frontier economics

Econometric analysis of professional indemnity insurance costs for legal service providers

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Executive Summary

Background

Professional indemnity insurance (PII) covers law firms against civil liability claims, usually as a result of claimed professional negligence.[1] Recent developments in the insurance market have led to significant increases in PII costs for professional services firms, including providers of legal services. The hardening market followed a previous period of lower PII costs. Reviews in 2019 by both the Prudential Regulation Authority (PRA) and Lloyd's of London[2] asked insurers to look at their underwriting policies and identified PII as one of the most underperforming lines of insurance, suggesting that insurers may have been setting their prices too low.

There is a lack of strong quantitative evidence on the extent of the costs increases, however conversations with the sector have suggested that PII costs are becoming an increasingly significant cost centre for at least some law firms, and that some smaller law firms may be poorly equipped to cope with rising costs. This raises concerns for legal services regulators, among them that law firms may be unable to obtain cover and/or may need to pass on increased costs to consumers, potentially leading to less choice and worse access to justice.

The Solicitors Regulation Authority (SRA) is the regulator of solicitors and law firms in England and Wales, protecting consumers and supporting the rule of law and the administration of justice. The SRA does this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards. It regulates around 160,000 practising solicitors.

The Legal Services Board (LSB) is the statutory oversight body for the regulation of legal services in England and Wales.

The SRA and the LSB share eight regulatory objectives,[3] among them to protect and promote the interests of consumers, and improve access to justice. The SRA and the LSB commissioned Frontier Economics to undertake independent analysis of the available data on the solicitors PII market. Frontier was asked to:

1. Investigate the factors that drive variation in insurance premiums, drawing on the data already collected by the SRA;

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[1] https://www.lawsociety.org.uk/Topics/Professional-indemnity-insurance/Guides/PII-overview

[2] For example: https://www.locktonconstructionpii.co.uk/news/professional-indemnity-insurance-why-the-market-is-hardening-and-how-firms-can-navigate-the-change.html; https://www.insurancetimes.co.uk/lloyds-clampdown-could-see-capacity-crunch/1429682.article

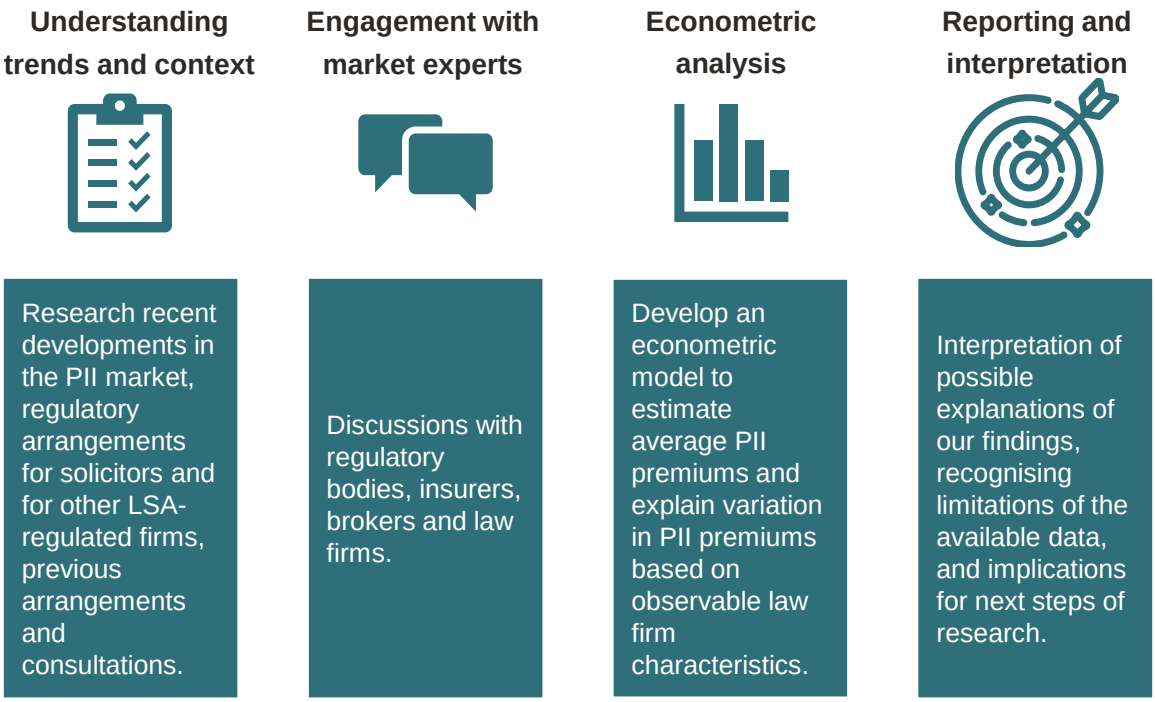
[3] https://www.legalservicesboard.org.uk/about_us/Regulatory_Objectives.pdf

2. To consider as far as possible the significance of insurance premiums in overall expenditure and pricing decisions, drawing on LSB pricing data; and
3. To consider as far as possible what regulatory actions could be considered to alleviate any concerns about worsening outcomes for consumers and providers.

Data sources and research approach

Our analytical approach is described at a high level in the figure below. In short, it involved a focused literature review, econometric analysis of matched data sets, interviews with key stakeholders and workshops with market experts. Our understanding from the literature review and engagement with market experts informed our econometric approach and helped us to interpret the results and potential regulatory options that could follow.

Figure 1 Analysis approach



Source: Frontier Economics

The key data sources used in the analysis were:

- **Surveys of regulated law firms** carried out by the SRA in the second half of 2022, including annual PII premiums and additional firm characteristics. The final sample covered ~280 SRA-regulated law firms, and just under 20 law firms regulated by CILEx Regulation.

- Data on firm characteristics drawn from pseudonymised **SRA data on regulated law firms,**[4] matched to survey responses using SRA firm identifiers.

- **Data on the average prices of different legal services**,[5] published by the LSB in 2020.

Findings

The PII premiums paid by law firms in our sample are typically between **3% and 9% of annual turnover, with a median value of 5%**.

The sample is a small fraction of the population of regulated law firms and estimates may suffer from selection bias (i.e. firms paying higher premium rates may have been more likely to respond to the survey). In our econometric analysis we examine all the available explanatory data and conduct econometric tests to confirm that the results are robust to the extent of the sample available.

As summarised in Figure 2, we find that, when holding all other features of the law firm constant, **smaller law firms and law firms specialising in property work tend to pay higher premium rates, i.e. higher premiums as a percentage of their annual turnover**. As an example, our model suggests that a law firm with the median turnover in our sample (£765k) would pay twice the premium rate of an identical law firm with an annual turnover of ~£3.2m. Law firms doing 60% of their work in property would pay a 50% higher premium rate than law firms that do 30% property work (the median amount), all else equal.

Using our estimates for premiums as a proportion of turnover, we can estimate the approximate contributions of PII premiums to legal prices paid by consumers across different areas of law.[6] We find that the same pattern largely holds, i.e. premium rates are highest in property. Out of the average £900 cost of the legal services involved in a typical sale/purchase of a freehold property, PII costs can account for around £70-£120 (8%-12%). The proportion is lower for divorce services: we estimate that for an uncontested divorce, PII costs accounts for only between £10-£60 (2%-7%) out of the total cost of £815.[7]

There could be a number of explanations for these findings, which we discuss in more detail in the main report. For example, smaller law firms may pay higher premiums because they are seen by insurers as representing a higher risk such as being a target for fraud. Alternatively, it may be driven by market structure where insurers have more of an incentive to maintain the business of larger law firms by keeping premiums low. With the available data we cannot

[4] Law firms registering with the SRA fill out an annual application form, which makes up this dataset. Details can be found here.

[5] Legal Services Board (2020), Prices research. https://legalservicesboard.org.uk/prices2020

[6] We assume full and equal pass-through of premiums to final prices, i.e. that premiums as a proportion of law firms' turnover is equal to premiums as a proportion of prices.

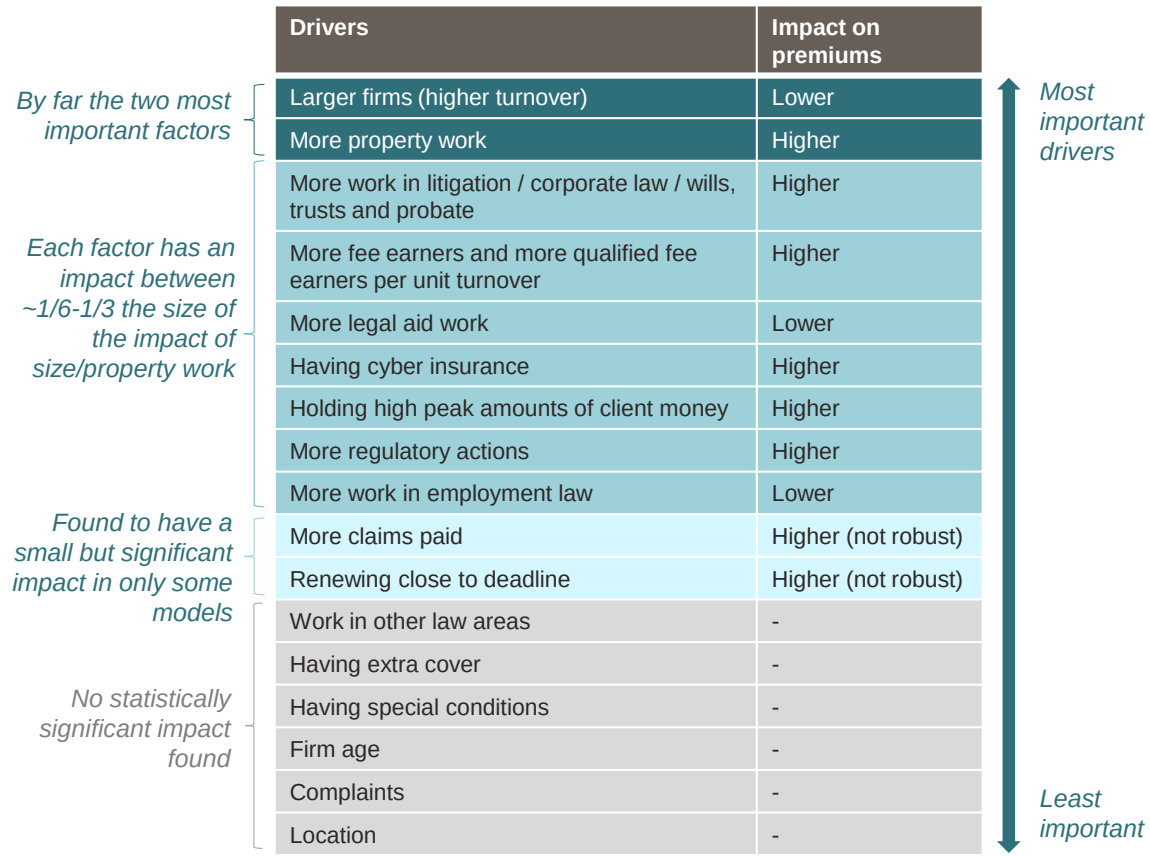
[7] The reported ranges represent 95% confidence intervals. 95% is the standard threshold for reporting statistical significance. 95% confidence interval indicates that there is a one in twenty probability of the result occurring by chance alone.

conclude with certainty which of these competing explanations is the most likely, or most important.

Other factors are also found to have some impact on premium rates but to a much lesser extent. For example, some other areas of law (e.g. litigation) are found to be associated with higher premium rates.

Information from insurers had suggested that a law firm's individual claims history is a key risk indicator, over and above the sector-wide claims associated with each area of law (e.g. in property). However, we find **no conclusive evidence of a link between premium rates and an individual law firm's claims history**. This finding should be interpreted with care as it may be associated with limited data, as discussed in more detail in the main report. For example, only a minority of the sampled law firms have had a claim made or paid in the reporting period, meaning there is limited variation that we can use to explore the relationship with premium rates.

Figure 2 Summary: Key findings



Source: Frontier Economics analysis of Solicitors Regulation Authority data

Discussion and potential next steps

Our findings confirm quantitatively the views expressed in previous conversations with stakeholders and suggest that smaller law firms, and law firms doing more property work, pay higher premium rates, all else being equal. Although 80% of law firms in our sample pay a premium rate of less than 10% of turnover, of the firms paying a higher rate than this, 90% are smaller firms.

Discussions with insurers suggested that although the pressures on PII costs from a hardening market cycle may begin to ease, costs are not expected to fall in the near term. The risks from an economic downturn or slowdown may put increased financial pressure on law firms and pressure on PII prices.

In this context regulators may have some concerns about:

- High prices for PII impacting the price paid by consumers for some services, if these high prices are passed on;
- Other impacts on law firms such as reducing resource for spending on innovation;

- Reduced competition in the PII market, meaning reduced choice for law firms in terms of insurance;
- In the extreme case, law firms being unable to afford cover at all and an increase in the number of law firms closing.

All of which could reduce consumers' access to legal services and their trust and confidence in the sector.

This report does not include any quantitative evidence on the historical trends in the cost or availability of PII cover, i.e. it is not a time series analysis, or an assessment of the competitiveness of the insurance market. Although we understand from the SRA that based on the most recent round of PII renewals there do not appear to be any significant issues as yet with law firms being able to obtain PII cover, this report does not contain any further evidence on the extent to which law firms might be impacted by rising prices.

When considering any regulatory options, their effect must be proportionate and well targeted. Potential explanations of the differentials in premium identified in this report include different risk profiles associated with areas of work or law firms, the insurer pricing model, and the PII market structure. It has not been possible to untangle these potential causes as part of this study, but future work could focus on more fully understanding:

- Whether or not PII costs are impacting law firms' operations or pricing decisions, or if there is a risk that this could be the case in the future;
- If this is found to be the case, what the potential impact could be for consumers;
- And, if it is found that consumers are likely to be impacted, which policy actions might be well targeted at addressing concerns.

This future research could involve additional data collection to more fully understand both sides of the PII market.

Actions that regulators and other stakeholders may wish to evaluate in the light of the available evidence include:

- Actions aimed at reducing the risk of PII claims for all law firms or for subsets of law firms, informed by the drivers of high premium rates found in our econometric results;
- Actions aimed at increasing transparency, both to allow law firms to access cover from a range of providers at reasonable prices and to allow regulators to assess whether financial protection arrangements are working effectively. This could involve improving information and reducing barriers to assessing risk accurately, such as publishing analysis of sector-wide trends and averages; asking insurers to publish more information on how risk is assessed; and targeting processes to make it easier for insurers to access data on smaller law firms;

- Actions which could involve examining alternative models to the current open market, for example drawing on models used in other sectors and jurisdictions, such as demand aggregation or mutual funds. Such change would however require a strong evidence base given the potential high burdens and risks.

Introduction

LSB review of financial protection arrangements

The Legal Services Board (LSB is the statutory oversight body for the regulation of legal services in England and Wales and was established by the Legal Services Act (LSA) 2007. The LSB is independent of both government and the profession. It oversees the approved regulators and regulatory bodies for the different regulated providers of legal services, including the Solicitors Regulation Authority (SRA).

The LSB publicly announced in May 2022 its intention to review financial protection arrangements (Professional Indemnity Insurance and Compensation schemes) to ensure that an appropriate level of protection exists for consumers and the cost to the profession is sustainable and affordable in the long term.

The purpose of the LSB's review is to provide all legal service regulators with sufficient evidence and a framework to:

- Carefully consider whether to make changes to their existing Professional Indemnity Insurance and Compensation schemes arrangements (across the whole of the regulated legal services sector) in order to ensure sustainable provision in the long term; and
- Start to address the root causes of risks in the legal services sector, which may be contributing to higher costs.

SRA review of professional indemnity arrangements

The SRA is the largest of the LSA regulatory bodies and regulates 159,568 solicitors in England and Wales, as well as legal services firms. The SRA and the LSB (as well as all regulatory bodies) share eight regulatory objectives[8] in the LSA, among them to protect and promote the interests of consumers, and improve access to justice. The SRA regulates in the public interest by (among other things) licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards.

Professional indemnity insurance (PII) covers law firms against civil liability claims, usually as a result of professional negligence.[9] The SRA requires the firms it regulates to have indemnity insurance policies that provide a specified minimum level of consumer protection (minimum terms and conditions (MTCs)),[10] which are among the most comprehensive requirements for professional indemnity cover of any profession.[11] All law firms are required to have a minimum

[8] https://www.legalservicesboard.org.uk/about_us/Regulatory_Objectives.pdf

[9] https://www.lawsociety.org.uk/Topics/Professional-indemnity-insurance/Guides/PII-overview

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

[11] https://www.sra.org.uk/globalassets/documents/sra/consultations/pii-post-consultation-position.pdf?version=4b0e0d

of £2 or £3 million cover, with some firms purchasing higher levels of cover based on the work they offer and the clients they serve. The requirements place a high weight on consumer protection, ensuring that consumers have access to financial compensation if something goes wrong. It is possible that the level of cover required places a higher burden on law firms that might not need the prescribed level of minimum cover for varying reasons. However, previous SRA proposals to reduce the minimum cover set out under the MTCs have not been taken forward partly because most firms and insurers indicated they would not necessarily reduce the level of cover or costs of PII.[12]

Recent developments in the insurance market have led to significant increases in PII costs for professional services firms, including providers of legal services. It is likely that multiple factors have influenced this hardening of the market. According to some market commentators, increases in claims has been a major driver.[13]

The increase may have also been driven by a hardening market after a previous period of lower PII costs. Reviews in 2019 by both the Prudential Regulation Authority (PRA)[14] and Lloyd's of London[15] asked insurers to look at their underwriting policies and identified PII as one of the most underperforming lines of insurance, suggesting that insurers may have been setting their prices too low. A subsequent reduction in capacity may have contributed to pressure on prices.

