

Solicitors Regulation Authority,
Policy and Strategy Unit – Professional,
Indemnity Insurance,
The Cube,
199 Wharfside Street,
BIRMINGHAM,
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15th June 2018

(By post and email: consultation@sra.org.uk)

Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the SRA's Consultation paper "Protecting the Users of Legal Services" (the "Consultation Paper")

The City of London Law Society ("CLLS") represents City lawyers through individual and corporate membership, including some of the largest international law firms in the world. The CLLS responds to a variety of consultations on issues of importance to its members through its specialist committees. This response to the Consultation Paper has been prepared by the CLLS Professional Rules and Regulation Committee. For further information see the notes at the end of this letter.

The SRA started a consultation on this topic in 2014 and in September 2015 we responded to the SRA's Discussion Paper of July 2015. We refer to that earlier response and refrain for setting out again all the arguments then made, though we believe them to continue to be substantially valid.

The questions and answers are inter-related, and it is impossible to compartmentalise, so to the extent relevant each answer should be considered as being applicable also to other questions.

Our response is:

Question 1: 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?

Strongly disagree

We have reviewed the response of The Law Society dated 6th June, setting out their analysis and arguments at length, and substantially concur in its contents on this and the other consultation questions.

We would add or emphasise the following points:

1. We query whether the SRA's statement that 98% of all claims settle for under £500,000 has taken into account sufficient historic claim data, given that it does not include settlement figures from insurers who exited the market in recent years and who faced large losses.
2. Even if it is right that most claims settle for under £500,000, insurers will still be exposed to where the bulk of the risk lies (because the new minimum terms are going to be £500,000, or £1m for conveyancing matters) in which case it is difficult to see that premiums would reduce.
3. Clients' agreement to limit law firm liability to the £500,000 or, as the case may be, £1m level (or theoretically nil for commercial clients, but that is not realistic), would have no effect on third party claims, for example, as under the *Dreamvar* decision or in respect of undertakings to the other side.
4. It will be problematic to rely on another firm's undertaking as we could not be sure that their insurers will deal with a claim, and in more instances we need to enquire about the level of cover.
5. As one commentator has pointed out, sometimes there may be uncertainty as to which insurer would be responsible for a claim, where circumstances were first notified to one insurer in one year, but the claim crystallises in a subsequent year with a different primary insurer. Insurers may dispute whether the claim arises from the circumstances previously notified or not. Currently each insurer is obligated by the Participating Insurer's Agreement with the SRA so one or other insurer must 'conduct any claim, including paying defence costs, and seek reimbursement later. If the majority of claims (commercial claims) faced by CLLS member firms are to be excluded from compulsory cover, this provision will be of no effect, and firms may be forced to defend themselves and pursue claims for reimbursement against insurers.
6. Over recent years failed large firms include 3 UK firms, 6 US firms with London offices and the London office of KWM. Partners in firms which fail will no longer have certainty that there is insurance cover - compulsory successor practice cover would not cover the commercial claims.
7. Those small firms that choose to be content to insure only at the new minimum cover levels, taking the risk for future work, will be exposed as regards past work where clients will, at best, have agreed to limit liability to £3m or, as the case may be, £2m - so the law firm will be exposed to such claims until the end of the limitation period. Therefore, many firms, even small firms, on a prudent basis, are likely to secure

more than £500,000 or, as the case may be, £1m cover, but, in our opinion, there is a risk that they may end up having to pay higher premiums overall than at present.

