statement because financial institutions and large corporations are clearly not members of the public.

However, we are not clear on the intent of this proposal. Is it to enable elements of the minimum terms not to apply; to allow insurers to exclude certain types of work or to allow insurers to exclude all work undertaken on behalf of financial institutions or commercial customers with an income below £2m?

Our concern is that this proposal will lead to under-insurance, increased failure of firms due to insufficient insurance (and subsequent disorderly closure) and a two-tier high street with smaller firms being precluded from commercial panels due to their inability to satisfy panel insurance requirements.

Furthermore, we do not agree with PARA 53 "Protecting the users of legal services: balancing cost and access to legal services" which is to base the exclusion on the turnover at the time when the act giving rise to the claim occurred. In our opinion, this proposal does not work for professional indemnity claims because these operate on a claims made basis i.e. for professional indemnity claims it is the policy in force at the time a claim is made that will respond to a claim. We are also concerned that basing the exclusion on the turnover at the time of the wrongful act (rather than the turnover at the time when the claim is made) would make it very difficult for firms to manage risk and for insurers to ascertain the level of turnover at the time of the wrongful act and, by extension, whether the exclusion should apply or not.

Whilst on the face of it, the application of the exclusion will reduce the risk exposure to insurers, unless the proposer can confirm that both the current turnover of commercial clients and the historic turnover of these clients over the previous six years is less than £2m, it is difficult to see how insurers can assess the risk exposure correctly.

Furthermore, this proposal will lead to a two tier market: larger firms being able to secure cover on the existing basis (due to premium spend) but smaller firms will not be able to secure cover on this basis. A more suitable alternative would be to require insurers to provide coverage for all commercial firms but to give them the ability to exclude cover for claims notified by commercial firms if they have not paid their premium, excess etc.

Q3. Do you think our definition for excluding large financial institutions corporations and business client is appropriate?

Miller response: Yes

Q4. To what extent do you agree that we should introduce a separate component in our PII arrangements meaning only firms that need to have cover for conveyancing services are required to buy this cover?

Miller response: Strongly disagree

We do not believe that restricting professional services definitions within the PII wording is not in the best interests of either clients or the profession and goes against market practice where broad definitions are used. Our assumption is that aim of this proposal is to provide underwriters with greater flexibility and to reduce premiums as a result. In practice we do not believe either aim will be satisfied. Underwriters already apply differential rating based on individual risk exposures and already have internal limits on their portfolio exposure to conveyancing risk.

Therefore, the impact of this proposal will be neutral. Of greater concern is that the proposal does not deal with the practicalities of a restricted definition in terms of legacy exposure, whether the insured undertakes a conveyance during the policy year or what if the insured does not declare such exposure, and simply says "we will provide guidance on this", which is of serious concern.

We strongly suggest that further detail in respect of the application of this proposal is provided in order to consider further.

Q5. Do you think our proposed definition of conveyancing services is appropriate?

Miller response: Yes

Q6. Do you think there are changes we should be making to our successor practice rules?

Miller response: **Yes**

We believe that the root of the problem with the current rules is twofold: first, the rules attempt to cater for / define every scenario and ensure there are no gaps; second, the current rules pass the regulatory responsibility of the SRA on to the insurance industry.
Our view is that successor practice is simple:

1. If a firm is to be merged with or absorbed into another firm the acquiring firm can decide whether it wishes to take on the past liability or not. Either way, the decision whether to assume past liability or not is a material disclosure to insurers.

2. If the acquiring firm is not taking on the past liability of the other firm, the other firm will need to trigger run-off (NB: this is already catered for in the Minimum Terms and Conditions).

3. Any merger or absorption would need to be approved by the SRA, and the SRA would need to be satisfied that the past liabilities of the merged or absorbed firm are covered by the acquiring firm under their own policy or that a run-off policy was triggered.

4. In the event of a run-off policy being triggered, we would like to see the SRA seriously tackle the issue of non-payment and prevent solicitors from practising until the debt is settled, whether they be employed at a successor practice or at another firm. We would also like to see the SRA tackle the issue of "phoenix firms", whereby a practice goes into run-off and then in effect re-establishes itself.

Q7. Do you agree with the approach we are taking to bring the MTCs and the PIA up to date?

Miller response: **Strongly agree**

The current arrangements have added multiple layers of complexity into policy drafting. The MTC and PIA are two separate (albeit interlinked) issues and should be treated as such. The result is that the end product provided is often unclear and in the vast majority of cases poorly drafted. This has a knock on effect in terms of disputes, understanding (client, insurer and broker) and innovation. Separating the MTC and PIA would also would also bring the legal profession into line with other regulated professions. We do not see any downside to this proposal for any party and would welcome its implementation.

