SRA BOARD
8 June 2021

CLASSIFICATION – PUBLIC

This paper will be published

Solicitors Indemnity Fund - Provision of post six year run off cover

Purpose

1 This paper updates the Board on recent developments in relation to termination of post six year run off cover (PSYROC) by the Solicitors Indemnity Fund (SIF).

Recommendation

2 The Board is asked to:

a) consider its position in relation to the provision of PSYROC through the SIF, and in particular, whether this should be extended beyond September 2021, in light of recent developments.

If you have any questions about this paper please contact: Juliet Oliver, General Counsel juliet.oliver@sra.org.uk

Equality, Diversity and Inclusion considerations

Consideration	Paragraph nos
This paper is about a particular aspect of arrangements for clients to recover against solicitors in civil claims for professional negligence. It relates to the impacts of the termination of PSYROC and so is relevant to those suffering loss – which may include people with vulnerabilities – and to firms which have closed with no successor practice, and the retired solicitors who worked within them. This will include a significant proportion of small firms including sole practitioners, which have a higher representation of Black, Asian and minority ethnic solicitors.	
A full Equality Impact Assessment will be done prior to any decision to close the Fund and to wind up SIF. The paper however proposes completing this process before the termination of PSYROC.	Paragraphs 28 and 29

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Background

3 Board members will recall from recent discussions that there are two live issues/workstreams in relation to the SIF with which the SRA is currently engaged.

4 The first relates to the decision taken by the Board to agree a programme of work to explore winding down the SIF and putting in place an alternative arrangement with a third-party insurer to meet the liabilities currently being met from the Fund. This was agreed in March last year, and an update most recently provided in April this year.

5 The second issue relates to the provision by the SIF of PSYROC, which is discussed further below and which is currently due to come to an end on 31 September 2021, following a decision by the Board in June 2020.

The role of SIF and post six-years run off cover

6 The background to the SIF is set out extensively in the previous papers, above (for the March and June 2020 and April 2021 Board meetings). However, key relevant facts are as follows.

7 The Law Society established the SIF in 1987 under section 37 of the Solicitors Act 1974, for the purpose of providing compulsory professional indemnity cover to all solicitor practices in England and Wales. It is funded by contributions from the profession. It is administered by a separate company, wholly owned by the Law Society, Solicitors Indemnity Fund Ltd (SIFL).

8 In September 2000, the SIF was placed into run-off following the introduction of an open market insurance model, which required firms to hold professional indemnity insurance (PII) with an insurer operating in the open market. The minimum terms for that insurance have always included a requirement that if a firm ceases without a successor firm, the last recorded insurer for the firm must provide six years 'run-off cover'.

9 SIF has remained liable for:

a. Claims made during the period a firm was covered by the SIF (1 September 1987 to 31 August 2000).

b. Claims made after 31 August 2000 by law firms that ceased without a successor practice on or before 31 August 2000. It is important to note that such run-off cover is not time-limited.

10 SIF also provides run-off cover to firms that ceased on or after 1 September 2000 once their mandatory six-year run-off cover has expired. This is known as supplementary run-off cover or post six-year run-off cover (PSYROC). This

arrangement was put in place by the Law Society, to run from 1 September 2007 (the point until which firms would be covered by their own mandatory six-year run-off cover) to claims notified before 30 September 2017. The cost of this cover is met out of the SIF surplus.

11 The Society's indemnification arrangements (along with its other regulatory functions) were subsequently delegated to the SRA following its establishment in 2006. The operation of the SIF is currently governed by the SRA Indemnity Rules 2012. At the Law Society's request, the SRA has extended the provision of PSYROC on two occasions, first in 2012 when it agreed a three-year extension to cover claims notified before 30 September 2020, and more recently in June 2020, when the SRA Board agreed to a one-year extension. The reason for the extension in June 2020 was to give the insurance market more time to work out whether and if so how it might develop alternative PSYROC products.

12 As stated above, the SRA Board has decided to take forward a programme of work to explore closing the SIF and replacing the way in which its ongoing liabilities are met going forward, by a master insurance policy. The aim is for the SRA Board to make a decision at the end of this calendar year. If the decision is made to close the Fund, the Board will need to make a decision about what to do with the residual funds. Under Rule 21 of the SRA Indemnity Rules 2012, these must either be used for another indemnity purpose under section 37 of the Solicitors Act, or be returned to the Law Society to be used for the benefit of the profession.

Recent developments

13 At the Board meeting in April 2021, members considered correspondence from the Law Society raising concerns about the impacts of the termination of PSYROC and asking questions about the rationale for the decisions taken by the Board in this respect.