8. MTC provides the most comprehensive scope of cover, with minimal exclusions, for PII in the world. Of concern even for City firms is the proposed removal entirely of the MTCs for work done for financial institutions and other large business clients (those with turnovers of more than £2m). This impliedly creates a de-regulated market, and may allow insurers to reduce scope of cover or impose higher premiums in return for the current (and comprehensive) protections under the existing MTCs, but which they will no longer be obligated to offer.
9. If a firm seeks to reduce its PII cover to the low levels proposed, then given the claims made nature of PII, previous clients, who have not yet made a claim, but may do so in the future, could be prejudiced and/or the law firm have an uninsured exposure. Clients may have instructed a firm in the knowledge of its then PII cover levels, but at the time of a claim find they are now substantially reduced.
10. We point out one particular difference compared to the liability position outside the legal sector (a professional services sector). In the case of a regular Companies Act company, a director rarely has personal civil liability, absent wrongful trading. In the case of an LLP, the LLP Act left open whether or not the partner (member) giving advice would have personal liability to the client in negligence on the basis of assuming a duty of care; it is certainly arguable.¹ Therefore potential inadequacy of level of PII insurance protection, which could be the consequence of the proposals, is of greater concern in the legal sector than the general commercial sector.
11. The SRA's paper is entitled "Protecting the users of legal services..." As mentioned in our September 2015 response, however, the SRA also has a statutory duty under section 37 of the Solicitors Act 1974, in relation to professional indemnity, to have regard to the protection of solicitors and their staff.² Thus, protection of clients is not the only concern; to the extent that the proposals increase risks of uninsured claims or costs for partners and employees, those increased risks or costs must be taken into account, as well as benefits (if any) to clients.
12. So, we do not concur that the change would benefit:
 - Solicitors' firms – any reductions in premium are likely to be minor in effect;
 - Clients, who would need to make enquiries as to cover levels of competing law firms – and without assurance that levels quoted (above £500,000 or, as the case may be, £1m) would remain in force; or
 - Law firm partners, who would be exposed to a greater degree to liability above insured levels and/or run off liability, including after retirement and/or after a firm has ceased to exist and/or have to bear additional insurance premiums.
13. If the proposals are designed to make small High Street practice more affordable, we wonder if, in fact, the consequence could be the reverse with either increased costs for similar cover as present or, if cover levels reduce, then a flight to quality away from small High Street practices.

Please bear these points in mind in relation also to the remaining questions.

¹ In the case of a general partnership the partner advising would have personal liability to the client in negligence, and fellow partners would have joint and several liability.

² See HL judgment in *Swain v The Law Society* [1983] 1 AC 598, quoted in the TLS 2014 Response para 19.

Question 2: 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?

Strongly disagree

Apart from private client work and employment advice, most work of CLLS member firms is for financial institutions and other large business clients.

CLLS member firms currently take out PII for a cover level substantially exceeding the MTC level and would continue to do so for the firm's (and partners') protection and because clients are increasingly enquiring on level of PII cover and setting minimum levels.

Making the distinction is likely to cause complications as The Law Society points out.

There is simplicity in the current PII market: MTC applies to all clients (commercial or individual) and the MTC conditions apply all the way up the excess layers tower and to run off in the event of a cessation of business. The SRA's proposals, even if individually attractive (which is not our view) risk upsetting those arrangements to the detriment CLLS member firms and their partners.

Question 3: Do you think our definition for excluding large financial institutions corporations and business clients is appropriate?

No

Though, in practice, CLLS member firms will obtain appropriate top-up cover in excess of the proposed MTCs, reflecting the nature and value of work undertaken, we concur in the opinions and arguments of The Law Society.

In addition, the definition of "large business clients" being those with a turnover of £2m is too low when considered in the context of relevant guidance: for example, the EU's Recommendation 2003/361 defines a "medium-sized business" as having a turnover of less than 50m Euros and a "micro business" as having a turnover of less than 2m Euros. Consequently, the SRA's proposals would classify as "large business clients" many small and medium sized enterprises, many of whom may not be sophisticated users of legal services.

Further to the above, there is apparent confusion between the SRA Consultation Paper (at page 53) which states that turnover will be assessed "*in the financial year at the time the act giving rise to a claim occurred*" whereas the draft MTCs at 6.3 state that the relevant assessment is of a client's turnover for its most recent financial year. If the assessment of turnover (and therefore application of MTCs) is intended to apply retrospectively, rather than on a claims-made basis, this might cause a client to be outside the scope of the MTCs entirely if, at the time the relevant act or omission took place, their turnover was more than £2M but where, at the time the claim is actually made, it is not. Moreover, the effect of this approach is that cover under the MTCs may be excluded for an act or omission which took place years before the new MTCs are actually introduced.

Question 4: 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?

Strongly disagree

Though, in practice, CLLS member firms will obtain appropriate top-up cover in excess of the proposed MTCs, reflecting the nature and value of work undertaken, we concur in the opinions and arguments of The Law Society.

