Surrey Law Society Response to the SRA Consultation on 'Post six year run-off cover and the Solicitors Indemnity Fund' (February 2022)

HISTORY

The Solicitors Indemnity Fund (SIF) was formed by The Law Society (TLS) in 1987 and provided professional Indemnity Insurance (PII) for solicitors through a mutual fund. In the late 1990s, many firms believed the SIF premiums were far too high and larger firms were subsidising smaller firms. It was believed that an open market solution would be far cheaper for the profession. A ballot of the profession took place and the profession voted to bring it to a close and obtain PII on the open market. As a result of this decision by the profession, SIF was put into runoff and closed to new entrants in September 2000. Those firms that had closed prior to September 2000 were told that they would continue to be covered by SIF indefinitely and that remains the position and that will continue even if the SRA proceeds with its intention to close it in September 2021.

One of the misconceptions that has been going around is that all firms have been assured by the Law Society or others that they will be covered by SIF indefinitely. That assurance has never been given apart from for those firms that closed prior to September 2000. By 2004 SIF had built up considerable reserves. It was recognized that SIF had far more reserves than were needed to deal with the claims of those firms which closed pre-September 2000. So, in 2004, the Society decided that some of those funds would be used to provide post 6-year cover (PSYROC) for the firms which closed post 2000 without a successor practice. At that time it was decided that this additional cover would continue for claims notified prior to September 2017. It was when the Law Society set up this post six-year run off cover by SIF that it was envisaged at that time it would close in September 2017.

The 2001 Office for Fair Trading report, **Competition in the Professions**, identified a number of issues that had the potential to disadvantage consumers in the legal services sector. In July 2003, Sir David Clementi was appointed to carry out an independent review of the regulatory framework for legal services in England and Wales. The terms of reference were:

To consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector; and

To recommend a framework which will be independent in representing the public and consumer interest, comprehensive, accountable, consistent, flexible, transparent, and no more restrictive or burdensome than is clearly justified.

This resulted in the Legal Services Act 2007[1]. By that Act the Legal Services Board (LSB) was created. It has 8 Regulatory Objectives[2] of which 3 are:

Protecting and promoting the public interest: This they define as being the public interest the interests of society as a whole. They say that there are certain factors to consider "which are always in the public interest, such as public confidence in the justice system, an effective legal system and public confidence in the regulatory system. The duty here is to "protect" and "promote", which is a proactive obligation to seek to advance the public interest and prevent impacts that are not in the public interest".

Improving access to justice: They say "Access to justice means being able to exercise your legal rights. In many senses this is reliant on the rule of law, which provides the necessary framework to allow access to justice to be achieved. Access to justice should mean that when disagreements arise in society, "just" or fair outcomes are achieved to resolve them". They say further "The duty here is to "improve", which recognises that there is an ongoing obligation to seek advancement. It also recognises the changing needs of consumers over time, which will mean expectations in relation to access to justice will evolve."

Protecting and promoting the interests of consumers: "This regulatory objective relates to promoting the interests of consumers as a whole, or specific groups of consumers… Consumers will include individual persons, small or large businesses, or other entities with a legal problem. The potential for consumer detriment is seen as greater for those types of consumers near the top of the list (individuals and small businesses or those without in house legal teams) where the imbalance in knowledge and power is the greatest. As a result, it is the first two types of consumers that will need the greatest."

The LSB has published new Rules and Guidance for regulators (like the SRA) which come into effect on 1 February 2022. By these, Regulators can only alter their regulatory arrangements if the LSB has approved those changes. The new regulations will require greater focus on the impact that any changes will have on, amongst others, consumers and those with protected characteristics. In introducing these changes the LSB have stated that it will introduce "a real opportunity to take ownership of the regulatory objectives to make the sector work better for consumers, the public and the legal professions".[3]

The Solicitors Regulation Authority (SRA) was created by The Law Society in response to the LSA as a separate body to oversee the regulation of solicitors. The SRA state: "Our aim is to serve the public interest and protect consumers of legal services. We work to protect members of the public and support the rule of law and the administration of justice". It says it's core work is "the public

[1] https://www.legislation.gov.uk/ukpga/2007/29/contents
[2] https://www.legalservicesboard.org.uk/about_us/Regulatory_Objectives.pdf
[3] https://legalservicesboard.org.uk/news/new-lsb-process-for-regulatory-changes-provides-greater-focus -on-regulatory-objectives

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protection and setting and maintaining of high standards for the profession" and asserts that "any modern consideration of the need for regulation must start with the public interest and consumers". Further it complains of "a lack of consistent consumer protection and redress". It asserts that "any justification for regulation in the legal services market… (has the) aim…of benefitting the consumer" Elsewhere they assert "legal services regulation (must be) firmly focused upon consumer needs for clarity, choice, quality and protections".[4]

However later in this response it becomes clear that the SRA are at odds with the Regulatory Objectives of the LSB when they say:

"The SRA's approach differs from that set out by the LSB in its paper. Whilst acknowledging the wider range of factors at play, the LSB puts very heavy emphasis on the primary purpose of regulation in this area being the promotion of competition and ensuring consumer redress. Our view is that this emphasis is too narrow, that all of the factors set out in ss.1 and 28 LSA must be considered as a part of a balanced package and that, if any were to be given particular emphasis, it should not be these two that sit at the top of the rankings."

