The Specialist
Property Law
Regulator

CLC Professional Indemnity Insurance Code and Guidance
CLC Professional Indemnity Insurance Operating Framework
Summary of Responses to the CLC Consultation Paper
May 2016

Summary

The CLC published its Consultation Paper on 5 May 2016. The Consultation Period ended on 20 May 2016. Although the consultation period was short, the CLC is pleased to note the number of responses received raising important points. The CLC has indicated in this Summary of Responses how it will take account of the points made.

None of the points raised lead the CLC to conclude that the proposals it has made are flawed and there was wide support for them.

The proposed approach will
- Improve consumer protection
- Provide firms with improved choice of insurance
- Reduce the regulatory compliance burden on firms and streamline regulatory processes
- Reduce the exposure of the Compensation Fund

The CLC is therefore now making its application to the LSB for approval of the amendments it has proposed to the CLC Professional Indemnity Insurance Code and Guidance or to the CLC Professional Indemnity Insurance Operating Framework, and for the Participating Insurers Agreement (PIA) and the CLC PII Policy Terms with revised run off provisions to be approved and come into force in time for PII renewals on 30 June 2016.

Introduction

By way of background, it is important to remember that allowing free choice of insurer on the open market was a recommendation of the Office of Fair Trading in 2011[1]. It was always possible that, given widespread uptake of that free choice, the Master Policy Scheme could become unsustainable. In 2015, there was widespread opt-out from the Master Policy for the first time when one third of CLC practices secured their PII through an insurer new to the market promoted by the SLC.

The evolution of the PII market for CLC practices demanded a response by the CLC. As with any regulatory action, we are guided by the need for proportionate measures that effectively target risk to maintain or enhance consumer protection while supporting innovation and growth in the provision of legal services.

[1] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/oft_advice.pdf

In preparing its proposals, the CLC held discussions with the two current insurers of CLC firms to ensure that the new model for PII was workable and would support provision of cover to all currently insured firms. It was also an opportunity to close gaps in the extent of run off coverage of closed practices to improve consumer protection and reduce the exposure of the Compensation Fund. We also looked at past claim levels to ensure that provision would meet all reasonably foreseeable circumstances. The proposals are therefore evidence-based and robust.

The PII Consultation Paper set out the CLC's proposal to move away from its Master Policy arrangements with a right for practices to opt-out of the Master Policy for Professional Indemnity Insurance. Instead, insurers will be asked to sign up to a PIA setting out Minimum Terms and Conditions of cover. CLC regulated entities will then be free to choose from amongst all Participating Insurers. As explained in the Consultation Paper:

I. These new PII Arrangements will make it much easier for CLC practices to compare PII policies offered by different insurers. It will make the PII approval process for CLC Practices and for the CLC much more straightforward than last year. Preliminary indications are that the changes will be welcomed by the profession because they make clear the requirements for CLC Practices to obtain PII and simplify the application procedure. Insurers' financial standing will need to be rated 'A' or above and the terms of PII cover must be equivalent to the CLC PII Policy Wording.

II. The effect of the new arrangements is:
   (a) to provide wider choice
   (b) to encourage CLC practices to take responsibility
   (c) to help the CLC set standards and regulate effectively

III. The changes are consistent with the regulatory objectives and in particular increase protection for consumers.

IV. The only significant difference between the PII terms currently in force and the CLC's new PII Arrangements relate to Run Off Cover. Insurers have agreed to provide six year run off cover of £2 million in aggregate inclusive of defence costs. If this limit were to be exceeded, an application could be made for a grant out of the CLC's Compensation Fund.

V. The CLC's PII regulatory arrangement have been amended (see Annex 1 & 2) to reflect the change in arrangements which are relatively straightforward.

Questions

The Consultation asked three questions:

(A) Do you agree with the proposal for the CLC to permit insurers who sign up to its Participating Insurers Agreement to provide professional indemnity insurance for CLC practices incorporating the CLC PII Policy Wording at Annex 3?

(B) Do you agree the proposal for run off cover to be provided to practices which close at no additional cost to those practices when they close?

(C) Do you agree the proposed amendments to the CLC's Professional Indemnity Code and Guidance and to the CLC's Professional Indemnity Insurance Framework at Annex 1 and 2 respectively?

No specific question was asked about the SRA proposals set out at paragraphs 31-34 of the Consultation Paper which are the subject of the SRA's Consultation Paper 'Removing barriers to switching regulators' although some respondents chose to comment on them[2].

Circulation of the Consultation Paper

The Consultation Paper was sent to managers of CLC practices and to other stakeholders, was posted on the CLC website and promoted in the CLC's email newsletter, on Twitter and LinkedIn. It was reported in the Todays Conveyancer, the Law Society Gazette and Legal Futures.