Anecdotally, the SRA has heard that PII costs represent a significant cost centre for some law firms and can be the second largest cost item for some firms after staffing costs, but there is a lack of strong quantitative evidence on the drivers of PII costs.

The SRA has also heard anecdotally that smaller law firms are less well equipped to face rising costs as PII costs tends to represent a higher share of their total turnover compared to larger firms. This creates concern about the ability of some law firms to obtain cover as well as a risk that PII costs are passed on to consumers, potentially leading to less choice and worse access to justice. There is also a lack of robust evidence on the implications of these increased PII costs.

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[12] Ibidem.

[13] For example: https://www.bdo.co.uk/en-gb/professional-services/insights/have-we-reached-the-peak-of-soaring-pii-costs; https://www.insurancebusinessmag.com/uk/news/professional-liability/where-is-the-uk-pi-market-heading-in-2023-429377.aspx; https://www.insurancetimes.co.uk/news-analysis/insurers-urged-to-take-a-fresh-approach-to-solicitors-pi-amid-growing-coverage-concerns/1443712.article; https://www.marshcommercial.co.uk/articles/pii-market-update-september-2021.

[14] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2019/letter-from-gareth-truran-pra-current-areas-of-focus-for-general-insurance-firms.pdf

[15] For example: https://www.locktonconstructionpii.co.uk/news/professional-indemnity-insurance-why-the-market-is-hardening-and-how-firms-can-navigate-the-change.html; https://www.insurancetimes.co.uk/lloyds-clampdown-could-see-capacity-crunch/1429682.article

Data gathering

To address this lack of evidence and understand the drivers of the issue, the SRA and LSB research teams agreed to work in partnership to facilitate the collection of data from law firms on premiums paid and firm-level characteristics, and from insurers on insurance claims and related data (with a focus on the SRA participating insurers). The aim of collecting this data was to gain a comprehensive picture of the PII market for legal services to better understand which areas of law or parts of the sector generated the most claims, to help explain different premium rates and identify the drivers of premium rates, and to inform regulators on how best to focus their actions.

Ultimately, the funders received a limited number of claims datasets from insurers. This did not give a sufficiently complete picture of this side of the market to be able to draw conclusions about the total value of claims by areas of law. Most of the data they were able to collect, and so used for this study, was instead SRA-collected data on premiums and firm characteristics from SRA-regulated firms. This was supplemented with data from CILEx Regulation-regulated law firms and aggregated claims data for law firms regulated by the Council for Licensed Conveyancers.

Aims and objectives of this study

Against this backdrop, the SRA and the LSB commissioned Frontier Economics to undertake independent analysis of the available data, the main source being data on premium rates paid by SRA-regulated law firms. Frontier was asked to:

1. Investigate the factors that drive variation in insurance premiums, drawing on the data available.
2. To consider as far as possible the significance of insurance premiums in overall expenditure and pricing decisions.
3. To consider as far as possible what regulatory actions could be considered to alleviate any concerns about worsening outcomes for consumers and providers.

Frontier used survey data on PII costs provided by the SRA, and interviews with insurers and market experts, to investigate these three research questions. This was supplemented by insights from the two claims datasets received from insurers, although this data covered a small portion of the market. The rest of this report is organised as follows:

- **Data and approach:** sets out the data sources used and our approach to understanding how PII premiums are set;
- **Descriptive statistics:** describes the sample of SRA-regulated law firms studied;
- **Econometric evidence:** sets out our econometric model investigating the drivers of PII premium rates and reports on findings and possible interpretations;

- **Significance for legal services costs:** estimates average PII premium rates by areas of law to summarise the significance of PII costs in legal services prices across different areas of law;
- **Future trends in the market:** sets out market participants' views on future trends in the solicitors PII market, gathered through our interviews;
- **Future data collection:** sets out how the analysis presented could be extended with additional data, and the potential challenges to data collection; and
- **Regulatory options:** sets out some of the possible regulatory options that might be available if the regulator were to determine that action is required.

The Annexes to the report set out the full results of all regression models; the data validation process, and econometric tests conducted.

Data and approach

In this section we describe the primary data sources used in our analysis, and the evidence gathering that underpins our econometric approach.

Data sources

Our econometric analysis relies on the following data sources:

- A **survey of SRA-regulated law firms.** The survey was carried out by the SRA in the second half of 2022 and recorded law firms' annual PII premiums and additional information such as any special conditions, extra cover obtained, and policy length. The survey data also included open-ended responses on law firms' experience of PII renewal, such as whether the firm has experienced changes in PII premiums, and whether PII premium costs influence the type of work they choose to do. There were 915 responses to the survey out of around 9,600 SRA-regulated law firms.[16] Of these, 295 law firms had reported premium data and their firm identifier for matching to the SRA dataset (see below). A further 14 law firms were dropped from the sample during the validation process, owing to responses which appeared to be data entry errors, leaving 281 law firms with usable data.[17]

- The **SRA's firm-level database.**[18] The database includes variables such as firms' annual turnover, the number of fee earners, percentage of turnover generated from different areas of law, and claims history. We extracted data from 2018-2022 in a pseudonymised format which was matched to survey responses using firm identifiers.

- A **survey of firms regulated by CILEx Regulation.**[19] A slightly reduced form of the same survey recording responses on law firms' annual PII premiums was answered by 25 law firms regulated by CILEx Regulation, of which 17 law firms had usable data.[20]

- **SRA data on regulatory actions taken** at the level of each SRA-regulated law firm. This data included all regulatory actions taken by the SRA regarding individual law firms in the past 10 years, including the outcome of these actions.

[16] As of October 2022, according to SRA website: https://www.sra.org.uk/sra/research-publications/regulated-community-statistics/data/solicitor_firms/

[17] The validation process is described in more detail in Annex B.

[18] Firms registering with the SRA fill out an annual application form, which makes up this dataset. Details can be found here.

[19] The Chartered Institute of Legal Executives regulates around 20,000 lawyers. We understand that the sampled firms represent the large majority of the population of firms regulated by CILEx Regulation (excluding the additional firms previously regulated by the Association of Chartered Certified Accountants, ACCA).

[20] The 8 firms removed from the analysis did not report data on premiums or other key characteristics.

- **Data on the average prices of different legal services**,[21] published by the LSB. The data reports average prices in 2020 for legal services in the areas of conveyancing; divorce law; and wills, trusts, probate, and estate administration.

In addition, we used datasets from the two insurers which provided data in response to the SRA and LSB data request. This data recorded PII claims made by firms regulated by the SRA and by the Council for Licensed Conveyancers (CLC). It was not possible to match the values of claims paid against our firm-level analysis, as the data was anonymised and covered only a small portion of the market. However, the data was used to indirectly inform the analysis as it provided an understanding of how the size and types of claim varied across different areas of law, and the most common causes of loss.

Approach

Our approach to analysing the data and developing our econometric model was informed by multiple sources:

- Background information on market trends and previous consultations on regulatory arrangements for solicitors' PII;
- Conversations with the SRA and LSB to understand the history and context of arrangements for solicitors' PII;
- Conversations with several market experts including insurers and brokers. The aims of these interviews were: to understand the approaches used to set premium rates for individual firms; to seek views on recent changes in the market and expected future trends; and to seek views on the impact of current regulatory arrangements for PII and of any future changes;
- Notes from previous interviews between the LSB and CLC regulated firms and between the SRA and its regulated law firms, and other PII market participants, which set out other stakeholder views beyond those we were able to speak to directly.

Our understanding from the sources above about the approach used to set a firm's annual PII premium has informed our choice of variables and specification for our econometric work. From these sources, we understand that:

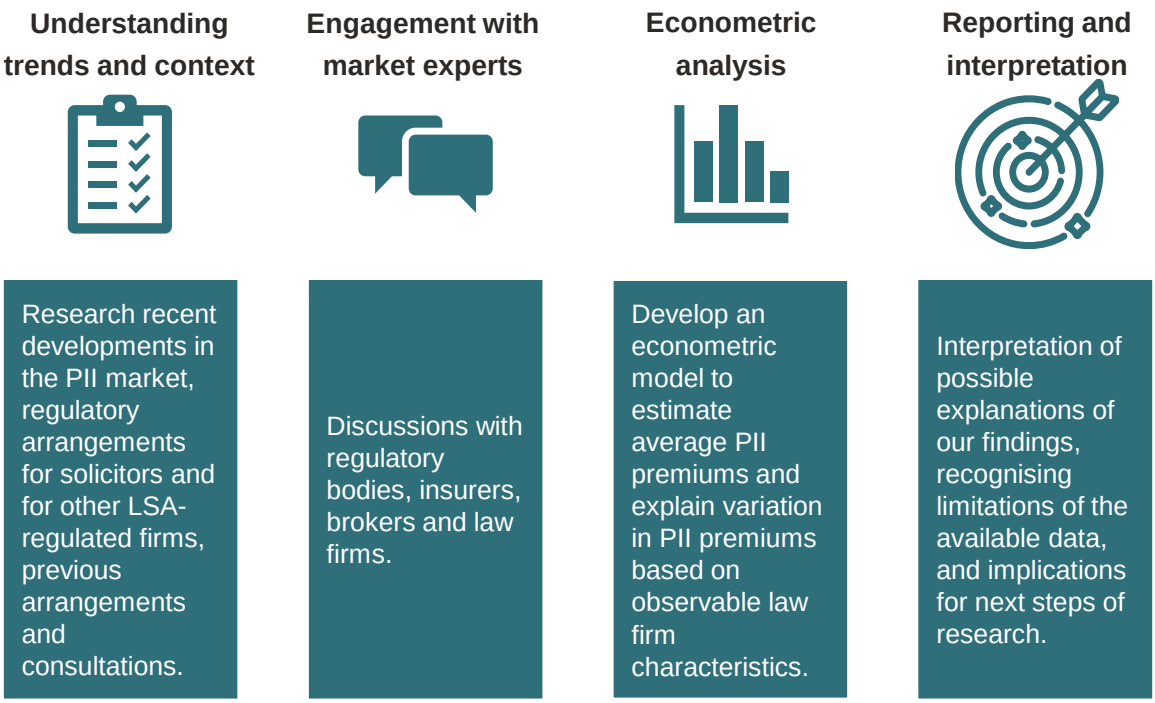
- Typically insurers set premium rates as a percentage of turnover (either recent turnover, forecast turnover for the next year, or a weighted average of both);
- A premium rate is set per area of law, based on the history of PII claims in that law area in the sector as a whole. For example, conveyancing is consistently cited as the area of law that accounts for the largest value of claims, and so has the largest associated premium rate;
- A weighted average premium rate is then set for a particular law firm depending on their recent or forecast split of work between different areas of law;

[21] Legal Services Board (2020), Prices research. https://legalservicesboard.org.uk/prices2020

- The premium rate for an individual law firm is then adjusted depending on the individual law firm's characteristics, for example the law firm's own claims history or internal processes. [22]

Based on this understanding we use the available data to investigate the relationship between law firms' premium rates as a percentage of annual turnover, and the law firm's work in different areas of law and individual characteristics. Our findings are explored in the following sections.

Figure 3 Analysis approach



Source: Frontier Economics

[22] We note that this is an understanding of one approach used to set premiums, based on our conversations with a minority of the insurers in the market: it is not necessarily representative of all approaches.

Descriptive statistics

In this section we summarise the characteristics of law firms responding to the survey, including what the data tells us about average PII premium rates.

Variables in the dataset

The variables from the matched dataset of SRA firm characteristics and PII premiums that we used in the econometrics were:

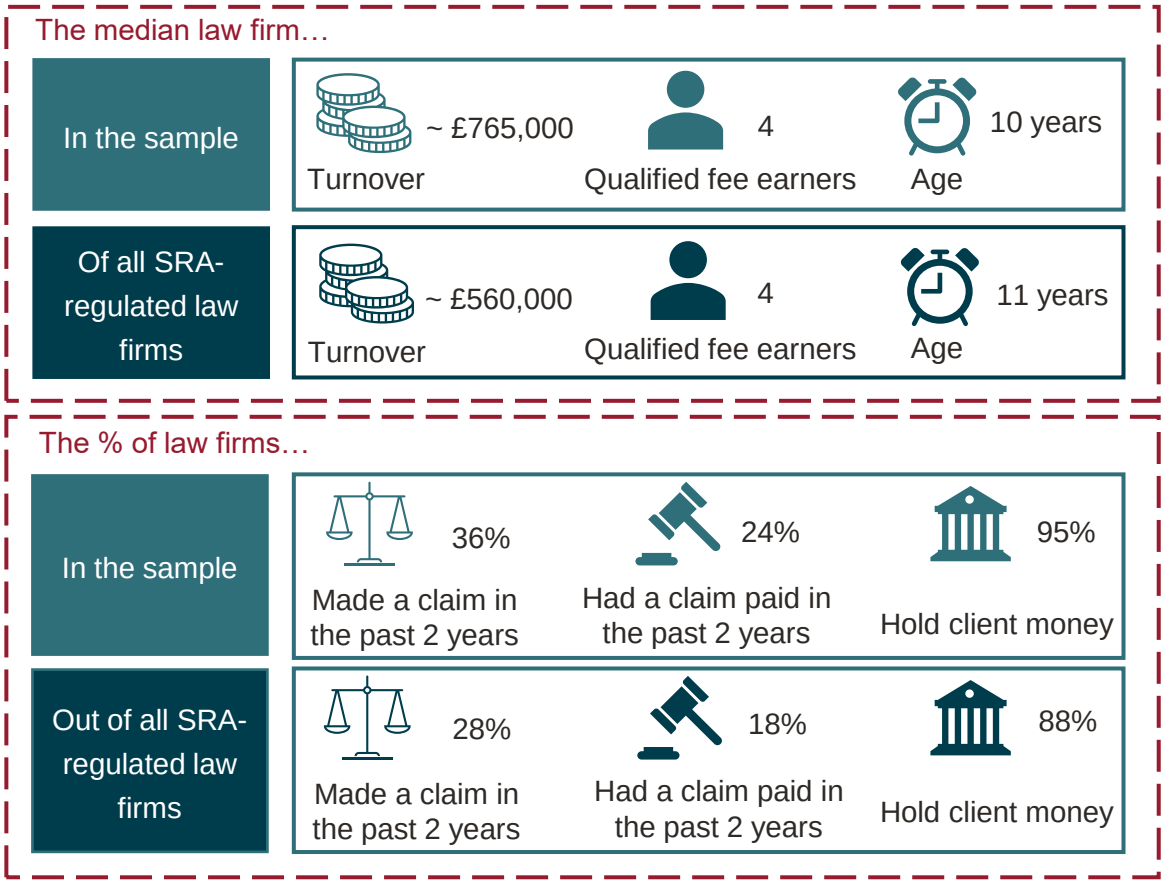
- Firm level descriptive information such as turnover, age of the firm, number of fee earners, the region in which the firm mainly operates and how much client money they hold;
- The number of claims paid and made within the last two years and whether a complaint had been made against the law firm in the past two years;
- Regulatory action and decisions made by the SRA against the law firm in the past 10 years;
- The percentage of turnover in different areas of law; and
- Information on the law firm's insurance arrangements, such as whether they have special conditions, the amount of extra cover and/or separate cyber cover, and how long before the deadline they renewed their insurance policy.

Sample data and comparison to all SRA-regulated law firms

Figure 4 presents descriptive statistics for the sample of SRA-regulated law firms responding to the PII survey, compared to all SRA-regulated law firms.[23] Additional descriptive statistics are set out in Annex A.

[23] Data for 'all SRA-regulated firms' drawn from SRA database.

Figure 4 Characteristics of firms in our sample compared to all SRA-regulated law firms



Source: Frontier Economics analysis of Solicitors Regulation Authority data

Law firms in our sample have an average annual turnover of £765k.

Most firms in both datasets are small, and this aligns with the wider law sector.[24] The sample contains a small number of law firms with very large turnover: 22 firms have annual turnover above £10m, and 3 firms have annual turnover above £100m.

Average turnover in our sample is £765,000 compared to an average of £560,000 for all SRA-regulated law firms. This suggests smaller law firms may be slightly under-sampled.

Law firms in the sample have an average age of 10 years, and employ 4 qualified fee earners, similar to the average SRA-regulated law firm.