And further: "The focus on consumer redress seems to us to be misplaced. Consumer redress is important, but what consumers really want is for services to be delivered in such a way that problems requiring redress do not arise in the first place."

The Legal Services Act (LSA) defines regulatory functions as including indemnification arrangements. SIF falls within the definition of indemnification arrangements. The Act defines indemnification arrangements in S 21 (2) (b) as: "in relation to a body, means arrangements for the purpose of ensuring the indemnification of those who are or were regulated persons against losses arising from claims in relation to any description of civil liability incurred by them, or by employees or former employees of theirs, in connection with their activities as such regulated persons". The Internal Governance Rules (IGR) required the Law Society to delegate regulatory functions, which includes indemnification arrangements, to the SRA. Therefore, by virtue of the Solicitors Act 1974, the LSA and the IGRs, the SRA have exclusive jurisdiction to decide on the continuation of or the closure of SIF. The Law Society cannot make that decision.

The SRA made a decision that run off cover post the six-year mandatory period is not a regulatory requirement and not required for client protection and decided that SIF should close in 2017. Following a request by the Law Society in 2013, the SRA agreed to extend the closure of SIF until September 2020. In 2016, TLS again invited the SRA to extend the closure of SIF until September 2023. The SRA declined to do so. However, as a result of pressure by TLS last year, it agreed to extend the closure date to September 2022.

[4] https://www.sra.org.uk/sra/consultations/consultation-responses/enhancing-consumer-protection-reducing-regulatory-restrictions/

Because of the constraints upon TLS by the LSA and the IGRs, TLS, as the representative body, is not allowed to fill the gap caused by the closure of SIF because to do so would constitute a regulatory function. This is the reality that TLS has to work under and unfortunately a lot of people have not fully understood legal position and the constraints that TLS is under.

WHO WILL BE AFFECTED BY THE CLOSURE OF SIF?

- Solicitors whose practice closed post September 2020 without a successor practice.
- Solicitors whose practice closed with a successor practice and that successor practice closed without a successor practice taking on all prior liabilities. This could therefore extend beyond the first successor practice.

And following a couple of court decisions[5]:

- Solicitor partners/directors who were members of an LLP or a limited company that has closed without a successor practice and no ongoing indemnity insurance.
- An individual employee or member of an LLP or a limited company that has allegedly been negligent and the LLP or a limited company has closed without a successor practice and no ongoing indemnity insurance.

And probably:

- Solicitors who have been employees of Charity Trust Corporations which have closed without appropriate cover.
- Solicitors and their employees who have been appointed Executors of deceased solicitors whose practices closed without appropriate cover. Even where a Section 27 Notice has been issued in the London Gazette it is by no means the case that a claim that became evident after such a notice and after the estate was distributed would not be enforceable where the claimant was unaware of the claim until 6 years had passed let alone at the time of the Notice and distribution.

Finally, there may be cases where the rule in Hedley Byrne v Heller would apply.[6]

In addition, because SIF was set up by TLS on the basis that its funds could only be used to protect the clients of solicitors and the solicitors who have no PSYROC it is arguably an undertaking by TLS in perpetuity for those covered by the scheme to use the funds raised for that purpose and that purpose alone. To proceed to close SIF, as the SRA have proposed, would breach that undertaking. The SRA are apparently content to make a decision that would cause TLS to breach that undertaking with no consequences for the SRA for doing so as they would not be liable to the clients claiming

[5] See Merrett v Babb [2001] EWCA Civ 214 and the cases therein cited.
[6] Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] A.C. 465 (28 May 1963)

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where there was no PSYROC. And there would inevitably be reputational damage to the profession were SIF to close.

Under the Minimum Terms and Conditions (MTC)[7], which can be found in the SRA Indemnity Insurance Rules, liability can arise on the part of another practice in circumstances where that other practice is deemed to be a successor of a closed practice. Successor practice provisions can be complicated but typically liability can be transferred where a principal of a closed practice sets up or joins a new practice and/or when the new practice holds itself out as a successor. So where that successor practice closes without a successor practice taking on all prior liabilities liability could affect the solicitors in the closed successor practice.