Q.8 To what extent do you agree that the changes to our PII requirements provide law firms with more flexible options to potentially lower insurance costs?

Miller response: **Strongly disagree**

PARA 72 : "Protecting the users of legal services: balancing cost and access to legal services" the SRA estimates that the impact of our proposed lower limit would be to reduce premiums by between 5% and 10%. However, the data used by the SRA to estimate reductions does not correlate and the SRA is unable to validate its conclusion. We have analysed the data, and our view is that the data does not support the SRAs estimate of a reduction in premiums of between 5% and 10%. Furthermore, the feedback we have received from insurers from across the market does not support the 5% to 10% estimate and we question why the SRA thinks premiums will reduce by between 5% and 10% when insurers and brokers alike are consistently saying they will not.

We do not agree with the assumption PARA 68 "Protecting the users of legal services: balancing cost and access to legal services" that having a differentiated limit will result in more accurate underwriting because the risk will be less. The reality is that all insurers currently require a work type declaration and differentiate pricing on this basis, so the proposal will not make any difference. The feedback we have received from insurers from across the market does not support the 5% to 10% estimate.
Furthermore, the no impact analysis has been made with regard to the cost of maintaining coverage for firms which wish to do so.

Our view is that the excess layer market will not want to reduce their attachment point or broaden coverage to do, which will result in less cover and additional premium.

Q.9 Do you agree the proposed level for the cap on cover in run-off provides adequate protection for the users of legal services whilst balancing the need for premiums to be more affordable?

Miller response: **Neither disagree or agree**

Again, there appears to be a lack of data to support the SRAs assumption at PARA 85 of "Protecting the users of legal services: balancing cost and access to legal services" that the proposed cap on run-off cover will reduce run-off premiums by between 9% and 17%. In theory, we agree that if an aggregated limit applied during the six year run-off period run-off costs should reduce.

However, the reality is that run-off is not attractive to insurers because, inter alia, they cannot cancel run-off for non-payment of premium. For this reason, it is highly unlikely that insurers will reduce their run-off premiums to "win" run-off business and almost certain that they will use the benefit of reduced exposure to subsidise the credit risk that they are required to take on run-off cases.

Given the comments above, we fail to see how the proposed cap on run-off cover will solve the problem of non-payment of run-off premiums and expect the run-off default rates to continue at their current level of 50% and disagree with the assertion that "we can expect this result in a reduction in the non-payment of run-off premiums which could reduce premiums even further".

No evidence was provided to respond to on the issue of adequacy.

Q.10 To what extent do you agree that the changes to our PII requirements could encourage new firms to enter the legal services market increasing choice for users of legal services?

Miller response: **Strongly disagree**

Given that we strongly disagree that the proposed changes will result in premium savings, it follows that that they will have no impact on whether new firms enter the market.

Furthermore, even if the stated savings were achieved, they would not determine whether a new firm is established or not: the saving would be one of a number of considerations and, in our experience would not be the deciding factor. There is already significant competition in the legal services market and we do not believe that the existing insurance arrangements have any impact on whether a new firm is established or not. No evidence has been provided to support the assertion at PARA 87 "Protecting the users of legal services: balancing cost and access to legal services" that if insurance costs reduce, this would be passed on to consumers. The SRA suggest that the proposed changes "could result in reduced premiums for firms that do lower risk work" (see PARA 90 "Protecting the users of legal services: balancing cost and access to legal services").

Our experience is that such firms already benefit from reduced premiums, have done for many years and that this is reflected in the pricing model of firms. No evidence was provided to support the statement at PARA 91 "Protecting the users of legal services: balancing cost and access to legal services" that "we can expect this to encourage new entrants into the market".

Q.11 Are there any positive or negative EDI impacts from the proposed changes to our PII requirements that you think we have not identified?

Miller response: **Yes**

EDI impacts have not been identified (save the assumption that premiums will reduce, resulting in such reductions being passed to the consumer which will in turn lead to increased consumer choice and access to justice). No data has been provided to support any EDI impacts.

Q.12 Are there any options for changes to our PII requirements that we are not proposing or have not identified that we should consider further? Please explain why and provide any evidence that supports your view

From the detail provided in the consultation, our view is the impact assessment and mitigation is inadequate. We do not agree with the following mitigation outlined in the impact assessment in respect of the following:

Challenge:
An aggregation cap could result in different outcomes for consumers depending on when they make a claim

Mitigating this Challenge:
There is opportunity to develop an open market run-off cover. This could lead to a competitive alternative to automatic cover provided by the current insurer.
There is no competitive run-off market for any other profession (including accountants, surveyors, engineers, architects, insurance brokers), so it is highly unlikely that one will develop for solicitors. Also, refer to response to Q5.