Around 1/3 of law firms in our sample have made a claim in the past 2 years.

[24] ONS data suggests that 73% of UK legal employers have less than 10 employees.

Most law firms in our sample have not made a claim, or had a claim paid, in the past two years.

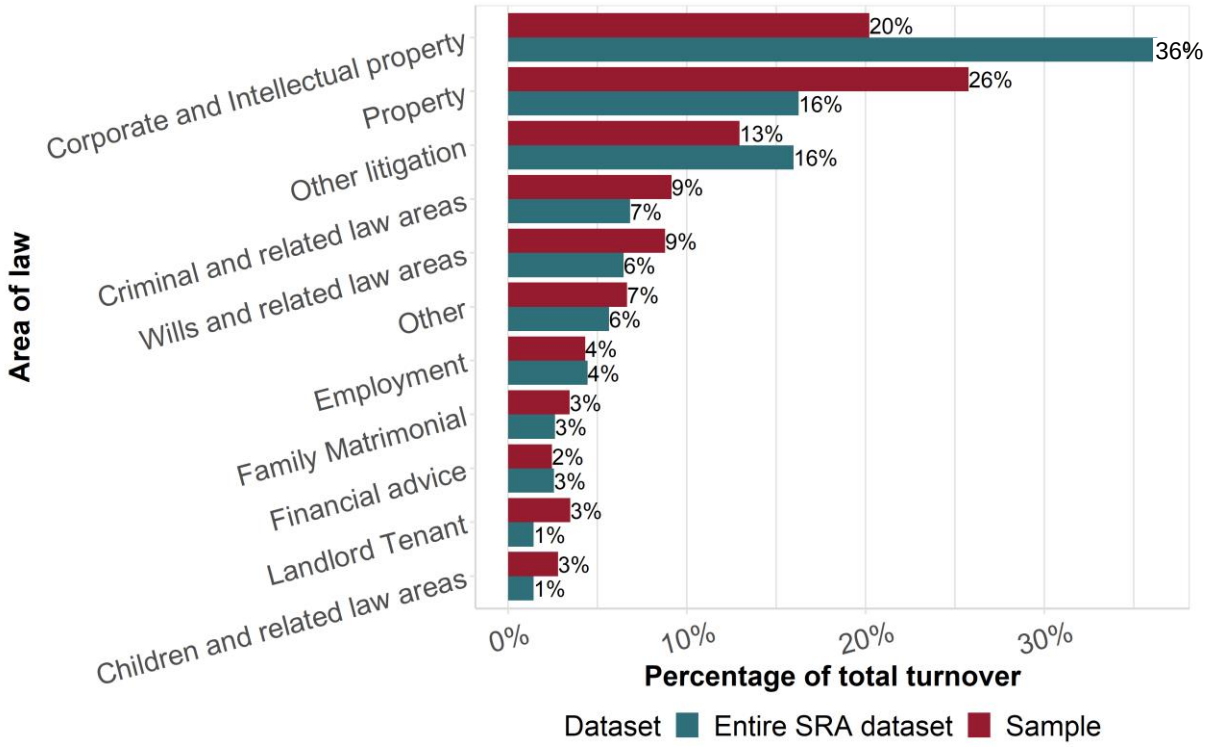
However, law firms in the sample are more likely to have a claim made or paid in the previous two years than firms in the wider SRA dataset. Larger law firms are more likely to have made claims, so this difference may be driven by an under-sampling of smaller law firms.

Corporate and intellectual property law and property account for the largest volumes of work in our sample. [25]

Figure 5 shows the percentage of total turnover generated by law firms in our sample in different areas of law, compared to all SRA-regulated law firms. For example, 26% of turnover generated by law firms in the sample comes from property work, compared to 16% of the turnover generated by all SRA-regulated law firms.

[25] Note that only a very small percentage of turnover comes from intellectual property law, but we have grouped this with corporate law for the purposes of our regressions.

Figure 5 Proportion of work in each area of law



Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *We grouped the SRA law areas into broader categories as sample sizes in some areas of law were too small. More detail is available in Annex C.*

Average premium rates

As discussed above, we understand that insurers set premium rates as a percentage of turnover. This is confirmed by a high correlation in our data between law firms' annual turnover and the premium amount. As a result, we investigate the drivers of premium rates (defined as annual premium divided by turnover).[26] In our econometric analysis in the following section, we control for the effect of turnover to investigate the other drivers of variation in PII premium costs. Figure 6 and 7 shows that premium rates are typically between **3% and 9%, with a median value of 5%**.

Some law firms have much higher premium rates, with 12 reporting values above 20%. These 12 law firms are all small – all have turnover below £850,000, and the median value among these 12 law firms is less than £50,000. In our econometric analysis we consider a sensitivity

[26] Premium relates only to the cost of basic insurance required under the SRA's minimum terms and conditions (MTCs) and does not account for the costs of extra cover or separate policies. Most firms (95%) report having annual insurance policies. Our econometric analysis is based on annual premiums, and so we annualise premiums for firms reporting longer insurance policies (18 or 24 months).

sample excluding these 12 law firms, to confirm that our results are not driven by a small number of smaller firms with very high premium rates.

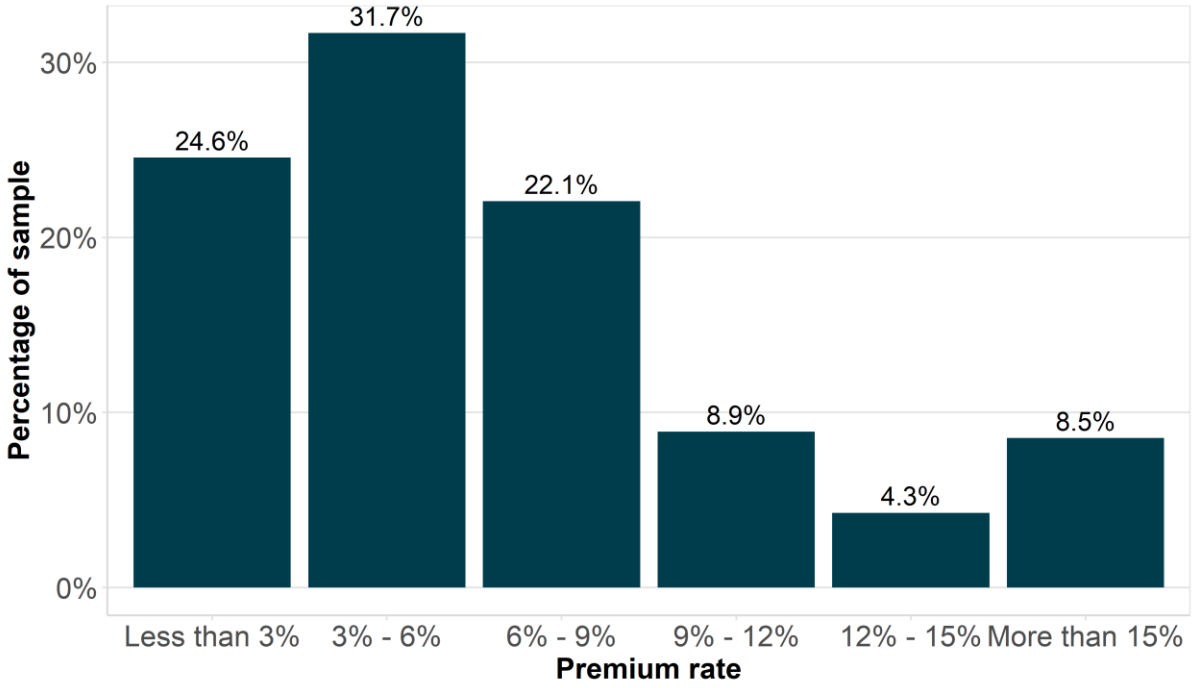
The differences between our sample and all SRA-regulated law firms means that the average premium rate in our sample may not be representative of the premium rate for all SRA-regulated law firms. We cannot determine in which direction our estimates of the average premium rate may be biased. For example, we under-sample smaller law firms, who pay higher premium rates, but we also over-sample property law firms, who also pay higher premium rates. Estimates may also suffer from sample response bias: in the context of increasing PII premiums, law firms facing especially large increases or for whom PII costs are a more important cost item, may have been more likely to respond to the survey questionnaire.

Figure 6 Median premium rates of law firms in the sample, % turnover

Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *Smaller law firms are defined as firms with turnover less than the median value of £765k. Law firms doing more property work are defined as firms doing more than the median amount of 30% of total turnover in property.*

Figure 7 Premium rates



Source: Frontier Economics analysis of Solicitors Regulation Authority data

Insurance arrangements

The survey data contains other information about a law firm's insurance arrangements: whether there are special conditions on their insurance; whether they purchase extra cover or separate cyber cover and the costs of these separate policies; the length of the policy; and how close to their renewal deadline firms received official confirmation of their insurance renewal.

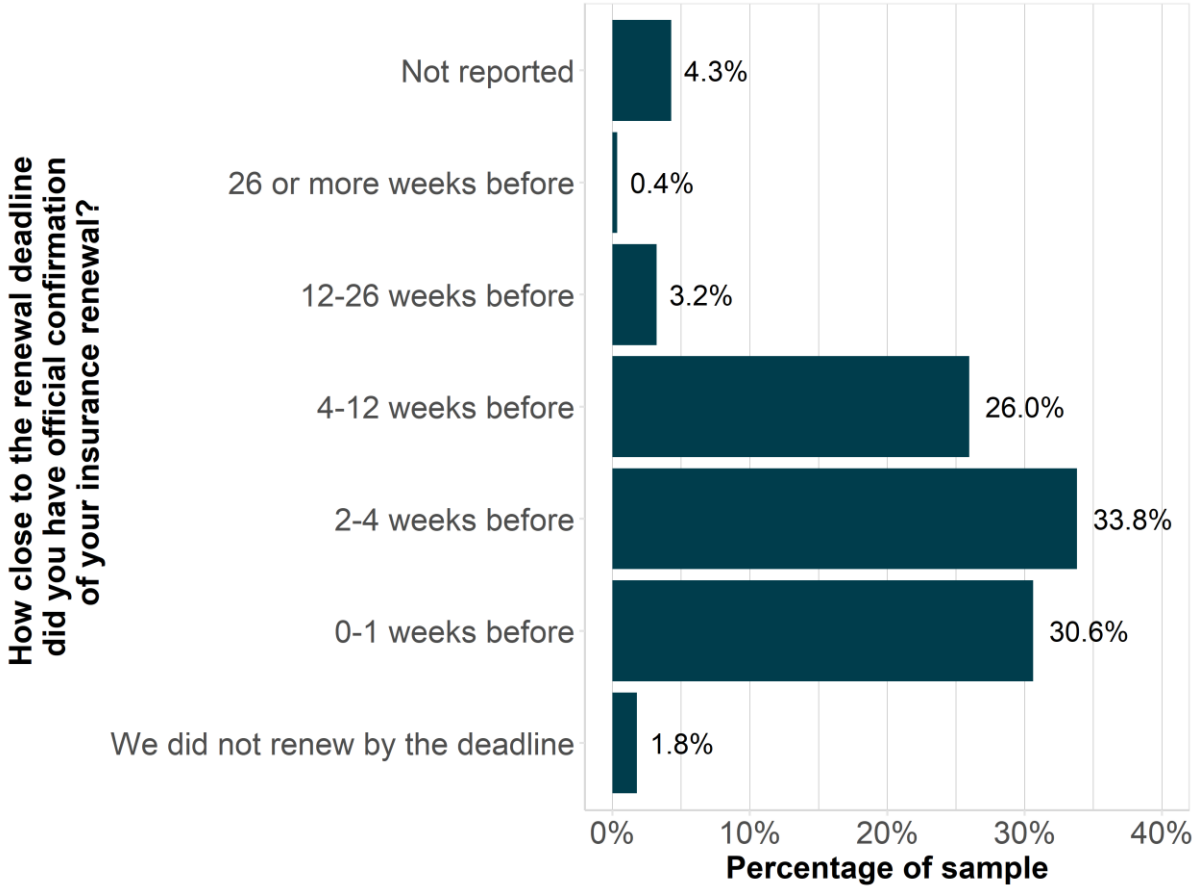
Only 10% of law firms in our sample report having special conditions in addition to the SRA's MTCs. They report conditions such as needing to purchase separate cyber insurance, conditions around a wrongful transfer of funds and provision of personal guarantees by principals of the firm such as partners, directors, members, or sole practitioners.

A large minority of law firms report purchasing extra cover and separate cyber insurance. 32% of firms purchase extra cover, at an average cost of 0.8% of their turnover. 44% of firms purchase separate cyber cover, at an average cost of 0.1%.

We note that the SRA MTCs would already cover any third-party losses resulting from a cyber-attack. Additional cyber insurance is taken out to cover first-party losses such as business interruption. Therefore we would not expect any direct link between a law firm having cyber insurance and the cost of its PII cover. We instead investigate this variable as a proxy: other unobserved factors about the firm may cause it to be more likely to take out cyber insurance, and also have some bearing on its PII premium rate (see Econometric evidence section for more discussion).

Figure 8 shows the percentage of law firms who received official confirmation of their insurance renewal at different lengths of time before the renewal deadline. 95% of firms in our sample who answer this survey question renewed within 12 weeks of the deadline. Just over 30% of firms renewed within a week of the deadline.

Figure 8 Length of time between official confirmation of insurance renewal and renewable deadline



Source: Frontier Economics analysis of Solicitors Regulation Authority data

Econometric evidence

We turn now to identifying the key drivers of premium rates for SRA-regulated law firms. We first outline our econometric methodology, then discuss our findings and possible interpretations.

Econometric approach

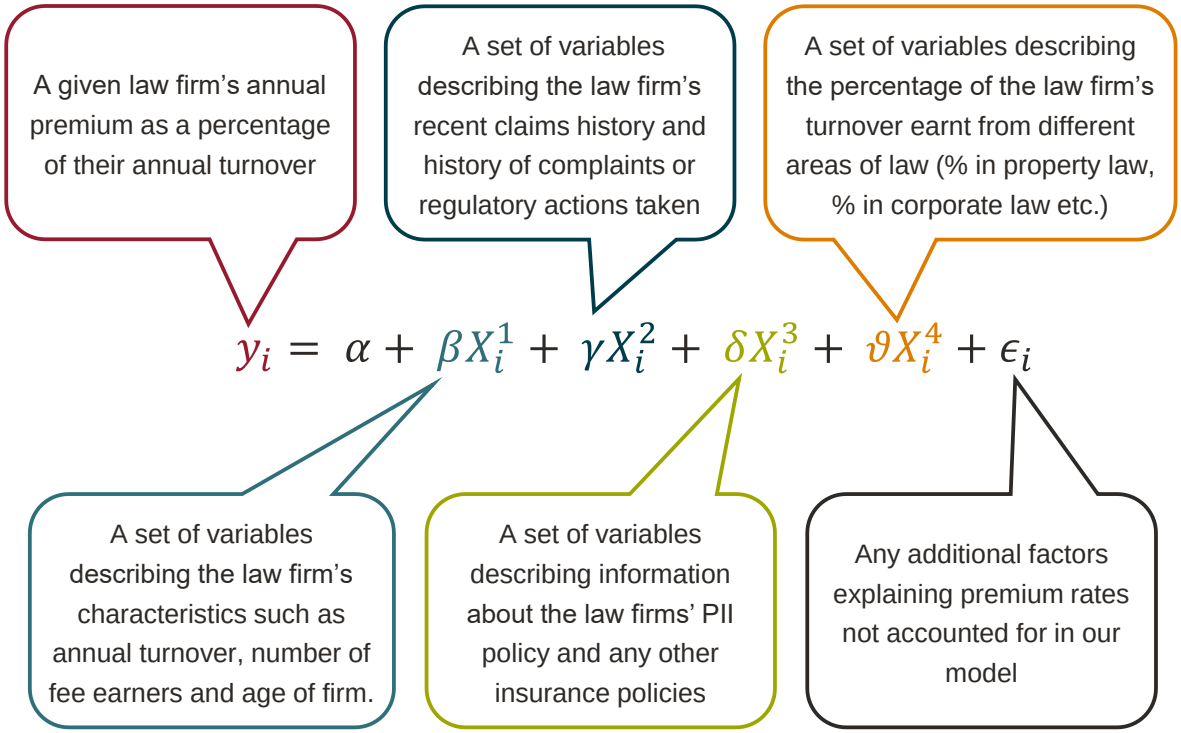
Our econometric methodology explores how law firms' premium rates (annual premium as a percentage of turnover) vary by firm characteristics. The advantage of using econometrics over basic descriptive statistics is to isolate how different firm characteristics can impact on PII premium rates while keeping all other features of the law firm the same.

Figure 9 presents our model. We estimate the relationship between premium rates (y_i) and the following variables:

- A set of variables describing law firm i's characteristics X_i^1 (annual turnover, number of fee earners, age of firm, etc);
- A set of variables describing law firm i's recent claims history X_i^2 (claims made or paid in the previous year) and history of complaints or regulatory actions taken;
- A set of variables describing information about the law firms' PII policy and any other insurance policies X_i^3; and
- A set of variables for the percentage of law firm i's turnover that is earned from different areas of law X_i^4 (% in property law, % in family law, etc).