If the solicitor operated either as a sole practitioner or within a traditional partnership, each principal is likely to remain personally liable for any negligence committed prior to the dissolution of the practice regardless of the nature of the professional services in question. This means that, even if no run-off insurance cover is in place to meet a claim, compensation could still be recoverable personally from an individual, or a number of individuals, where negligence has been established. Even if the professional services in question were provided by either a private limited company or a limited liability partnership that has since been dissolved, if run off cover is not in place it may nevertheless be possible to pursue a claim against, and recover compensation from, a negligent employee. While such claims are often considered as a last resort, they can sometimes be the only resort and there are a number of good reasons why they are likely to become increasingly common. While the potential to recover any compensation awarded against a relatively junior professional may well be limited, as a result of the dramatic increase in property values over the last 20 years and the significant value of many personal pension plans, the prospects of recovering compensation from established professionals can be very good.

Whether personal liability should be imposed on an employee has been a troublesome issue for the courts when dealing with claims for professional negligence. Over the last 20 years, many professionals have avoided the unincorporated structures of the past, preferring to practise through private limited companies (PLCs) and limited liability partnerships (LLPs). In doing so, the potential to recover compensation from multiple principals has been reduced to a single legal entity. Further, and for the sole practitioner too, personal contracts of appointment have been replaced by corporate ones, only then to be performed by employees. There are other factors such as changed PII purchasing practices where many small and some medium sized practices choose to purchase their PII policies online without tailoring them via a broker to the needs of the practice. The potential for a significant fiscal shock, leading to ever more challenging, and perhaps recessionary, economic trading conditions is another. In turn, a significant number of professional practices, small, medium and large, could face closure, just at the time when professional negligence claims activity traditionally increases. Dozens of law firms have closed over failure to obtain PII due to an ever-

[7] https://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/

hardening market. Research shows that 340 legal practices closed in 2019 without a successor practice. 2019 is the last year for which the SRA have released such figures.

In combination, these events suggest that it may become increasingly common for claimants to assert liability on the part of professional employees personally, in order to recover compensation for the losses they have sustained as a result of professional negligence.

From the above it can be seen that the ambit of those who could potentially affected include consumers who only become aware of the negligence after the expiry of 6 years from the closing of the practice and solicitors and their staff. The SRA appear to think the closure of SIF is not a consumer issue, or if it is the number affected is so small as to be dismissive of its impact on them. They prefer to characterise the issue of one that allows solicitors to sleep peacefully at night.

WHAT HAS THE LAW SOCITY BEEN DOING?

The closure of SIF has been top of the PII Committee's Agenda since 2016. For the last two years the Chair, Nicholas Gurney-Champion, and TLS staff members from policy and the commercial teams have been in discussion with brokers, underwriters and insurers to see if there was any appetite for a market solution to fill the gap caused by the closure of SIF. There have been in excess of 30 meetings over the last 18 months alone and these meetings are ongoing. Then In early 2020 the SIF Working Group was set up to address this issue. It consists of the TLS CEO, Robert Bourns, the Chair of the Board, Michael Garson, Lubna Shuja (who was at the time Chair of MCC and is now Vice President), Pieter de Waal, the Counsel to the Law Society and Nicholas Gurney-Champion. The Working Group concluded that from the evidence they had obtained a SIF replacement in the market was not going to happen, and with COVID in full force, the ability of our retired members to obtain alternative cover caused by the closure of SIF was going to be impossible. Therefore, a further request was made to the SRA to extend the closure of SIF for a further three years. It was granted until September 2021. A further request for an extension was made and the SRA board considered this request and, reluctantly, agreed to extend it for a further year until September 2022. The reasoning behind their only granting a one-year extension was that they believed a further extension beyond one year was unaffordable, a view that TLS disputes.

Those discussions with insurers are ongoing. Some interesting and possibly helpful suggestions have been made. It is too early to say whether those discussions will provide any workable solution. The PII market at the moment and the Covid situation have very much hindered progress, but there is still hope that a solution can be found but no certainty.

In tandem with this, the SIF Working Group decided to take advice from leading counsel as to TLS's position under the Legal Services Act and the IGRs . They wanted clarity on what TLS could do within the rules and what TLS could or could not force the SRA to do, not only with regard to keeping SIF open but also with regard to the SIF surplus.

Leading counsel confirmed:

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1. That the Law Society itself carrying out indemnification arrangements for its members is unlawful.
2. That the decisions as to SIF Closure are the sole domain of the SRA; and
3. That in exercising its regulatory functions, the SRA must act within the statutory duties of the Legal Services Act. They must act in a way which is compatible with the regulatory objectives and they must act reasonably and rationally.

