

Entity regulation consultation  
Bar Standards Board  
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The logo for the Legal Services Consumer Panel is a blue circle containing the text "LEGAL SERVICES CONSUMER PANEL" in white, stacked vertically.

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SERVICES  
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PANEL

5 September 2014

Dear Sir/Madam,

### **Bar Standards Board consultation on entity regulation**

The Panel is pleased to respond to this consultation. Our response has been informed by particularly focussing on a number of the consumer principles including: safety – (consumers will feel more confident about using legal services if they are properly indemnified against loss), fairness (regulation should ensure that all consumers have an equal opportunity to obtain redress) and of course redress itself (regulation should ensure that consumers can be adequately compensated for harm or loss they suffer as a result of failures of service).

Our response has also benefited from our meeting with BSB officials in August. This response should be read in conjunction with our previous submissions to BSB consultations on aspects of the proposed entity regulation regime.

#### **Minimum cover amount**

The BSB proposes to build on the existing Handbook provisions by including a general duty for all entities to put adequate insurance in place. This is an overarching principle that means the minimum cover amount will be just that; higher risk entities will need to purchase higher cover as required. We support this proposal, and likewise welcome the requirement for entities to undertake an annual risk assessment and the BSB's intention that its Supervision Department will scrutinise an entity's risk analysis to determine the level of cover.

The BSB propose a minimum level of cover of £500,000 for entities, which is the current level for the self-employed Bar. Its starting point is that the insurance required for entities should be broadly similar to that currently provided to the self-employed Bar unless there is a regulatory reason to treat them differently. The BSB also wishes to avoid regulatory arbitrage should the approved regulators adopt significantly different terms.

In the Panel's view, the BSB has overstated the regulatory arbitrage point. The risk profile of lawyers differs between approved regulators and so

different cover amounts would be consistent with risk-based regulation. This reasoning explains our objection to the SRA's proposal to reduce its minimum PII cover to £500,000, yet why we felt able to support ICAEW's proposal for the same cover amount. Each situation should be treated on a case by case basis, with a firm emphasis on evidence.

It is difficult for us to take an informed view on whether £500,000 is the right amount for BSB-regulated entities. On the positive side, the BSB regulates a relatively small number of providers when compared to solicitors, and historically it seems the Bar Mutual Indemnity Fund (BMIF) has provided an adequate level of consumer protection. The need to avoid entry barriers for small entities also carries force of argument and this affects consumers in terms of the breadth of choice in the market.

Against this, the BSB anticipates entities having a higher risk profile than self-employed barristers. It expects entities to offer a wider range of legal work and run on a larger scale – with greater volumes of work, turnover and complexity of structure as a result. We understand that BMIF premiums are calculated by reference to fee income and areas of practise. Therefore, should the minimum cover amount not have a significant influence on premiums, the issues around barriers to entry and cost of legal services become less relevant. A lack of evidence that promised cost savings would follow a reduction in the minimum cover amount featured in the LSB's recent warning notice on the SRA's PII proposals.

Furthermore, in the absence of BMIF claims data and in light of other recent BSB changes which change the risk profile of the profession, for example public access and litigation work, it is hard for us to assess if £500,000 is right for self-employed barristers, let alone entities. Our 2013 publication on *Financial Protection Arrangements*<sup>1</sup> called for greater transparency and open channels for information sharing between regulators and those who hold data. However, we understand the BSB still do not have access to data collected by BMIF. Of course such information may be commercially sensitive and insurers would not want it to be widely disseminated. Yet surely, some arrangement must be possible to allow the regulator to have access to data which would allow it to make informed decisions on the right levels of cover.

We note the possible future requirement for both the self-employed bar and entities to carry whichever is the higher of a minimum level of insurance or a multiple of turnover. This is one way of ensuring that small firms carrying out low risk activities obtain an appropriate level of cover, whilst at the same time making sure that large firms or those carrying out high risk work (with potentially high levels of financial risk) hold an amount of cover which adequately protects consumers. We urge the BSB to conduct further research into the costs and benefits of this proposal, as it may provide a better way of identifying the optimum levels of cover.