Challenge:
Increased complexity in the process for firms to buy the cover they need

Mitigating this Challenge:
We still expect insurers to offer firms the options to 'top up' their insurance policy to include a level of cover for financial institutions on the same terms as our compulsory insurance. The evidence since 2000 is that this will not be the case, as insurers have always differentiated the coverage provided above the minimum levels and we would expect insurers to do the same should this proposal be adopted.

Q.13 To what extent do you agree that the proposed changes to the Compensation Fund would clarify its purpose as a targeted hardship fund protecting the vulnerable that need and deserve it those in most?

Miller response: **Strongly disagree**

The changes don't clarify the purpose of the Compensation Fund, they completely change the purpose from a Compensation Fund to a Hardship Fund. Our understanding is that the Compensation Fund was set up by an Act of Parliament to help people who have suffered financial loss due to a solicitors' dishonesty or failure to pay money he has received (SRA 2010).

The SRA Compensation Fund Rules 2011 (3.1 and 3.2), are also very clear and define the purpose of the Fund. The Compensation Fund's purpose seems very clear. The proposal changes the purpose rather than clarifies.

With regard to reference to the judgement made by the Court of Appeal in the Mortgage Express Case, it appears a little strange to use this as justification for change 20 years after the judgement was made.

Q.14 Are there any options for changes to how we manage the Compensation Fund that we have not identified that we should consider further?

Miller response: No

Q.15 To what extent do you agree that we should exclude applications from people living in wealthy household?

Miller response: Strongly agree

The Compensation Fund is not a hardship fund. For the reasons stated above, the Compensation Fund clearly is a fund to provide compensation to people who have suffered financial loss due to a solicitors' dishonesty or failure to pay money he has received.

On this basis, you cannot exclude people because of their wealth or income – if they have lost money due to a solicitors' dishonesty then it is right they should be compensated.

The rationale is based on dubious investment schemes which effect very few people (see PARA 101 "Protecting the users of legal services: balancing cost and access to legal services").

Would it not be fairer to simply exclude such investment schemes rather than to base eligibility on a wealth threshold for all legal services?

We disagree with the need to define what is and what is not the 'usual business of a solicitor' (see PARA 120 "Protecting the users of legal services: balancing cost and access to legal services"), we believe that it would be more practical and more clear to exclude specific areas of concern.

Changing the Compensation Fund to a Hardship Fund will result in less public protection.

Q.16 Do you think our proposed measure of wealth and threshold for excluding these application is appropriate?

Miller response: No

Q.17 Do you think we should be making any other changes to eligibility and/or the circumstances where we would make a payment?

Miller response: No

Q.18 Do you think we have set out the right approach for assessing when a maximum payment has been reached?

Miller response: No

The application does not seem fair or equitable in any of the scenarios. In our opinion a fairer approach would be to limit payments per individual claimant and / or individual retainer.
Adopting this approach to scenarios A and C would result in outcomes as follows:

- Scenario A £500k is paid to both Mr and Mrs A - £1m in total
- Scenario C £500k in paid to K and L (£1m in total)

We agree with the application in respect of scenario B and D.

Q.19 Do you think the current formula remains a fair way to apportion the costs of maintaining the Compensation Fund?

Miller response: Yes

Q.20 What steps do you think might be reasonable for someone to take to investigate a scheme/transaction before committing money to it and that it is genuine?

We do think it is reasonable to expect that investors will make an informed decision before committing any investment. If a solicitor is involved in a scheme that solicitor will be regulated by the SRA and for most people this would be sufficient to give legitimacy to any scheme. That said, each case should be judged on its merits.

Q.21 Do you think setting out clear Guiding Principles in the rules or as guidance could make the purpose and scope of the Fund and how we make decisions clearer to users of legal services and their advisors?

Miller response: Yes

Please refer to response to Q13. We disagree with the following proposed guiding principles: -The purpose of the Fund is to help people who need it the most when they have lost money as the result of a solicitors actions by replacing some or all of that money. -The Fund may sometimes have to decide that it will or will not pay grants in particular circumstances, such as for certain types of case, particular losses or to defined groups of people who have lost money

As per our response to Q13, our understanding is that the Compensation Fund was set up by an Act of Parliament to help people who have suffered financial loss due to a solicitors' dishonesty or failure to pay money he has received (SRA 2010).

Q.22 Are there any positive or negative EDI impacts from the proposed changes to the Compensation Fund that you do not think we have identified?

Miller response: No

Q.23 Can you suggest any other approaches or strategies that the SRA might adopt to prevent firms being victims of cybercrime attacks?

We would suggest a consultative forum with insurers, banks and brokers on this issue.

Closing

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