We investigate premium rates based on our understanding of insurers' approach to setting premiums (see Data and approach section). This approach was supported by our findings from the previous section that annual premiums are strongly correlated with annual turnover.

Figure 9 Relationship estimated by econometric analysis



Source: Frontier Economics

Findings: SRA-regulated law firms

Table 1 presents the results of our main econometric model.

The 'Impact' column summarises the predicted percentage change in the premium rate, as a result of changes in the key driver variables that we consider. We present 'standardised coefficients', which are a way to compare impacts consistently between different variables.[27] Higher percentage changes indicate variables with a larger impact.

[27] Standardized coefficients' refer to how many standard deviations the dependent variable (premium rates) will change, per standard deviation increase in the independent variable.

Table 1 Regression results: Main model: Impacts and significance

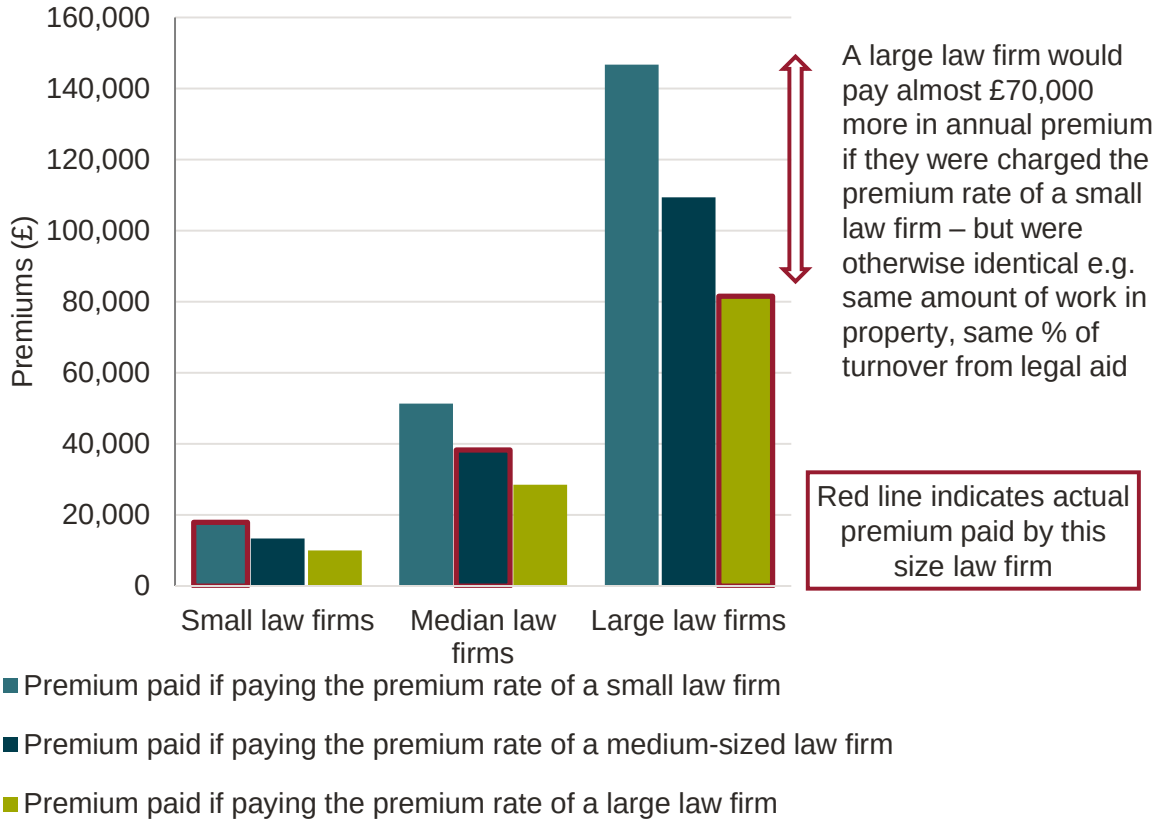
Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Statistical significance – Is the impact of the variable likely different from 0 by chance alone?	
Firm characteristics:			
Annual turnover, £ (log)	-59%	***	⬇
Total fee earners, % turnover (log)	14%	***	⬆
% of fee earners who are qualified	12%	***	⬆
Age, years (log)	-2%		
Largest amount of client money held, % turnover	9%	**	⬆
Average amount of client money held, % turnover	-8%	**	⬇
Claims, complaints, regulatory history:			
Firm made a claim in last 2 years (Y/N)	8%		
Amount of claims made in last 2 years, % turnover	-5%		
Firm had a claim paid in last 2 years (Y/N)	-1%		
Amount of claims paid in last 2 years, % turnover	8%	**	⬆
Complaint made against firm last year (Y/N)	-1%		
Average number of regulatory flags per year in last 10 years, % turnover	7%	**	⬆
Insurance type:			
Firms has separate cyber insurance (Y/N)	6%		
Cost of separate cyber insurance, % turnover	10%	**	⬆
Firm renewed 1 week or less before deadline	6%		
Law areas:			
% turnover in legal aid	-11%	**	⬇
% turnover in property law	45%	***	⬆
% turnover in corporate law	15%	***	⬆
% turnover in wills, trusts and probate	11%	**	⬆
% turnover in litigation	10%	***	⬆
% turnover in financial advice	1%		
% turnover in employment law	-5%	***	⬇

Number of observations	281
R2	0.72
Root MSE	0.44

Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *We present the impacts of a standard deviation (sd) change in each variable in order to compare in a consistent way the impact of each driver on premium rates. Standard deviations are a measure of the spread of the data: a large standard deviation means data points are, on average, further from the mean. Higher percentage changes indicate variables with a larger impact.*
****,**, * indicates that the marginal effects are statistically different from zero at the 99% (1 in 100 chance of the value differing from 0 by chance alone), 95% (1 in 20 chance) or 90% (1 in 10 chance) level respectively. These are the standard levels at which to report significance*
Full results including regression coefficients and p values are reported in Annex D.

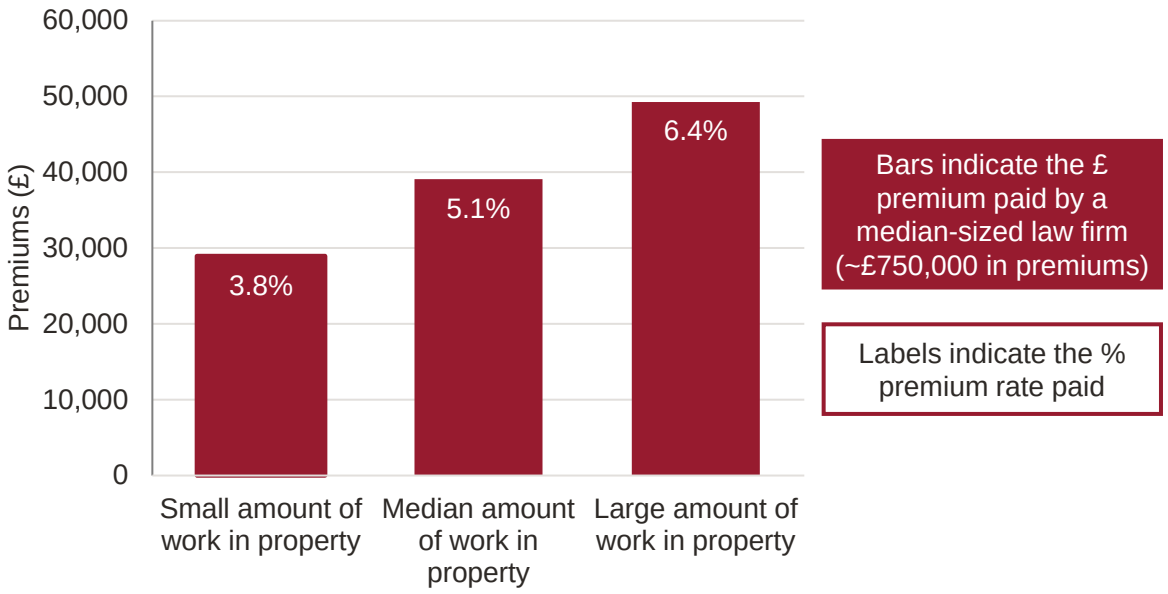
Figure 10 The impact of firm size on premiums



Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *A 'small' law firm is a firm with turnover at the 25th percentile (i.e. one quarter of firms in the sample are smaller than these firms). A 'large' law firm is a firm with turnover at the 75th percentile (i.e. one quarter of firms in the sample are larger than these firms).*

Figure 11 The impact of property work on premiums



Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *A 'small' amount of work in property is a law firm at the 25th percentile for property work (2.53% of turnover; i.e. one quarter of firms in the sample do less property work than this amount). A 'large' amount of work in property is a law firm at the 75th percentile for property work (51% of turnover; i.e. one quarter of firms in the sample do more property work than this amount). The median amount of work in property is 30%.*

What are the drivers?

We find the two most important drivers to be firm size (in terms of annual turnover), and the proportion of turnover generated from property work.[28]

Figure 10 shows the predicted values of the £ premium paid by law firms of different sizes, if they were to pay the premium rate charged for other law firms. Our model predicts that small law firms pay premium rates of 6.7% while large law firms pay premium rates of 3.7%. For a large law firm, this means a saving of nearly £70,000 in premium – whilst for a small law firm this means an additional £8,000 cost.[29]

Figure 11 shows the impact of property work on premiums for a median-sized law firm (with turnover of around £750,000). This median-sized law firm will pay an extra £20,000 in PII

[28] Property work includes conveyancing but is broader. We understand conveyancing is a higher risk area of law but we did not have access to granular-enough data to investigate conveyancing on its own.

[29] The notes in Figure 10 set out what we mean by 'small' and 'large' firm for the purpose of this example

premiums when they do a large amount of work in property compared to a small amount of work in property – this is more than 2.5% of their turnover.[30]

A number of other law firm characteristics and legal work areas have a medium-sized impact on premium rates.[31] These factors typically have between one sixth and one third of the impact of law firm size/property work. For example, a single standard deviation increase in the percentage of turnover from legal aid is associated with an 11% fall in PII premium rates. For the median law firm, this means an increase in legal aid work from 5% to 10% of turnover, associated with a fall in the premium paid from 5.1% to 3.7% - equivalent to a saving of £11,000.

Although we find some impact of law firms' individual claims history, and of renewing close to the deadline (both associated with higher premium rates), we do not find these results to be statistically robust between model specifications.[32] The lack of a robust effect of firm specific claims may be due to the fact that aggregate claims in an area of law, rather than firm specific claims, are what matter to insurers. This means the claim-related impact on premium will be picked up by variables capturing areas of law with lots of claims (e.g. property). Alternatively the finding could be due to data limitations, as discussed in more detail below.

Which factors are not significant?

We find other variables have no statistically significant impact on premium rates. These are:

- The age of the law firm;
- The law firm's complaints history;
- Whether a law firm has extra cover over and above the minimum PII requirements (yes or no, and what value);
- Whether a law firm has special conditions on its PII cover; and
- The law firm's percentage of work in other legal areas (apart from property, litigation, wills, corporate law, employment law).

[30] The notes in Figure 11 set out what we mean by 'small' and 'large' amount of work in property for the purpose of this example

[31] We do not find a statistically significant effect of a greater percentage of work in financial advice, however the financial advice variable does have a large (non-standardized) coefficient (with the second-largest legal area coefficient after property). The reason for the coefficient being non-significant may be due to the limited amount of variation in our sample, which contains only 10 firms working in financial advice. We also understand from conversations with insurers that financial advice is generally considered a relatively risky area of law from a PII perspective. We have therefore retained the financial advice variable in our preferred model, despite the variable not being statistically significant, to avoid introducing bias to other coefficient estimates.

[32] We experimented with multiple models and combinations of variables to arrive at the preferred model specification presented in Table 1. Owing to the relatively small sample size and a number of highly correlated explanatory variables, the combinations of variables included can have an impact on which variables are found to be significant. For these 2 variables (claims paid and renewal date), the impacts were not consistently positive or statistically significant depending on the combination of variables included. This casts doubt on the strength of these variables in explaining premium rates.

In addition to our main model presented in Table 1, we also ran a 'full' model containing all available data and variables. The results of the full model are presented in Annex F. Owing to the small sample size, it was preferable for us to restrict the model down to only the key drivers of interest. The full model demonstrates some additional factors found not to be significant explainers of premium rates.

How much of the overall variation do we explain?

The variables included in our main specification in Table 1 together explain 72% of the variation in the premium rate in our sample. The remaining 28% of the variation remains unexplained.

We have examined all the available explanatory data and included all variables we find to be associated with variation in firms' premium rates in our model, and conducted econometric tests to confirm the model is correctly specified (see Annex H). This means that the results are robust to the extent of the data available.

The remaining unexplained variation in premium rates will be driven by factors about the law firms in our sample that we do not observe. As an example this could include variations in the profit margin earned by different insurance providers. It may also be related to limitations of the available data, such as observations of individual firms' claims history. We discuss this in more detail in the Non-drivers section below.

Sensitivities

In order to draw conclusions from our model, the model should be robust to the variables included and the sample used.

Our full model as set out in Table 1 shows that our findings are robust to controlling for additional variables, i.e. that we find the same key drivers to have the most explanatory power even when different combinations of explanatory variables are included.

As an additional check, we ran our main model on a sensitivity sample which excludes law firms with premium rates above 20% (as discussed in the Descriptive Statistics section, these are a number of smaller law firms with very high premium rates, for more detail see Annex B). The main findings do not change when we look at this reduced sample of law firms, suggesting that our results are not driven by a subset of law firms. Annex E sets out the results of this specification.

We analysed the errors of the model and used econometric tests which confirm that our model is a good fit for the data and does not suffer from statistical issues. More detail on these is provided in Annex H.

Drivers

In this section we run through the law firm characteristics which are found to be explainers for the premium rates paid (the following list is in approximate decreasing order of significance and size of impact on premium rates). We also discuss possible interpretations of each result, informed by our discussions with legal regulators and market participants.

We note that each of the factors discussed are only possible explanations. We report all the possible interpretations that we heard during our research and our interviews with stakeholders and market participants, but with the available data it is not possible to place any relative weight on the competing explanations.

We divide the possible interpretations into three categories:

- **Risk profile:** The factor drives a higher premium rate because it is an indicator of the law firm being more likely to account for more, or higher value, claims. The insurer observes the risk indicator and charges a higher premium rate responding to the perceived higher level of risk. We note that in this analysis we have no data on the other side of the market (costs for insurers, in terms of value of claims paid), so we cannot make any assessment of the accuracy of risk models, or whether the risk factors considered are appropriate to be taken into account.
- **Pricing models:** The factor drives premium rates because of the way that insurers assess and target risk, but is not necessarily related to the claims risk of the law firm.
- **Market structure:** The factor drives premium rates because of the level of competition, or the balance of market power between insurers and law firms.

1. Smaller law firms pay higher premium rates

We find that smaller law firms pay a higher premium rate as a percentage of their turnover. A single standard deviation increase in (logged) turnover is associated with a 59% decrease in the premium rate paid.

As an example, this would predict that law firms with the median turnover in our sample (£765k) pay twice the premium rate of law firms with an annual turnover of ~£3.2m, all else being equal.

This finding matches anecdotal evidence we heard from the market, and reports from smaller law firms in survey responses and elsewhere about paying high premium rates. We have a number of possible contributing explanations discussed in the sections below.

Risk profile

Smaller law firms may be seen as more risky, and so are charged a higher premium rate. This could be for a number of reasons:

- We heard in interviews with insurers that smaller law firms tend to have lower capitalisation, and a lower ability to absorb losses or cross-subsidise from another area of the business. This means that one large claim has the potential to threaten the financial health and/or continued operation of the firm, in a way that is much less likely for a larger firm. Insurers reported that they will be more concerned for smaller law firms than larger law firms about the possible non-payment of premiums, and non-payment of excesses, as well as concerned over the increased likelihood of providing runoff cover for a smaller law firm in the event of its closure.[33]
- We heard that smaller law firms can be more of a target for fraud, e.g. Friday afternoon fraud[34], and smaller law firms may have less resources to put robust processes in place to minimise the risk of claims, for example peer-to-peer reviewing. However, we do not find evidence of this: in our data on all SRA-regulated law firms, we find that smaller law larger law firms have made a similar average number of claims in the past 2 years, per £1m turnover.[35]

Market structure

Market structure could lead to better offers for larger law firms than smaller law firms:

- Insurers may have more of an incentive to maintain the business of larger law firms by keeping premiums low;
- Insurers may have more incentive to take the time to understand the larger law firms before providing a quote. The low margin on the smaller law firms may make it less worthwhile taking the same time to understand them and their risk profile;
- We heard that some insurers will not insure law firms below a certain size, resulting in less competition in the market for insurance for smaller law firms. However, we do not find evidence of this: from our data on SRA-regulated law firms we do not find evidence of some insurers not insuring smaller law firms;
- Larger law firms may have a dedicated PII team to negotiate renewal, whereas smaller law firms rely on brokers.