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<sup>1</sup> Legal Services Consumer Panel, *Financial Protection Arrangements*, June 2013. <http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf>.

## **Aggregation of claims**

We have concerns over the proposal to allow aggregation of claims. The risk to consumers is that where large losses arise there is a possibility that individual claims may not be met and this would happen on an arbitrary basis. Further, the definition of what is to count as one claim is broadly drawn, in particular the clause allowing insurers to aggregate 'similar' acts or omissions could be abused by insurers. The ongoing case of *Godiva Mortgage Ltd v Travelers Insurance Company* case turns on the interpretation of the definition of 'any one claim' in the SRA's rules.

The *Godiva* case illustrates the possible risk that consumers could be left out of pocket due to the use of caps on claim aggregation. The case concerns a partner at a law firm who was involved in a number of allegedly fraudulent property transactions. When the losses came to light numerous claims were brought against the firm, including by the claimant, *Godiva*, a lender. The law firm has gone into liquidation and cannot meet the claims. The insurer asserts that all the activities from the partner's involvement in alleged fraudulent activity can be aggregated as one claim and capped at £2 million (the Solicitors Regulation Authority's current cap). However, the total losses in the case could exceed £50 million in reality. The Law Society and the SRA have been given permission to intervene in the case by the High Court. The case was due to be heard in the first half of 2014 but is now listed for November 2014.

In addition, we note that the aggregation limit, as currently drafted, would be the limit of cover held by the firm. The BSB supervision team will take into account whether the entity is carrying out types of work which could result in claims being aggregated when they are assessing whether the level of cover the firm holds is appropriate. Nonetheless this means that in some circumstances the aggregation limit could be as low as £500,000. Further, the breadth of the current clause means it is unclear whether multiple consumers, who have used different entities, yet encounter the same or similar issues could have their claims aggregated. An example could be widely used defective software which results in poor quality work. Because, unlike some other regulators, the BSB does not have a compensation fund which such claims might be able to fall back on, the impact on consumers would be even greater.

## **Nature of clients**

We disagree with the BSB's intention that the proposed minimum terms should apply to all clients. Corporates and other large buyers are better able to assess risks and suffer less from the information asymmetries present for smaller consumers, such as individuals, small businesses and small charities. Although there may be some practical difficulties, these should not be insurmountable. Experienced or wealthy clients should be capable of negotiating the terms of cover they require. Furthermore, we believe scarce regulatory resources should be directed towards those who are less able to protect themselves.

Individuals, small businesses and small charities should be treated in the same way. However, *Bar Mutual* currently allows a defendant to demand security costs from a company claimant to be held against the barrister's

costs in the event the claimant should lose. This may have a chilling effect on those small businesses who wish to bring a justified claim.

### **Other issues**

The Panel agrees with the BSB's analysis around intervention, and that it would be in the client's interest for the BSB to have the power to intervene if and when required. We note the BSB will consult on the policy issues at a later date. For the moment we are content with the proposed interim Handbook rules before the BSB gains statutory powers.

We recognise that the current terms of cover do not need to deal with successor practices, although there is still provision for run-off cover. The new provisions will require a successor entity to have insurance in place which covers claims relating to the previous practice. Otherwise the entity will need to enter run-off. The Panel is content with these proposals, and agrees that the duration of run-off should cover at least the statutory limitation period of six years.

We note with interest the proposal to find different ways of managing exit, for example by holding run-off deposits in escrow accounts. The Panel made a similar proposal in our publication on *Financial Protection Arrangements*<sup>2</sup> and we would certainly be supportive of innovative ideas like this being scoped out in more detail.

We are content with the proposals around misrepresentation and non-disclosure, as these will ensure a good level of consumer protection.

I hope these brief comments are helpful. Please contact Harriet Gamper, Consumer Panel Associate, with any enquiries.

Yours faithfully



Elisabeth Davies  
Chair

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<sup>2</sup> Legal Services Consumer Panel, *Financial Protection Arrangements*, June 2013, p. 38.  
<http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf>.