The Solicitors Regulation Authority
The Cube, 199 Wharfside Street,
Birmingham,
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By email only to protectlegalusers@SRA.org.uk

15 June 2018

Dear Sir/Madam

Response to the SRA consultation on protecting the users of legal services: balancing cost and access to services.

The Legal Services Consumer Panel (the Panel) welcomes the opportunity to respond to the Solicitors Regulation Authority's (SRA) consultation on proposals to review and change its Professional Indemnity Insurance (PII) and Compensation Fund arrangements.

The requirements for solicitors to have PII, and to contribute to a Compensation Fund offers protection to solicitors and consumers alike. Regulatory prescription for insurance cover safeguards solicitors and consumers against loss, allowing them to contract with greater confidence and peace of mind. Liabilities following mistakes can lose solicitors their business and their reputation, and consumers can suffer significant financial loss as a consequence of errors or omissions.

In a changing landscape, with growing external uncertainties, new regulatory flexibilities and diverse partnerships, the risks are as significant as ever. A scandal affecting a single firm can erode public confidence in legal services if financial protection arrangements are not robust. That said, we are sympathetic to attempts to assess whether current requirements are prohibitive, inflexible and costly or discriminatory, and to alleviate these where necessary and feasible.

The main proposals in relation to PII and Compensation Fund cover are:

1. To reduce the compulsory minimum level of PII to £500,000, or £1m if a firm does conveyancing work;
2. To cap the total level of compulsory run-off cover at £3m for conveyancing firms and £1.5m for all other firms in aggregate over six years.
3. To remove the protection of the SRA-prescribed minimum policy to commercial customers with a turnover in excess of £2m.
4. To re-designate the Compensation Fund as a hardship fund.
5. To limit eligibility to the Compensation Fund to those whose household assets are less than £250.000 and exclude lost fees of barristers or experts
6. To reduce the maximum Compensation Fund payment to £500,000 from £2m.

Overview of the Consumer Panel's concerns

Evidence from the Law Society's data shows that 4.8 per cent of total turnover in the legal services market goes on purchasing PII cover. We agree that this is substantial, but this expense has to be considered alongside the value it provides: consumer and solicitor protection, and wider market confidence. The SRA asserts that PII is the single biggest cost of regulation, with small firms particularly affected. However, we know that some small firms are able to negotiate lower premiums when low risk work is involved.

The SRA states that reducing the compulsory level of PII cover to £500,000 would lead to a reduction in premiums, which would be passed on to consumers, resulting in a reduction in legal costs. However, the SRA itself states that there is no evidence or guarantee that these savings would be passed on to consumers.

Moreover, evidence from the Law Society shows that even if the SRA reduces compulsory levels of cover to £500,000, the savings passed on to consumers will be negligible. In its response to the SRA, the Law Society convincingly demonstrates that a 9 to 17 per cent saving as predicted would lead to a reduction in fees of 0.4 to 0.8 percent[1]. This translates to a saving of £5.30 in legal fees for a conveyancing transaction costed at £650, and a saving of £5.88 on a divorce service costed at £721[2].

More worryingly, the savings anticipated have not been balanced against other costs which are likely to be incurred (and indeed likely to increase), specifically, the cost of top-up covers. At present firms are obligated to buy top-up insurance cover if, after an internal assessment, the minimum level of cover is deemed insufficient for their practice. The SRA argues that this duty will continue under the new regime, so that firms, where necessary, will be under a regulatory obligation to purchase insurance above the £500,000 or £1m minimum claims limit stipulated by the SRA. However, evidence from the Law Society's response shows that the cost of top-up cover has been rising for a number of years[3]. This means that savings on premiums are likely to be even more conservative than the 9 to 17 per cent anticipated by the SRA. The Law Society notes that *"at present, only 22 per cent of firms purchase top-up cover. But, top-up cover will assume a new significance if the reforms go ahead, as the SRA is proposing sizeable cuts to solicitors' indemnity limits, from the current levels of £2 million or £3 million, to £1 million for solicitors that offer conveyancing services, and just £500,000 for everyone else".*

The Panel notes that the SRA proposes to establish a separate minimum level of cover for conveyancing services of £1m. We do not believe that this is adequate for conveyancing work, particularly in regions where house prices are high.