Pricing model

When offering a PII quote, underwriters have a fixed cost associated with understanding law firms' operations and understanding the risk profile. We heard that some insurers will have a

[33] SRA MTCs require insurers continue providing cover even where premium (including for run-off cover) is not paid, for example because a firm has gone out of business

[34] Anecdotal evidence suggests that conveyancing fraud, where property buyers are scammed into transferring money to a fraudster rather than their conveyancer, is more likely to take place on a Friday because of the number of transactions which complete on that day and to prevent immediate investigation into the scam over the weekend, as buyers may not realise until Monday. For example, see https://www.which.co.uk/news/article/friday-afternoon-fraud-the-scam-that-wipes-out-your-house-deposit-in-seconds-aczyy9J2tFkK

[35] We only have data on number of claims and not claim values.

minimum premium, in £ terms, to cover these costs, which will amount to a larger proportion of turnover for smaller law firms than larger law firms.

2. Law firms doing more property work pay higher premium rates

We find that law firms doing more work in property law pay a higher premium rate as a percentage of their turnover. A single standard deviation increase in the proportion of property work is associated with a 45% increase in the premium rate paid.

As an example, this would predict that law firms that have 60% of their work in property pay a 50% higher premium rate than firms that do 30% property work (the median amount).

Note that we find no difference between the impact of commercial and residential property. Both are found to have a similarly large effect on premium rates.

This driver was consistently reported across the market, with a number of explanations discussed in the sections below.

Risk profile

Property is seen as the riskiest area of law:

- Property (or conveyancing) is consistently cited as the area of law with the most PII claims. We understand that insurers calculate a premium rate for each area of law based on the average historical claims that they have observed from that law area. Our sample of claims data shows that property claims have both the highest total and highest average (i.e. per claim) value, across different law areas;
- Conveyancing-related claims are also seen as difficult to predict because of long-tail risk (claims can arise many years later, making firm-level risk harder to observe). For a risk averse insurer, this would increase the average premium rate charged;
- The property market is associated with systemic risk, linked to the economic cycle, for example the downturn of the housing market. Insurers underwriting multiple law firms working in property will be concerned about systemic risks and large losses across the portfolio.

Market structure

We heard that some insurers will not cover law firms doing a large amount of property work (commonly reported as above 25-30%). This may limit the choice of PII provider for law firms doing a large amount of property work. However, we do not find evidence of this: from our

data on SRA-regulated law firms we do not find that some insurers do not insure law firms doing more than 25-30% property work.[36]

3. Law firms doing more work in litigation, corporate law and wills, trusts and probate pay higher premium rates

We find that law firms doing more work in litigation; corporate law; and wills, trusts and probate pay a higher premium rate as a percentage of their turnover. The size of the effect is around 1/4 -1/3 that of the impact of work in property law. This finding could be related to the risk profile as discussed below.

Risk profile

These are seen as relatively higher-risk areas of law:

- One explanation could be that these areas of law account for larger number of (or higher total value of) claims. Our sample of claims data shows relatively high average claim values in the areas of company or commercial law, and in litigation. It was also noted by our interviewees that these areas of law involve clients, especially business clients, that may be more likely to trigger a claim compared to clients in other areas of law;
- We heard that the risk of claims arising after long delays (as discussed for property above) can also apply to wills, trusts and probate law.

We note that our findings are based on data from one point in time. We understand that the law areas considered more or less risky change over time. For example, we understand from a conversation with one insurer that personal injury was for a time (pre-2008) considered a much higher risk area of law in terms of indemnity claims, but that this is no longer the case.

4. Law firms with more fee earners, and more qualified fee earners (per £ turnover) pay higher premium rates

We find that law firms that have more fee earners, and more qualified fee earners[37], for the same amount of turnover, pay a higher premium rate.

[36] In our data, the number of insurers of firms doing more than 25-30% of property work is similar to the number of insurers of firms doing less than this amount.

[37] Qualified fee earners are members of one of the following professions, entitled to practice such as: solicitors; other UK lawyers such as barristers, licensed conveyancers; Scottish solicitor; European lawyers; registered European lawyers; and other overseas lawyers included registered foreign lawyers.

As an example, this would predict that firms with 50% more fee earners than the median amount (for the same amount of turnover) pay a 10% higher premium, and pay a 14% higher premium rate if 3/4 of those fee earners are qualified, compared to 1/2 being qualified. Possible explanations are discussed in the sections below.

Risk profile

We heard that a small volume of work per fee earner may be interpreted as a higher risk operation, for example indicating higher risk of losses and higher risk of non-payment of premiums if the firm goes out of business. On the other hand, we would also have expected that having more qualified staff as a proportion of turnover would reduce risk, by improving the amount of supervision/oversight of risk, which would have produced the opposite result to what we observe. So this is inconclusive.

Pricing model

Theoretically, insurers may price PII premiums in terms of the number of fee earners working at a firm, and possibly qualified fee earners, instead of the volume of work undertaken (turnover). We heard from one interviewee that this is common practice in underwriting in the US. However, we consistently heard that the standard practice in the UK is to consider volume of work in terms of turnover and not staff or fee earners.

5. Law firms doing more legal aid work pay lower premium rates

We find that law firms doing more legal aid work pay a lower premium rate. The size of the effect is around 1/4 that of the impact of work in property law.

As an example, this would predict that law firms doing an extra 10% of their work in legal aid (e.g. 15%, compared to the mean amount of 5%), pay a 7% lower premium. Possible explanations are discussed in the sections below.

Risk profile

Legal aid work is seen as a relatively low-risk area of law in terms of indemnity claims:

- We heard from interviewees that the nature of legal aid work may mean it is less likely to result in claims, e.g. due to clients who are less likely to have the resources or motivation to claim than in other areas of legal work;
- All legal aid work is subject to Legal Aid Agency (LAA) requirements, which include requirements for supervision and additional regulation of standards under legal aid

contracts which are audited by the LAA.[38] Some work will also be subject to additional regulatory requirements (e.g. OISC for immigration);

- We do not have claims data on legal aid work to confirm that the number/volume of claims is relatively low, but the finding is in line with the approach taken by the Bar Mutual Fund, which applies a lower average premium rate to immigration work compared to other areas of law.

6. Law firms taking out separate cyber insurance pay higher premium rates

We find that law firms that have separate cyber insurance, and more cyber cover as a proportion of their turnover, pay a higher premium rate. The size of the effect is around 1/8 that of the impact of work in property law.

As an example, this would predict that law firms that have separate cyber insurance pay a 6% higher PII premium rate compared to law firms that do not, and law firms that have cover costing 0.2% of their turnover pay a 2% higher premium rate compared to law firms with cover costing 0.1% of their turnover.

As already discussed, the SRA's MTCs would already cover any third-party losses resulting from a cyber attack. Additional cyber insurance is taken out to cover first-party losses such as business interruption. Therefore we would not expect any direct link between a law firm having cyber insurance and the cost of its mandatory PII cover. We instead interpret this finding as being related to other unobserved factors about the law firm that may cause it to be more likely to take out cyber insurance, and also cause it to have a higher PII premium. Possible explanations are discussed in the section below.

Risk profile

- Law firms that have recently experienced a cyber attack, or who feel more at risk of a cyber attack, might be more likely to take out cyber insurance to cover business interruption.[39] These law firms might also pay a higher PII premium, due to a higher risk of third party claims caused by a cyber attack.
- We heard from one interviewee that law firms taking out cyber insurance will be more likely to be engaged in digital services, e.g. using AI platforms, high volume interactions through computers not face-to-face/phone/email. The nature of this business might also drive a higher PII premium.

[38] https://www.gov.uk/topic/legal-aid-for-providers/contracts and https://www.gov.uk/guidance/legal-aid-agency-audits

[39] In our data, firms who have made claims or had claims paid are more likely to have cyber insurance. For example, 19% of firms without cyber insurance have made a claim, compared to 58% of firms with cyber insurance. However, this correlation could be driven by firm size, or other factors: larger firms are more likely to have made claims and more likely to have cyber insurance.

7. Law firms holding larger and variable amounts of client money pay higher premium rates

We find that law firms that hold a higher peak amount of client money (i.e. a higher maximum amount of client money held at any point during the year), relative to their turnover, pay a higher premium rate. We find a similar-size negative effect of the average amount of client money held, relative to turnover.

This finding indicates that the ratio between the peak and average amount of client money held is a driver of premium rates. This means that higher premium rates are attached to law firms that have large peaks in the amount of client money they hold relative to their average, compared to law firms that hold a more stable amount of client money throughout the year.

As an example, this predicts that a law firm whose peak amount of client money held is five times its average amount pays a 13% higher PII premium rate, compared to a law firm holding a peak amount twice its average amount (which is around the average in the sample).

Risk profile

We heard from interviewees that insurers will ask law firms about their credit control procedures and segregation of client money. Holding high peak amounts of client money could indicate a law firm with a greater variety in the number and value of transactions, and/or a law firm with a small number of high value clients, which can be a risk indicator as it is harder to understand and predict losses.

8. Law firms with more regulatory actions pay higher premium rates

We find that law firms that have had more regulatory actions taken against them in the last 10 years (per £1m turnover) pay a higher premium rate.

As an example, this predicts that for each extra regulatory action taken (per £1m turnover), a law firm will pay a 7% higher premium.

Risk profile

While insurers do not have access to the SRA dataset of regulatory actions used in our model, they do have access to the register of formal decisions made against the law firm, and can ask the law firm to confirm how many open investigations they have.[40] However, we understand from the SRA that insurers do not typically request this information, or ask for this

[40] https://www.sra.org.uk/consumers/solicitor-check/

information on application forms. We therefore interpret this finding as an indirect effect, i.e. it suggests that firms with more regulatory actions also have other factors, observed by insurers, that are associated with higher premium rates. One theory is that law firms that are more likely to have regulatory actions taken also have poorer processes in place to reduce the risk of claims: insurers at least partially observe this risk through the information collected, and charge higher PII premium rates.

9. Law firms doing more employment work pay lower premium rates

We find that law firms doing more employment work pay a lower premium rate. However, the impact is small: the size of the effect on premium rates is around 1/9 of the size of the effect of property work on premium rates.

For example, the average amount of employment work is 3% of turnover. A law firm instead doing a larger amount of employment work - 10% - would pay a 4% lower premium rate than a law firm doing the average amount of employment work.

Risk profile

This finding is likely related to employment law being rated as a low-risk area with a relatively low number/value of claims.

10. Law firms having more claims paid in last two years pay higher premium rates

We find a small effect on premium rates of the amount of claims that law firms have had paid in the previous 2 years (per £1m turnover). We note that the effect is not robust between model specifications and the sample used, for example when a small number of smaller law firms with very high premium rates are excluded from the analysis, we do not find an effect (see Annex E). We also find no impact of the number of claims that law firms have made in the past 2 years on PII premium rates.

This finding runs counter to information from interviewees, who all reported that a law firm's claims history would be used as a risk indicator.

We heard that insurers use claims in two ways: first (sector-wide) to look at average claims by law area to set average premium rates; and second (firm-level) to adjust individual law firms' premium rates. We find strong evidence for the first effect (effects on premium rates of amount of work in property; litigation; corporate law; wills, trusts and probate; legal aid and employment law) but no strong evidence for the second effect.

We have two possible interpretations, discussed in the sections below.

Pricing model

The finding could be genuine and reflect insurer pricing behaviour. We heard from some interviewees that although claims are looked at as an important risk factor, how the law firm has responded to a claim will also be taken into account. For example, if a law firm puts in procedures to minimise the risk of a repeat claim, this might prevent the claims being seen as a future risk factor and avoid an impact on the premium rate charged.

Data limitations

Alternatively, it may be that the data we have is insufficient to detect an effect of claims on premium rates:

- Only 36% of the law firms in our sample have made a claim in the last 2 years, and only 24% of law firms have had a claim paid in the same time span. Of those making claims, only 47% made more than one claim. This limits the variation that we can use to explore the relationship with premium rates. It is possible that using data over a longer time span, e.g. data for the last 10 years, might yield stronger results.
- Our data includes only the number of claims, and not value. Data on the value of claims might make it possible to distinguish law firms paying higher premium rates because of making more high value claims, e.g. from property claims: we understand from our claims data from one insurer that average claims values differ significantly across areas of law. Theoretically this data could distinguish more of a 'firm-level' claims effect, separate from the 'sector-level' effect that we find.
- Data on claims paid is not linked to when the original claim was made. Claims being paid in the previous 2 years could result from claims being made in earlier years, and from work carried out even earlier, particularly in the case of legal services such as wills and property, which carry long-tail risks.
- We understand that the claims data contained in the SRA dataset is self-reported, so relies on the accuracy of law firms' reports to the SRA about claims.

On the whole we see the data limitations as being the more likely explanation, but would require more complete data on claims history to be able to distinguish the impact.

11. Law firms renewing close to the deadline pay higher premium rates

We find a small effect on premium rates for law firms who had official confirmation of the renewal of their policy close to the deadline (within a week). We note that the effect is not robust between model specifications and the sample used, for example when a small number of smaller law firms with very high premium rates are excluded from the analysis, this finding no longer holds (see Annex E).

Market structure

It is possible that the finding is not robust due to the effect being small and because of limited sample size. If the finding is genuine, a possible explanation is that a late renewal involves a cliff-edge for the law firm who cannot continue to operate without PII cover, leaving limited room to negotiate and limited choice in insurer or alternative quotes.

Risk profile

On the other hand, one interviewee noted that a law firm submitting paperwork close to the deadline may be interpreted as a risk indicator, for instance if the law firm has tried to get cover from alternative providers and failed. One interviewee noted that in PII for other professions, and in other insurance markets, the deadline is less 'hard' and renewal can happen over a longer timeframe, avoiding some cliff-edge instances. We understand from the SRA that while the SRA has moved away from having a fixed PII renewal date included in the rules, law firms have not taken the opportunity to move their renewal date even though timings might clash with other reporting obligations.

Non-drivers

In this section we run through the law firm characteristics which we have found to not be significant explainers for the premium rates paid. We also discuss possible interpretations of each result, informed by our discussions with legal regulators and market participants.

We note that in all cases, the findings are subject to the data available: the relatively small sample size may limit the statistical significance in some cases.

1. We do not find a significant impact of work in other law areas

The other law areas considered include criminal law; family and divorce law; landlord/tenant law; and children, mental health, and social work. We find the amount of work done in these areas to not be statistically significant, indicating that the premium rate applied to these areas of law is not statistically different from the average rate applied across all areas, i.e. they are considered to be 'average' in terms of the risk of PII claims.

2. We do not find a significant impact of extra cover

We do not find a significant impact on PII rates of a law firm having extra cover, or the amount of extra cover held. We would not necessarily expect an impact of extra cover on PII, given that the cover would not impact on the losses claimed for under minimum PII conditions. However, it was suggested that one explanation of the 'larger law firm' effect could be that, as larger law firms are more likely to purchase extra cover, they might be offered discounts on

basic PII cover in order for insurance providers to win their business. We do not find any evidence for this effect, although it may be linked to lack of variation as noted above.

3. We do not find a significant impact of special conditions

We do not find a significant impact on PII rates of special conditions attached to the PII policy, such as conditions around a wrongful transfer of funds or provision of personal guarantees by members. We could expect this effect to go in either direction: either the attachment of special conditions might indicate that the law firm has some risk indicators; or the special conditions reduce the exposure of the insurer to losses, and so reduce the cost of providing cover. It is possible that the two effects in opposite directions results in the variable having no net impact.

Alternatively, the lack of variation in our sample could mean that no significant effect is found. One interviewee noted that the policy type has limited effect on the premium rate because of the limited scope to vary policies under the minimum terms and conditions.

4. We do not find a significant impact of law firm age

We do not find a significant impact on PII rates of the law firm's age. We would not necessarily expect an impact of firm age unless this could be seen as a risk indicator. We note that age is insignificant after controlling for annual turnover, i.e. it is still the case that new, smaller law firms may pay higher premium rates than established larger law firms.

5. We do not find a significant impact of law firm complaints

We do not find a significant impact on PII rates of complaints made against the law firm as recorded by the SRA.[41] This may be due to limited variation in the data, which records only if a complaint has been made or not in the last 2 years and not the number of or reason for complaints. We would not necessarily expect an effect of complaints on PII rates, as we understand that complaints can be made for a wide variety of reasons and are not necessarily related to firm practices, or likelihood of claims.

6. We do not find a significant impact of law firm location

We do not find a significant impact on PII rates of law firms' locations (regional). Again, we would not expect law firm location to indicate a risk factor or likelihood of claims due to the wide variety of reasons that complaints are made.