Accordingly, in March 2021, the Law Society wrote to the SRA asking them to fully explain, in accordance with the requirements of the LSA, why they have made the decision to close SIF. The SRA responded in early May and failed to deal with the request. The TLS wrote again in forceful terms, asking them to properly and fully answer questions posed and to give detailed reasons for their decision. The SRA considered its response and then in November 2021 it produced a document that detailed their view of the options for PSYROC[8] [9]

In addition to this, TLS had a meeting with the LSB consumer panel to appraise them of the imminent closure of the SIF. They were horrified, as would be expected, and indicated they would raise this with the LSB and with the SRA. After a meeting between the TLS President and the LSB Consumer Panel, a joint letter was prepared and sent to the SRA setting out the joint concerns for consumers and for members and requesting the closure of SIF be put on hold.[10]

Then high-level conversations took place with the LSB, who are now taking an active interest in our concerns, followed by a three-way meeting between the LSB, the SRA and the TLS which took place on 26th May 2021. TLS emphasised the impact of closing SIF on members and consumers. They made it clear that there must be an extension in the short term to allow a solution to be identified and created. Both the SRA and the LSB have confirmed that they have been receiving direct contact from many concerned members. The LSB set out how they believe affordability should be defined and that the SRA should take this on board and discuss with their Board.

SRA board chair Anna Bradley said: 'The board welcomes the keen interest that is now being shown by the profession and others in SIF. But it is disappointing that this came so late in the day[11] and as a result is set against the backdrop of significant concerns about the future viability of SIF.

'There is now limited time available to look at what are complex matters around whether there is, in principle, a regulatory place for post six-year run-off cover. We will need to give careful consideration to finding the right regulatory balance between consumer protection and issues of proportionality, affordability and the wider public interest.'

[8] Post Six Year Run Off Cover
[9] https://www.sra.org.uk/sra/news/press/indemity-fund-consultation/
[10] https://www.lawgazette.co.uk/news/dont-close-the-sif-in-this-tough-insurance-market-sra-urged/5108591.article
[11] In fact, this issue has been ongoing for the last 9 years with constant contact and communication by The Law Society with the SRA and this statement is therefore inaccurate.

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The SRA says the latest extension will allow for work to agree a long-term position on whether there is a place for post six-year cover in its regulatory arrangements and its attention will now turn to reviewing comparable run-off cover arrangements, claims patterns, impact assessments and ultimately winding up the SIF. They have since produced a Consultation Paper containing their view of the options available.

The SRA have also said it will consult on its next steps, including alternative indemnity and discretionary uses for any residual surplus in the SIF, for example a hardship fund. The SIF had net assets of £22.48m at 31 October 2020, with around 200 cases ongoing.

So all in all their decision is not a victory but a reprieve.

We should approach this issue by looking at the potential impact on consumers as well as those who have retired or those to be retired in the future rather than treating the issue as an actuarial consideration. Some would say there is nothing that TLS or the market can ever offer that is better than a scheme underwritten by the whole profession. Others would say, as they did when the profession voted to have a market led approach to PII, that the whole profession is carrying the burden for SME's and sole practitioners. Some solicitors do not see direct benefit to themselves from an extension - an issue already raised in Council that will no doubt be supported by a section of the profession. These views do not, it seems, take into account the rights of consumers and the reputational impact on the profession of the closure of SIF. The SRA has the power to levy for any shortfall in SIF at any time.

COMMUNICATIONS AND CHALLENGES

Meetings have taken place with interested groups to appraise them of what is going on. There has been publicity through the Gazette and direct communications with local law societies going on over the last 12-18 months which has considerably ramped up over the last few months. One of the challenges is making direct contact with retired members. Sadly, neither TLS nor the SRA have data for membership going back more than about six or seven years. Trying to make contact with firms and members who closed down their practices since 2000 has been extremely challenging. Moreover the application of GDPR has prevented TLS from using all the communications facilities that could exist to raise awareness of the issue within the profession and amongst those who have retired from practice.

COMMENTS ON THE SRA CONSULTATION DOCUMENT

Firstly, it is evident to those who have read the Consultation document and informed themselves of the debate on this issue that the SRA have decided that SIF must close. This Consultation is therefore window dressing in the light of that decision and unlikely to cause the SRA to change its mind. It

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seems likely that there is no solution in the PII market and that altering the MTC's[12] or creating a Master Insurance Policy would create more difficulties that it would solve. We believe that this issue is fundamental to consumer protection and the objectives of the SRA towards solicitors. We believe that contrary to the view expressed by the SRA there may well be an increase of claims arising after the end of the mandatory run off cover. We also take the view that there is a reputational issue here to which the SRA have not given appropriate recognition. Therefore, we oppose any solution that causes the closure of SIF. We take the view that if the SRA are able to shrug off this responsibility they should not do so until the Legal Services legislation has been amended to allow TLS to assume responsibility for PSYROC and to raise an annual levy along the lines that they have indicated.

Prepared on behalf of the Surrey Law Society
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[12] Minimum Terms and Conditions. See https://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/