14 In its letter of 25 March 2021, the Law Society reported on its work with the insurance market. They stated that this had not identified any commercial market alternatives for the provision of PSYROC, and that the "*problem is made worse by the timing of the SIF closure, which coincides with an especially hard market for purchasing mandatory professional indemnity insurance. The cost of this insurance saw an increase of 10-15% in March this year on top of a rise of 30% in the previous year*". In short, it concluded that whilst there may be limited pockets of cover available for more recent firm closures, the position for firms that have been closed for some time will be increasingly difficult.

15 We responded to the Law Society to clarify the Board's position in a number of respects. We confirmed that no decision had yet been taken regarding the closure of the Fund, the release of surplus or the use that might be made of this. We recognised the position in relation to the hardening insurance market,

and offered to work together to develop proposals for how the residual funds might best be used to benefit affected solicitors, such as a hardship fund.

16 However, since then events have moved on rapidly. We have received a significant number of communications from the Law Society and others, and engaged in active discussions with the Law Society, the Legal Services Board and the Legal Services Consumer Panel, on the impacts of the closure of PSYROC and what alternative options for cover might be available going forward. The paragraphs below discuss this in more detail.

17 The President of the Law Society published an article in the Gazette on 17 May 2021 calling on the SRA to extend the SIF beyond September 2021 and to provide certainty as to our future plans. This was followed up by further correspondence, as follows:

a. A letter dated 18 May 2021 (annex 1), strongly seeking an extension, based on concerns about the absence of alternative options for PSYROC and the detrimental impact of its termination on both consumers and affected solicitors.

b. A letter dated 19 May 2021 (annex 2), clarifying that the Law Society would not be pursuing alternatives options, such as a hardship fund, and calling on the SRA to prioritise and lead this work. The reasons given include: that this would not be a suitable or adequate replacement for the indemnity cover provided by the SIF; that the Society lacks the infrastructure, capacity and expertise to do so, however the SRA has such expertise; and, that they believe they are likely to be legally constrained from doing so as the Legal Services Act provides that "indemnification arrangements" – and the decision to discontinue the SIF – are regulatory matters. The Society also highlighted the need for an assessment of whether it is necessary and appropriate to wind up PSYROC (against the regulatory objectives and given the lack of alternative available arrangements), and, for reasons of adequate planning and continuity, the need to understand as soon as possible the SRA Board's position on use of surplus.

c. A joint letter from the Law Society and the Legal Services Consumer Panel, dated 20 May 2021 (annex 3), seeking an extension or immediate alternative arrangement to mitigate the impact of closure. This refers to the lack of alternative cover through the insurance market, and the fact that the fund appears to be affordable, and the lack of any analysis of the impact on consumers of this change at this time, or of alternative options which could be considered. This letter was reported in an article in the Law Society Gazette, which also quoted that SIF had net assets of £22.48m at 31 October 2020, with around 200 cases ongoing.

18 In addition to the above, we have received separate enquiries from the Legal Services Consumer Panel and the Legal Services Board, seeking an

explanation for the decision to bring PSYROC to an end when this appears to be affordable.

19 We have also received a significant number of communications from individual solicitors (example attached at annex 4 to illustrate nature of concerns expressed), and those representing sole practitioners and other solicitors likely to be affected by the termination of PSYROC (example from the Sole Practitioners Group attached at annex 5). These call for the decision to bring PSYROC to an end in September 2021 to be reconsidered, and challenge the reasonableness of the decision, on the basis that this has been done without adequate warning or safeguards when money is still available. Some of the common themes are:

a. They and others have paid money into the fund for this to be used for indemnity purposes, and that it should continue to do so at least until the fund is exhausted. They were unaware at the point their firms were closing that this would come to an end.

b. The Fund still appears viable – it has remained stable at £22m once claims are accounted for.

c. Their efforts to obtain alternative insurance have not proved fruitful, and provide no guarantee this will be available, or at what cost, going forward.

d. This represents a failure of the SRA's statutory role to protect the public, given the detriment to consumers whose claims may be unable to be met (in addition to the impact on the affected solicitors).

20 We have of course since then continued to engage with SIF Limited on the plans for the replacement of the Fund with a master policy solution. We have heard further from them regarding the impact of any extension on those plans, and the continued concerns they hold about:

a. the viability of the fund to continue to provide PSYROC beyond September 2021, and September 2022 at the latest;

b. the erosion of the assets of the fund given the disproportionate costs of continuing to maintain the SIF to meet the dwindling historic claims and the small number of PSYROC claims going forwards;;

c. the impact of a further extension of PSYROC on the plans to close down the SIF and to transfer responsibility for remaining claims to a third-party insurer which can administer those claims more efficiently alongside its existing business.