[41] Complaints made is a self-reported measure of formal complaints under the organisation's complaint handling procedure. This includes, but is not limited to, complaints referred to the Legal Ombudsman. More details are available here

Findings: Law firms regulated by CILEx Regulation

In addition to our sample of SRA-regulated law firms, we have a sample of survey data from 17 law firms regulated by CILEx Regulation.[42] We used a separate specification to test if premium rates differed significantly between SRA-regulated and CILEx Regulation-regulated law firms. This specification used a more limited set of variables, as we did not have the same amount of data on CILEx Regulation-regulated law firms as on SRA-regulated firms, so were not able to control for the same number of drivers.

When including CILEx Regulation-regulated law firms in the sample, we find similar drivers to be the most significant (turnover and work in property law), which is unsurprising given that SRA firms make up the large majority of observations in the sample. We also find that CILEx Regulation-regulated law firms pay 12% lower PII premium rates on average, controlling for the factors included in Table 2. This result is statistically significant at the 5% level, despite the low sample size.

However, we caveat that we cannot place a lot of weight on this finding given the small number of CILEx Regulation-regulated law firms sampled, and some apparent inconsistencies in reporting between the two surveys.[43] That said, an interesting avenue of future work would be to obtain a larger sample of data on premium rates paid across law firms regulated by different legal services regulators to investigate differences in drivers of premium rates, for example to examine whether differences in average premium rates are related to differences in the MTCs.

[42] As noted above, these 17 firms represent a large proportion of firms regulated by CILEx Regulation before

[43] For example, possible inconsistencies in practice area definitions.

Table 2 Regression results: Model including CILEx Regulation-regulated firms: Impacts and significance

Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Statistical significance	
Firm characteristics:			
Annual turnover, £ (log)	-74%	***	↓
Age, years (log)	-4%		
Largest amount of client money held, % turnover	7%		
Claims, complaints, regulatory history:			
Firm made a claim in last 2 years (Y/N)	15%	***	↑
Amount of claims made in last 2 years, % turnover	-2%		
Law areas:			
% turnover in property law	43%	***	↑
% turnover in corporate law	14%	***	↑
% turnover in wills, trusts and probate	7%	*	↑
% turnover in employment law	-4%	*	↓
Regulator:			
Regulated by CILEx Regulation (Y/N)	-12%	**	↓

Number of observations	298
R2	0.64
Root MSE	0.49

Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *We present the impacts of a standard deviation (sd) change in each variable in order to compare in a consistent way the impact of each driver on premium rates. Standard deviations are a measure of the spread of the data: a large standard deviation means data points are, on average, further from the mean. Higher percentage changes indicate variables with a larger impact.*
****,**, * indicates that the marginal effects are statistically different from zero at the 99% (1 in 100 chance of the value differing from 0 by chance alone), 95% (1 in 20 chance) or 90% (1 in 10 chance) level respectively. These are the standard levels at which to report significance.*
Full results including regression coefficients and p values are reported in Annex G.

Significance for legal services costs

In this section we estimate average PII premium rates as a proportion of legal service prices, to understand the significance of PII for law firms' overall costs.

The large majority of law firms in our sample typically work across multiple areas of law. For this reason we use a regression to estimate the average premium rate applying to each area of law. We divide the sample into larger and smaller law firms to understand the different average rates faced by larger and smaller firms across different legal services. The results of this analysis are shown in Figure 12.[44] Although the errors associated with the estimates are high due to small sample sizes, the highest point estimates are found in the area of property, and the average premium rate paid by smaller property law firms is significantly higher than that paid by larger property law firms.

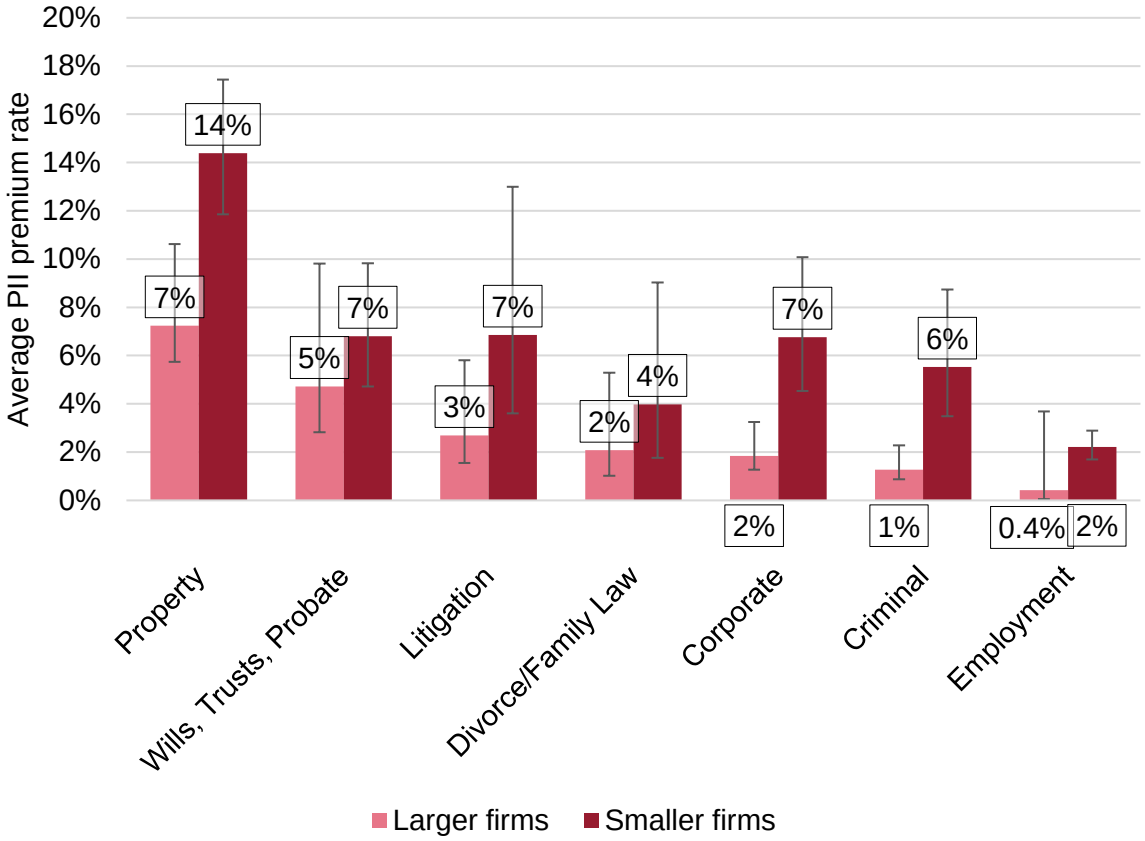
In addition, we apply the estimated average premium rates (across all law firms) to the average service prices in several areas of law, estimated by the LSB. This estimates the significance of PII costs in the legal services prices paid by consumers.

We find that the same pattern largely holds i.e. premium rates are highest in property: for a typical sale/purchase of a freehold property which costs on average just under £900, PII costs can represent around £70-£120 (8%-12%) of that price. The value is lower for divorce services: we estimate that for an uncontested divorce, PII costs accounts for only between £10-£60 (2%-7%) out of the total cost of £815.[45]

[44] We note that this analysis aims to understand the actual average rates applying to firms operating in each area: unlike our main findings, we do not control for other firm characteristics. For example, firms working in corporate law are also more likely to hold large and variable amounts of client money: this will be a partial contributor to the relatively high average premium rates applying to corporate law, in addition to the 'basic' premium amount that would apply to corporate law.

[45] The reported ranges represent 95% confidence intervals. 95% is the standard threshold for reporting statistical significance. 95% confidence interval indicates that there is a one in twenty probability of the result occurring by chance alone.

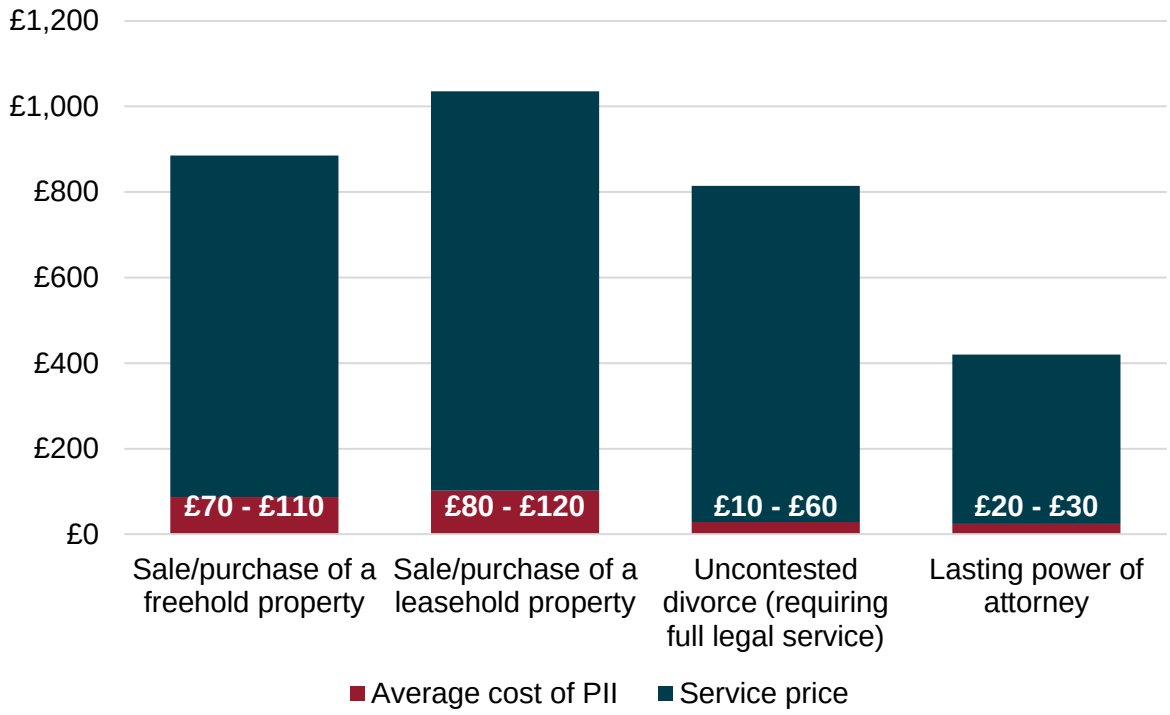
Figure 12 Estimated average premium rates by firm size and area of law



Source: *Frontier Economics analysis of Solicitors Regulation Authority data*

Note: *Full regression results are presented in Annex I.*
'Smaller firms' are defined as firms with less than the median turnover of all the firms working in that area of law.
Landlord and tenant law; children, mental health and social work law; and financial advice are excluded from reporting due to these areas accounting for only a small proportion of overall turnover in the sample (reducing confidence in results).
Error bars show 95% confidence intervals.

Figure 13 Estimated average PII costs as a proportion of legal service prices



Source: *Frontier Economics analysis of Solicitors Regulation Authority data; LSB Prices Research (2020); ONS Services PPI (2020-2022)*

Note: *Average prices for legal services reported by the LSB for 2020 are adjusted to 2022 prices using the ONS Services producer price inflation series for Legal services.*
Assuming full and equal pass-through of PII costs from law firms to consumers across different legal services, i.e. that PII costs amount to the same proportion of legal services prices as the proportion of firms' turnover.

Future trends in the market

As part of our interviews with insurers and other market experts, we looked to understand the current and expected future trends in the PII market. We heard that significant change in the market or a reversal of recent trends is not expected in the near future. Three trends were commonly cited, discussed in more detail below.

Trend 1. No imminent market softening

The solicitors' PII market, along with PII for other professions, has recently been in a 'hardening' cycle, with increasing PII premiums in 2020-2022. Market participants do not see a turning of the market cycle as being likely in the near term. The entrance of new providers is not seen as likely, as the solicitors' PII market is not seen as profitable. General inflationary pressure across the economy is expected to apply in the same way to insurance.

However, interviewees did state that there are signs that the hardening market pressures are easing or slowing, if not reversing completely. Prices are expected to continue to rise, but at a slower rate. Some interviewees expected a possible 'plateau' in premiums, after accounting for general inflation.

Trend 2. Risks of economic downturn

As of March 2023, the Office for Budget Responsibility (OBR) was forecasting a 0.2% fall in UK GDP in 2023. All interviewees cited the risk of a slowdown / downturn / recession as a key risk affecting their business and pricing approach. Economic downturns are associated with more fraudulent activity, increasing claims risk, and also with more law firms going out of business, which can lead to non-payment of premiums as well as additional claims. Insurers were concerned about the potential for systemic risks from the property market if there is a fall in house prices, which impacted businesses in the 2008 recession, on top of ongoing current risk factors in the property market such as claims arising from cladding and leasehold property ground rents. We heard that smaller law firms are usually hit harder in downturns, being more likely to suffer financial risks, and more likely to be targets for fraud.

Trend 3. Risks from cyber-related losses

Market participants reported that increased losses from cybercrime (across the market) have put upward pressure on PII premiums. The fraud increase has been seen particularly in conveyancing, involving both cyber attacks and impersonation. As a result some PII insurers now insist that law firms purchase separate cyber cover, which covers first-party cyber-related losses (such as business interruption). A separate cyber policy does not save on the law firm's PII claims, because the basic conditions of PII already cover any third-party cyber-related losses, but insurers reported that having a separate cyber policy is seen as a positive signal

that the law firm is mitigating risk.[46] The market for cyber insurance is relatively immature, and there is not yet a full picture yet of realised losses.

Responding to market pressures

In addition, interviewees offered their views on how insurers can respond to pressures in a hardening market. Insurers have three options when responding to increased cost pressures:

- **Risk aversion:** Insurers can choose to be more selective in who they insure, in order to mitigate risk. However, this approach relies on the insurer being able to accurately observe risk and identify the law firms accounting for risks. Information may be limited, and information may be asymmetric (available to the law firm and not the insurer). In addition, risks may be systemic, applying across the sector and so impossible to mitigate by selecting among law firms. An extreme outcome might see the insurer exit the market.
- **Reduce exposure:** Another option is to reduce exposure to risk by providing narrower cover, for example a higher excess or a lower total amount of cover per claim. However, the scope to narrow cover is constrained by the minimum terms and conditions (MTCs), which set minimum levels of cover that law firms must obtain to ensure appropriate consumer protection. Another option for reducing exposure is to require special conditions, for example personal guarantees of excesses and/or premiums from law firm partners.
- **Increased prices:** The third option to respond to cost and risk pressures facing insurers is to increase the premium rates they charge solicitors. If the scope to use the first two options, i.e. to be risk averse, or to reduce exposure, is limited, the corresponding use of the other option (increased prices) will be higher, increasing the price increases observed in a hardening market.

[46] We note that we find the opposite relationship in our econometric analysis although we do not interpret this as a direct link and have some possible explanations as to why this may be the case (see Econometric evidence section).

Future data collection

While we have used the data available to investigate the drivers of premium rates, some evidence gaps remain. With additional data it may be possible to answer more questions about the solicitors' PII market, for example being able to distinguish further between some of the different possible explanations of premium rate drivers (are differences related to the risk profile of the law firm, the market pricing model, or the market structure?).

In this section we set out potential avenues for future data collection that could improve the quality of the evidence about the market; the expected benefits of this collection; and the expected challenges or burdens.

We divide these potential avenues into three categories:

- **Premium data from law firms;**
- **Other data about law firms;** and
- **Other data sources.**

Premium data

In this study, premium data was collected through a survey, resulting in usable data for 281 SRA-regulated law firms and 17 CILEx Regulation-regulated law firms. Future data collection could involve:

A larger sample: A larger number of observations could increase the statistical confidence in our estimates of the drivers of premium rates, for example being able to include more variables in the final model, and conclude with more confidence on variables that are insignificant for premium pricing decisions (versus results being due to small sample size or lack of variation). A larger sample would also enable use of stratified weights to estimate average premium rates that are representative of the population of regulated law firms.

A broader sample: A sample including more law firms regulated by other LSA regulators, for example those regulated by the CLC,[47] would allow more comparison to be drawn between the drivers of premium rates under different regulatory arrangements.

Time series data: Data on premiums over time (ideally for the same law firms, i.e. a panel dataset, or asking firms to report their historical data for multiple years) would allow two additional avenues for analysis:

[47] Note that whilst we received some data from CLC, it was not in the right format to include in our main analysis as firms were not identifiable, and so could only indirectly inform analysis. CLC firms would be of particular interest given our results showing the high premium rates attached to conveyancing work.

- Sector-wide analysis of the hardening PII market i.e. tracking how much average premium rates have increased by on average, and if the reported increases in premiums have differed across different segments of the market;
- Analysis of the drivers of changes in premium rates for law firms year-to-year, i.e. are changes experienced by a particular firm from one year to the next driven by changes in that firm's circumstances (e.g. taking on more property work),or driven by sector-wide factors (e.g. increased systemic risk in property work).

Possible challenges

- Further data collection could involve a high burden on the regulator collecting the data and on law firms responding.
- Data responsibility would need to involve setting clear parameters on the intended use of any data collected.
- The vast majority of law firms are regulated by the SRA, which limits the degree to which data can be used to make comparisons between regulatory arrangements.