With regards to proposed changes to the Compensation Fund arrangements, the Panel is very concerned that such extensive reduction in consumer protection, removing groups of individuals including those who suffered ordinary income

[1] The Law Society's response to the SRA's consultation document, 7 June 2018
[2] Ibid
[3] While the cost of premiums fell 7.7 per cent from 2014-15 to 2015-16, the cost of top-up cover over the same period increased 9.9 per cent. Similarly, although there was a 1.3 per cent fall in the cost of mean premiums from 2015-16 to 2016-17, the price of top-up cover went up by 2.3 per cent

losses, has not been backed by research, evidence or detailed analysis. Research centred on consumers who have previously accessed the fund would have aided understanding of consumers' needs in this area. Without it, the Panel cannot support any of the proposals where the risks appear to be overwhelmingly redirected towards consumers.

Overall, the SRA's PII and the Compensation Fund proposals highlights areas of significant reduction in consumer protection. In arriving at its position, the Panel considered whether the appropriate balance of responsibility and indeed risk has been struck between consumers and providers, taking into consideration consumers' lack of expertise and experience in dealing with legal matters. No evidence in the consultation suggests that the balance is correct.

We offer reflections on key aspects of the proposals below. We hope that the SRA will consider carefully what we say before making its final decision.

Reflection on the key areas

Claims limit

The Panel is reluctant to support the proposal to lower the level of minimum compulsory cover to £500,000 for any one claim and we do not believe that the £1m cover for conveyancing is adequate. We accept some of the arguments put forward by the SRA, but for us to support a decision of this magnitude – that involves transferring substantial risk from firms to consumers -we would need to be convinced there would be at least commensurate benefit for consumers. No such evidence has been presented.

We have concerns about the data set that have been used to justify these proposals. As is widely reported, the claims data collated by the SRA does not cover the whole market. It accounts for 75 per cent of insurance policies by premium over a 10 year period beginning in 2004 and ending in 2014. This means that four years' worth of data is not accounted for. Moreover, key data on insurers that have left the market or become insolvent is also missing. Equally concerning is the fact that the SRA now says that 98 per cent of claims fall within the proposed £500,000 limit, but it previously said the figure was £580,000 based on the same data.

Although the SRA notes that there is likely to be a 7 to 19 per cent savings for firms in insurance premiums, as noted above there is no guarantee that firms will pass on these savings to consumers and no comparable evidence from other sectors or jurisdictions that such savings have been passed on. The truth of the matter is that the SRA are proposing that consumers lose current protections, without being certain of gaining anything. The risk of being underinsured would be transferred to consumers at marginal or no benefit. This would not be a fair or desirable outcome and we believe it would ultimately erode trust in solicitors and devalue one of the things that sets them apart from other providers of legal services.

We also note that the proposals are not under pinned by consumer research, which is very concerning with change of this magnitude. Our research on Risk and the Role of Regulation[4] showed that consumers across the spectrum expect that when they use a solicitor they will be protected if something goes wrong. They do not think about checking to see the level of protection in place, they simply assume it

[4] Risk and Role of Regulation

will because they are solicitors. Furthermore, there are a number of risks which consumers do not consider at all, such as fraudulent activity by a lawyer, meaning they are not able to make empowered choices in this context.

Although the SRA notes that only 2 per cent of claims are above £500,000, it is significant to note that this 2 per cent accounts for a substantial proportion of claims by value, 47 per cent to be precise. The Panel is concerned that unless firms make a realistic and honest assessment of cover required, at each renewal date or during the year and top-up their insurance cover, there may be insufficient insurance to cover the number of claims above £500,000.

Throughout the consultation document the SRA has referred to the obligation on firms to have appropriate insurance in place. The SRA has noted that this is often achieved with the procurement of top-up insurance. However, evidence suggests that top-up insurance is often more expensive than the baseline cost of insurance. Therefore, it cannot be certain that firms will readily choose this option. Moreover, the SRA has not outlined any proposal to focus supervisory activities on ensuring that firms have appropriate cover.

If, the SRA decides to go ahead with the proposed changes, it would be very important to impose an information duty on lawyers. This would mean lawyers would have to make it very clear to consumers when their insurance cover was not high enough to cover the consumer's assets, and should be done before work was started (where possible) to allow the consumer to switch to a lawyer with a higher level of cover if they wanted to.

Where information was not provided, or not provided in a clear and noticeable way, any shortfall where a problem did materialise should fall on the compensation fund (where the sum exceeds the maximum that can be awarded by the Legal Ombudsman). However, if the SRA goes ahead with the changes it proposes to the compensation fund eligibility this would be futile, and leave some consumers open to little or no regulatory redress.

