

SRA BOARD
31 January 2023

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This paper will be published

Consumer protection for post six-year negligence

Reason for paper	<p>This paper:</p> <ul style="list-style-type: none"> • Summarises and discusses the key points made in response to our consultation on draft rules for the future indemnity scheme for post six-year negligence. • Invites the Board to make the rules for the scheme. • Outlines our implementation plan to launch the scheme in October 2023.
Decisions(s)	<p>The Board is asked to:</p> <ol style="list-style-type: none"> a) consider the key points made in the recent consultation and our proposed response b) with effect from 1 October 2023, designate the SRA as the person responsible for holding, managing and administering the Solicitors Indemnity Fund (SIF) pursuant to rule 4.5 of the SRA Indemnity Rules 2012 c) make the SRA Indemnity Fund (Amendment) Rules [2023] d) note the implementation plan for the launch of the future scheme.
Previous Board and committee consideration	<p>Following previous discussions on the future of SIF including in June 2021, April 2022 and July 2022, the Board at its meeting in September 2022 agreed:</p> <ul style="list-style-type: none"> • That an SRA-run indemnity scheme offered the most cost-effective and proportionate solution to providing consumer protection for post six-year negligence. • That we consult on the arrangements and rules of that indemnity scheme.
Next steps	<p>If the Board agrees with the recommendations of this paper we will:</p> <ul style="list-style-type: none"> • Publish a report on the outcome of the consultation. • Submit an application to the Legal Services Board (LSB) to approve the rules of the future scheme. • Continue work to prepare to take over the management of SIF on 1 October 2023.

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

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Consumer protection for post six-year negligence

Summary

- 1 This paper reports on the outcome of our October 2022 [consultation](#) on consumer protection arrangements for post six-year negligence. The paper sets out the main points raised in response to the consultation and our proposed responses. It also highlights changes we propose to make to the draft rules of the future scheme in response to consultation responses, in respect of:
 - the appointment of an independent arbitrator in the event of a dispute on the coverage of the scheme
 - deciding on the use of the residual assets of the scheme if it is closed at some point in the future.
- 2 The paper invites the Board to make the final rules of the future scheme (annex 1), which will provide consumers with the same level of protection in the same way as SIF does now, in line with the approach set out in the October 2022 consultation. A tracked comparison showing the changes to the current rules is at annex 2.

Background

- 3 Following an earlier consultation in September 2021, the Board decided in April 2022 to consider further the issues raised and the options for delivering post six-year indemnity cover. To support the Board's consideration of the cost-effectiveness of the options, we commissioned expert independent advice from the consultancy arm of Willis Towers Watson (WTW). We issued a [discussion paper](#) in August 2022 outlining the options being considered and inviting views on some specific issues.
- 4 At its meeting in September 2022, the Board:
 - Agreed that we should maintain consumer protection for post six-year negligence as a regulatory arrangement with the same level of cover as is provided by SIF.
 - Decided to provide this protection via an indemnity scheme operating under the direct control of the SRA.
 - Decided that we should consult on our approach and the detailed rules setting out how the SRA-controlled indemnity scheme will operate.
- 5 The subsequent consultation, which ran from October 2022 until 3 January 2023, set out why the Board decided to provide consumer protection via an

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SRA-run indemnity scheme, and invited views on draft rules for the scheme and on its regulatory and equality impact. The consultation set out that our approach would be to use a mechanism in the SRA Indemnity Rules 2012 which allows us to designate the SRA as the body responsible for holding and managing SIF. It set out that we would manage SIF through our established operational infrastructure, with outsourced expertise as needed, and that this would result in cost savings compared to its existing management arrangements. WTW had assessed the capability of the SRA, in partnership with a suitable outsourced claims handler, to provide a post six-year indemnity scheme and were confident that we could provide a fit for purpose arrangement with only slight changes to existing operations.