Other data on law firms

As well as data on annual premiums paid by law firms, further data collection about law firms would allow further analysis of premium drivers. Extensions to the data collection used in this report could cover:

Improved claims data: In the Econometric evidence section we discussed the limitations to the available claims data which may explain why we do not find a link between law firms' premium rates and their claims history. Improved data on each law firm's claims history would allow better exploration of this link. This could include:

- **Longer time series:** Existing data covers only claims made/paid in the previous two years. Our conversations with market participants suggest that insurers would consider a longer time period for claims history.
- **Value of claims:** Current data includes only the number of claims. The value of claims would provide for richer analysis, as we understand from our sample of claims data from two insurers that the average value of claims differs significantly by practice areas.
- **Claims by practice area:** As above, data on the practice area attached to each law firm's claims would increase the ability to test for possible reasons for differences in the treatment by insurance providers of firms' previous claims.
- **Reasons for claims:** Data on the reasons for each law firm's claims would allow us to test if there is a different effect on premium rates of claims made for different reasons, i.e. if some claims are more of an indicator for the insurer for that firm's future risk than others.

- **Claims paid by year claim was made:** In current data, claims paid are recorded by the year that they were paid out, and not by the year that the original claim was made. Being able to trace claims paid to the year the claim was made, and all claims made to the year the original work was carried out, would allow us to investigate the point in time at which a new claim is taken into account by insurer's modelling. It would also allow us to look at the importance of long tail risks, for example in wills, trusts and property, where a claim can arise from work carried out many years earlier.
- **Notifications:** One market participant suggested that insurers take into account claims risk not at the point that a claim is made, but at the point that a notification is made by the law firm to the regulator that a claim is in progress: we could test this through data on notifications.
- **Data consistency**: This could involve increasing the assurance of the accuracy of claims data, for example by comparing to insurer records, as we understand existing claims data to be self-reported.

Collecting additional variables: Collecting additional variables would allow us to test for additional drivers of premium rates (particularly combined with a larger sample). These drivers could potentially contribute to explaining the 28% of variation currently unexplained in our preferred model. This may also increase our ability to distinguish between risk profile factors and market structure/pricing model factors, for example the importance of negotiating power for larger versus smaller law firms. These could include:

- Indicators for the financial health of a law firm, for example indicators that insurers might interpret as showing risk of non-payment of premiums/excesses;
- Quality marks;
- If the insurance was negotiated directly or via a broker;
- Supervision ratios in terms of partners/managers;
- Number of transactions by practice area.

Collecting comparable data: In a broader sample including law firms regulated by different legal services regulators, the same variables should be collected to be used as explanatory variables in a regression model, and data should be measured in a consistent way. For example, practice areas in terms of different areas of legal services should be defined consistently between different regulated law firms (either in the regulator's standard data collection or through a separate data collection targeted at studying PII). For example, we found some differences in the definitions of practice areas used by CILEx Regulation compared to the SRA. Some of the data available for SRA-regulated law firms was also not available for CILEx Regulation-regulated law firms, meaning a more limited regression model with fewer explanatory variables had to be used.

Data consistency: Data should be measured consistently between variables. For example, if surveyed data records annual premiums for law firms from a particular renewal date, then data

on annual turnover for those law firms should cover the data available at that point of renewal, or submitted in the renewal request (similarly for claims and other data).

Possible challenges

- Further data collection could involve a high burden on the regulator collecting the data and on law firms responding. The burden created would need to be proportionate to the expected benefits of the knowledge generated.
- The data collector would need to clearly set out the intended use of the collected data and be clear about the safeguards in place to protect confidential information.
- Data collections carried out by different regulators would need to be aligned and in a consistent format, using consistent definitions.

Other data across the market

A further extension would be to collect additional data on claims and/or premiums paid from across the market, in order to increase transparency and to aid a full view of the operation of the solicitors PII market. For example, this could involve collecting data directly from insurers.

To be matched to the econometric analysis, the data would need to include firm identifiers and be possible to match to data on firm premiums and regulatory data. Ideally it would need to cover a large majority of the total insurance market in order to cover all law firms reporting premiums in a survey sample.

Collecting this data would allow:

- **Data assurance:** Confirming self-reported data from law firms on claims, premiums paid, etc.
- **Sector-wide analysis:** Allows calculation of total claims by practice areas, to help explain different average premium rates.
- **Analysis of pricing models:** Objective and quantitative analysis of insurer pricing models and extent to which premiums paid by law firms align with firms' claims risk.

Possible challenges

- After the initial data request from the SRA and LSB, representatives of insurance providers indicated that most insurers would not be supplying data.
- There may be commercial sensitivities and concerns from insurers over sharing such data. Concerns could be mitigated through engagement and providing secure methods for data sharing, but may increase the burden of collection on the regulator.

Regulatory options

In this section we discuss some potential options for regulators to consider in light of our findings. The area is a complex one for regulators and some options have been explored previously but not taken forward. Many of the options have potentially sizeable knock-on impacts. When considering any regulatory options, their effect must be proportionate and well targeted.

This report does not include any quantitative evidence on the trends in the cost or availability of PII cover, or an assessment of the competitiveness of the insurance market. Although we understand from the SRA that based on the most recent round of PII renewals there do not appear to be any significant issues as yet with law firms being able to obtain PII cover. This report does not contain any further evidence on the extent to which law firms might be impacted by rising prices.

Further research could first investigate the extent to which rising PII costs are impacting law firms' operations or pricing decisions, or might do so in the future. As one example this could include analysis of the past market entry and exit of smaller law firms and the potential role played by PII premiums, and using this to consider how law firm entry and exit might be impacted in the future, depending on scenarios for how PII prices might evolve. This might also involve investigating how law firms are impacted by the availability of insurance and competition between providers.

Research could take into account how the market is expected to evolve, for example considering impacts on law firms in the context of an expected economic slowdown and law firms facing other financial pressures alongside PII costs.

Second, if impacts on law firms are found or expected, this research could involve examining the potential impact on consumers, in line with the LSA regulatory objectives. This could include investigating:

- Pass-through of PII costs to legal services prices and any impacts on affordability for some consumers;
- The extent to which law firm exit or changes to operations (if found to be a risk) might reduce consumers' access to legal services, and/or their trust and confidence in the sector;
- The knock-on impacts on service provision if law firms have less resource for spending on improving access to affordable legal services and innovation in service delivery.

Third, this research could consider what regulatory actions might alleviate any concerns about worsening outcomes for consumers and providers, weighing up expected benefits against any costs or other knock-on impacts.

Below we list at a high level some potential options for regulatory action identified through conversations as part of this research, noting some of the expected challenges associated with each potential option.[48]

We note that this is an initial list of possible avenues for future exploration, and that cost-benefit analysis or an assessment of the impacts of these options is outside the scope of this report.

Reducing risk

Options and potential benefits

This option would involve, for each risk factor identified in our research, considering options to improve law firms' processes or address market factors to reduce the risk of claims, reducing the cost of providing PII cover.

As one example, we find that law firms holding higher peak amounts of client money pay higher premium rates. The Legal Services Consumer Panel in 2014 also identified this as a risk factor for solicitors, and suggested the alternative of escrow accounts as used by barristers.[49] The SRA Account Rules already cater for the use by law firms of a third party managed account (TPMA). The use of TPMAs could be seen as a possible option for law firms to signal risk reduction practices to insurers, and benefit from lower premiums.

We understand from the SRA that anecdotal reports from law firms suggest that currently the use of TPMAs is not seen by insurers as a reason to reduce premiums. An option for further investigation could be to look at whether more widespread use has the potential to reduce instances of negligence and therefore reduce PII claims, or at alternative options to target the root cause of the risk factor behind holding client money (for example, targeting risk caused by the volume of transactions and/or high-value clients, as discussed in the Drivers section under point 7).

Similarly, options could be explored to address particular risk factors faced by law firms such as high value claims in certain law areas. As one example, insurers identified risks across the market as a reason behind high premiums on property work. Some of these are potentially harder to target e.g. if related to the wider economic cycle, however some could be targeted specifically such as reports of targeted Friday afternoon fraud.

[48] We note that changes to minimum terms and conditions are excluded from the list given the 2019 post-consultation position. https://www.sra.org.uk/globalassets/documents/sra/consultations/pii-post-consultation-position.pdf?version=4b0e0d

[49] https://www.legalservicesconsumerpanel.org.uk/publications/research_and_reports/documents/Consumer%20Impact%20Report%203.pdf

Possible challenges:

- Opportunities for risk reduction need to be carefully explored as some law firms may have taken steps to do this already. It may be the case that there are no remaining options that are easy to identify and implement.
- This assumes that any reduced likelihood of claims will be passed on to law firms and to consumers through a competitive PII market.
- The burden of following processes to reduce risk may be high for smaller law firms in the short term and not result in net cost reduction during this initial period.

Improved transparency / data sharing and information collecting

Options and potential benefits

We heard from market participants that average premium rates are decided based on each insurer's data on claims history and risk drivers, and that this can create information gaps, for example if an insurer covers only a small number of law firms operating in a particular area of law.

Increased sector-wide data sharing has the potential to improve the accuracy of insurer models, allowing better targeting of pricing. For example, this could involve publishing an assessment of the sector-wide claims values per unit turnover by area of law, and for smaller versus larger law firms. Publishing ranges, rather than point estimates, could help to mitigate any risk of collusive practice due to the publication of information.

We also understand that underwriters have a fixed cost associated with understanding a law firm's operations and understanding their risk profile. We heard that some insurers will have a minimum premium, in £ terms, to cover these costs, which will amount to a larger proportion of turnover for smaller law firms than larger law firms.

Standardised information collection, such as a standardised renewal form, could reduce the burden of collecting renewal information for insurers. Regulatory action to influence the renewal timetable, for example through the participating insurer agreement, or controlling the process by hosting an online gateway for renewal, could encourage earlier exchange of information and avoid cliff-edge situations for law firms struggling to access cover. Such actions could also reduce the burden for smaller law firms seeking multiple quotes for PII cover. Making it easier to access standardised information on law firms, for example accessing non-sensitive data held by regulators, could lower the cost barrier for smaller law firms to obtain PII cover, in particular to seek competing quotes from multiple providers.

Possible challenges:

- Regulators, law firms, and insurers would need to have the necessary time and resources available to provide, compile, analyse and publish data.
- Data responsibility would need to involve setting clear parameters on the intended use of any data collected. This could preclude the collection of any commercially sensitive data.
- Insurers might want to collect extra information not included on the standard form. Similarly law firms may not want to be limited in their scope to report good practices which may be taken into account to reduce premiums. There could be scope to account for this, for example a standardised set of information collected on a standard form, and then an additional extra insurer-specific form, but this may create additional administrative burden eroding potential benefits.
- The possibility of a detrimental impact on competition between insurers from standardising the information collected and used to set premiums would need to be considered.

Balance between level of protection and cost of cover

Options and potential benefits

The MTCs for solicitors PII are among the most comprehensive requirements for professional indemnity cover of any profession.[50] The requirements place a high weight on consumer protection, ensuring that consumers have access to financial compensation if something goes wrong. Setting the requirements involves setting a balance between the level of consumer protection provided and the cost of cover.

One example is the requirement for insurers to continue providing coverage when solicitors fail to pay their PII premiums or excesses. This provides consumers with continued protection even if their solicitor has not paid their premium or excess. However, the market participants we interviewed cited the risk of non-payment as a key reason why smaller law firms may be charged higher premium rates.

We understand that the SRA will take regulatory action when there is evidence of a wilful refusal to pay. The SRA has also already made changes to its firm closure process to improve the information that is required when a firm closes, including whether run-off cover has been paid for and about any successor practice. One alternative option would be to investigate

[50] https://www.sra.org.uk/globalassets/documents/sra/consultations/pii-post-consultation-position.pdf?version=4b0e0d

lowering the threshold for regulatory action to be taken, or changing the conditions of continuing cover after non-payment of premiums.[51]

This could potentially lower the premium rates paid by law firms who currently absorb the costs associated with the risk of other law firms not paying their annual or run-off premium..

Possible challenges:

- The SRA has raised concerns about consumers not having access to PII in cases where a law firm does not pay premiums/excesses and insurers having the ability to cancel policies as a result.
- This assumes that the reduced risk of non-payment will be passed on to law firms and to consumers through a competitive PII market.

Alternative models

Options and potential benefits

If there was need and a strong evidence base for more significant reform, regulators could look at alternative models to the open market for solicitors PII, such as those used in other parts of the legal services sector and in other professional regulated sectors e.g. financial services.

Examples of alternative models include:

- Demand aggregation;[52]
- A mutual fund arrangement.[53]

Given the significance of such a change, it may be beneficial to first pilot on a small sample to test the efficacy of this approach and whether it is proportionate. A pilot would help to draw out any unintended consequences, of which there is a higher risk for this option than other options. Alternative models could be explored through a regulatory sandbox such as that used by the Intellectual Property Regulation Board.[54] Alternative models could be explored for only

[51] The role of the SRA would not be to enforce payment, but instead to take action in the instances when a firm has failed to ensure it takes out and maintains adequate PII.

[52] For example, the Law Society of Scotland use a Master Policy, where they appoint a broker to arrange PII cover for all firms, rather than individuals firms arranging their own cover. https://www.lawscot.org.uk/members/regulation-and-compliance/master-policy/

[53] One example of a mutual fund arrangement in legal services is the Bar Mutual Fund. https://www.barmutual.co.uk/

[54] https://ipreg.org.uk/pro/new-regulatory-arrangements/guidance/pii-sandbox

a subset of law firms, for example only smaller law firms or areas of practice, or could cover the whole market.

Alternative models have the potential to address concerns in the PII market through changing market structure, if further investigation were to conclude that there is a lack of effective competition, and/or through altering the way in which risk is shared between law firms.

Possible challenges:

- Because of the potential high burden of implementing alternative models, there would need to be a greater confidence that expected benefits to the market would outweigh potential downsides. A strong evidence base would need to be collected to support such reforms, including investigating knock-on impacts and the chance of unintended consequences.

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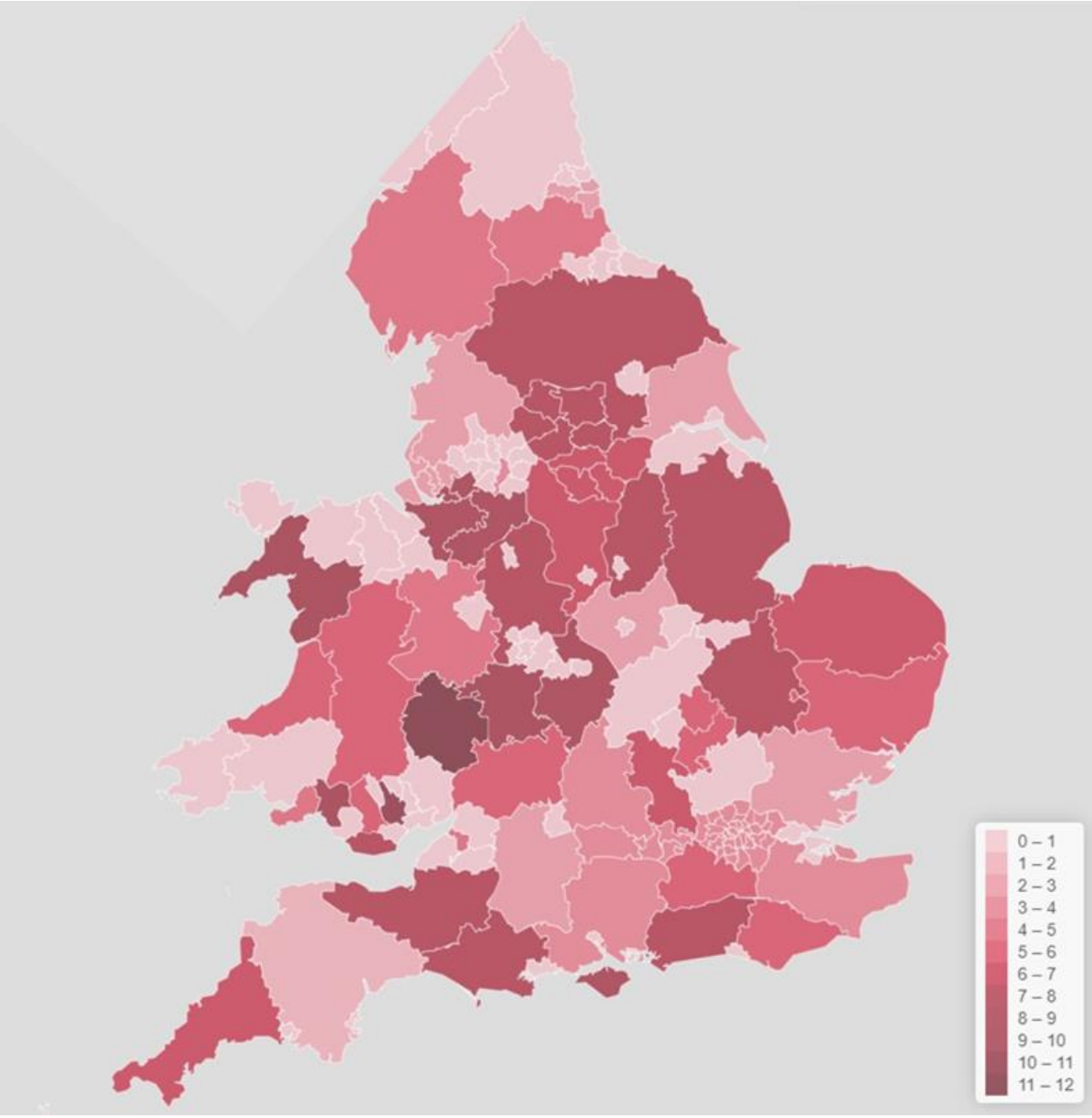
Annex A – Additional descriptive statistics

Figure 14 shows the percentage of all SRA-regulated law firms responding to the survey by region. This shows that no region is over or under-represented in the survey. If certain regions were over-sampled, in particular London, this may lead to concern as different factors might lead to different premium rates in different areas.