In addition, under the requirement to obtain separate additional MTC cover for conveyancing work, firms which intend to obtain only the minimum cover (which approach the SRA argues will be cheaper and is a primary motivation for the proposed changes) will need to negotiate and put in place separate insurance arrangements. This will have to apply to both the conveyancing and non-conveyancing aspects of their business, which will add time and costs. This is not necessary under the current arrangements, since the current minimum cover of either £2m or £3m applies to all legal services.

Question 5: Do you think our proposed definition of conveyancing services is appropriate?

No

Though this would not, in practice, arise for CLLS member firms, we concur in the opinions and arguments of The Law Society.

Any attempt to limit liability to correspond to the MTC level of cover would have no effect on third party claims, for example, as under the *Dreamvar* decision or in respect of undertakings to the other side.

Question 6: Do you think there are changes we should be making to our successor practice rules?

Yes

We concur in the opinions and arguments of The Law Society; in particular, regarding increased risks should the current proposals be implemented.

Question 7: Do you agree with the approach we are taking to bring the MTCs and the PIA up to date?

Strongly disagree

We concur in the opinions and arguments of The Law Society; in particular, regarding claim amounts asserted far exceeding actual settlements, loss of confidence in firms and increased risks on a sale of a practice.

Question 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?

Strongly disagree

We concur in the opinions and arguments of The Law Society; in particular, we concur with them in their view that the proposals will not save firms money overall.

Like The Law Society, the CLLS disagrees with the proposed changes which will increase complexity, reduce protections for the public, and could increase costs for firms due to the need for various types of top-up cover and administrative costs.

Question 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?

Neither disagree nor agree

We concur in the opinions and arguments of The Law Society that this is an important subject and that further research and analysis is required. Also, retiring solicitors who will need to consider purchasing top-up cover for their run-off period in order to cover former clients who expected to be covered by the existing MTCs levels.

Question 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?

Strongly disagree

Given that City of London commercial firms insure for far more than MTC require, the proposals will have no effect (positive or negative) on firms entering the City market, whether non-City firms opening in the City, foreign law firms opening in the City or break-aways from existing firms.

However, we concur in the opinions and arguments of The Law Society; in particular, we concur with them in their view that the potential savings, if any, would be small and could be illusory. In the case of small firms nationally doing low risk advisory work, different remedies could be targeted at them, without overhauling the entire market.

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

Yes

Though the effects highlighted by The Law Society are likely to be felt only outside CLLS member firms, we concur in their opinions and arguments.

Question 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

We concur with The Law Society that this is an important subject and that further research and analysis is required.

Question 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?

Neither disagree nor agree

The Compensation Fund is not a topic in which the CLLS Professional Rules and Regulation Committee has any particular expertise. However, the analysis and arguments of The Law Society on questions 13 – 22 look persuasive. Accordingly, we do not specifically address **Questions 14 to 22**.

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

This is a separate and very important topic in its own right.

It should be borne in mind that currently, PII under MTC covers all civil liability arising from legal practice (subject to specified exceptions), so client losses (including client money) arising from the firm's negligence, for example, in lack of preparedness against hacking, are covered by the PII insurance. So only the firm's first party losses are uninsured without cyber insurance.

In outline:

- Further efforts should be made to raise clients' awareness of the risks and how to navigate them – here efforts can be targeted at individuals and small businesses, as large businesses will have deployed their own resources to buying in IT security expertise;
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- Any proposal to weaken the protection under MTC (or law firm PII policies generally) should be resisted; and
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- We concur with The Law Society in the merits of a sector-wide approach, and the merits of Cyber Essentials or ISO 27001.
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The CLLS would happily contribute to a wider debate on cyber risks.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact me initially on +44 (0) +44 207 427 3033 or by email at jonathan.kembery@freshfields.com in the first instance.

Yours faithfully

Jonathan Kembery
Chairman
Professional Rules and Regulation Committee
City of London Law Society

About the CLLS

The City of London Law Society (CLLS) represents approximately 17,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies

and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a wide range of consultations and comments on issues of importance to its members through its 18 specialist Committees. The CLLS is registered in the EU Transparency Register under the number 24418535037-82. Details of the membership of the CLLS Professional Rules and Regulation Committee are found here:

http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=151&Itemid=469