The CLC received 15 responses:

- 8 from CLC practices - the CLC currently regulates 230 practices (8 respondents represent 3.5% of CLC practices).
- 3 from SRA practices
- 4 from other stakeholders, namely the Legal Services Consumer Panel (LSCP), the Council of Mortgage Lenders (CML), the Society of Licensed Conveyancers (SLC) and the Law Society (TLS).

The Responses

The responses must be seen in the context that the two sets of insurers who provided PII to 98% CLC practices in the 2015-2016 insurance year have signed up to the PIA which incorporates the CLC PII Policy Wording. Whilst a case may be made that some of the terms, such as for run off, may be more onerous for insurer than is currently required elsewhere in the market, they have been accepted by those insurers. To that extent the CLC is able to demonstrate that there are insurers with current direct experience of CLC practices who are willing to continue providing PII on the revised terms for that market. Should a firm fail to secure coverage, the CLC has proven systems in place to ensure an orderly managed close down if sale or merger is not possible.

The SLC said that the consultation did not make it clear that the changes to the run off requirements and cessation of the Master Policy issues are entirely separate issues. It is noted that in its response the SLC agreed both proposals, although the PIA proposal was agreed strictly on the basis that the PIA should continue in effect to act as a Mater Policy (in the traditional sense). This point is addressed further below.

Responses to Question (A) and the CLC's Reply to the Issues raised

The CLC asked:

> Do you agree with the proposal for the CLC to permit insurers who sign up to its Participating Insurers Agreement to provide professional indemnity insurance for CLC practices incorporating the CLC PII Policy Wording at Annex 3?

Responses from CLC practices

Responses from 3 CLC practices agreed that the CLC should move to the PIA, as proposed. Whilst in principle in agreement with the proposition, one practice considered that the requirements of the PIA are too onerous for insurers. The fact that insurers have already agreed PIA terms suggests this is not correct for all insurers. The other four CLC practices which did not agree the proposal were

[2] https://www.sra.org.uk/sra/consultations/removing-barriers-switching-regulators.page

concerned that moving away from the Master Policy is likely to mean that some CLC practices will not be able to secure PII under the new arrangements. The SLC has suggested that the PIA should require all insurers to offer terms to all CLC practices. Both sets of current insurers have confirmed that they are willing to offer terms to all practices which they currently insure.

The experience of PII renewal in 2015 was that many CLC practices chose to move away from the Master Policy, because of enhanced renewal terms offered both other insurers. As reported in the CLC Consultation Paper, a third of CLC practices moved away from the Master Policy in 2015. It appears that whilst approving a market based solution for PII, there is a continuing desire for retention of the Master Policy. In the view of the CLC these aspirations are mutually exclusive. Insurers will of course wish to maximise their coverage of the CLC market, but they must ultimately be able to determine whether to offer PII terms to any practice which they consider puts at risk the ability of the insurer to continue offering PII to that market.

Responses from SRA practices
Two of the SRA practices indicated that they agreed to the PIA proposal. The third did not consider that the CLC's changes had gone far enough to accommodate SRA requirements and so enable them to transfer to CLC regulation.

Responses from stakeholder organisations
LSCP said in its response that it supports the CLC's proposal to move away from its Master Policy arrangements on the grounds that this will enhance choice and competition. TLS said it had no particular view. CML said that they would welcome confirmation that the CLC plan to retain, at least for the time being, their Master Policy for those firms who wish to continue insuring under that arrangement. For the reasons set out above, the CLC does not propose that the Master Policy arrangements should be retained. However, it has been reassured by confirmation that insurers who have underwritten the CLC's Master Policy since 2004 have signed up to the PIA and to that extent there is continuity, albeit not under the Master Policy itself.

Responses to Question (B) and the CLC's Reply to the Issues raised

The CLC asked:

> Do you agree the proposal for run off cover to be provided to practices which close at no additional cost to those practices when they close?

Responses from CLC practices
With one exception, all CLC practices agreed to the CLC's proposal for run off. The practice which did not agree considered that the requirement was too onerous for insurers. It also considered that it might also prove over the longer term to be unnecessarily expensive in terms of additional premiums for practices which continue to trade beyond six years. This was a point also made by TLS. In the CLC's view this will be a factor which should be taken into account by all parties in agreeing renewal terms. As set out above, these requirements have been accepted by two sets of insurers, although the CLC agrees it may not be accepted by other insurers.

Responses from SRA practices
Two of the SRA respondents agreed the proposal. The third thought that it did not go far enough in meeting the requirements of the SRA.