Figure 14 Percent of all SRA-regulated law firms responding to survey, by region



Source: Frontier Economics analysis of Solicitors Regulation Authority data

Annex B – Sample for econometric analysis

In this section we discuss the survey of premiums paid by SRA-regulated law firms, the main sample used for econometric analysis, and the sensitivity sample used to confirm that our results are not sensitive to outliers.

Observations dropped to create the main sample

Our main sample is made up of 281 law firms. Of the 915 responses to the survey, over 600 law firms are dropped due to duplicates and missing data. A further 14 law firms are dropped due to data entry issues which results in implausible values of the premium rate.

Table 3 Observations dropped to create the main sample

Process	Number of observations remaining
Original survey data	915
Removing duplicates, law firms who do not report their SRA ID (to allow matching with the SRA regulated data) and law firms with missing data in key variables	295
Drop law firms with premium > turnover	286
Drop law firms with implausibly low absolute premiums (< £50)	284
Drop law firms with implausibly high premium rates (> 60%), or a very low premium rate	281

Source: Frontier Economics

Observations dropped to create the sensitivity sample

Our sensitivity sample is made up of 269 law firms. We drop 12 law firms from the main sample who have a premium rate of greater than 20%. The aim of the sensitivity is to investigate whether our results are driven by law firms with large premium rates, rather than being a feature of all law firms in the sample.

The median turnover in this sample is £806,000 – slightly higher than the £765,000 in the wider sample, reflecting that it is smaller law firms who have the highest premium rates. The median premium rate is 4%.

Annex C – Grouping of law areas

Due to the large number of areas of law in the SRA data, we group similar areas to deal with sample size issues. Areas of law are grouped based on their similarities and expected level of risk.

Table 4 Grouping of law areas

Law area investigated in regressions	Included SRA law areas
Property	Property - commercial; Property - residential
Corporate	Commercial/corporate work for listed companies; Commercial/corporate work for non-listed companies; Intellectual property
Wills, trusts and probate	Wills, trusts and tax planning; Probate estate administration
Litigation	Litigation - other
Financial advice	Bankruptcy Insolvency; Financial Advice Regulated FSA; Financial Advice Regulated SRA
Criminal	Criminal; Discrimination/civil liberties/human rights; Immigration; Personal injury
Family and divorce	Family matrimonial
Children and social work	Children; Social Welfare; Mental Health
Landlord/tenant	Landlord and tenant (commercial and domestic)
Employment	Employment
Other	Arbitration and alternative dispute resolution; Consumer; Non-litigation (other); Planning

Source: Frontier Economics

Annex D – Main model regression results

In the Econometric evidence section we present the main model results in terms of impacts (standardised coefficients) and statistical significance. In this section we present the full regression output including non-standardised coefficients.

Table 5 Regression results: Main model

Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Regression coefficients	Statistical significance (p values)	
Constant:				
Constant		2.05	<0.005	***
Firm characteristics:				
Annual turnover, £ (log)	-59%	-0.28	<0.005	***
Total fee earners, % turnover (log)	14%	0.19	<0.005	***
% of fee earners who are qualified	12%	0.43	0.01	***
Age, years (log)	-2%	-0.02	0.62	
Largest amount of client money held, % turnover	9%	0.02	0.02	**
Average amount of client money held, % turnover	-8%	-0.02	0.02	**
Claims, complaints, regulatory history:				
Firm made a claim in last 2 years (Y/N)	8%	0.13	0.22	
Amount of claims made in last 2 years, % turnover	-5%	-0.05	0.24	
Firm had a claim paid in last 2 years (Y/N)	-1%	-0.03	0.79	
Amount of claims paid in last 2 years, % turnover	8%	0.14	0.03	**
Complaint made against firm last year (Y/N)	-1%	-0.02	0.83	
Average number of regulatory flags per year in last 10 years, % turnover	7%	0.06	0.03	**
Insurance type:				
Firms has separate cyber insurance (Y/N)	6%	0.09	0.13	
Cost of separate cyber insurance, % turnover	10%	19.55	0.02	**
Firm renewed 1 week or less before deadline	6%	0.10	0.11	
Law areas:				
% turnover in legal aid	-11%	-0.58	0.01	**
% turnover in property law	45%	1.27	<0.005	***
% turnover in corporate law	15%	0.57	<0.005	***
% turnover in wills, trusts and probate	11%	0.39	0.02	**
% turnover in litigation	10%	0.52	0.01	***
% turnover in financial advice	1%	0.80	0.66	
% turnover in employment law	-5%	-0.45	0.01	***

Number of observations	281
R2	0.72
Root MSE	0.44

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively.*

Annex E – Sensitivity regression results

Our sensitivity sample is made up to 269 firms, with 12 firms dropped from the main sample who have premium rates of more than 20%.

The majority of the results do not change from the main sample, with the same direction on the coefficient and no change in statistically significant.

However, the average number of claims paid in the last two years becomes insignificant (indicated in grey in the table). We also find no joint significance of all the claims made and paid variables. This suggests that the significance of the claims variables is not robust – we discuss the significance of this variable in detail in the main body of our report.

Table 6 Regression results: Sensitivity sample

Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Regression coefficients	Statistical significance (p values)	
Constant:				
Constant		1.45	0.03	**
Firm characteristics:				
Annual turnover, £ (log)	-57%	-0.26	<0.005	***
Total fee earners, % turnover (log)	12%	0.16	0.02	**
% of fee earners who are qualified	11%	0.37	0.01	**
Age, years (log)	-3%	-0.03	0.43	
Largest amount of client money held, % turnover	7%	0.01	0.03	**
Average amount of client money held, % turnover	-8%	-0.02	0.01	***
Claims, complaints, regulatory history:				
Firm made a claim in last 2 years (Y/N)	6%	0.08	0.39	
Amount of claims made in last 2 years, % turnover	-3%	-0.03	0.45	
Firm had a claim paid in last 2 years (Y/N)	0%	0.00	0.97	
Amount of claims paid in last 2 years, % turnover	5%	0.10	0.18	
Complaint made against firm last year (Y/N)	-1%	-0.02	0.83	
Average number of regulatory flags per year in last 10 years, % turnover	9%	0.07	0.01	**
Insurance type:				
Firms has separate cyber insurance (Y/N)	4%	0.06	0.31	
Cost of separate cyber insurance, % turnover	11%	20.55	0.01	***
Firm renewed 1 week or less before deadline	3%	0.05	0.43	
Law areas:				
% turnover in legal aid	-11%	-0.54	0.02	**
% turnover in property law	52%	1.33	<0.005	***
% turnover in corporate law	16%	0.56	<0.005	***
% turnover in wills, trusts and probate	13%	0.47	0.01	***

% turnover in litigation	10%	0.50	0.01	***
% turnover in financial advice	1%	0.85	0.63	
% turnover in employment law	-5%	-0.39	0.01	**

Number of observations	269
R2	0.70
Root MSE	0.42

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively.*

Annex F – All variables regression results

Table 7 presents results from our 'full' model investigating all available variables. Owing to the small sample size, it was preferable for us to restrict the model down to only the key drivers of interest. This is the 'main' model presented in our Econometric evidence section.

In the table below, grey shaded cells indicate the variables which were removed or adapted when included in the main model. Some variables with close correlations became individually significant when other variables were removed from the model (e.g. renewal time).

Table 7 Regression results: All variables

Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Regression coefficients	Statistical significance	
Constant:				
Constant		2.19	0.01	***
Firm characteristics:				
Annual turnover, £ (log)	-61%	-0.29	<0.005	***
Total fee earners, % turnover (log)	-1%	-0.01	0.97	
Qualified fee earners, % turnover (log)	17%	0.20	0.55	
% of fee earners who are qualified	3%	0.11	0.85	
Age, years (log)	-2%	-0.02	0.64	
Client money held (Y/N)	5%	0.19	0.16	
Largest amount of client money held, % turnover	10%	0.02	0.06	*
Average amount of client money held, % turnover	-9%	-0.03	0.03	**
Smallest amount of client money held, % turnover	0%	0.00	0.73	
Claims, complaints, regulatory history:				
Firm made a claim last year (Y/N)	7%	0.12	0.27	
Amount of claims made in last year, % turnover	-5%	-0.05	0.27	
Firm had a claim paid in last year (Y/N)	-1%	-0.02	0.84	
Amount of claims paid in last year, % turnover	7%	0.12	0.06	*
Complaint made against firm last year (Y/N)	-2%	-0.03	0.73	
Average number of regulatory flags per year in last 10 years, % turnover	6%	0.06	0.04	**
Insurance type:				
Firm has separate cyber insurance (Y/N)	5%	0.07	0.24	
Cost of separate cyber insurance, % turnover	12%	22.99	0.01	***
Firm has extra insurance cover (Y/N)	2%	0.03	0.66	
Cost of extra insurance cover, % turnover	-3%	-2.12	0.16	
Firm has special conditions on PII policy	3%	0.09	0.27	
Firm renewed 1 week or less before deadline	4%	0.08	0.29	
Firm renewed 1 month or less before deadline	2%	0.03	0.71	
Law areas:				

Firm does legal aid work (Y/N)	-1%	-0.03	0.76	
% turnover in legal aid	-10%	-0.56	0.05	*
% turnover in property law	44%	1.24	<0.005	***
% turnover in corporate law	17%	0.63	<0.005	***
% turnover in wills, trusts and probate	12%	0.44	0.05	**
% turnover in litigation	10%	0.53	0.03	**
% turnover in financial advice	1%	0.72	0.71	
% turnover in criminal law	0%	0.00	0.98	
% turnover in family and divorce law	0%	-0.01	0.97	
% turnover in landlord/tenant law	-1%	-0.05	0.89	
% turnover in other law areas	-1%	-0.04	0.89	
% turnover in employment law	-5%	-0.39	0.09	*

Number of observations	281
R2	0.73
Root MSE	0.44

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively. Grey shaded cells indicate variables removed from the main model.*

Annex G – CILEx Regulation model regression results

In the Econometric evidence section we present the results for a specification and sample including 17 CILEx Regulation-regulated law firms as well as the main SRA-regulated sample, in terms of impacts (standardised coefficients) and statistical significance. In this section we present the full regression output including non-standardised coefficients.

Table 8 Regression results: Sample including CILEx Regulation-regulated firms

Drivers	Impact: percentage change in the premium rate (from a 1sd change in variable X)	Regression coefficients	Statistical significance (p values)	
Constant:				
Constant		1.30	<0.005	***
Firm characteristics:				
Annual turnover, £ (log)	-74%	-0.35	<0.005	***
Age, years (log)	-4%	-0.05	0.25	
Largest amount of client money held, % turnover	7%	0.01	0.15	
Claims, complaints, regulatory history:				
Firm made a claim in last 2 years (Y/N)	15%	0.25	0.01	***
Amount of claims made in last 2 years, % turnover	-2%	-0.02	0.67	
Law areas:				
% turnover in property law	43%	1.20	<0.005	***
% turnover in corporate law	14%	0.57	<0.005	***
% turnover in wills, trusts and probate	7%	0.26	0.09	*
% turnover in employment law	-4%	-0.31	0.07	*
Regulator:				
Regulated by CILEx Regulation (Y/N)	-12%	-0.41	0.02	**

Number of observations	298
R2	0.64
Root MSE	0.49

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively.*

Annex H – Econometric tests conducted

In this section we summarise the econometric tests conducted which confirm that our model is correctly specified.

Testing for non-linearity

We use the Ramsey RESET model to test for the presence of non-linearity. Non-linearity means that some variables may be having a varying effect on premium rates. For example, the impact on premium rates when a law firm's turnover from property increases from 5% to 10% may not be the same as the impact when it increases from 20% to 25%. Alternatively, the impact on premium rates when turnover from property increases might depend on the size of the firm – suggesting an interaction term between property and turnover is needed.

Under this test, the null hypothesis is that the model is well-specified and that no additional non-linear terms (such as squares or interaction terms) need to be included. The p value of this test is 0.25, so we do not reject the null hypothesis that the model is well-specified.

Testing for heteroskedasticity

We use the Breusch-Pagan/Cook-Weisberg test for heteroskedasticity. Heteroskedasticity means the variance of the errors in the regression results is not constant across observations. For example, if the variance of the errors increases with turnover this means that the model is less good at predicting premium rates for larger firms. No heteroskedasticity (homoskedasticity) is a key assumption for regression results to be efficient. The presence of heteroskedasticity might also suggest that there are other issues with the model, for example non-linearity.

Under this test, the null hypothesis is that there is no heteroskedasticity. The p value of this The p value of this test is 0.09, which means we would not reject the null hypothesis (no heteroskedasticity) using the standard 5% confidence level.

We use robust standard errors[55] to correct for the presence of any heteroskedasticity in the data. Robust standard errors can be used whether or not there is heteroskedasticity in the data: if there is no heteroskedasticity, robust standard errors will be equivalent to normal standard errors.

[55] Standard errors are used to calculate p values for the coefficients, used to determine whether or not they are significant in explaining the dependent variable (premium rates)

Annex I – Estimating premium rates for each area of law

In the Significance for legal services costs section we present results for average premium rates estimated by area of law and firm size. In this section we present the full regression output including non-standardised coefficients.

Table 9 Regression results: Averages by areas of law

Drivers	Regression coefficients	Statistical significance (p values)	
Law areas:			
% turnover in property law	-2.32	<0.005	***
% turnover in corporate law	-3.20	<0.005	***
% turnover in wills, trusts and probate	-2.84	<0.005	***
% turnover in litigation	-3.34	<0.005	***
% turnover in financial advice	-9.75	<0.005	***
% turnover in criminal law	-3.38	<0.005	***
% turnover in family and divorce law	-3.34	<0.005	***
% turnover in children and social work law	-4.14	<0.005	***
% turnover in landlord/tenant law	-3.06	<0.005	***
% turnover in other law areas	-3.22	<0.005	***
% turnover in employment law	-4.16	<0.005	***
Number of observations	281		
R2	0.95		
Root MSE	0.71		

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively*

Table 10 Regression results: Averages by areas of law and firm size

Drivers	Regression coefficients	Statistical significance (p values)	
Law areas:			
% turnover in property law, smaller law firms	-1.94	<0.005	***
% turnover in property law, larger law firms	-2.63	<0.005	***
% turnover in corporate law, smaller law firms	-2.69	<0.005	***
% turnover in corporate law, larger law firms	-3.99	<0.005	***
% turnover in wills, trusts and probate, smaller law firms	-2.69	<0.005	***
% turnover in wills, trusts and probate, larger law firms	-3.05	<0.005	***
% turnover in litigation, smaller law firms	-2.68	<0.005	***
% turnover in litigation, larger law firms	-3.62	<0.005	***
% turnover in criminal law, smaller law firms	-2.90	<0.005	***
% turnover in criminal law, larger law firms	-4.36	<0.005	***
% turnover in family and divorce law, smaller law firms	-3.22	<0.005	***
% turnover in family and divorce law, larger law firms	-3.87	<0.005	***
% turnover in children and social work law, smaller law firms	-3.93	<0.005	***
% turnover in children and social work law, larger law firms	-4.34	<0.005	***
% turnover in landlord/tenant law, smaller law firms	-2.83	<0.005	***
% turnover in landlord/tenant law, larger law firms	-4.14	<0.005	***
% turnover in other law areas, smaller law firms	-2.77	<0.005	***
% turnover in other law areas, larger law firms	-4.38	<0.005	***
% turnover in landlord/tenant law, smaller law firm	-3.58	<0.005	***
% turnover in landlord/tenant law, larger law firms	-8.48	0.03	**
% turnover in employment law, smaller law firms	-3.81	<0.005	***
% turnover in employment law, larger law firms	-5.49	<0.005	***

Number of observations	281
R2	0.97
Root MSE	0.56

Source: Frontier Economics analysis of Solicitors Regulation Authority data

*Note: ***,**, * indicates that the marginal effects are statistically different from zero at the 1%, 5% or 10% level respectively 'Smaller s' are defined as firms with less than the median turnover of all the firms working in that area of law.*