Aggregate cap for Run off cover

The SRA proposes to introduce an aggregate cap on the level of claims made over the six years period of run off. The current limit for any one claim is £2m, but there is no limit to how many claims an insurer can pay over the period of insurance. Insurers complain they are unable to predict how much they could ultimately have to pay out. The risk to consumers is that where very large losses arise, there is a possibility that individual claims may not be met. Losses could arise from systematic fraudulent or negligent activity in a firm. Simultaneous proposals, to limit access to the Compensation Fund (discussed below) means that consumers may find themselves with no protection. The Panel is strongly against this proposal. We note that in conveyancing aggregate claims can quickly exceed £3m.

The Council for Licensed Conveyancers have changed their scheme so that run-off premiums are built into PII and not paid by firms as a one off payments, this is the type of solution we would expect the SRA to explore. This is the type of solution we would expect the SRA to explore as a way of maintain consumer protections whilst spreading provider costs over a period of time.

Excluding financial institutions and large business clients

The Consumer Panel itself has a remit to represent the interests of a wide range of consumers but we prioritise those consumers who are less able to give voice to their own interests. Our 2013 publication on Financial Protection Arrangements[5] explicitly focused on individual consumers, small businesses and small charities. We recognise that large corporate buyers are better able to assess risks and suffer less from the information asymmetries that are present for smaller consumers in the legal services market. Larger buyers may also have the market power to demand changes to standard terms where these do not provide them with adequate protection.

We are sympathetic with the proposal but believe the definition of a large business may be overly restrictive. We are not convinced that using turnover figure to set the threshold for large business clients is appropriate, particularly when this is set at £2m, which we consider low. We do not believe that many businesses with turnover of £2m plus are sophisticated buyers of legal services and so we would have liked to see the justification for this baseline rooted in a carefully assessment and evidence.

We would also like to note that the Companies Act definition of SMEs is that they meet two of the following criteria:

1. Turnover less than £25m
2. Less than 250 employees
3. Gross assets less than £12.5m

The policies of government and other regulators are often guided by these criteria, we would suggest that they should be used as the cut-off in this case as well unless there are clear reasons not to.

Compensation Fund arrangements

On considering all the arguments, the Panel cannot support any of the proposals relating to changes to the Compensation Fund arrangements. It is difficult for the Panel to provide an informed view on the Compensation Fund proposals because there is little to no information to support the extensive reduction in consumer protection and collateral damage suffered by other suppliers. The document does not offer any convincing rationale for the proposed changes, no analysis of the advantages or disadvantages, no quantified costs and benefits, and no historic data on claims made or grants awarded.

It is important to note that the Compensation Fund already operates on a discretionary basis without any guarantees that money will be paid out to those who have suffered financial loss as a result of a solicitors' dishonesty or fraud. Dishonesty and fraud are not covered by the Minimum Terms and Conditions of PII arrangements. Therefore, the Compensation Fund acts as an essential part of the overall consumer protection landscape.

There is limited information on the number of claims that the SRA receives, processes and settles. However, the SRA is proposing to reduce the maximum payment of £2m

[5] Financial Protection Arrangements, LSCP, 2013

to £500,000. The SRA states that only a few payments have been for more than £500,000, but there is little data or analysis for the Panel to assess, hence our concern that the full impact of this proposal on consumers suffering high loss has not been adequately understood or taken into account.

The SRA proposes to target the fund on those who need it the most by introducing a ban on individuals with "*net household financial wealth – which excludes physical wealth, property and pension assets – of over £250,000"*. It said this was about 5 per cent of the population but the Panel fundamentally objects to a proposal that would see some consumers, who have suffered loss as a result of a solicitor's dishonesty or fraud uncompensated because they are deemed wealthy enough to bear the loss. We are not aware of other sectors where such a rationale is successfully applied and no examples are given in the consultation. It is akin to saying that if one driver is negligent and harms another driver and her vehicle, the errant driver should only pay compensation if the injured driver is not a high earner.

The Panel has raised concerns in the past about the lack of transparency in the way the Compensation Fund is dispensed and there is nothing in this set of proposals to alleviate the lack of transparency. In fact, the proposals are likely to make the arrangements even more opaque. We are also mindful of the argument made by the Law Society that these proposals are likely to lead to unintended and perverse consequences for consumers.

Conclusion

There is a need for the SRA to be realistic about the risks that consumers can reasonably be expected to both understand and manage. There was little recognition in the proposals of the importance of ensuring consumers can understand where and to what extent they are and are not protected when choosing a solicitor.

We believe that much more needs to be done to get the balance right for consumers who will be exposed to higher risks and reduced redress mechanisms, if these proposals are implemented as proposed.

Yours sincerely,

S Chambers

Sarah Chambers
Chair
Legal Services Consumer Panel