- 6 The consultation noted that SRA control of SIF would:
- Provide us with clear oversight of the arrangement's operating costs and risk management decisions, and access to relevant management information about operations and claims.
 - Enable us to report transparently on, and keep under review, the costs and benefits of post-six-year consumer protection.
 - Ensure that this consumer protection is delivered in a way that is aligned and consistent with our other consumer protection arrangements. The scheme would be governed within and by the SRA as the regulator responsible for consumer protection.
- 7 The consultation invited responses on the draft rules for an SRA-controlled post six-year indemnity scheme and views on revised draft regulatory and equality impact assessments. The draft rules were largely based on the existing SIF rules, amended in some respects to bring them more into line with our other current regulatory arrangements.

Key issues raised in response to the consultation

- 8 We received 45 responses to the consultation. Annex 3 contains (i) a summary of the key points made in consultation (other than those which have led to proposed changes to the rules, discussed below) and our proposed responses to them, and (ii) an analysis of the overall responses. Most respondents did not provide substantive comments on the draft rules or the impact assessments. Instead, they generally supported continued arrangements for claims arising after the expiry of the mandatory six year run-off cover provided by insurers.
- 9 Some responses argued that the arrangements should continue to be managed by the Solicitors Indemnity Fund Limited (SIFL) or another organisation such as the Law Society. Reasons given included that the scheme should be independent of us as the regulator, that running such a scheme is beyond our remit as a regulator, and that we do not have the expertise needed to manage an indemnity scheme. The Board has decided to maintain post six-year cover for consumer protection purposes, as part of our regulatory

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arrangements (which include, “indemnification arrangements” under section 21 of the Legal Services Act 2007); therefore bringing the scheme under our control is clearly within our remit as a regulator. The issue of the expertise needed to run the scheme is discussed in annex 3 (i) (‘case for transfer to SRA-controlled body’).

- 10 Some respondents were concerned that given previous proposals to close SIF, we might seek to do so again after taking it under our control. The October 2022 consultation set out the reasons for our Board’s decision to continue to provide consumer protection for post six-year negligence via an SRA-controlled indemnity scheme providing the same scope of cover as now. It also noted that this approach will enable us to keep under review the costs and benefits of this protection. We are subject to statutory and public law obligations to act in a fair and proportionate manner at all times. If we were to decide in future to propose to close SIF or change the scope of its cover, we would have to make the case for those changes which would be the subject of public consultation, and would then require LSB approval.
- 11 The residual assets of SIF (and any additional funding raised by future levies on the profession) will remain ring-fenced and only available for the purpose of indemnifying post six-year losses.
- 12 Responses also raised questions and concerns about a range of specific issues, including our approach to consultation, the evidence to support our proposal, the language and construction of the rules, the management and reporting of the future scheme, and the separation of our indemnification and disciplinary functions. These issues and our proposed responses are set out in annex 3 (i), which the Board is invited to consider.
- 13 The October 2022 consultation:
 - noted that in response to our 2021 consultation, stakeholders had raised concerns that reducing or removing consumer protection could indirectly disadvantage people with certain protected characteristics, and that this feedback had informed our Board’s decision in September 2022 to maintain the current level of protection
 - said that we had not identified any equality impacts on specific groups of regulated individuals or consumers as a result of the Board’s decision.

Responses to the October 2022 consultation did not raise any further evidence or concerns about equality impacts.

Proposed changes to the draft rules

- 14 The consultation invited views on the draft rules. The Law Society raised two specific issues in response to which we are proposing to make changes to the draft rules, as follows.

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CLASSIFICATION – CONFIDENTIAL***Arbitration in the event of a coverage dispute***

The draft rules provided that a dispute about whether a claim is within the scope of the indemnity will be referred to a sole arbitrator, to be agreed by the indemnified and the SRA or to be appointed by an SRA authorised decision maker, for determination. The current SIF rules provide for an arbitrator to be appointed by the President of the Law Society. The Law Society's consultation response argued that there may be concerns that if the SRA is responsible for the appointment of an arbitrator, the appointee may not be impartial. This was supported by some other respondents.