21 We attach a further copy of the confidential letter and actuarial report considered by the Board last June, at annex 6, and a letter from the Chair of

SIF Ltd of 27 May 2021 at annex 7. This highlights the economic and practical considerations of any extension beyond September this year.

22 In particular, it notes that in a conventional insurance company in run-off the time is always reached when the cost of administration of remaining claims becomes disproportionate to the value of claims actually being paid. Here, there are unavoidable fixed costs of management and professional fees [redacted], and on top of that there is the cost of insurance protection [redacted]. Stalling the current third party negotiations which are taking place as part of the "wind up" project, may bring to an end the opportunity to find an alternative solution via a master policy, in light of the small and unconventional nature of the SIF's business.

23 The letter confirms the way in which the solvency of the fund is assessed: This is on the same basis that this would be done by an insurer – namely through an external actuarial assessment looking at the number and value of claims that are likely to be made. It assesses a range of possible outcomes, with associated confidence levels, and the consequential requirements around capital reserves. The letter confirms that SIFL's view based on the assessment last year was that an extension of PSYROC for three further years would not have been possible, and hardens their position in terms of two, now saying that this would be borderline. Any assessment can only look ahead for a limited period, [redacted].

Discussion

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[redacted]

Current position/considerations

31 The operation of the SIF through run off, to its ultimate closure, was a task that was inherited by the SRA when it was established, due to the fact that "indemnification arrangements" are a regulatory function under the Legal Services Act: notwithstanding that they (and run-off cover in particular) serve dual purposes: continuity of client financial protection (which is principally a regulatory function) and the 'sleep easy' factor for retired solicitors (which is principally a representative function).

32 Accordingly a decision needs ultimately to be made about whether it is necessary and appropriate to continue the Fund and, as part of that, whether an alternative indemnity purpose exists for the money. This will allow a decision to be made on whether and how the surplus might be used to extend consumer protection for those with a claim falling outside of the six year period.

[redacted]

34 This needs to be done in the most robust and effective manner possible. In reaching decisions about the future of PSYROC provision through the SIF, and the future of the Fund and of PSYROC more broadly, we will need to be mindful of our regulatory objectives and any equality impacts - as well as the context in which the arrangements were set up. A further extension of, at least, one year, would give us the opportunity to do so, and to communicate our position effectively and to manage the expectations of all affected stakeholders. This is particularly important given our understanding now about what solicitors contributing to SIF were led in the past to believe in relation to the continuation of PSYROC.

Recommendation: the Board is asked to consider its position in relation to the provision of PSYROC through the SIF, and in particular, whether this should be extended beyond September 2021, in light of recent developments.

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Supporting information

Links to the Corporate Strategy and/or Business Plan

35 This paper relates to objective 1 in the corporate strategy: We will set and maintain high professional standards for solicitors and law firms as the public would expect and ensure we provide an equally high level of operational service. The paper discusses indemnification arrangements, which help to achieve our regulatory objective to protect consumers of legal services by ensuring they are able to recover for loss suffered as a result of professional negligence.

How the issues support the regulatory objectives and best regulatory practice

36 This paper discusses the provision of indemnity cover through the Solicitors Indemnity Fund. As stated above, indemnity arrangements support the regulatory objective to protect consumers of legal services by ensuring they are able to recover for loss suffered as a result of professional negligence.

Public/Consumer impact

37 The paper discusses the termination of PSYROC, and decisions to be made about the alternative arrangements that might be put in place for providing consumer protection for those with a claim falling outside of the normal six year limitation period.

What engagement approach has been used to inform the work and what further communication and engagement is needed

38 We have engaged with stakeholders, in particular the Law Society, the Legal Services Board, and the Solicitors Indemnity Fund Ltd, about the issues in this paper.

What equality and diversity considerations relate to this issue

39 The issues discussed in this paper relate to the impacts of the termination of PSYROC and so are relevant to those suffering loss – which may include people with vulnerabilities – and to firms which have closed with no successor practice, and the retired solicitors who worked within them. This will include a significant proportion of small firms including sole practitioners, which have a higher representation of Black, Asian and minority ethnic solicitors. A full Equality Impact Assessment will be done prior to any decision to close the Fund and to wind up SIF. The paper however proposes completing this process before the termination of PSYROC.

How the work will be evaluated

40 There are no formal evaluation arrangements for the issues raised in this paper.

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Annexes

[redacted]

NB: these annexes will not be published because they relate to emerging strategy or policy or are commercially sensitive