Responses from stakeholder organisations

The SLC agreed the proposal and commented that it should be an attraction for solicitors firms considering switching regulators. LSCP said that it is broadly supportive of the provision relating to run off cover. However, it is concerned that the cap of £2 million aggregate may leave some gaps in consumer protection; consumers may be left out of pocket in multiple negligence cases for example.

CML welcomed the move to require PI to provide run off cover. It was concerned that the effect may result in the level of protection provided for its members and their customers being reduced. It looked for assurance that there is a healthy PI insurance market. It would like to see higher levels of cover over the run off period. It also asked that a process is put in place to proactively notify lenders if a firm's cover lapses and for an explanation how the CLC has assessed the risk to the Compensation Fund in the event that practices are unable to obtain cover.

The CLC explained in the Consultation Paper that whilst there is a requirement to purchase run off cover for a minimum of six years following closure of a practice, in a number of instances the former principals have not had the funds to pay the premium. The CLC has been in discussions with insurers to investigate ways in which run off cover could be incorporated into CLC PII Provisions at no additional cost to CLC practices at point of closure. After discussions insurers have agreed to provide £2 million run off cover in aggregate. If the aggregate limit were to be exceeded an application could be made for a grant out of the Compensation Fund. This is a significant improvement on the current position which in effect places much greater reliance on the Compenastion Fund and thus poses greater financial risk to the regulated community that provisions that fund.

It is important to note that insurers have acknowledged that they should price premiums at a level which will enable them to provide run off cover to practices at no additional costs at the point of closure.

LSCP states that they appreciate the reality of commercial insurance and accept that trade off will be necessary when balancing varying interests. This is the exercise which the CLC has undertaken.

Responses to Question (C) and the CLC's Reply to the Issues raised

> Do you agree the proposed amendments to the CLC's Professional Indemnity Code and Guidance and to the CLC's Professional Indemnity Insurance Framework at Annex 1 and 2 respectively?

There were no substantive comments on the proposed amendments. Comments made which answered the question in the negative followed the responses to Questions (A) and (B).

Switching Regulators

In addition to asking for responses to the specific questions it had raised, the Consultation Paper invited comments on the proposals as a whole. Some respondents took advantage of this invitation by commenting on paragraphs 31 to 34 under the heading 'Switching Regulators' which were prompted by the SRA's Consultation Paper 'Removing barriers to switching regulators'.

LSCP commented that if larger SRA regulated firms move to the CLC, 'there is likely to be an accompanying increase in liabilities and risks which may impact on run off covers. The figures used to assess the appropriateness of the proposed run off cap may change. We would therefore suggest a review two years post implementation of the changes'. The CLC agrees it will carry out a review as suggested.

LSCP asked what the position would be if a SRA practice changing to CLC regulation provided services which the CLC is not currently authorised to regulate. We should make clear that only the conveyancing and probate operations of a mixed practice firm would be able to transfer to regulation by the CLC. Therefore, the point under discussion here is what might occur in a situation where a mixed SRA practice transfers conveyancing and probate into regulation by the CLC and either continues to provide other legal services under the SRA or ceases to provide those services, essentially closing its SRA practice. LSCP said that approved regulators must work together to ensure that gaps or loopholes in run-off coverage that might arise do not result in consumer detriment or lack of clarity. The CLC has already identified this risk and will work with the SRA to agree appropriate mitigating steps. Further, any practice applying to be regulated by the CLC will need to satisfy the CLC that it had appropriately mitigated any such risk. This may be by continuing to provide such services under a different regulatory regime or by taking out run off insurance for that part of the practice.

CML noted that the SRA's consultation ended after the CLC's consultation and enquired whether the CLC had considered what it would do in such an event. It also asked for assurance of the measures which the CLC will have in place to identify firms who may be looking to move regulators due to poor performance/monitoring or disciplinary issues with their former regulator. The CLC carries out due diligence on all applicants for a licence which include asking the SRA to confirm the regulatory record of a practice and its principals. Insurers will separately carry out their own due diligence. No licence will be issued to a practice until evidence of insurance is produced and until the CLC is satisfied with the standards of that practice.

TLS commented that there is a significant risk in SRA firms wishing to close switching to CLC regulation in order to avoid the SRA run off premium. The CLC has identified this risk, as have insurers, and separate processes are in place to identify those practices seeking to transfer for this purpose.

TLS submit that solicitors' clients should not receive a lower level of cover because their provider has switched regulator. It says that in response to the SRA's consultation it will argue that clients should be afforded equivalent SRA MTC run off cover if the firm switches to another approved regulator. In the CLC's view, it is for the SRA to determine the appropriate level of cover.