SIFL have advised us that the arbitration mechanism is very rarely used. To provide greater reassurance that any appointment of an arbitrator will be fair, we propose to amend the rules to provide that where an arbitrator is required the SRA will invite an appropriate independent body to appoint the arbitrator. Bodies such as the Chartered Institute of Arbitrators (CIArb) and the Centre for Effective Dispute Resolution (CEDR) run independent schemes to appoint arbitrators in disputes.

Maintenance and termination of the Fund

SIF's rules provide that if the scheme closes and the SRA does not identify an alternative indemnity purpose for its assets, the Law Society may decide how to use the residual assets for the benefit of the profession. The Law Society's consultation response noted that the draft rules left the decision on the use of these residual funds to the SRA, and argued the Society should retain a role in this.

We have reconsidered this having regard to the reasons for the establishment of SIF and the Law Society's role in making decisions about the use of residual funds for which there is no alternative indemnity purpose. We propose to amend the final rules to provide that in the event of the scheme closing, and where the SRA does not identify an alternative indemnification purpose for the residual funds, they will be transferred to the Law Society which will determine how they will be used for the benefit of the profession.

The City of London Law Society (CLLS) suggested that the draft rules should include an explicit power for the SRA to terminate the arrangements if they cannot be run in a proportionate way or become disproportionate or unfair. We do not consider that to be necessary. We will keep the proportionality and effectiveness of SIF under review as we do with all our regulatory arrangements. Both IF's current rules and the new rules include a general power to terminate the fund if we were to decide it was no longer necessary or appropriate to maintain it. Any such decision would be subject to our obligations to act fairly and proportionately, and would be subject to public consultation and LSB approval.

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CLASSIFICATION – CONFIDENTIAL**Future approach to asset and liability management**

- 15 The WTW report which accompanied the October 2022 consultation identified scope for a future scheme to realise potentially significant cost savings by optimising its asset and liability management. This includes the approach to reserving against claims and insuring SIF. In the consultation we noted that the future financial strategy for the scheme would involve consideration of the potential to use SIF's existing assets to contribute to the running costs of the scheme. And/or to take a more targeted approach to future investment to generate returns to help support the scheme. This has the potential to reduce or defer the need for levy funding, as the Sole Practitioners Group highlighted in its response to the 2021 consultation.
- 16 As discussed in annex 3 (i), the Law Society in its response to the consultation pressed for more details about our approach to managing assets and liabilities, and for that approach to be included in our application to the LSB. The CLLS suggested that there should be a specific duty in the rules for us to have regard to standard investment criteria and to take proper advice from a suitably qualified person in managing the scheme's funds.
- 17 We will continue to engage with stakeholders on this topic. We are commissioning expert advice on the transition from SIFL to the SRA, on topics including:
- the future provisioning policy and capital reserves policy of the fund
 - the scale and timing of any future levy funding
 - the future handling of SIF's historic claims and future liabilities
 - considerations around the future asset and liability management approach of SIF, building on issues identified by WTW
 - the need for and timing of any new actuarial assessment to support those decisions.
- 18 If the Board makes the proposed rules at its January 2023 meeting then we intend to seek LSB approval of the rules shortly afterwards, in good time ahead of us taking on the management of SIF in October 2023. Operational decisions about how we manage SIF, such as our asset and liability strategy, will also be made in good time to meet the October implementation date. These operational decisions are not regulatory arrangements and we are confident that we can go live with the transfer of SIF and operate the arrangements set out in the Rules from the beginning of October. We will continue to engage with interested stakeholders on these issues, and will publish further information before the scheme launches.
- 19 We will ensure continued expert advice on the future management of SIF as required. This will inform our reserving policy on an ongoing basis and the need for and timing of any levy on the profession. If it is necessary to collect a levy from the profession to help fund the arrangements, we will consult separately on any proposals as we committed to do in the October 2022 consultation.

