

Reform of the solicitors' minimum terms and conditions and the compensation fund

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Introduction

Nearly 4 years ago, in May 2014, the SRA decided to embark on a major programme of regulatory reform with the aim of reducing regulatory burdens for law firms whilst maintaining important protection for consumers.

It has now launched its long awaited consultation on reforming the Solicitors Minimum Terms & Conditions (MTCs) and the Compensation Fund. In conjunction with the consultation it is anticipated that the Participating Insurers' Agreement (PIA) will also be updated to reflect modern day working practices and to remove any overlap or duplication between the MTCs and the PIA.

Overview

As long ago as 2014 the SRA proposed changes to the Minimum Terms, namely:-

1. a reduction in the level of mandatory cover to £500,000
2. the introduction of an aggregate limit on claims
3. the requirement for compulsory cover for claims by individuals/SMEs/trusts & charities
4. a reduction to run off cover to a minimum of 3 years
5. a requirement for firms to assess the level of cover appropriate to their firm beyond the minimum

At the time the SRA were heavily criticised, not only because of the timing and limited opportunity for key stakeholders to respond, but also because of concerns that it was moving too quickly, had not undertaken any proper impact assessment or gathered supportive evidence. As a result 3 of the 5 proposals were deferred, the LSB rejected a reduction in the level of cover to £500,000 but approved a new Outcome to be incorporated into the Code of Conduct requiring self-assessment by firms as to the level of cover appropriate for them.

July 2015 saw the SRA publish another consultation discussion paper on reforms & protecting clients' financial interests. The SRA's intention was to use the feedback to inform proposals for a further consultation in early 2016. This time the proposals were more wide ranging than those set out in 2014 and proposed:

1. only covering claims by consumers
2. an aggregated limit on cover, rather than any one claim
3. £500,000 limit on cover - to include Claimant costs
4. a reduction in run off cover to 3 years from 6 and a hardship fund for smaller firms deterred from closing
5. removing cover for non-disclosure and other policy breaches
6. also removing cover for partner fraud and
7. an extended indemnity period

Again the consultation attracted criticism including the lack of additional evidence beyond that available in 2014 to support the proposal. As a result no doubt of criticisms, the SRA announced in November 2015 that it would again delay its expected consultation on MTC reforms.

Key proposed changes to the MTCs

The Consultation announced last month proposes the following key changes:-

1. **Reducing the claims limit:** Currently firms must have minimum cover of £2,000,000 rising to £3,000,000 for firms with certain structures. The SRA propose to reduce this to £500,000 for all firms apart from claims for conveyancing services. Some 98 percent of historic claims in the 10 years of historic data which the SRA say it has evaluated would have fallen within this limit.
2. **A higher limit for conveyancing:** Those firms carrying out conveyancing services would need a minimum of £1,000,000

cover, reflecting the higher risks of working in that area and making sure the public are protected where problems are most likely.

3. **Flexibility around who the cover should protect:** The SRA see no need for the MTCs to include cover for financial institutions, corporate and other large business clients. It also proposes to introduce a conveyancing component in insurance so that only firms that need cover for this work are required to buy it.
4. **Changes to run-off:** A six-year run-off period will remain but with caps of £3,000,000 for firms that need conveyancing services cover and £1,500,000 for other firms. The SRA consider this will make it easier for firms to close properly and reduce the risk that solicitors delay retirement unnecessarily.
5. **Changes to defence costs arrangements:** to enable more flexibility for firms and insurers. Defence costs will however continue to be in addition to the level of indemnity provided.

There are no plans to include a total cap for levels of claims made during a single indemnity period, exclude cover for claims arising from cyber/fraud or criminal activity and which results in losses from solicitors' client accounts, extend exclusions for dishonesty to stop innocent partners claiming under the policy or alter insurers' obligations where firms do not pay the excess.

Comment

The SRA's overall objectives with these changes are to:

1. reduce the costs of PII in the hope that the savings will be passed on to consumers of legal services;
2. reduce the costs of run-off cover to make it easier for firms to close;
3. remove barriers for new firms wanting to enter the market;

The proposals have been described as "*fundamentally flawed*"; by Howden as "*...nonsensical*" and "*lunacy*" and the suggestion that the reforms would lead to a reduction in premiums as "*Whimsical*".

The Law Society's Vice President Christina Blacklaws said plans to cut client protections are '*utterly misguided*' and would hurt solicitors and clients alike. In its April briefing note The Law Society commented:-

1. **Costs savings:-** whilst the cost of PII is substantial it is not disproportionate. The Law Society's most recent PII Survey found that the mean premium as a percentage of turnover remained unchanged at 4.8 per cent, (although this was higher for sole practitioners, at 6 per cent). While it is certain that the SRA's proposals would reduce protections, there is no guarantee of a reduction in costs.

The SRA's dataset suggests that 98 per cent of successful claims are settled for less than £580,000. The proposed single claim limit of £500,000 is clearly intended to encompass the great majority of claims. But if the reforms are calibrated to exclude only a little more than two per cent of claims, it is difficult to see how any appreciable savings are to be made - a view echoed by a number of insurance brokers.

2. **Increased complexity and need for top-up cover:-** as a result of these changes, more firms will need to consider purchasing top-up cover. This is likely to raise costs in two ways. Firstly, an administrative cost in considering precisely what top-up cover the firm will need. Secondly, the cost of the premium for the top-up cover, which may not be as comprehensive in its coverage as firms might like. The SRA's own findings suggest that around one in fifty successful claims is settled for an amount in excess of £580,000. Based on this, The Law Society expect that many prudent solicitors will choose to take on additional cover. It is also easy to imagine that - given the 'claims made' basis of solicitors' PII - clients who had work carried out under the existing arrangements may well insist that the current levels of cover are maintained. Such circumstances may compel solicitors to purchase top-up cover, that would bring them up to the current level of cover, but at a higher price than under the existing MTCs.

The consultation and the application both present potential cost savings as a key driver for the change but there is only limited evidence that this will be achieved. In particular, the impact on the price of top-up cover does not seem to have been explored in any detail and the time that may be required for the market to adjust to the new regulatory requirements (in a way which may result in these potential cost savings) has also not been explored sufficiently.

3. **Reduction in protections for firms and clients:** 'The [SRA's] data pack shows that if the minimum level of protection was reduced to £580,000, 98% of claims would be met. However, the effect on a solicitors' firm and its partners in the remaining 2% of cases where the claim was not fully met by insurance, could be catastrophic. A claim of £2m, in the absence of top-up insurance, could lead to a shortfall of almost £1.5m. In some situations, high value uninsured risks could easily lead to firm insolvency and a reduction in competition and choice.

The existing MTCs ensure that risk is not transferred from firms to individual consumers. As the Legal Services Consumer Panel said in 2014, "fairness demands that consumers should only be expected to take on risks which they know about and can safely manage". It remains unrealistic to expect individual consumers to understand and take informed

decisions about the level of professional indemnity insurance cover.

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