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- 20 We are confident that this approach poses no risk to the financial viability of the scheme. SIF is currently well funded; the 2022 WTW report noted that SIFL has aimed to maintain surplus capital sufficient to withstand losses in excess of a 1-in-200 year event. WTW's 2021 report indicated that there is sufficient capital to fund claims without risking SIF's viability in the near term at least. If SIF sees a significant increase in claims requiring new levy funding in the near future, the long lead time for claims on the fund will allow sufficient time to design, consult on and implement the levy.

Implementation plans

- 21 Our operational systems and teams are preparing to take receipt of claims from 1 October 2023. Our planning work includes engaging with SIFL to ensure the smooth transfer of operations, selecting a suitable outsourcing partner to manage claims, any necessary IT changes, staff training, the development of web-based guidance and information, and both internal and external communication plans. We are also developing a framework to record, analyse and report on data about the functioning and impact of the future scheme. A draft summary implementation plan is at annex 4.

Recommendations: the Board is asked to:

- a) **consider the key points made in response to the recent consultation and our proposed response**
- b) **with effect from 1 October 2023, designate the SRA as the person responsible for holding, managing and administering the Solicitors Indemnity Fund (SIF) pursuant to rule 4.5 of the SRA Indemnity Rules 2012**
- c) **make the SRA Indemnity Fund (Amendment) Rules [2023]**
- d) **note the implementation plan for the launch of the future scheme.**

Next steps

- 22 If the Board agrees with the recommendations of this paper we will:
- Publish a report on the outcome of the consultation.
 - Submit an application to the LSB to approve the rules of the future scheme.
 - Continue work to prepare to launch the future scheme on 1 October 2023.

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Supporting information

Links to the Corporate Strategy and/or Business Plan and impact on strategic and mid-tier risks

- 23 This paper relates to objective one 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.*

How the issues support the regulatory objectives and best regulatory practice

- 24 This paper confirms arrangements for the provision of consumer protection for losses caused by solicitors' negligence. This engages regulatory objectives including protecting and promoting the interests of consumers, protecting the public interest, and promoting competition. The paper recommends that the Board make the '[SRA Indemnity Rules 2023]' so that we can implement plans for SIF to be managed and administered by the SRA. The arrangements will deliver for consumers based on analysis of the case for consumer protection and the options for a proportionate regulatory response, in line with the principles of better regulation.

Public/Consumer impact

- 25 The paper follows our most recent consultation which invited views on draft updated regulatory and equality impact assessments. It sets out our view of the need for additional consumer protection. The updated draft assessments confirm that as protection for consumers is not changing and the scope of indemnity is the same as it is under current arrangements managed by SIFL, there is no negative impact. We will continue to monitor the impacts on consumers as we manage the scheme and collect better information.

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

- 26 This paper reflects the stakeholder feedback to the recent consultation. We have extensively engaged on the future of SIF for a number of years. As part of the recent consultation, we have engaged with bodies representing consumers of legal services, solicitors, and other stakeholders most of which have provided a supportive response to the decision to continue with consumer protection arrangements for post six-year negligence.
- 27 We will continue to work with stakeholders as we look to implement changes. We will work on our communications package that will support our plans for implementation.

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What equality and diversity considerations relate to this issue?

28 The consultation invited views on the updated draft equality impact assessment. By maintaining consumer protection via an SRA run indemnity scheme, we have not identified any likely equality impacts on specific groups of regulated individuals or consumers. No impacts have been identified in response to the consultation.

How the work will be evaluated

29 The evaluation framework developed for our Looking to the Future reforms will be adapted to consider and review the impacts of these new arrangements. Management information that we collect on the effectiveness of the scheme will also feed into the wider review of financial protection arrangements being conducted by the Legal Services Board.

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Date 23 January 2023

Annexes

- Annex 1:** SRA Indemnity Fund (Amendment) Rules [2023]
- Annex 2:** Tracked comparison of current and future SRA Indemnity Fund Rules
- Annex 3:** (i) Key issues raised in consultation and our response, and (ii) overview of consultation responses
- Annex 4:** Draft summary SRA Implementation plan

NB: annex 4 will not be published because it relates to emerging strategy or policy